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THE SILENT DEPRESSION: HOW ARE MINORITIES FARING IN THE ECONOMIC DOWNTURN?

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

SEPTEMBER 23, 2009

Serial No. 111–89

Printed for the use of the Committee on Oversight and Government Reform



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THE SILENT DEPRESSION: HOW ARE MINORITIES FARING IN THE ECONOMIC DOWNTURN?

WEDNESDAY, SEPTEMBER 23, 2009

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10;03 a.m. in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the committee) presiding.

Present: Representatives Towns, Issa, Cummings, Kucinich, Tierney, Clay, Watson, Lynch, Quigley, Kaptur, Cuellar, Bilbray, Jordan, Flake, Chaffetz, and Luetkemeyer.

Staff present: Beverly Britton Fraser, counsel; Kwane Drabo, investigator; Jean Gosa, clerk; Velginy Hernandez, press assistant; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Marc Johnson, assistant clerk; Phyllis Love, Christopher Sanders, and Alex Wolf, professional staff members; Mike McCarthy, deputy staff director; Leah Perry, senior counsel; Jason Powell, counsel and special policy advisor; Leneal Scott, IT specialist; Shrita Sterlin, deputy director of communications; Ron Stroman, staff director; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Rob Borden, minority general counsel; Jennifer Safavian, minority chief counsel for oversight and investigations; Frederick Hill, minority director of communications; Dan Blankenburg, minority director of outreach and senior advisor; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Benjamin Cole, minority deputy press secretary; Kristina Moore, minority senior counsel; and Mark Marin, minority professional staff member.

Chairman TOWNS. The committee will come to order.

Good morning and I thank all of you for being here.

Our Nation faces the most daunting economic downturn since the Great Depression. One year ago, many of our Nation's largest and oldest banks teetered on the edge of collapse. The value of businesses and personal net worth plummeted as the Stock Market tumbled. In turn, companies downsized or closed their doors, leaving millions standing in unemployment lines, desperate for work.

Home prices plunged and exotic home loans ballooned, creating sticker shock for many homeowners. Americans began to lose their homes to foreclosures at a terrible pace. In response, Congress extended unemployment benefits, created programs to preserve home

ownership, and passed a massive economic stimulus program to retain and produce jobs.

While our economy is still fragile, there are some signs of improvement. But as our Nation lays down the tracks of economic revitalization, we must be sure that every American has boarded the train headed toward recovery.

Unfortunately, recent reports indicate that not only are many racial and ethnic groups being left behind, but many never received a ticket to board the recovery train. And that is the crux of our problem.

For most racial ethnic minority groups, the great recession is, in reality, a great depression. People of color were worse off before the start of our Nation's economic downturn and have been losing their jobs and their homes at a faster rate ever since. Disparities in unemployment cut across age and gender lines, particularly among African Americans and Hispanics. And this is even evident when education is taken into account.

The national unemployment rate is 9.7 percent. African American unemployment is 15 percent, and Hispanic unemployment is at 13 percent. In my home State, the unemployment rate for African American residents of New York City rose four times as fast as the jobless rate for Caucasians between the first quarter of 2008 and the first quarter of 2009.

A similar difference is seen in home foreclosures, which are impacting minority groups at a far higher level than the national average. It appears that African Americans and Hispanics are far more likely to have higher-priced mortgages.

As indicated in a report by the Center for American Progress, when borrowing from 14 of the Nation's top banks, such as Bank of America and Wells Fargo, in 2006, 17.8 percent of Caucasian borrowers were given higher-priced mortgages while 30.9 percent of Hispanics and a shocking 41.5 percent of African Americans received them.

There is evidence that African Americans and Hispanics may have been targeted for those pricier loans. I was appalled to learn of affidavits filed by former Wells Fargo employees which indicate that these loans were routinely called "loans of mud people" or "ghetto loans." If true, and if this kind of reprehensible practice was widespread, it indicates the need of congressional reexamination of financial services regulations in general, and the home mortgage business in particular.

Let me conclude by saying I look forward to hearing testimony on policy solutions that can ensure that all Americans see real economic recovery. For example, does the road map to equitable recovery include a further extension of unemployment benefits or stricter provisions within the mortgage modification program to ensure that banks are properly modifying the mortgages of all eligible homeowners?

Again, I want to thank the witnesses for appearing today and I look forward to hearing your testimony.

And just before I yield to my ranking member, in addition to receiving the testimony of the witnesses before us today, the committee has received several statements for the record from an array of experts. These statements are authored by the Economic Policy In-

stitute, Pugh Charitable Trust, and the Asian American Justice Center. These organizations represent vital organizations that stand at the front lines in serving minority communities and examining our Nation's recession.

Without objection, I enter these written statements into the record.

[NOTE.—The information referred to may be found at the end of the hearing.]

Chairman TOWNS. I will now yield to the gentleman from California, Congressman Issa, the ranking member, who has been very, very involved in all of the issues of this committee.

[The prepared statement of Chairman Edolphus Towns follows:]

HOUSE COMMITTEE ON
OVERSIGHT & GOVERNMENT REFORM

CHAIRMAN EDOLPHUS TOWNS
OPENING STATEMENT

HEARING

"THE SILENT DEPRESSION: HOW ARE MINORITIES FARING IN THE RECESSION?"

SEPTEMBER 23, 2009

Good morning and thank you for being here.

Our nation faces the most daunting economic downturn since the Great Depression. Only a year ago, many of our nation's largest and oldest banks teetered on the edge of collapse. The value of businesses and personal net worth plummeted as the stock market tumbled. In turn, companies downsized, or closed their doors, leaving millions standing in unemployment lines, desperate for work. Home prices plunged and exotic home loans ballooned, creating sticker shock for many homeowners. Americans began to lose their homes to foreclosure at a terrible pace.

In response, Congress extended unemployment benefits, created programs to preserve homeownership, and

passed a massive economic stimulus program to retain and produce jobs. While our economy is still fragile, there are some signs of improvement.

But as our nation lays down the tracks of economic revitalization, we must be sure that every American has boarded the train headed toward recovery.

Unfortunately, recent reports indicate that not only are certain racial and ethnic-specific groups being left behind, but many never received a ticket to board the 'recovery train' to start off with.

For most racial and ethnic minority groups, the Great Recession is, in reality, a Great Depression. People of color were worse off before the start of our nation's economic downturn and have been losing their jobs and their homes at a faster rate ever since.

Disparities in unemployment cut across age and gender lines, particularly among African-Americans and Hispanics, and are even evident when education is taken into account. For instance, while the national unemployment rate is 9.7

percent, African-American unemployment is 15 percent and Hispanic unemployment is at 13 percent. In my home state, the unemployment rate for African-American residents of New York City rose four times as fast as the jobless rate for Caucasians between the first quarter of 2008 and the first quarter of 2009.

A similar difference is seen in home foreclosures, which are impacting minority groups at far higher levels than the national average. Moreover, it appears that African-Americans and Hispanics were far more likely to have higher-priced mortgages.

As indicated in a report by the Center for American Progress, when borrowing from 14 of the nation's top banks, such as Bank of America and Wells Fargo, in 2006, 17.8 percent of Caucasian borrowers were given higher-priced mortgages, while 30.9 percent of Hispanics and a shocking 41.5 percent of African-Americans received them.

There is evidence that African-Americans and Hispanics may have been targeted for these pricier loans. I was appalled to learn of affidavits filed by former Wells

Fargo employees, which indicate that these loans were routinely called loans for "mud people" or "ghetto loans."

If true, and if this kind of reprehensible practice was wide-spread, it indicates the need for Congressional re-examination of financial services regulation in general, and the home mortgage business in particular.

At today's hearing I look forward to hearing testimony on policy solutions that can ensure that all Americans see real economic recovery. For example, does the road map to equitable recovery include a further extension of unemployment benefits, or stricter provisions within the Mortgage Modification Program to ensure that banks are properly modifying the mortgages of all eligible homeowners?

Again, I want to thank the witnesses for appearing today, and I look forward to hearing their testimony.

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Mr. ISSA. Thank you, Mr. Chairman.

I, too, would like to ask unanimous consent that a document be placed in the record. It is the minority report entitled, "The Role of Government Affordability Affordable Housing Policy."

Chairman TOWNS. Without objection.

[The information referred to follows:]

U.S. House of Representatives

Committee on Oversight and Government Reform

Darrell Issa (CA-49), Ranking Member



The Role of Government Affordable Housing Policy in Creating the Global Financial Crisis of 2008

MINORITY STAFF REPORT
U.S. HOUSE OF REPRESENTATIVES
111TH CONGRESS
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
JULY 1, 2009

INTRODUCTION

The housing bubble that burst in 2007 and led to a financial crisis can be traced back to federal government intervention in the U.S. housing market intended to help provide homeownership opportunities for more Americans. This intervention began with two government-backed corporations, Fannie Mae and Freddie Mac, which privatized their profits but socialized their risks, creating powerful incentives for them to act recklessly and exposing taxpayers to tremendous losses. Government intervention also created "affordable" but dangerous lending policies which encouraged lower down payments, looser underwriting standards and higher leverage. Finally, government intervention created a nexus of vested interests – politicians, lenders and lobbyists – who profited from the "affordable" housing market and acted to kill reforms. In the short run, this government intervention was successful in its stated goal – raising the national homeownership rate. However, the ultimate effect was to create a mortgage tsunami that wrought devastation on the American people and economy. While government intervention was not the sole cause of the financial crisis, its role was significant and has received too little attention.

In recent months it has been impossible to watch a television news program without seeing a Member of Congress or an Administration official put forward a new recovery proposal or engage in the public flogging of a financial company official whose poor decisions, and perhaps greed, resulted in huge losses and great suffering. Ironically, some of these same Washington officials were, all too recently, advocates of the very mortgage lending policies that led to economic turmoil. In a number of cases, political officials even engaged in unethical conduct, helping their political allies, family members and even themselves obtain lucrative positions in the mortgage lending industry and other benefits. At a time when government intervention in private markets has become alarmingly common, government "affordable housing" initiatives offer important lessons about the dangers of government efforts to manipulate or conjure outcomes in the market.

EARLY HISTORY OF FANNIE MAE AND FREDDIE MAC

Prior to the creation of Fannie Mae, there was no national mortgage market in the United States. Instead, the mortgage industry was concentrated primarily in urban banking centers, making affordable home financing difficult to come by for many rural residents. The widespread banking failures of the Great Depression exacerbated this problem. In response, Congress passed the National Housing Act of 1934, creating the Federal National Mortgage Association, or Fannie Mae, as a purely governmental agency. Fannie Mae purchased home loans from mortgage lenders and financed these purchases by issuing government bonds. Fannie, and its congressionally-chartered competitor Freddie Mac, removed the burden of these liabilities from bank balance sheets, freeing up capital that otherwise would have been tied down to protect the banks from the risk of loan default. As policymakers intended, this service increased the amount of money local banks could lend to homebuyers – it increased the liquidity of the mortgage market.

In 1968, President Lyndon Johnson, facing mounting budget deficits and criticism over American involvement in Vietnam, contrived a scheme to reduce government debt by privatizing Fannie Mae. Enacted as part of the Housing and Urban Development Act of 1968, this maneuver amounted to an accounting sleight-of-hand that removed Fannie Mae's large liabilities from the Federal balance sheet in a single stroke. In reality, however, the markets never truly believed that the newly-designated government-sponsored enterprise ("GSE") was in fact a private company.

FANNIE AND FREDDIE: WHY THEY DOMINATED THE MORTGAGE MARKET

Fannie Mae's and Freddie Mac's dominance in the secondary mortgage market was made possible by numerous competitive advantages stemming from their unique relationship with the federal government. These advantages for the two GSEs were justified by the government as an implicit subsidy to American homeowners in the form of reduced mortgage rates. With the help of these subsidies, Fannie and Freddie were able to squeeze out their competition and corner the secondary mortgage market. At their height, they controlled over three-quarters of the secondary market for prime mortgages in the United States. Wall Street and others were left with the nonprime, non-conforming market, mainly risky subprime and Alt-A loans.[1]

Their chief advantage began with their government sponsored mission: Fannie and Freddie were charged by Congress with keeping the secondary mortgage market liquid and increasing the availability of affordable housing. They enjoyed a $2.25 billion line of credit from the U.S. Treasury. Because of this mission and their special connection to the Federal government, the market viewed them as extensions of the U.S. government and therefore "too big to fail." No other private companies could borrow money at such an affordable rate. Private debt markets were willing to lend the GSEs money at an interest rate not much greater than the "risk-free" rate they charged the U.S. government itself.

As a business model, Fannie and Freddie would sell bonds in the debt markets at a relatively low cost and use the borrowed money to turn around and purchase mortgages from primary lenders like Countrywide Financial that dealt directly with customers seeking home loans. Oftentimes, they would then bundle many of these mortgages into securities and either sell them to investors, who paid Fannie and Freddie a fee to guarantee payment in the event the mortgages defaulted. The GSEs could also hold the securities in their own portfolios, making profits off the difference between their low cost of debt and the higher rates borrowers paid on their mortgages.

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[1] Federal bank regulators have defined subprime borrowers as those with multiple recent mortgage delinquencies, foreclosures or bankruptcies, a high probability of default as indicated by a credit score below 660, and/or a debt service-to-income ratio of 50 percent or greater. *See* http://www.federalreserve.gov/Boarddocs/SRletters/2001/sr0104a1.pdf. Investopedia.com defines Alt-A mortgages as "types of loans [that] are attractive to lenders because the rates are higher than rates on prime classified mortgages, but they are still backed by borrowers with stronger credit ratings than subprime borrowers. However, with the higher rates comes additional risk for lenders because there is a lack of documentation - including limited proof of the borrower's income."

Another advantage Fannie and Freddie enjoyed was that Congress, by statute, allowed them to operate with much lower capital requirements than their private sector competitors. Federally-regulated banks are required to hold 4 percent capital against their mortgages. By federal law, however, Fannie Mae and Freddie Mac were only required to hold 2.5 percent capital against their on-balance sheet mortgages, and only 0.45 percent against mortgages they guaranteed.[2] According to one witness who testified before the Committee on the role of the GSEs in the financial crisis, "the capital requirements were an anomaly that artificially restrained depository institutions from competing effectively with the GSEs."[3] Much like the borrowers who took advantage of government efforts to lower down payments on mortgages, low capital requirements allowed Fannie Mae and Freddie Mac to use huge amounts of leverage. During hearings on the collapse of Wall Street investment bank Lehman Brothers, Members of the Committee were outraged to learn that Lehman Brothers was leveraged at a ratio in excess of 30-to-1. However, Fannie and Freddie used their congressionally-granted advantages to leverage themselves in excess of 70-to-1, and even did so in an undiversified market – housing. Furthermore, because their abnormally low capital requirements were set by U.S. law, the GSEs' weak regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO") that was supposed to regulate the safety and soundness of the companies, could not raise the GSEs' capital requirements or limit their borrowing to address their overleveraging without congressional action. This exposed the GSEs and – ultimately, the taxpayers – to tremendous latent risks in the event of a housing market collapse.

Fannie Mae and Freddie Mac were also allowed to sell debt to banks in the guise of "preferred shares," and the government even encouraged banks to hold this debt, which exposed them to catastrophic consequences in the event of a GSE collapse. Only about 50 percent of the capital the GSEs held consisted of equity raised from the sale of common stock and retained earnings. The other 50 percent was raised through the sale of preferred stock to banks at below-market rates.[4] Fannie and Freddie were able to do this because federal bank regulators allowed federally-regulated national banks to apply a risk-weighting of just 20 percent against GSE preferred stock.[5] This stands in stark contrast to their holdings of other preferred stock, which required risk weighting of 100 percent. In other words, the federal government encouraged regulated banks to purchase GSE preferred stock by allowing them to hold 80 percent less capital against it compared to similar assets, providing a major subsidy to their purchase of what amounted to cheap borrowing by Fannie and Freddie.

Fannie Mae and Freddie Mac were also exempt from key regulatory and market oversight. For example, their congressional charters exempted them from oversight by

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[2] *See* P.L. 102-550, Sec. 1362.
[3] See Arnold Kling, testimony before the House Oversight and Government Reform Committee, (December 9, 2008).
[4] *See* Edward Pinto, testimony before the House Oversight and Government Reform Committee, (December 9, 2008).
[5] *See* Office of the Comptroller of the Currency, Interpretive Letter #964, (May 2003), *accessed at* http://www.occ.treas.gov/interp/may03/int964.pdf.

the Securities and Exchange Commission ("SEC"): the GSEs are the only publicly-traded corporations exempt from SEC oversight. It was not until scandals in 2003 and 2004 revealed that the companies had used non-approved accounting practices to manipulate earnings that they agreed to "voluntary" SEC filings. The GSEs were also exempt from market oversight of the quality of their mortgage-backed security issuances. The GSEs packaged much of their $5 trillion in mortgages into mortgage-backed securities. These securities were sold to investors, who received the interest and principal payments associated with the underlying mortgages much like a bond. Fannie and Freddie also guaranteed investors that they would take the loss if the security went bust due to defaults among the underlying mortgages. Mortgage securitization is a useful financial tool that can be used to increase liquidity and spread risk. However, as with most tools, securitization can become dangerous when not used with the proper safety precautions.

One critical safety precaution is a credit rating derived from a risk analysis of the mortgages that underlie a mortgage-backed security. During the Committee's investigation of the root causes of the financial crisis, it became evident that the so-called "Big Three" credit rating agencies had become hopelessly compromised, issuing top-line "AAA" ratings on the mortgage-backed securities and collateralized debt obligations of many Wall Street firms.[6] However, Fannie Mae and Freddie Mac securities were exempt from even this flawed process. Instead, all GSE securities carry an implicit "AAA" rating because of the federal government's backing. As the quality of the mortgages the GSEs were willing to buy declined, this exemption became increasingly dangerous to taxpayers.

These competitive advantages and exemptions from regulatory oversight allowed Fannie Mae and Freddie Mac to muscle out their competition and grow to dominate over three-quarters of the secondary market for prime mortgages in the United States. The GSEs entered the 1990s as financial giants that, by most accounts, had successfully helped usher in affordable housing opportunities for Americans while practicing sound lending principles: a requirement for a substantial down payment and reasonable assurances that a borrower could repay a home mortgage.

THE POLITICIZATION OF MORTGAGE LENDING

As publicly traded corporations, the GSEs faced the obligation of all corporations – to maximize the value of shareholders' equity. This meant seeking out profitable opportunities to invest in housing and, to the maximum extent possible, pushing the envelope of innovation in mortgage finance to compete for market share. However, unlike any other publicly traded corporation, Fannie Mae and Freddie Mac also answered in a very direct way to the federal government and elected officials in a manner reminiscent of the "crony capitalism" of countries such as Russia or China, which preserve a large state-owned enterprise sector. Fannie and Freddie answered to the Department of Housing and Urban Development ("HUD"), which set quotas for GSE investment in affordable housing, as well as to Congress and the White House, which

[6] The "Big Three" are Moody's Investors Service, Standard & Poor's, and Fitch Ratings.

sought to use them as vehicles to advance the politically popular goal of increasing the national homeownership rate. This was done directly through legislation and regulation which mandated affordable housing lending and indirectly through political pressure from politicians and advocacy groups. This created incentives for Fannie and Freddie to curry political favor with Congress and necessitated a massive lobbying effort which GSE executives termed "political risk management." As the New York Times summarized it:

> Fannie Mae, the nation's biggest underwriter of home mortgages, has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people and felt pressure from stock holders to maintain its phenomenal growth in profits.[7]

In the early 1990s, Fannie and Freddie began to come under considerable pressure to lower their underwriting standards, particularly on the size of down payments and the credit quality of borrowers. A deeply flawed 1992 study published by the Federal Reserve Bank of Boston, purporting that minorities faced discrimination in mortgage lending, was particularly influential at the time. This study has since been shown to have been based on inaccurate data, including loans which were supposedly made to borrowers with a negative net worth. When researchers ran the models again after correcting the flawed data, the discrimination that had been the study's central finding disappeared.[8] Yet the damage had been done and Congress seized on the study as part of a major legislative reorganization of the GSEs' function.

In 1992, Congress passed the Federal Housing Enterprises Financial Safety and Soundness Act, which created an "affordable housing mission" for Fannie Mae and Freddie Mac. This legislation directed HUD to establish three separate quotas requiring the GSEs to set aside a certain percentage of their yearly mortgage purchases to loans with affordable characteristics. These quotas were expressed as the minimum share of mortgages that Fannie and Freddie purchased every year which had to be made to "low- and moderate-income families ... low-income families in low-income areas and very low-income families," as well as borrowers in "central cities, rural areas, and other underserved areas."[9] Congress granted HUD the authority to adjust these three affordable housing quotas for the GSEs over time, allowing both Democratic and Republican Administrations to consistently make campaign promises to boost homeownership through government intervention in the market. Consequently, under both the Clinton and Bush Administrations, HUD dramatically increased these quotas, which reached their zenith when the Bush Administration raised them to 56 percent, 27 percent and 39 percent, respectively.

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[7] *See* Steven A. Holmes, "Fannie Mae Eases Credit to Aid Mortgage Lending," *The New York Times*, (September 30, 1999) *accessed at* http://www.nytimes.com/1999/09/30/business/fannie-mae-eases-credit-to-aid-mortgage-lending.html.

[8] *See* Stan J. Liebowitz, "Anatomy of a Train Wreck: Causes of the Mortgage Meltdown," *Independent Policy Report*, (October 3, 2008), *accessed at* http://www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf.

[9] *See* note 2 at Title XIII.

HUD's affordable housing quotas represented major departures from the GSEs' prior commitment to underwriting only sustainable mortgages. Fannie Mae's original congressional charter acknowledged the risks involved in low down payment loans because it allowed Fannie to purchase loans with less than a 20 percent down payment only in concert with certain mitigating factors such as private mortgage insurance or a repurchase agreement with the mortgage originator.[10] The establishment of the HUD quotas broke this convention and set the stage for the dramatic politicization of mortgage lending.

In 1994, Fannie Mae CEO Jim Johnson announced the company's first affordable housing initiative, the $1 trillion "Opening the Doors to Affordable Housing" program. Johnson, a long-time friend of both President Clinton and Treasury Secretary Robert Rubin, took the helm of Fannie in 1991 after a stint at Lehman Brothers. In an article entitled "Fannie Mae's Trillion-Dollar Giveaway," written about this initial affordable housing initiative, the Los Angeles-based Family Savings Bank criticized Fannie Mae's past practices for relying too heavily on borrowers' income and debt levels when underwriting loans. Although some would consider using such metrics to be prudent, the article stated that these guidelines "must have been written sometime in the 1800s." It praised Mr. Johnson's $1 trillion commitment because it would introduce "qualifying flexibility," for low-income borrowers, allowing them to reduce their down payments to as little as 3 percent. The article cited "pressure from President Clinton's administration," as the primary influence on Fannie Mae's decision to lower its lending standards.[11]

The GSEs also allowed politicians to claim credit for earmark-like affordable housing initiatives in their districts without having to appropriate the money in Congress. In 1994, Johnson opened Fannie Mae's first "partnership office" in a congressional district. These partnership offices "issued thousands of press releases" featuring Members of Congress assisting Fannie Mae with affordable housing initiatives.[12] They also had a reputation for hiring relatives of Members of Congress as employees.[13] This political strategy won Fannie and Freddie allies on Capitol Hill who would prove invaluable in fending off calls to rein in their risky borrowing and lending practices.

In 1995, Johnson seeded the Fannie Mae Foundation with $350 million of Fannie stock. The company used this foundation to spread millions of dollars around to politically-connected organizations like the Congressional Hispanic Caucus Institute.[14] It also hired well-known academics to write papers that gave an aura of academic rigor to policy positions favorable to Fannie Mae. For example, one paper coauthored by now-Director of the Office of Management and Budget Peter Orszag, concluded that the chance was

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[10] *See* Federal National Mortgage Association Charter Act, *accessed at* http://www.fhfa.gov/GetFile.aspx?FileID=29.
[11] *See* Valencia Roner, "Fannie Mae's Trillion-Dollar Giveaway," *Black Enterprise*, (November 1, 1994).
[12] *See* Bethany McLean, "Fannie Mae's Last Stand," *Vanity Fair*, (February 2009).
[13] *See* Peter J. Wallison and Charles W. Calomiris, "The Last Trillion-Dollar Commitment," *American Enterprise Institute Financial Services Outlook*, (September 2008), *accessed at* http://www.aei.org/docLib/20080930_Binder1.pdf.
[14] *See* note 12, *supra*.

minimal that the GSEs were not holding sufficient capital to cover their losses in the event of a severe economic shock. The authors suggested that "the risk to the government from a potential default on GSE debt is effectively zero," and that "the expected cost to the government of providing an explicit government guarantee on $1 trillion in GSE debt is just $2 million."[15] As of May 14, 2009, the taxpayers had already been exposed to $700 billion of GSE bailouts, including $59.8 billion of capital injections by the U.S. Treasury, $73 billion of GSE debt purchases by the Federal Reserve, and $567.3 billion of direct purchases of GSE mortgage-backed securities by both the Fed and Treasury.[16]

CLINTON ADMINISTRATION REFORMS – CRA AND THE NATIONAL HOMEOWNERSHIP STRATEGY

1995 was a pivotal year in the politicization of mortgage lending. In that year, the Clinton Administration implemented a major reform of the Community Reinvestment Act ("CRA") and issued its National Homeownership Strategy ("the Clinton Strategy"), both of which increased pressure on Fannie and Freddie to loosen their lending standards.

The CRA was originally passed in 1977 to prevent banks from engaging in "redlining" – refusing to lend to otherwise credit-worthy borrowers in lower-income neighborhoods. Until 1995, the legislation was largely ineffective because it was very broad in its directives to both banks and regulators. For example, while the legislation called for federally-regulated banks to meet "the credit needs of [their] entire community, including low- and moderate-income neighborhoods," it also directed the regulators to "encourage" banks to achieve this goal. It went on to require regulators to "consider" any failure when banks seek approval from the government for actions such as mergers and acquisitions.[17] It was not surprising that this expansive language was not effective in achieving compliance, as demonstrated by the relative infrequency of CRA enforcement actions against banks.

However, in 1995, the Clinton Administration implemented a major regulatory reform of CRA which emphasized "performance-based evaluation." The impact of this reform was that regulators would no longer rate banks based on their efforts to lend to customers using equitable procedures but rather on the volume of their lending. According to one academic study of CRA, this regulatory change marked "a shift of emphasis from procedural equity to equity in outcome." Furthermore, the "lending test" component of the regulatory review process, which was the "most heavily weighted component of CRA

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[15] *See* Joseph E. Stiglitz, Jonathan M. Orszag and Peter R. Orszag, "Implications of the New Fannie Mae and Freddie Mac Risk-based Capital Standard," *Fannie Mae Papers*, (March 2002).

[16] *See* U.S. Department of the Treasury, "Monthly Treasury Statement of Receipts and Outlays of the United States Government," (April 30, 2009), *accessed at* http://fms.treas.gov/mts/mts0409.pdf. *See also*, Board of Governors of the Federal Reserve System, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks," (May 14, 2009), *accessed at* http://www.federalreserve.gov/releases/h41/Current/h41.pdf.

[17] *See* AKM Rezaul Hossain, "The Past, Present and Future of Community Reinvestment Act (CRA): A Historical Perspective," (October 2004) at 13.

examination," included criteria for the "use of innovative or flexible lending practices." As demonstrated time and again by congressional advocates of affordable mortgage lending, "innovative and flexible" means reduced down payments and riskier, unsustainable lending.[18] This shift of regulatory emphasis from ensuring equitable lending procedures to ensuring equitable lending outcomes regardless of borrowers' ability to repay was subtle but significant. When combined with the endorsement of "flexible and innovative" mortgage underwriting, this change in the CRA represented a troubling move away from prudent and sustainable mortgage lending towards government endorsement of lower quality lending to those of modest means.

Although the annual value of CRA home mortgage lending increased some 250 percent between 1996 and 2008, CRA lending never exceeded about 3 percent of total originations.[19] While CRA cannot be directly blamed for the huge volumes of risky nonprime mortgages that were eventually purchased by Fannie, Freddie and Wall Street investment houses, CRA continued a pattern of behavior of lowering mortgage underwriting standards in order to drive up the national homeownership rate.

The other important event of 1995 was the release of the Clinton Administration's *National Homeownership Strategy*. The document's foreword, penned by HUD Secretary Henry Cisneros, cited President Clinton's directive to "lift America's homeownership rate to an all-time high by the end of the century." Among the methods the Strategy proposed to achieve this bump in the homeownership rate was lower down payments. It observed that, "low- and moderate-income families often cannot become homeowners because they are unable to come up with the required downpayment." It goes on to direct that, "lending institutions, secondary market investors [Fannie Mae and Freddie Mac are the dominant players in the secondary market], and other[s]...should work collaboratively to reduce homebuyer downpayment requirements." The Clinton *Strategy* also called for increased use of "flexible underwriting criteria," which it said could be achieved in concert with "liberalized affordable housing underwriting criteria established by...Fannie Mae and Freddie Mac." It also called for "financing strategies, fueled by the creativity and resources of the private and public sectors to help homeowners that lack cash to buy a home or to make the payments."[20]

The Clinton *National Homeownership Strategy* made only a passing acknowledgement of the risks associated with reducing borrowers' equity in their mortgages and instituting "flexible underwriting standards:"

> The amount of borrower equity is an important factor in assessing mortgage loan quality. However, many low-income families do not have access to sufficient funds for a downpayment.

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[18] *Id.* at 54-57.

[19] CRA volume data *accessed at* http://www.ffiec.gov/craadweb/national.aspx, total subprime mortgage originations *accessed at* www.mortgagedaily.com.

[20] *See* U.S. Department of Housing and Urban Development, *The National Homeownership Strategy: Partners in the American Dream*, (May 1995).

Instead it praised lenders for their efforts thus far toward reducing this "barrier to home purchase" but urged that "more must be done." The report noted that in 1989 only 7 percent of mortgages had less than a 10 percent down payment but that by 1994 this had increased to 29 percent. The *Strategy* praised lenders for developing "innovative low-down payment programs" and applauded Fannie Mae for announcing 3 percent-down payment mortgages. HUD also issued new rules that allowed the GSEs to count subprime mortgages made to low-income borrowers toward their affordable housing goals.

In retrospect, President Clinton's rebranding of prudent down payments of 10 to 20 percent as "barrier[s] to home purchase" takes on great significance. As with the 1995 CRA reform and the Clinton Administration's decision to allow the GSEs to count subprime loans toward their affordable housing goals, this represented a shift in government policy from one that emphasized equity of procedure to equity of outcome. This emphasis on equity of outcome inevitably created tremendous pressure on regulated institutions to make more loans to low-income borrowers. It also created pressure for secondary market investors such as Fannie Mae and Freddie Mac to buy these loans. The correspondingly lower emphasis on how the loans were being made inevitably meant less attention would be paid to their quality and sustainability.

A Freddie Mac spokeswoman later acknowledged that the Clinton HUD's decision on subprime loans "forced us to go into that market to serve the targeted populations that HUD wanted us to serve." Clinton's HUD Assistant Secretary William C. Apgar, Jr. has since called the decision a "mistake," while his former advisor Allen Fishbein called the loans that the GSEs started buying to meet their affordable housing goals "contrary to good lending practices," and examples of "dangerous lending."[21] President Clinton himself acknowledged his role in efforts to loosen mortgage lending standards when he admitted that "there was possible danger in his administration's policy of pressuring Fannie Mae...to lower its credit standards for lower- and middle-income families seeking homes."[22] These accumulated government affordable housing policies, including the Clinton *Strategy*, trapped millions of Americans in mortgages they could not afford.

LOWER LENDING STANDARDS SPREAD AND CAUSE THE HOUSING BUBBLE

Risky mortgage lending, particularly loans with very low down payments, contributed directly to the rise of a housing bubble. Had this risky lending been contained within the low-income segment of the market targeted by politicians advocating more "innovation" in "affordable lending," the damage to the wider economy might have been minimal. However, these "innovations" in "flexible" loans products spread beyond just affordable lending into the entire U.S. mortgage market. The lure of reduced underwriting standards

[21] *See* Carol D. Leonnig, "How HUD Mortgage Policy Fed the Crisis," *The Washington Post*, (June 10, 2008).
[22] *See* Walter Alarkon, "Clinton Rejects Blame for Financial Crisis," *The Hill*, Sept. 9, 2008, *accessed at* http://thehill.com/leading-the-news/clinton-rejects-blame-for-financial-crisis-2008-09-25.html.

held true not just for borrowers of modest income but for those at all income levels. Although the erosion of mortgage underwriting standards began in Washington with initiatives like the CRA as a way to reduce "barriers to homeownership," this trend inevitably spread to the wider mortgage market. One observer noted:

> Bank regulators, who were in charge of enforcing CRA standards, could hardly disapprove of similar loans made to better qualified borrowers. This is exactly what occurred.[23]

Borrowers – regardless of income level – took advantage of the erosion of underwriting standards that started with government affordable housing policy. As one study observed,"[o]ver the past decade, most, if not all, the products offered to subprime borrowers have also been offered to prime borrowers."[24] For example, Alt-A and adjustable-rate mortgages became incredibly popular with borrowers – who were generally not low-income – engaging in housing speculation. As home prices continued their dizzying rise, many people decided to cash in by buying a house with an adjustable-rate mortgage featuring a low introductory teaser rate set to increase after a few years. These borrowers, confident in the oft-cited assertion that U.S. home values had never before fallen in the aggregate, planned to sell or refinance their investment before the mortgage rate adjusted upward, pocketing the difference between the initial purchase price and the subsequent appreciation in value. However, buyers failed to grasp the effect of a government policy that had quietly eroded the prudential limits on mortgage leverage, creating a dangerous speculative bubble.

As the size of down payments for mortgages fell, so too did borrowers' equity stake in the homes they purchased. This had two important effects. First, it eliminated the borrower's "skin in the game," increasing the likelihood that he or she would walk away from the mortgage if times got tough. It also increased the borrower's leverage (debt) as measured by the Loan-to-Value ratio.[25] This leverage allows borrowers to purchase more expensive houses than they would otherwise be able to afford at a given level of income.

It was this process of steadily increasing leverage that drove the complete decoupling of home prices from Americans' income and fed the growth of the housing bubble. As the average down payment shrank and leverage correspondingly increased, the amount of mortgage debt relative to borrowers' income increased. This increasing leverage in turn eroded the power of supply and demand to restrain irrational price increases. In a normal housing market, free of government intervention, an increase in home prices would have been restrained when the marginal, or next, home seller tried to charge a price too high

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[23] *See* Peter J. Wallison, "Cause and Effect: Government Policies and the Financial Crisis," , *American Enterprise Institute Financial Services Outlook*, (November 2008), *accessed at* *http://www.aei.org/docLib/20081203_1123724NovFSOg.pdf*..

[24] *See* James R. Barth, Tong Li, Triphon Phumiwasana, and Glenn Yago, "Surprise: Subprime Mortgage Products Are Not The Problem!" (December 2007), *accessed at* http://www.milkeninstitute.org/pdf/Subprime-Mortgage-Products.pdf.

[25] According to Investopedia.com, "leverage" is, "the amount of debt used to finance a firm's assets. A firm with significantly more debt than equity is considered to be highly leveraged. Leverage is most commonly used in real estate transactions through the use of mortgages to purchase a home."

for prospective borrowers to afford. This home seller would have been forced to cut his or her unreasonable price.

Once government-sponsored efforts to decrease down payments spread to the wider market, home prices became increasingly untethered from any kind of demand limited by borrowers' ability to pay. Instead, borrowers could just make smaller down payments and take on higher debt, allowing home prices to continue their unrestrained rise. Some statistics help illustrate how this occurred. Between 2001 and 2006, median home prices increased by an inflation-adjusted 50 percent, yet at the same time Americans' income failed to keep up. For the 30 years prior to 2000, the ratio of U.S. home prices to income averaged only about 4-to-1 – in other words, the average American lived in a home costing four times his annual income. In just five years, from 2000 to 2005, that ratio doubled to 8-to-1. As a result of homes becoming more expansive and seemingly less affordable, the only way for many Americans to buy a home during the housing bubble was to dramatically increase their leverage. It is not surprising, then, that between 2000 and 2006 mortgage debt in the U.S. increased by 80 percent. According to one early warning in 2006, the odds against such an increase in the price-to-income ratio occurring naturally were greater than 300-to-1.[26]

Government actions distorted the housing market, yet advocates of affordable housing policies, such as Congressman Barney Frank (D-MA), have asserted that those who criticize these policies seek to place blame for the financial crisis solely on borrowers of modest means.[27] This misses the mark entirely. In fact, responsibility for the erosion of mortgage lending standards, which began with government affordable housing policy, rests squarely on the policy makers who advocated these ill-conceived policies in the first place. Borrowers quite naturally responded to the incentives they were given, irrespective of their socioeconomic status, and risky lending spread to the wider mortgage market.

SPECIAL INTERESTS: THE RISE OF THE "AFFORDABLE" HOUSING COALITION

Under continuing political and economic pressure, the trend toward lowering mortgage lending standards continued apace throughout the 1990s. The GSEs altered their automated mortgage underwriting criteria to encourage banks to make loans to borrowers with damaged credit, in large part to satisfy the Clinton Administration's demand that the GSEs do more to increase homeownership among low-income and minority borrowers as laid out in the Administration's affordable housing strategy.[28] In this vein, Johnson's

[26] *See* Andrew LaPerriere, "Housing Bubble Trouble: Have we been living beyond our means?" *The Weekly Standard*, (April 10, 2006).
[27] *See* Glen Johnson, "Frank Says GOP Housing Attacks Racially Motivated," *Associated Press*, (October 6, 2008).
[28] According to Investopedia.com, "automated underwriting" is "a computer-generated loan underwriting decision. Using completed loan application information, an automated underwriting system retrieves relevant data, such as a borrower's credit history, and arrives at a logic-based loan decision. Automated underwriting engines can provide near-instantaneous loan approval or denial decisions;

successor, Fannie Mae CEO Franklin Raines said that the company had "expanded home ownership for millions of families in the 1990's by reducing down payment requirements."[29] Raines told the Mortgage Bankers Association that he and Freddie Mac CEO Richard Syron "made no bones about their interest in buying loans made to borrowers formerly considered the province of nonprime and other niche lenders." Raines said his goal was, "to push products and opportunities to people who have lesser credit quality."[30]

Fannie Mae and Freddie Mac would ultimately announce over $5 trillion in affordable housing initiatives. Many of these loans came increasingly from large non-bank mortgage lenders like Countrywide Financial Corporation, the country's largest mortgage lender and a major innovator in pushing subprime loans. These non-bank lenders rose to fill the void in mortgage lending left in the wake of the savings and loan crisis, and they grew rapidly in response to government policies that encouraged lower lending standards. A symbiotic relationship developed between these non-bank lenders and the GSEs. For example, Fannie Mae under CEO Jim Johnson reached a "strategic agreement" with Countrywide CEO Angelo Mozilo, under which "Countrywide agreed to deliver a large portion of Fannie's annual loan volume in exchange for special financing terms."[31] In fact, Countrywide regularly accounted for 10 to 30 percent of all the loans purchased by Fannie Mae in a given year. In the words of Mozilo: "If Fannie and Freddie catch a cold, I catch the fucking flu."[32]

Freddie Mac also joined in the subprime action, according to internal documents obtained by the Committee. For example, Freddie developed a plan to partner with non-bank mortgage lender Ameriquest by installing its automated underwriting software on-site.[33] Fannie and Freddie both used their automated underwriting software to divert subprime and Alt-A loans from private label securitizers on Wall Street, driving up demand for risky junk mortgages. By 1997, Fannie Mae was offering to buy loans with only a 3-percent down payment, and by 2001 was offering to buy zero-down payment loans.[34]

Not only could these loans be used to satisfy the government's demand for more low-down payment affordable mortgages, they turned out to be highly profitable as well. Combined with the value of their government subsidies and their ability to operate without far-flung retail operations, the GSEs were phenomenally profitable. Fannie Mae enjoyed perhaps the highest level of net income per employee in the world – about

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therefore, implementing automated underwriting systems can save a considerable amount of time, as manual underwriting can take as long as 60 days to complete. In addition to the time savings, automated underwriting is preferred because it is based on algorithms, eliminating human bias. Freddie Mac maintains and markets a large automated underwriting engine known as Loan Prospector, and Fannie Mae has an automated underwriting engine known as Desktop Underwriter."

[29] *See* note 7, *supra*.

[30] *See* Neil Morse, "Looking for New Customers," *Mortgage Banking*, (December 1, 2004), *in* note 13, *supra*.

[31] *See* Glenn R. Simpson, "Countrywide Made Home Loans to Gorelick, Mudd," *The Wall Street Journal*, (September 25, 2008).

[32] *See* Paul Muolo and Matthew Padilla, *Chain of Blame*, New York: John Wiley & Sons, (2008), at 112.

[33] *See* Freddie Mac, document produced to the Committee, Bates FMAC0013683-FMAC0013692.

[34] *See* note 23, *supra*.

$900,000 per employee according to one estimate.[35] The GSEs paid their executives handsomely as well. Fannie CEO Franklin Raines earned over $90 million in compensation during his six-year tenure.[36] Fannie and Freddie paid billions more to their shareholders every year in dividends. Thus, government subsidization of GSE operations amounted to little more than corporate welfare. Indeed, both the Congressional Budget Office and the Federal Reserve found that only about half of this taxpayer subsidy ever came back to the taxpayers in the form of lower mortgage rates.[37]

Similarly, Wall Street investment houses like Lehman Brothers, Bear Stearns, and Merrill Lynch, which came to specialize in packaging and investing in the lowest-quality tranches of mortgage-backed securities, profited hugely from the increased volume that government affordable lending policies sparked. Private-label securitization of subprime mortgages grew from $60 billion-a-year in 1997 to nearly $500 billion-a-year by 2006.[38] These firms could not compete in any segment of the market Fannie and Freddie chose to close off to them because the GSEs could always undercut Wall Street's costs by virtue of their government-granted competitive advantages. However, as with the GSEs' relationship to non-bank lenders such as Countrywide, Wall Street formed its own symbiotic relationship with Fannie and Freddie. Wall Street firms profited from buying and selling GSE mortgage-backed securities, which because of the government backing were deemed to be as safe as Treasury bonds – but with a higher yield. For their part, the GSEs became the largest purchasers of the "AAA"-rated tranches of Wall Street's private-label securities, while Wall Street invested in the lower-quality portions. However, without the GSEs' participation, it is unlikely that Wall Street could have formed these pools of toxic mortgages, making Fannie and Freddie the indispensable actors in the subprime market.[39] This resulted in consistent downward pressure on down payments and on the credit quality of borrowers, fueling the housing bubble.

The nexus of political advocates of affordable housing, non-bank mortgage lenders like Countrywide, the homebuilding industry, and Wall Street firms came together to create a powerful affordable housing coalition led by Fannie Mae and Freddie Mac and their congressional allies. This group of vested interests used its money, power and influence to protect its political prerogatives and profits, blocking repeated attempts at reform and distorting the relationship between government and business. Between 1998 and 2008, Fannie Mae and Freddie Mac spent over $176 million on lobbyists.[40] They paid lobbyists to influence Members of Congress to block legislative proposals that would

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[35] *See* Owen Ullmann, "Crony Capitalism: American Style," *The International Economy*, (July/August 1999).

[36] *See* OFHEO, "Report of the Special Examination of Fannie Mae," (May 2006), *accessed at* http://www.fhfa.gov/webfiles/747/FNMSPECIALEXAM.pdf.

[37] *See* Congressional Budget Office, "Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac," (May 1996), at xiv, *accessed at* http://www.cbo.gov/ftpdocs/0xx/doc13/Fanfred.pdf. *See also,* Wayne Passmore, Board of Governors of the Federal Reserve System, "The GSE Implicit Subsidy and the Value of Government Ambiguity," (2005), at 3, *accessed at* http://www.federalreserve.gov/Pubs/feds/2005/200505/200505pap.pdf.

[38] Data from Standard & Poor's and Moody's, *accessed at* www.mortgagedaily.com.

[39] *See* note 13, *supra*.

[40] *See* www.opensecrets.org.

have stripped them of their preferential advantages. The GSEs even paid lobbyists just so they would not lobby against them. As one person who was offered money not to lobby against the GSEs noted, Fannie and Freddie could rely on a simple and politically powerful message touting their commitment to homeownership to blunt any efforts to rein them in.[41] If that failed, according to one congressional staffer who preferred anonymity, the GSEs could take a tougher line:

> Fannie has this grandmotherly image, but they'll castrate you, decapitate you, tie you up and throw you in the Potomac. They're absolutely ruthless.[42]

When Congressman Jim Leach (R-IA) proposed assessing a fee on the GSEs to offset the federal subsidy they receive on their cost of borrowing, "it took just twelve hours for Fannie to blow the idea out of the water." Fannie Mae also forced then-Treasury Secretary Larry Summers to "tone down" a report that was originally going to criticize the cozy relationship between the federal government and the GSEs.[43] When Congressman Paul Ryan (R-WI) sought to increase regulation of the GSEs, Fannie Mae sent lobbyists to harass him in his Wisconsin congressional district, going so far as to call his constituents and accuse him of seeking to increase mortgage rates, generating 6,000 angry responses to his office. When Ryan transferred to a committee without direct oversight of the GSEs, Fannie CEO Raines sent him a "congratulatory" note. "He meant good riddance," said Ryan.[44] When Congressman Christopher Shays (R-CT) introduced legislation to end the GSEs' unique exemption from SEC registration, he "had lobbyists literally barging into my room," while Fannie CEO Raines reportedly called the lawmaker to ask, "What the hell have [you] done?" The GSEs retaliated by ending their home-buying forums in Shays' congressional district in an attempt to hurt him politically.[45] Congressman Cliff Stearns (R-FL), who scheduled hearings on Freddie Mac's use of improper accounting procedures in 2004, had his jurisdiction over the GSEs stripped by House Speaker Dennis Hastert (R-IL), who assigned the task to Michael Oxley (R-OH), who was the most frequent featured guest at 19 of the fund-raisers Freddie Mac held for members of his committee.[46]

Just as the perils of opposing the vested interests of the affordable lending coalition were rife, so the rewards for supporting them were lucrative. From 2000 to 2008, the GSEs and their employees contributed nearly $15 million to the campaigns of dozens of Members of Congress on key committees responsible for oversight of Fannie and Freddie.[47] At the time federal regulators seized the insolvent companies, sitting Members of Congress had received over $4.8 million in political contributions since 1989, with over $3 million of that coming from the GSEs' political action committees.

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[41] *See* Bara Vaida, "Battling Fannie and Freddie," *National Journal*, (October 18, 2008).
[42] *See* note 35, *supra*.
[43] *Id.*
[44] *See* Paul A. Gigot, "The Fannie Mae Gang," *The Wall Street Journal*, (July 23, 2008).
[45] *See* Matthew Murray, "A $90 Million Package Gets Lambasted Again," *Roll Call*, (December 10, 2008).
[46] *See* note 44, *supra*. *See also* Pete Yost, "Freddie Mac Lobbyist Staged 50 GOP Fund-Raisers as Congress Let Legislation Die," *The Associated Press*, (July 18, 2003).
[47] *See* Common Cause, "Ask Yourself Why...They Didn't See This Coming," (September 24, 2008), *in* note 13, *supra*.

Of that total, 57 percent went to Democrats, and 43 percent to Republicans.[48] Not all of this fundraising was in compliance with federal law. In 2006, Freddie Mac paid the largest fine in Federal Election Commission history – $3.8 million – for improperly using corporate resources to hold 85 fundraisers for Members of Congress, raising a total of $1.7 million.[49]

Fannie Mae and Freddie Mac regional partnership offices provided millions in additional contributions to politicians who supported them by funding affordable housing projects in congressional districts. For example, one press release from the office of Senator Charles Schumer (D-NY) read, "Schumer Announces up to $100 Million Freddie Mac Commitment to Address Fort Drum and Watertown Housing Crunch." The release touted that, "Schumer has frequently partnered with Freddie Mac on creative, affordable housing initiatives around the state," and that Freddie had committed to purchase $100 million of loans originated by HSBC bank, including "low-down payment loans."[50] These politicians could then claim credit with their constituents for bringing home these earmark-like subsidies which didn't have to go through the scrutiny of the normal appropriations process.

Fannie and Freddie also served as a revolving door for powerful former politicians, their aides and even their family members. Jim Johnson managed Walter Mondale's 1984 presidential campaign, chaired the vice presidential selection committee for presidential candidate John Kerry, and was involved in President Barack Obama's vice presidential selection process. Franklin Raines had been President Clinton's Director of the Office of Management and Budget. Former Clinton Deputy Attorney General Jamie Gorelick served as Vice-Chairman of Fannie Mae and earned over $26 million in compensation.[51] Former Fannie Senior Vice President John Buckley had served as a Republican Congressional staffer and senior advisor to the presidential campaigns of Ronald Reagan in 1984 and Bob Dole in 1996. Another former Fannie Senior Vice President, Arne Christenson, had been a senior advisor to Republican House Speaker Newt Gingrich.[52] The son of Republican Senator Bob Bennett worked for Fannie Mae's Utah regional office, while Democratic Representative Barney Frank's partner, Herb Moses, worked at Fannie Mae from 1991 to 1998 as Assistant Director for Product Initiatives while Frank sat on the House Banking Committee with responsibility for oversight of the GSEs.[53]

Until President George W. Bush ended the practice, the President of the United States appointed five members to the GSEs' boards. This was a unique arrangement among

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[48] *See* Open Secrets, "Update: Fannie Mae and Freddie Mac Invest in Lawmakers," *accessed at* http://www.opensecrets.org/news/2008/09/update-fannie-mae-and-freddie.html.

[49] *See* Federal Election Commission press release, "Federal Home Loan Mortgage Corporation ("Freddie Mac") Pays Largest Fine in FEC History," (April 18, 2006), *accessed at* http://www.fec.gov/press/press2006/20060418mur.html.

[50] *See* Senator Charles Schumer press release, (November 20, 2006), *accessed at* http://schumer.senate.gov/SchumerWebsite/pressroom/record.cfm?id=266131.

[51] *See* note 36, *supra*.

[52] *See* note 35, *supra*.

[53] *See* note 12, *supra*. *See also* Bill Sammon, "Lawmaker Accused of Fannie Mae Conflict of Interest," *Fox News*, (October 3, 2008), *accessed at* http://www.foxnews.com/story/0,2933,432501,00.html.

publicly-trade companies and solely a function of their hybrid public-private nature. These board positions were highly lucrative sinecures with which Presidents could reward their political allies. Typically, those appointed to the board by the President served for very short periods of time and contributed very little to the day-to-day operations of the company, yet were paid handsomely. For example, current White House Chief of Staff Rahm Emanuel was appointed to the board of Freddie Mac by President Clinton in February 2000, where he served for only 14 months and in return received $320,000 in compensation. He also sold Freddie Mac stock worth between $100,001 and $250,000. He did not serve on any of the board's working committees and the board itself met no more than six times a year. Clinton also appointed lobbyist and golfing partner James Free and former aide Harold Ickes to the Freddie Mac board.[54]

Other members of the affordable lending coalition also were involved in buying influence among Washington figures. One of the most notable examples was Countrywide's use of preferential mortgages to curry favor with so-called "VIPs." Countrywide CEO Angelo Mozilo styled this the "Friends of Angelo" program. Officials with direct responsibility for overseeing GSE operations, including Senators Christopher Dodd and Kent Conrad and HUD Secretary Alphonso Jackson (responsible for setting the GSEs' affordable housing quotas), received sweetheart mortgages from Countrywide. Key congressional staffers with responsibility for oversight of Fannie and Freddie also received sweetheart mortgages, including Clinton Jones III, Republican Chief Counsel of the House Financial Services Committee, which oversees the GSEs. Jones eventually left his job in Congress to join Fannie Mae as a vice president.[55] Another staffer who received a sweetheart mortgage from Countrywide was Joyce Brayboy, Chief of Staff to Congressman Mel Watt. Watt is a member of the House Financial Services Committee and the Congressional Black Caucus, a group noted for its strong support of the GSEs' affordable housing "mission." High-level GSE executives were also beneficiaries of Mozilo's largesse, including Fannie Mae CEO Jim Johnson, who also was a key conduit for referring other "VIPs" to the program, Franklin Raines, and Fannie Vice Chair and former Clinton Justice Department official Jaime Gorelick.[56]

SCANDALS AT FANNIE AND FREDDIE

In 2003, Fannie Mae and Freddie Mac were at the height of their power. They dominated the secondary mortgage market, including a combined exposure of $372 billion to subprime mortgages made to borrowers with FICO scores below 660, 81 percent of the total market.[57] Wall Street firms were responsible for a mere 19 percent of this market. However, accounting scandals were about to hammer the GSEs' share prices, threaten

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[54] *See* Bob Secter and Andrew Zajac, "Rahm Emanuel's Profitable Stint at Mortgage Giant," *The Chicago Tribune*, (March 26, 2009).
[55] *See* Dan Golden, "Angelo's Fannie Pack," *Conde Nast Portfolio*, (July 17, 2008).
[56] *See* House Oversight and Government Reform Committee, "Friends of Angelo: Countrywide's Systematic and Successful Effort to Buy Influence and Block Reform," (March 19, 2009) *accessed at* http://republicans.oversight.house.gov/media/pdfs/20090319FriendsofAngelo.pdf. *See also* note 31, *supra*.
[57] *See* Edward Pinto, information provided to the Committee on Oversight and Government Reform, based on an analysis of securities filings and mortgage market data.

their market share, and create an urgent need for a pro-active political influence strategy to blunt calls for reform.

In 2003 and 2004, it became known that GSE executives had manipulated accounting rules to maximize profits and executive compensation, breathing new life into efforts by the Bush Administration and some in Congress to properly regulate them. This in turn forced the GSEs to seek shelter with their congressional benefactors, the advocates of affordable housing policy.

As part of their highly profitable business model, Fannie Mae and Freddie Mac both built up huge investment portfolios of mortgages and mortgage-backed securities, from which they earned the principal and interest payments. This was both the most profitable and the riskiest part of their business model. Part of the risk was that the companies had to use complex hedging operations to compensate for the inherent volatility of an undiversified portfolio of home mortgages in order to maintain the illusion of smooth and steady earnings growth. If Congress became aware of the risks they were taking, the GSEs feared it would have greatly strengthened calls to rein in the companies' over-leveraging by increasing their capital requirements. While this would have protected taxpayers by increasing the regulatory capital cushion beneath the GSEs' investments, the companies opposed it because it threatened their profitability.

Conducting the necessary hedging of the GSEs' portfolio perfectly was impossible, particularly with prices rising so rapidly during the growth of the housing bubble. Officials at Fannie and Freddie decided to cheat by manipulating the companies' earnings with improper accounting practices in order to hide volatility from their investors and the government. An internal Freddie Mac investigation revealed this improper behavior, forcing the board to promptly oust the company's top leadership in June 2003 and announce that it would restate earnings. It turned out that Freddie Mac had been underreporting earnings on derivatives and bonds that had dramatically increased in value due to falling interest rates between 2000 and 2003 by $5 billion. Freddie did so to maintain the illusion of the steadily increasing returns its investors had come to expect, disguising the increasingly volatile nature of its undiversified investments in the housing market.

The fact that Freddie's Board of Directors had been briefed on management's plan to massage earnings yet did not question it raised serious doubts about the board's motivations and effectiveness. In its report on the scandal, OFHEO singled out the presidentially-appointed board members such as Rahm Emanuel, who sat on the Board at the time it was apprised of the improper accounting scheme, as an "anachronism" which should be "repealed so shareholders can elect all Directors."[58] This was a stinging indictment of the crony capitalism that led directly to lax oversight and perverse incentives for the GSEs to behave improperly.

[58] *See* OFHEO, "Report of the Special Examination of Freddie Mac," (December 2003), at vi, *accessed at* http://www.fhfa.gov/Preview-FHFAWWW/webfiles/749/specialreport122003.pdf.

To its credit, OFHEO responded to revelations of fraud at Freddie Mac, and launched an investigation of Fannie Mae as well. In 2004, OFHEO announced that Fannie Mae had also "deviated from generally accepted accounting principles in order to conceal losses, reduce volatility in reported earnings, present investors with an artificial picture of steadily growing profits, and to meet financial performance targets that triggered the payment of large bonuses" to its executives.[59] The SEC conducted an independent review that confirmed OFHEO's findings of improper behavior, and within weeks the leadership team led by Mr. Raines resigned from Fannie Mae. Fannie was forced to revise its earnings downward by $6.3 billion. OFHEO found that "Fannie Mae's executives were precisely managing earnings to the one-hundredth of a penny to maximize their bonuses while neglecting investments in systems internal controls and risk management."[60] The regulator found that earnings management, "made a significant contribution to the compensation of [CEO] Franklin Raines."[61] Raines ultimately earned over $50 million at Fannie Mae while Freddie Mac CEO Leland Brendsel earned almost $20 million in salary, bonuses and dividends at Freddie Mac.[62]

The accounting scandals caused outrage on Capitol Hill and prompted Members of Congress and the Bush Administration, including Federal Reserve Chairman Alan Greenspan, to seek reform legislation that would have limited the GSEs' risky mortgage portfolios and high-leverage debt issuance by empowering their regulator to require them to hold additional capital. In response, Fannie Mae and Freddie Mac sought protection from their strongest political protectors, the advocates of high-risk affordable lending. The GSEs essentially doubled down on risky low down payment lending to shore up support on Capitol Hill and fend off attempted regulation. GSE congressional supporters, many of whom sat on key committees charged with oversight of the housing and mortgage industries, made repeated public statements in support of the push to reduce the quality of underwriting at the GSEs and to block congressional efforts at better regulation.

For example, at a hearing of the House Financial Services Committee on the GSE accounting scandals, Congresswoman Maxine Waters (D-CA) publicly praised the GSEs for implementing their "affordable housing mission, a mission that has seen innovation flourish, from desktop underwriting to 100 percent [zero-down payment] loans."[63] And in a speech delivered at the swearing-in ceremony of the Congressional Black Caucus in 2005, Franklin Raines' successor, Fannie Mae CEO Daniel Mudd, sent a clear signal to congressional advocates of loosened lending standards that his company sought political cover in order to blunt efforts to address the serious structural problems posed by the GSEs. Mudd told the assembled Members that he was "humbled...to reaffirm the friendship and the partnership between Fannie Mae and the Congressional Black

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[59] *See* Mark Jickling, Congressional Research Service, "Accounting Problems at Fannie Mae," (December 7, 2006).
[60] *See* OFHEO press release, "Fannie Mae Façade," (May 23, 2006), *accessed at* http://www.fhfa.gov/webfiles/2095/52306fnmserelease.pdf.
[61] *Id.*
[62] *See* Fannie Mae document produced to the Committee, Bates FM-COMP-COGR-00009. *See also* Freddie Mac document produced to the Committee.
[63] *See* House Financial Services Committee hearing, (September 25, 2003).

Caucus," and noted that "[s]o many of you have been good friends to Fannie Mae and our [affordable housing] mission...You've been friends through thick and thin." In reference to the accounting scandal, Mudd noted:

> We have indeed come upon a difficult time for Fannie Mae. There is much to be done inside my company and I humbly ask you to help us and to help me. If there are areas where we are missing, if there are areas where we could do better, we'd like to hear it from our friends and I'd be so bold as to say, our family first.

He noted pointedly that "Fannie Mae has lent more money to more minorities and more underserved individuals than any single company in history," and reassured Members that "you will see Fannie Mae reaching out and listening to the [Congressional Black] Caucus" and opined that "you are also the conscience of Fannie Mae, keeping us on course to serve those who need serving most."[64]

This speech by Fannie Mae's CEO reveals much about the unique relationship between the GSEs and congressional advocates of lower mortgage lending standards. The company was desperate to maintain its unfair competitive advantages granted by Congress in the wake of the accounting scandals and increased calls to strip it of some of those privileges. Its leadership clearly decided that the best strategy was to play up the politically popular albeit short-sighted goal of lowering their standards in order to increase the national homeownership rate and please their political benefactors. That the effect of this strategy was to trap Americans in unsustainable mortgages and feed the growth of a housing bubble merely heaped insult upon injury.

REFORM OF FANNIE AND FREDDIE THWARTED: FOR A PRICE

The GSEs' political risk management succeeded in thwarting congressional and Bush Administration attempts at reform. In 2004, Senators Hagel, Sununu, Dole, and McCain, took up Fed Chairman Alan Greenspan's call to create stronger regulatory oversight of the GSEs and limit the amount of leverage GSEs could use to invest in risky mortgage lending. While this would not have interfered with the GSEs' role in providing a secondary mortgage market, it would have reduced their ability to fund high-risk lending with borrowed money and cut into the companies' fabled profit margins and executive compensation. However, when the Senate Banking Committee took up the legislation, S.1508, Democrats and some Republicans opposed it as originally drafted. For example, the legislation was approved by the Committee only after Senator Robert Bennett, whose son was employed by the Fannie Mae partnership office in Utah, attached an amendment that stripped the provision which would have allowed a new regulator to limit the GSEs' leverage.[65] This led the Bush Administration to withdraw its support from the weakened legislation, which ultimately failed to pass the full Senate.

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[64] *See* Daniel Mudd speech, (January 4, 2005), *accessed at* rtsp://video.c-span.org/project/c04/c04010405_cbc.rm.

[65] *See* note 12, *supra*. *See also* Leslie Paige, Citizens Against Government Waste, "GSE Reform in Critical Stage," (May 1, 2004), *accessed at* http://www.cagw.org/site/News2?page=NewsArticle&id=7769.

A similar scenario unfolded in 2005 when the Senators reintroduced their GSE reform language. Once again the bill, S.190, failed to get a single Democratic vote in the Banking Committee. Among the Democrats who voted against the bill were Senator Christopher Dodd, who received a sweetheart mortgage from Countrywide, and Senator Charles Schumer, who had so prominently advertised a $100 million Freddie Mac affordable housing program in his state. Without any Democratic support, the legislation failed to garner sufficient support for a vote on the Senate floor and was never enacted.

The House of Representatives also took up GSE reform in 2005 with the passage of H.R. 1461. However, the legislation did not allow the new federal regulator it would have created to limit the size of the GSEs' portfolio. As a result, the Bush Administration, citing Fed Chairman Alan Greenspan's insistence on the need for such a measure, once again withdrew its support and the bill died.

In return for political protection from oversight and reform, however, Fannie Mae and Freddie Mac were forced to placate their congressional protectors with an ever-increasing commitment to high-risk lending. That Fannie and Freddie felt such political pressure is made clear in an email exchange at Freddie Mac regarding the company's decision to not place an upper limit on the number of defaulting affordable loans the company was underwriting. Freddie Mac's senior vice president in charge of its affordable housing mission admitted that the higher default rates typical of lower-quality affordable mortgages could do serious "[h]arm to households and neighborhoods." This grim reality notwithstanding, "[t]ipping the scale in favor of no cap [on defaults] at this time was the pragmatic consideration that [it] would be interpreted by external critics as additional proof that we are not really committed to affordable lending."[66] Clearly the GSEs feared a backlash from powerful advocates of looser mortgage standards so much that they could not even agree to place limits on how many defaults they would tolerate for one of their more risky loan products, irrespective of the obvious damage this lending was doing to families and neighborhoods.

Politicians who favored reduced lending standards in the name of increasing the homeownership rate among their constituents cheered on these efforts. For example, members of the Hispanic Caucus in the U.S. House of Representatives formed a special housing initiative called *Hogar* to encourage increased lending to Latino borrowers in their districts through reduced standards. These lawmakers received financial and policy support from the subprime lending industry as well as from Fannie Mae and Freddie Mac, which in return received congressional support for their drive to make low-quality loans. According to one report, for $150,000 in campaign contributions a year, subprime lenders could supply a research fellow to produce studies for *Hogar* that would in turn be used by industry lobbyists to push low-quality mortgage lending among Latino borrowers. For $100,000 a year in donations, the congressional group "offered to provide news releases from the Hispanic Caucus promoting a lender's commercial products for the Latino market." Freddie Mac partnered with *Hogar* to produce a study of Latino homeownership in 63 congressional districts which found that Latino homeownership

[66] *See* Freddie Mac document produced to the Committee, Bates FMAC0013801-FMAC0013802.

had increased thanks to "new flexible mortgage loan products" and recommended "further easing of down-payment and underwriting standards."[67] Indeed, according to the U.S. Census Bureau, Latino homeownership increased by 47 percent during the housing bubble, from 4.1 million to 6.1 million between 2000 and 2007. This was an astonishing rate of increase at a time when the national homeownership rate rose by just 8 percent.

Along with political pressure from Congress for more low-quality affordable housing loans, Fannie Mae and Freddie Mac also caved in to the temptation to lower their standards in an attempt to take market share away from Wall Street. This pressure amplified the effect of the push by politicians to lower their underwriting standards in order to do more risky affordable lending. These dual pressures were noted in an email from Freddie Mac's chief risk officer:

> [T]he push to do more affordable business and increase share means more borderline and unprofitable business will come in. The best credit enhancement is a profit margin and ours is likely to get squeezed as we respond to these market pressures.[68]

But even as Fannie and Freddie acted to placate political allies who they needed to help thwart reforms, some GSE employees were beginning to develop a new fear. A Fannie Mae presentation obtained by the Committee explicitly acknowledged conditions indicative of a housing bubble, including an overheated market and the proliferation of increasingly risky mortgages. Yet when faced with the choice of "staying the course" or "meeting the market where it is," the presenters recommended developing "underground" efforts to delve into subprime and "alternative" markets in order to avoid becoming "less of a market leader."[69]

One case study that illustrates the dual pressures of the politicization of mortgage lending and the push for market share is the internal debate at Freddie Mac over its purchase of No-Income, No-Asset ("NINA") mortgages, a type of Alt-A loan. These risky loans did not verify a borrower's income or assets. The company's chief risk officer warned his fellow executives in 2004 that the mortgages in question would prove to be dangerously risky and that Freddie Mac would likely give in to the temptation to continue lowering its standards to attract market share. "In 1990 we called this product 'dangerous' and eliminated it from the marketplace," he wrote to his colleagues.[70] He also warned that these mortgages were "disproportionately targeted towards Hispanics," making "[t]he potential for the perception and the reality of predatory lending with this product...great".[71] He also predicted that these loans were going to "borrowers who would have trouble qualifying for a mortgage if their financial position were adequately

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[67] *See* Susan Schmidt and Maurice Tamman, "Housing Push for Hispanics Spawns Wave of Foreclosures," *The Wall Street Journal*, (January 5, 2009).
[68] *See* Freddie Mac document produced to the Committee, Bates FMAC0013756.
[69] *See* Fannie Mae document produced to the Committee, Bates FM-COGR_00177162 – FM-COGR_0177172.
[70] *See* Freddie Mac document produced to the Committee, Bates FMAC0013672.
[71] *See* Freddie Mac document produced to the Committee, Bates FMAC0013739.

disclosed," with first-year delinquency rates ranging from 8 percent to 13 percent.[72] However, according to another executive, the company pushed ahead, buying billions of dollars worth of these loans "to ensure we hit share objectives and continue to diversify our customer base."[73]

Freddie Mac executives sought to control the risk of these junk mortgages by implementing certain minimum parameters such as only buying loans made to borrowers with at least a 680 credit score. However, in a nod to the competitive pressures of the market, the chief risk officer warned that "we have already had requests from [J.P. Morgan] Chase and Wells [Fargo] to allow this offering to go to 660 [credit scores]," and that competition between Fannie and Freddie "will likely compete the borrower profile [down] to a level where understanding income and assets really does matter. I don't know how to put the genie back in the bottle."[74] He continued:

> I know this is where the market is evolving...Having said that, we did no-doc lending [in the late 1980s and early 1990s], took inordinate losses and generated significant fraud cases. I'm not sure what makes us think we're so much smarter this time around.[75]

Another Freddie Mac executive admitted that pressure to reduce underwriting quality and purchase these loans was "largely driven by a need to allow lenders to compete" with reduced documentation mortgages at Countrywide and Bank of America.[76] At the same time, the chief risk officer also acknowledged that, "the push to do more affordable business and increase share means more borderline and unprofitable business will come in."[77]

FALLOUT: TAXPAYERS PAY FOR FANNIE'S AND FREDDIE'S BINGE ON RISKY MORTGAGES

As long as housing prices continued to rise, the GSEs' exposure to risky nonprime loans remained manageable. With the bursting of the bubble, however, the underlying weaknesses of Fannie Mae and Freddie Mac, caused by years of purchasing low-quality loans and dangerously high levels of leverage, began to show. In 2007, the GSEs reported combined losses of over $5 billion, the first full-year loss for Fannie Mae since 1985 and the first ever for Freddie Mac. These losses were dwarfed in 2008, however, when the GSEs reported combined year-end losses in excess of $108 billion. The companies' share prices plummeted by 60% between July 2007 and July 2008.[78]

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[72] *Id.*
[73] *See* Freddie Mac document produced to the Committee, Bates FMAC0013673.
[74] *See* Freddie Mac document produced to the Committee, Bates FMAC0013675.
[75] *See* Freddie Mac document produced to the Committee, Bates FMAC0013676.
[76] *See* Freddie Mac document produced to the Committee, Bates FMAC0013757.
[77] *See* note 68, *supra*.
[78] *See* Mark Jickling, Congressional Research Service, "Fannie Mae and Freddie Mac in Conservatorship," (September 15, 2008).

In response to these mounting losses, Congress finally passed much-needed reform legislation, the Housing and Economic Recovery Act of 2008 ("HERA"), which was signed into law on July 30. HERA created a new regulator, the Federal Housing Finance Authority ("FHFA") to replace OFHEO. Congress gave the new agency the power to review and approve new types of mortgages, set capital requirements, limit the GSEs' portfolio sizes, and force them to sell assets. FHFA was also granted the power to place Fannie and Freddie into conservatorship and reorganize them in order to prevent their insolvency.[79]

These reforms came too late to protect taxpayers from a huge government bailout. On September 7, 2008, FHFA, in consultation with Treasury Secretary Henry Paulson, exercised its new authority and placed Fannie Mae and Freddie Mac into conservatorship, wiping out common shareholders and taking on the responsibility for running the companies. In addition to the collapse of the GSEs' share price and their mounting losses, one of the factors in this decision appears to have been Treasury's discovery that the GSEs had overstated their capital reserves by $64 billion by relying on government-granted tax credits which they would probably never be able to use and were therefore worthless. Treasury also discovered that the GSEs were not marking losses on their subprime and Alt-A loans to market and were carefully managing their public reporting of these losses.[80] Finally, the full extent of the GSEs' involvement in risky lending had started coming to light. For example, in its 2007 10-K, filed in February 2008, Fannie Mae finally disclosed its large exposure to first mortgages with so-called "silent seconds" – second loans made to cover down payment and closing costs. Freddie Mac divulged its own exposure to such risky mortgages in its second quarter 10-Q filed in August 2008.

During the House Oversight and Government Reform Committee's investigation starting, in the fall of 2008, it became clear that Fannie Mae and Freddie Mac were in fact leaders in risky mortgage lending. According to an analysis presented to the Committee, between 2002 and 2007, Fannie and Freddie purchased $1.9 trillion of mortgages made to borrowers with credit scores below 660, one of the definitions of "subprime" used by federal banking regulators.[81] This represents over 54% of all such mortgages purchased during those years. If one factors in Alt-A and adjustable-rate mortgages, this analysis found that, at the end of 2008, Fannie and Freddie were still exposed to $1.6 trillion of risky default-prone loans. Thus, at year-end 2008, Fannie Mae and Freddie Mac were responsible for 34 percent of all outstanding subprime mortgages and 60 percent of all outstanding Alt-A mortgages in the United States.[82]

Fannie and Freddie were not only enabling a huge amount of subprime and Alt-A lending – the extremely high delinquency and default rates on these mortgages demonstrate that the GSEs were directly damaging both themselves and their borrowers. At year-end

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[79] *See* Congressional Research Service, "Housing and Economic Recovery Act of 2008," (December 5, 2008).

[80] *See* Gretchen Morgenson and Charles Duhigg, "Mortgage Giant Overstated the Size of Its Capital Base," *The New York Times*, (September 7, 2008).

[81] *See* note 57, *supra*.

[82] *See* Edward Pinto, presentation to the American Enterprise Institute, "How Serious Is the Mortgage Problem That Will Confront President Obama?" (January 16, 2009).

2008, Fannie's and Freddie's main line of business by volume continued to be backing safe mortgage lending, with 66 percent of their exposure consisting of prime loans. As of December 31, 2008, this 66 percent exposure to prime mortgages, even with the deterioration in the housing market, was only suffering a serious delinquency rate of about 0.5 percent, accounting for only 10% of the GSEs' total losses. On the other hand, nonprime loans, which accounted for only 34% of the GSEs' risk exposure at the end of 2008, were suffering a 6% delinquency rate, accounting for 90% of the GSEs' losses.[83] Put another way, the GSEs'nonprime loans were 14 times more likely to be in serious delinquency than their prime loans. In the end, failures on nonprime GSE mortgages may account for the failure of roughly 1 in 6 home mortgages in the U.S., or 8.8 million foreclosures.[84]

The continuing losses caused by Fannie and Freddie's binge on junk mortgages have already cost the taxpayers dearly. Under the terms of their conservatorship, the U.S. Treasury is committed to inject up to $400 billion of capital into Fannie and Freddie to offset their losses and maintain solvency. These capital injections take the form of Treasury purchases of preferred stock in the companies. As of April 30, 2009, the Treasury had spent $59.8 billion on such purchases.[85] In addition, the Federal Reserve has also pledged to purchase GSE debt issuances, of which the Fed had bought nearly $77 billion worth as of May 20, 2009.[86] Finally, both Treasury and the Fed continue to purchase massive amounts of GSE mortgage-backed securities directly – over $567 billion-worth as of May 20, 2009.[87] The sum of these federal aid packages brings the total current taxpayer exposure to GSE liabilities to over $700 billion.

Even more than Wall Street firms, Fannie and Freddie used high leverage to borrow money and gamble on low-down payment affordable and speculative mortgages. Unlike Wall Street, however, the GSEs did this with the mandate and the blessing of Congress and successive Administrations, which encouraged them to use their government-granted competitive advantages to engage in a race to the bottom, boosting the national homeownership rate for political gain.

All told, the government experiment in unsustainable affordable mortgage lending based on low down payments and "flexible" credit criteria has sucked the equity out of the U.S. housing market, trapped millions of Americans under crushing debt, and seriously damaged global financial markets. In 2006, the value of U.S. housing was estimated at $22 trillion. By October 31, 2008 this had fallen to $18.5 trillion. As of the end of 2008, there was about $12 trillion in mortgage debt, of which 42 percent consisted of default-prone loans, with 70 percent of all mortgage debt guaranteed by the federal government. This means that at the end of 2008, the U.S. housing market had a loan-to-value ratio of

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[83] *Id.*
[84] *Id.*
[85] *See* U.S. Department of the Treasury, "Monthly Treasury Statement of Receipts and Outlays of the United States Government," (April 30, 2009), *accessed at* http://fms.treas.gov/mts/mts0409.pdf.
[86] *See* Board of Governors of the Federal Reserve System, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks," (May 20, 2009), *accessed at*, http://www.federalreserve.gov/releases/h41/Current/h41.pdf.
[87] *See* notes 85 *and* 86, *supra*.

66 percent. If U.S. housing prices fall an additional 15 percent to $11 trillion by the end of 2009, the U.S. housing market will be leveraged at a ratio of 110 percent, meaning the market on average will be in negative equity, or "under water."

These statistics are alarming enough on their own, but the real tragedy of the government's affordable housing policy is the impact on average Americans, particularly those of modest means. Millions of these borrowers, who were supposed to have been helped by federal affordable housing policy, have now been forced into delinquency and foreclosure, destroying their asset base, their credit, and in some cases their families. For example, Latino homeowners, who once appeared to be among the most frequent beneficiaries of affordable housing policies, are now the victims of the policies that their political representatives in Washington once championed. According to the Pew Hispanic Center, nearly one-in-ten Latino homeowners said they had missed a mortgage payment or were unable to make a full payment, while 3 percent said they have received a foreclosure notice in the past year. At the same time, 62 percent of Latino homeowners said there have been foreclosures in their neighborhoods and 36 percent say they are worried about their own homes going into foreclosure.[88]

The consequences of these policies have also brought the entire global financial system to the brink of collapse, destroying trillions in equity and untold numbers of lives. It is essential to reexamine the borrow-and-spend, high-leverage policies that became prevalent in the mortgage market as a result of well-intentioned-but-reckless decisions made by elected officials on behalf of the American people. Without such a return to fiscal discipline and responsibility, we will continue making the same mistakes that led us to the current financial crisis.

LEARNING THE RIGHT LESSONS

Washington must reexamine its politically expedient but irresponsible approach to encouraging higher levels of homeownership based on imprudently small down payments and too little emphasis on borrowers' creditworthiness and ability to repay their loans. Unfortunately, very few elected officials would be comfortable echoing Yale University economist and housing expert Robert Shiller, who writes: "[T]he subprime housing dilemma in the United States points up the problems with over-promoting homeownership. Homeownership, for all its advantages, is not the ideal housing arrangement for all people in all circumstances."[89] However, failing to learn the mistakes of our overleveraged binge on mortgage debt will almost certainly doom the country to repeating the same mistakes again and again.

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[88] *See* Mark Hugo Lopez, Gretchen Livingston and Rakesh Kochhar, Pew Hispanic Center, "Hispanics and the Economic Downturn: Housing Woes and Remittance Cuts," (January 8, 2009) at i.
[89] *See* Robert J. Shiller, *The Subprime Solution*, Princeton, NJ: Princeton University Press, (2008), at 6.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. Chairman, in preparation for today's hearing I met with my staff and many of my staff felt that this was a no-win hearing for Republicans. And, in fact, if we run away from the crisis that is before us today, it would be a no-win hearing.

The truth is that Republicans share no small blame for the economic turn down. We were in charge during a time in which policies, some of them predating us, proliferated. We were very much involved in watching an explosion of home values that led to a lack of affordability, that led to both government and non-government entities finding more and more clever solutions to try to make sure that somebody could still secure a home mortgage even if, in fact, it bordered on being a Ponzi scheme and certainly depended on a future gain in order to exit or refinance that property.

But today the hearing is going to go far beyond that. It is going to go into some of the core problems that have existed for a generation. The 9.7 percent national unemployment rate, as compared to the 15 percent unemployment rate for African Americans, is not a new figure. We have failed to deal with the disparity of employment versus unemployment for all of my life.

Today, I believe we need to begin the process of honestly recognizing whether it is home affordability, home foreclosure or, most importantly, access to real employment, to real jobs, and access for entrepreneurs in the minority community to get to the American Dream through access that this committee has authority over, and that is Federal contracts and the disbursement of funds including the stimulus.

I believe this is the beginning of an opportunity for the chairman and the Democratic Members along with the ranking member and the Republican Members to come to grips with the fact that, until there are jobs in the inner city that pay well, that in fact are jobs created by real entrepreneurial activity, by real products and services the American people want, we will not deal with that.

Many leaders in the community, including a former Member of this body, Jack Kemp, have often said that we also have to come to grips with the other side of the problem. We have to come to grips with, in fact, the family structure, and whether the government encourages families to stay together. Families that stay together do better, finish education, go on to have better jobs and better lives.

Additionally, we have to recognize that education, more than anything else, is an indicator of employment in our future economy. In the past, many good jobs were available in the unionized industries of auto, steel, rubber and, even today, when construction times are good, lesser skilled, lesser educated workers willing to work hard and acquire skills can often go through internships and journeyman programs and become highly paid. All of those jobs and more are beginning to be in our rearview mirror and not before us.

The jobs of the future depend on an education. Not just a high school education, and not an education that simply talks about feeling good about your community but, in fact, gaining real, tangible skills in computer sciences, in math and in those skills that allow the future jobs to be available to all.

So, although this is not the Committee on Education and the Workforce, this is not in fact the Appropriations Committee, we do have a special role. We have an ability to set policy for government contracting and government spending that has in fact disadvantaged the small entrepreneurial businesses.

In my home State of California, we have more Hispanics than we have African Americans. In the home I grew up in Cleveland, we had more African Americans than we had Hispanics. But one thing that you see in any inner city in America is, in fact, more small businesses, more businesses that have limited capital and are less likely to get government contracts unless the government changes how they put contracts together, how do they outreach to those communities and how, in fact, they debundle the large contracts that generally mean the small and minority businesses are given only lip service for second or third tier contracts.

We do have that jurisdiction. We do have an obligation to hear the witnesses today and to take that next step on a bipartisan basis to make sure that we do not come back a generation from now talking about unemployment and lack of opportunity when, in fact, the largest single spender in American is, in fact, the Federal Government and we have done a poor job.

So, Mr. Chairman, I ask the remainder of my opening statement be placed in the record and I look forward to us working together on these important issues.

[The prepared statement of Hon. Darrell E. Issa follows:]

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Statement of Darrell Issa, Ranking Member

Committee on Oversight and Government Reform

"The Silent Depression: How Are Minorities Faring In The Economic Downturn?"

September 23, 2009

Thank you, Mr. Chairman, for holding this important hearing. As the Government Oversight and Reform Committee, we have a unique ability – and responsibility – to expose the central role played by well-intentioned but reckless government policies in causing this financial crisis which has had a particularly severe impact on minorities and low-income communities across this country.

Mr. Chairman, statistics amply demonstrate that while the national unemployment rate of 9.7% is unacceptably high, the unemployment rate among some key minority populations is even worse. Unemployment for African Americans is 15% and for Hispanics it is 13%. The same disproportionate impact holds true for home foreclosures – which plagues our nation's urban centers as well as suburbia.

Not only is it appropriate, but it is critical for Congress to dig deeper and understand why minorities in America are bearing a disproportionate burden of these hard times. Accordingly, I look forward to hearing the insights of the witnesses before us so that we can continue to dig into the underlying cause of the racial disparity in the rates of foreclosures and unemployment.

But first, I would like to ask unanimous consent for a report authored by my staff, "The Role of Government Affordable Housing Policy in Creating the Global Financial Crisis of 2008" be entered into the record of today's hearing.

A principal conclusion of this staff report is that a series of well-intentioned but reckless government policies helped create the housing bubble which led to this financial crisis – a crisis which has disproportionately hurt some of our most vulnerable citizens. The federal government's affordable housing policies, intended to increase home ownership rates, actually encouraged risky and unsustainable lending by lowering down payments and underwriting standards on mortgages.

Both Republican and Democratic politicians encouraged Fannie Mae and Freddie Mac to buy mortgages with extremely low down payments, creating a market for risky subprime lending, much of it done with the good intention of increasing minority and low-income homeownership. Tragically, this had the unintended consequence of putting many first-time, minority and low-income homebuyers in over their heads, with insufficient equity to weather the coming downturn in prices.

As Members of Congress, we have a responsibility to face the unintended consequences of federal housing policy head-on because it has hurt real people in this country, of every race, class and creed. In the case of affordable housing, the unintended consequences are thousands of Americans with impaired credit, a destabilized credit market, and historically high levels of unemployment. In August 2009, one in every 357 U.S. housing units received a foreclosure notice and the national foreclosure rate has increased nearly 18 percent from August 2008 to August 2009.

The foreclosure crisis is no longer one limited to subprime loans. High unemployment is exacerbating efforts to resuscitate the housing market. When the housing crisis began in 2007, the unemployment rate was about 4.6%, today it is 9.7%. Growing unemployment is overtaking subprime mortgages as the main driver of foreclosures, threatening to send even higher the number of borrowers who will lose their homes and making the foreclosure crisis far more complicated to unwind.

We cannot afford to repeat the mistakes of the past. Rather than looking to the government to be the solution, we must search for ways to empower Americans to do what they do best – to innovate, create new markets, and grow the economy. This is the fundamental flaw of the Administration's stimulus. It looked to the government to spend taxpayer dollars in an attempt to stimulate the economy. Six months ago the President promised that this huge government expenditure would "save or create up to 4 million jobs." But on September 11th, National Economic Council Director Lawrence Summers admitted the unemployment rate of 9.7 percent is "unacceptably high" and "will on all forecasts remain unacceptably high for a number of years."

The fact remains that the engines of economic growth are small businesses and a well-regulated free market which creates opportunities for everyone, minority Americans included. Small businesses were responsible for 64% of all job creation over the past 15 years. In fact, firms with fewer than 500 employees accounted for 64% of the net new jobs created between 1993 and 2008. We should be especially vigilant to create an economic climate that promotes and encourages entrepreneurial activity and risk taking. I am pleased that Harry Alford, the President of the Black Chamber of Commerce is here to share his insight into the challenges minorities face in this recession. I look forward to his testimony, as well as the testimony of the other witnesses.

Chairman TOWNS. Without objection and I thank the gentleman for his statement.

Any other Members seeking recognition?

We will now turn to our first panel of witnesses. It is committee policy that all witnesses are sworn in, so Secretary Skinner, Mr. Carr and Dr. Weller, please stand and raise your right hands.

[Witnesses sworn.]

Chairman TOWNS. You may be seated. Let the record reflect that they answered in the affirmative. You may now be seated.

Mr. Skinner, we will start with you and then we will just come right on down the line. And the way it works here is that when you start out the light is on green. And then, it switches to yellow, and that means you have 1 minute left. And then it becomes red. And red, all over the United States, means stop.

Mr. SKINNER. Thank you.

Chairman TOWNS. But let me introduce you first, though.

Mr. Raymond Skinner has served as secretary of the Department of Housing and Community Development for the State of Maryland since February 2007 and previously held the same position from 1998 to 2003. As Secretary, Mr. Skinner manages Maryland's home ownership, mortgage insurance and small business assistance programs, as well as housing development and community revitalization programs.

Prior to his appointment as secretary, Mr. Skinner was president and CEO of the Skinner Group, providing consulting services in affordable housing finance and community and economic development. He also previously served as director of the Prince George's County Department of Housing and Community Development and as executive director of the District of Columbia Office of Business Development.

He comes to us with a tremendous amount of experience.

Let me just introduce the others before we call on you, Mr. Skinner.

Mr. James Carr is the chief operating officer for the National Community Reinvestment Coalition [NCRC.] It is an association comprised of 600 local development organizations across the country whose mission is to improve the flow of capital to communities and stimulate economic growth.

In addition to his current position, Mr. Carr is a visiting professor at Columbia University in New York and has also served as an international advisor on financial modernization and housing finance to China, Mexico, Turkey and Columbia.

We welcome you, Mr. Carr.

Dr. Christian Weller is a senior fellow at the Center for American Progress as well as an associate professor of Public Policy at the University of Massachusetts in Boston. Prior to joining the center, he was part of the research staff at the Economic Policy Institute where he remains a research associate.

He has also worked at the Center for European Integration Studies in Germany, and served in the banking sector in Germany, Belgium and Poland. Dr. Weller comes before us today representing the Center for American Progress Action Fund.

We welcome you, too, as well, Dr. Weller.

So now, Mr. Skinner, if you move forward with those rules that we set. Thank you very much. We are delighted to have you.

STATEMENTS OF RAYMOND A. SKINNER, SECRETARY, MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT; JAMES H. CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION; AND CHRISTIAN E. WELLER, PH.D., SENIOR FELLOW, CENTER FOR AMERICAN PROGRESS ACTION FUND

STATEMENT OF RAYMOND A. SKINNER

Mr. SKINNER. Thank you, Mr. Chairman, and good morning Mr. Chairman, Ranking Member Issa and members of the committee.

For the record, my name is Raymond Skinner, secretary of the Maryland Department of Housing and Community Development. It is my pleasure to be here this morning representing Governor Martin O'Malley, Lieutenant Governor Anthony Brown and the people of Maryland.

I am going to focus my testimony this morning on the impact of foreclosures on minority households and communities in Maryland. But I hope to have an opportunity to talk about some of the other issues that you raised in your opening remarks. I have provided my written testimony for the record.

Today's topic is of grave concern to Governor O'Malley. No part of the State of Maryland has been immune from the foreclosure and subprime lending crisis. But it has hit hardest on the communities that are predominantly African American and Hispanic.

Recent figures from Realty Trac find that Maryland has the 12th highest rate of foreclosure events in the Nation and the situation in our State is worsening as a result of the troubled economy.

Foreclosures in Maryland are highly correlated with race. Baltimore City and Prince George's County, MD's two majority minority jurisdictions, account for 26 percent of the State's population, but 42 percent of the State's foreclosure events, according to the Realty Trac data.

As can be seen on the map on page 4 of my written testimony, 74 percent of the most severely impacted hot spots, and we refer to hot spots as those areas of concentrated foreclosures, 74 percent of the most severely impacted hot spots, neighborhoods, are, in fact, in minority communities.

The economic implications of foreclosure are devastating and impact homeowners, lenders, communities and can lead to longer term social costs. Foreclosures cost Maryland $4 billion in 2007, with the majority of those costs concentrated in minority communities including $963 million occurring in Prince George's County alone.

This crisis was set off by the resetting of the subprime and exotic loans. But now, the context is really changing. An increasing number of foreclosures are tied to prime loans, which is likely the result of unemployment and reductions in income. In Maryland, African American residents accounted for 51 percent of unemployment claims in 2008, versus being only 30 percent of the population.

Securing access to safe mortgages for minority households is key because they represent the growth area in the State. Between 2000

and 2007, white households actually declined in Maryland while the number of minority households grew substantially.

I am proud to say that our department is working aggressively on this front to open the door for home ownership but in a safe and sustainable manner. In 2007, 53 percent of the over 4,000 mortgage loans that we financed through my department helped minority households to purchase a home. We dramatically outpaced private financial institutions which provided, in 2007, just 30 percent of their mortgages to minority households according to the HMDA data.

At the same time, we did a better job of keeping households in their homes. As of March 31, 2009, our single family portfolio delinquency rate was 6.4 percent, which was considerably less than the remainder of the country which, for that same period, was a little over 8 percent.

The success of our effort to facilitate greater financial access to minority households, while at the same time having a lower delinquency rate, underscores that banks and brokers can do a much better job of providing sustainable access to equal credit.

In June 2007, in response to the mounting foreclosure numbers, Governor O'Malley created a Homeownership Preservation Task Force which I co-chaired. The task force gave a number of key recommendations which led to, first of all, legislative reforms that increase the time between default and foreclosure, ban prepayment penalties on certain loans, required that lenders make assurance that a borrower can repay a loan, and it enacted greater penalties for mortgage fraud and made the foreclosure process more transparent and fair.

The Washington Post described the bills that were passed in the Maryland legislature as one of the most sweeping legislative and regulatory reforms in the country.

Second, new loan programs to help homeowners who got stuck in some of the exotic expensive subprime loans, to help them, these homeowners who got stuck in these loans. We came up with new lending programs to help them get out of some of those subprime loans.

Third, we initiated consumer education that included establishment of a Maryland HOPE hotline and a Web site, as well as a statewide network of housing counseling agencies. We have helped to structure workshops that have proved effective in bringing distressed homeowners face-to-face with counselors and attorneys and been able to work out foreclosure modifications on the spot.

Maryland's efforts are continuing. But today, as the crisis continues, we find ourselves with limited ability and we are seeking some Federal help in a couple of areas, including more funding for our counseling agencies and more support for State housing finance agencies in general, including the ability of GSE's to purchase our bonds.

Thank you for the opportunity to testify and I would be happy to answer questions.

[The prepared statement of Mr. Skinner follows:]

THE HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
Remarks by Raymond A. Skinner, Secretary
Maryland Department of Housing and Community Development
September 23, 2009

Chairman Towns, Ranking Member Issa, and Members of the Committee:

For the record, my name is Raymond A. Skinner and I am the Secretary of the Maryland Department of Housing and Community Development (DHCD). It is a pleasure to be here today to discuss the impact of foreclosures on minority households and communities in Maryland. I have provided written testimony that I would like to submit for the record.

This is a topic of grave concern to Governor Martin O'Malley, Lt. Governor Anthony Brown and the State of Maryland, because, as you shall see, while no part of our state has been immune to this crisis, it has hit hardest on those communities that are predominantly African American or Hispanic; and the effects in those communities have been most severe – disrupting families, destabilizing neighborhoods and undercutting the legacy that those hardworking families are able to leave to their children.

It is important to emphasize that last point. The face of foreclosure in Maryland is the face of hardworking families who sought only to share in the American Dream; to provide a better quality of life for their children; to contribute to their communities and to add to the cultural, social and economic vitality of the state. These people were victimized more often than not by careless, unethical or unscrupulous lenders who deliberately targeted minority families and communities for expensive, exotic and often fraudulent loans.

Many years ago, the National Geographic Magazine described Maryland as "America in miniature." The magazine was talking about the geography of our state, but they might also have been talking about our most precious resource – our people. And so, I believe Mr. Chairman that what we are finding in Maryland has significance for communities across our great country.

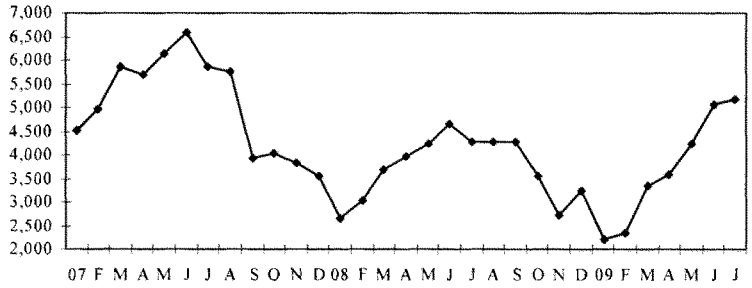
The economic crisis before us was prefaced by massive economic expansion and particularly an unprecedented growth in housing prices. In Maryland, average home prices grew by more than 120 percent from $163,000 in 2000 to $362,000 in 2007. In some DC suburbs, average sale prices grew past a half million dollars. Incomes could not by any means keep pace with this growth. Coupled with policies to help facilitate homeownership, exotic mortgages helped fuel the growth in the real estate market. For some, these mortgages were the only means to gain entry to the American Dream in such high cost environments. And as we have seen, this entry has become perilous for many, helping trigger what some economists are calling the Great Recession.

Maryland has by no means been immune to the waves of foreclosures impacting communities across the nation. Recent figures from RealtyTrac find that we have the 12th highest rate of foreclosure events in the nation. In August, 5,491 foreclosure filings were reported, which is an increase of 6.6 percent from the previous month and 70.7 percent over the prior year. A troubling statistic in Maryland is that notices of default continue to be trending upward with more than 2,900 last month alone.

The recent foreclosure data does provide some hope however. The statistics highlight that the number of notices of sales soared by 241.5 percent over the prior month to 2,162 events. This suggests that there is increasing confidence in the real estate market. Home prices are stabilizing in Maryland and the numbers of sales are increasing.

The strong growth in foreclosure sales as well as the continued high number of defaults caused Maryland's foreclosure rate to deteriorate from the 17th highest in the nation in July to the 12th highest in August. Unfortunately, this trend of increasing foreclosure events runs counter to the nation's which decreased slightly by 0.5 percent in August but were up 18 percent over the prior year.

EXISTING HOME SALES, MARYLAND
JANUARY 2007-JULY 2009



Source: Maryland Association of Realtors and Economy.com

FORECLOSURE EVENTS IN MARYLAND AND U.S., AUGUST 2009

Indicator	Notices of Default	Notices of Sales	Lender Purchases	Total
Maryland				
Number of Events	2,947	2,162	382	5,491
Change (Last Month)	-16.3%	241.5%	-61.7%	6.6%
Change (Last Year)	37.3%	468.9%	-44.7%	70.7%
U.S.				
Number of Events	138,224	144,113	76,134	358,471
Change (Last Month)	2.8%	4.1%	-12.7%	-0.5%
Change (Last Year)	16.1%	53.4%	-16.2%	18.0%

Source: RealtyTrac

FORECLOSURE INTENSITY AND RACIAL/ETHNIC PROFILES IN MARYLAND COMMUNITIES
SECOND QUARTER 2009

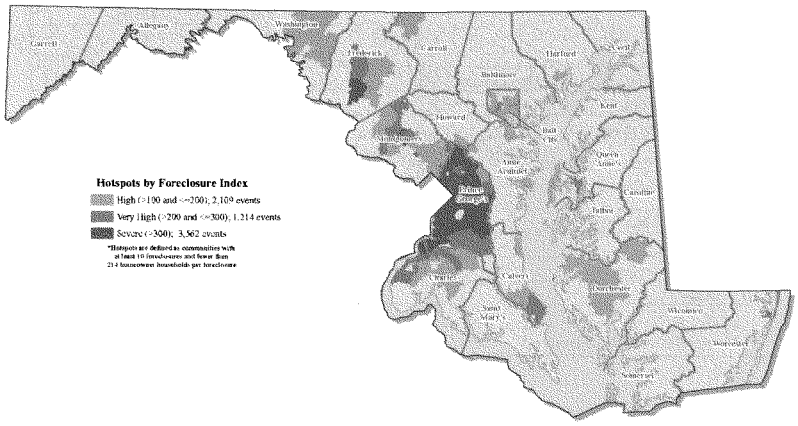
	Foreclosure Intensity			
Category	**Moderate**	**High**	**Very High**	**Severe**
Number of Households per Foreclosure (Avg)	363	156	87	54
Number of Foreclosures	2,435	2,109	1,214	3,562
Percent of Foreclosures	26.1%	22.6%	13.0%	38.2%
Race/Ethnicity of the Communities				
White	75.6%	58.8%	51.8%	25.7%
Minority	24.4%	41.2%	48.2%	74.3%
African American	15.9%	30.0%	33.5%	60.0%
Hispanic	4.1%	6.7%	9.1%	11.2%
Asian	4.7%	5.1%	7.0%	5.2%
Other	3.8%	6.0%	7.7%	9.2%

Source: DHCD, Office of Research

Foreclosures in Maryland are highly correlated with race. Baltimore City and Prince George's County, Maryland's two majority minority jurisdictions, account for 26.3 percent of the state's population but over the last 18 months have hosted about 42 percent of the state's foreclosure events. Foreclosures in Maryland are also highly concentrated within 102 "Hot Spot"[1] communities where during the 2nd Quarter of 2009, 73.9 percent of all foreclosures took place. Seventy four percent of the most severely impacted hotspot communities are in minority communities. Prince George's County's population is 63.5 percent African American and 11.3 percent Hispanic. The Twenty-eight "Severe Hot Spot" communities in Prince George's County accounted for 34.1 percent of all of Maryland's foreclosures. These hot spots are devastating because the concentration of vacant and for sale homes drives real estate values down further. More homes in the community become in danger of being underwater adding more fuel to the spiraling collapse of area home values. Homes sit vacant and deteriorating further impacting values and sales opportunities.

[1] A foreclosure *Hot Spot* is defined as a community that had more than ten foreclosure events in the current quarter and recorded a foreclosure concentration ratio of greater than 100. The concentration ratio, in turn, is measured by a foreclosure index. The index measures the extent to which a community's foreclosure rate exceeds or falls short of the State average foreclosure rate. An index of 100 represents the average foreclosure rate of 214 homeowner households per foreclosure across Maryland communities that reported more than 10 foreclosures in the second quarter.

FORECLOSURE HOT SPOTS IN MARYLAND
2nd Quarter 2009

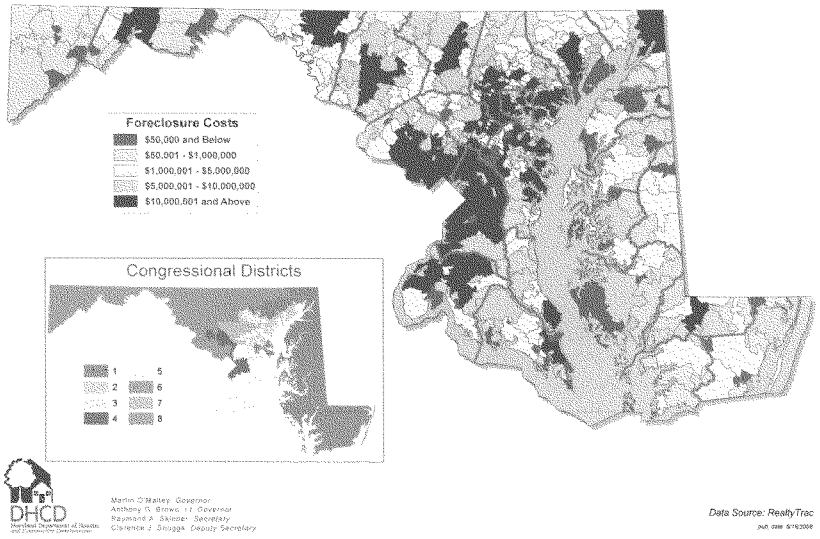


Source: RealtyTrac and DHCD Office of Research

The economic implications of foreclosures are devastating. Homeowners face the loss of accumulated home equity, deteriorating credit ratings, legal and administrative fees, and lower prospects in credit, labor, insurance and rental housing markets. The costs to lenders include the opportunity cost of principal and interest not yet received, servicing costs, legal costs, costs of property preservation and costs of property disposition. Property foreclosures also cause a decline in the value of the foreclosed house as well as the value of the neighboring properties. Reduced property values and the resulting lower property tax base, along with increased local government expenditures related to additional policing of vacant properties, contribute to the growing social costs of foreclosures.

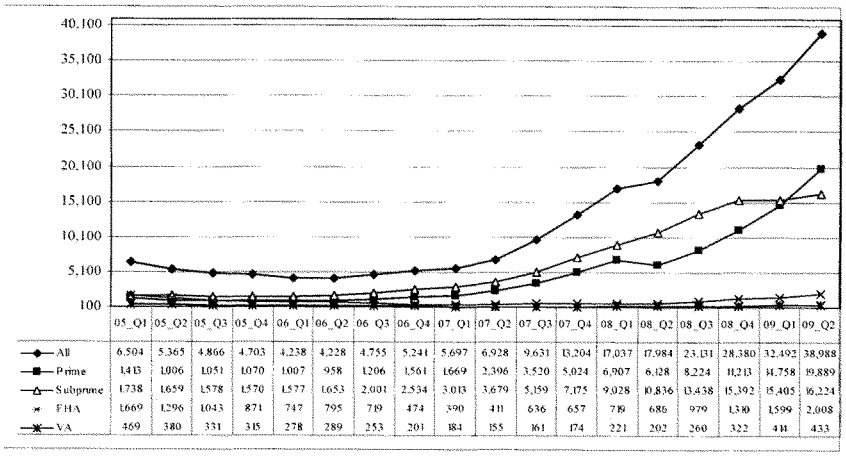
In 2008, DHCD conducted a study of estimated economic costs of property foreclosures in Maryland by Zip Code for calendar year 2007 using RealtyTrac, and ESRI data. Our analysis focused on the magnitude of the economic losses associated with property values, real property tax receipts, borrowers' additional administrative costs, and costs to the lenders. The estimated economic costs of property foreclosures in Maryland included $3.1 billion in the loss of property value, $32.3 million in the loss of local real property tax receipts, $96.9 million in various administrative charges to homeowners, and $790.9 million in losses to lenders. Therefore, total economic costs of foreclosures associated with property foreclosure events was an estimated $4.0 billion in 2007 dollars. Locally, in 2007, one quarter of the foreclosure events took place in Prince George's County. The economic loss there alone was estimated at $963.5 million. Given the increasing number of foreclosures in the last 18 months, the costs have increased substantially.

MARYLAND FORECLOSURE COSTS BY ZIP CODE
2007



Maryland's and the nation's foreclosure crises was set off by the resetting of the subprime and exotic loans. Some households with these loans had good credit and strong income and were able to refinance into a safer and sustainable mortgage product. Others, we have found, took out more debt than they had the ability to repay and that there was little that could be done except hope for a quick home sale. The context has changed however. As the economy deteriorated bringing job loss, foreclosures are taking on a different face. As of the 2nd quarter of 2009, the majority of the nation's foreclosures are now on prime loans.

NUMBER OF FORECLOSURES BY QUARTER
2005 Q1 TO 2009 Q2



	05_Q1	05_Q2	05_Q3	05_Q4	06_Q1	06_Q2	06_Q3	06_Q4	07_Q1	07_Q2	07_Q3	07_Q4	08_Q1	08_Q2	08_Q3	08_Q4	09_Q1	09_Q2
All	6,504	5,365	4,866	4,703	4,238	4,228	4,755	5,241	5,697	6,928	9,631	13,204	17,037	17,984	23,131	28,380	32,492	38,988
Prime	1,413	1,006	1,051	1,070	1,007	958	1,206	1,561	1,669	2,396	3,520	5,024	6,907	6,128	8,224	11,213	14,758	19,889
Subprime	1,738	1,659	1,578	1,570	1,577	1,653	2,001	2,534	3,013	3,679	5,159	7,175	9,028	10,836	13,438	15,392	15,405	16,224
FHA	1,669	1,296	1,043	871	747	795	719	474	390	411	636	657	719	686	979	1,330	1,599	2,008
VA	469	380	331	315	278	289	253	201	184	155	161	174	221	202	260	322	411	433

Mortgage Bankers Association: National Delinquency Survey

Unemployment continues to rise and in Maryland it has grown by 3.3 points over the last 18 months to 7.2 percent. This too is disproportionately affecting minority households. While African American residents in Maryland account for 29.8 percent of the state's population, they accounted for 51.2 percent of unemployment claimants in 2008. Coupled with a weak real estate market and no income, these households have had limited alternatives but foreclosure.

All of these trends are particularly devastating on the progress that has been made to work towards equity in achieving homeownership – the largest investment and wealth generating opportunity American's typically have. In 1990 in Maryland, 72 percent of white households owned a home compared to 43 percent for African Americans. The African American homeownership rate increased steadily during the 1990s and into the new millennium according to 2005 – 2007 American Community Survey Data which found that the rate reached 52 percent prior to the foreclosure crisis. It is also important to be cognizant that the foreclosures represent not just a massive loss of wealth and progress, but it handcuffs a household's ability to advance in the near future. Foreclosure devastates one's credit and to be able to borrow again to reestablish homeownership will take a long time for these households.

In Maryland, securing access to safe mortgages and helping minority households work towards the American Dream is particularly critical because minority households represent the state's growth. Between 2000 and 2007, Maryland saw white households decline by 29,457 while the number of minority households increased by 117,911 (for a net increase of 88,454).

I'm proud to say that our Department is working aggressively on this front to open the door for homeownership but in safe and sustainable manner. As one of 55 Housing Finance Agencies,

we have access to tax exempt mortgage revenue bonds that we use to finance safe mortgage products coupled with downpayment assistance to help first time homebuyers purchase home. Each year, we help finance on average 2700 units of affordable rental housing and help 2000 households buy a home. In the 2007, 53 percent of the 4111 mortgage loans we financed helped minority households purchase a home. We dramatically outpaced private financial institutions which provided in 2007 just 30 percent of their mortgages to minority households according to HMDA data. Housing Finance Agencies like DHCD also do a better job of keeping households in their homes. As of March 31, 2009 our active single family indenture's delinquency rate was 6.43 percent. This is considerably less than the remainder of the country which for the same period was 8.80 percent. The success of our efforts to facilitate financial access to minority households underscores that banks and brokers can do a better job of providing sustainable equal access to credit. We are high performing agency but to respond to Maryland's foreclosure challenges, we have expanded our mission to incorporate homeownership preservation.

The Maryland HOPE Story

Maryland's response to the foreclosure and subprime lending crisis was early, proactive, multi-dimensional and focused on those communities that were hardest hit, which as we have seen were predominantly African American and Hispanic.

In June 2007, in response to the mounting number of foreclosures nationally and in Maryland, Governor Martin O'Malley created the Homeownership Preservation Task Force to study how the state could best respond and promote, protect and preserve homeownership. This effort was motivated by the understanding that ensuring that the state's hardworking families had access to affordable housing – particularly homeownership – is a key component of stable families, prosperous communities and an economically vibrant Maryland.

The task force was chaired by Department of Labor, Licensing and Regulation Secretary Thomas E. Perez and myself, as Department of Housing and Community Development Secretary. Meeting throughout the summer - and bringing together lenders, brokers, foreclosure attorneys, nonprofit organizations, local governments, consumer advocates and realtors - the task force issued its report in October of that year, identifying a number of key strategies. Those recommendations were put into effect in the following months, resulting in what the Washington Post described as "one of the most sweeping legislative and regulatory reforms in the country." For example, the governor introduced in the 2008 legislative session, and later signed into law, four emergency measures that created greater protections for homeowners and made Maryland's foreclosure process more transparent and fair.

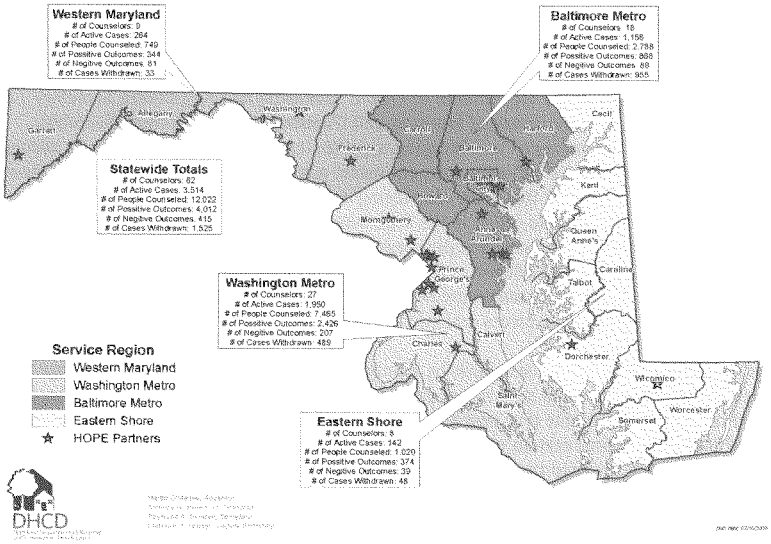
The reforms tightened lending standards by banning pre-payment penalties on mortgage loans; required lenders to assure that a borrower can repay a mortgage loan and to do so at the fully indexed rate for an adjustable rate loan and to document the borrower's income and assets; stiffened penalties against certain predatory lending practices and extended the process so that homeowners have more time to explore their options. Previously, the rules allowed foreclosure in a minimum of 15 days from the date of filing. Under the new statute, the process takes 150 days from default to sale. In 2009, the legislature approved an additional measure enhancing notice to renters when their landlord is in foreclosure.

In addition to those statutory reforms, Maryland created three solid programs under its Homeowners Preserving Equity (HOPE) Initiative to help homeowners who got stuck with some of those exotic, expensive, and in some cases fraudulent, loans at the height of the housing boom. The Lifeline Refinance Mortgage program provides a refinancing option to qualified Marylander's who may be facing financial difficulties after purchasing a home with an adjustable rate mortgage but who are not yet delinquent. The Bridge to HOPE Loan program provides qualified Maryland homeowners with short-term relief. And the Homesaver Refinance Mortgage program provides a refinancing option to qualified Marylanders who are no more than two months delinquent.

Maryland also invested significant resources into a new infrastructure to help beleaguered homeowners get safe, reliable, accurate and free information about their alternatives and the state resources in place to help them. The state established the Maryland HOPE Hotline and Web site and a statewide network of counseling agencies. In addition, we launched our statewide "Mortgage Late? Don't Wait!" advertising campaign to encourage homeowners to act as quickly as possible when they experience financial difficulties. This message has aired on Spanish language outlets and publications.

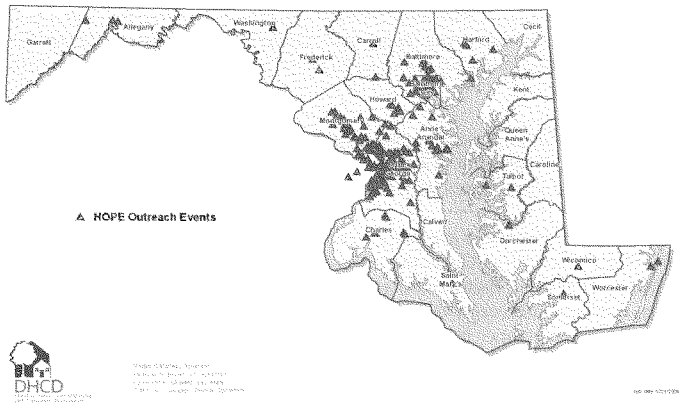
This was accompanied by an aggressive outreach effort and housing counseling campaign that was recently credited by NeighborWorks with being fourth among states in the number of homeowners served through the National Foreclosure Mitigation Counseling program.

HOUSING COUNSELING ACTIVITY, FY 2009



Those efforts have had a dramatic impact. As of August 2009, Maryland has received 28,650 calls for help on its HOPE Hotline and the state has helped 7,912 families avoid foreclosure. Moreover, Maryland has not waited for those in trouble to call. In the past fiscal year alone, the state participated in 154 foreclosure prevention workshops and forums in partnership with community and faith-based organizations, reaching more than 26,000 people and distributing well over 80,000 informational brochures at the site or through the mail.

MARYLAND HOPE OUTREACH EVENTS, FY 2008 AND 2009



Workshops were held at all corners of the state. But the bulk of them were in communities such as Prince George's County and Baltimore City that were hardest hit by foreclosures and where the majority of those affected were African American or Hispanic. The state worked closely with African American clergy and with Hispanic community organizations to ensure that those communities were aware of the workshops and that the resources were tailored to meet their needs. The state participated in five bilingual foreclosure prevention workshops, helping more than 400 Hispanic families.

Workshops such as those hosted by Maryland Seventh District Congressman Elijah Cummings in June and September have proven particularly effective because they bring distressed homeowners face to face with counselors, pro bono attorneys and lenders to work out customized, on the spot plans. More than 1,900 people, the majority of them African American or Hispanic, attended the two foreclosure prevention workshops in the Baltimore area and the model is being replicated statewide.

An additional arm in Maryland's multi-dimensional response to the crisis was launched in July 2008 with the Foreclosure Prevention Pro Bono Project. The Chief Judge of Maryland's Court of Appeals, Judge Robert M. Bell sent an appeal to more than 33,000 attorneys in the state, asking

them to volunteer their time to give pro bono representation to the unprecedented numbers of families facing foreclosure. More than 600 attorneys have volunteered to be part of the project, with representatives participating in the many workshops and forums.

Last, but by no means least, Maryland stepped up its investigative and enforcement efforts to protect homeowners against fraud and other predatory lending practices. For example, a joint investigation by state and federal authorities resulted in the indictments during the summer of 2008 of eight individuals who deliberately targeted homeowners facing foreclosure in minority communities in what authorities believe is the largest case of mortgage fraud in Maryland history. In March 2009, one of the chief conspirators pleaded guilty in federal court to conspiracy to commit mail and wire fraud in connection with a mortgage fraud scheme that falsely promised to help homeowners facing foreclosure keep their homes. Seven other conspirators have pleaded guilty for their part in the $35 million mortgage fraud scheme and face up to 30 years in prison.

In addition to such enforcement efforts, Maryland's Department of Housing and Community Development and the Department of Labor, Licensing and Regulation have worked aggressively to ensure that consumers are armed with the information they need to resist fraudulent practices.

State regulation and enforcement are being complemented by legal actions at the local level– particularly in Baltimore City. Under the leadership of current Mayor Dixon who followed now Governor Martin O'Malley, Baltimore is seeing growth, investment, and opportunity. The City is working to stabilize and reverse the devastating demographic and economic trends it has endured over the last 50 years. No city lost more residents than Baltimore did during the 1990s and it retains some the nation's highest poverty rates, highest vacancy rates, lowest income levels, and lowest labor force participation rates. But the economic expansion that took place in the nation prompted new investment in Baltimore City neighborhoods, a bevy of new homeowners, and expanded economic opportunities. The foreclosure challenges facing the nation are working against the progress that was made.

Working to protect these gains, the City of Baltimore has recently made national news in a Fair Housing Act law suit against Wells Fargo for reverse redlining or targeting African American neighborhoods for bad loans. The shocking story is still unfolding but the City is alleging that there was an economic incentive structure within Wells Fargo that encouraged its employees to steer African American's into subprime loans and engage in other deceptive practices. The City has documented that in 2006 Wells Fargo made high-cost loans to 65% of its African American borrowers in comparison to 15% of its white borrowers in Baltimore. In addition, the City has found that Wells Fargo's refinance loans were 2.5 times more likely to be a high cost loan than a refinance loan to a white borrower. Loans in African American neighborhoods went into foreclosure at 4 times the rate of those in predominantly white Baltimore neighborhoods.[2] The State of Maryland is not a party to the suit and because it is still in court I must limit my comments on the case. However, Chief Solicitor Suzanne Sangree of the Baltimore City Law Department testified recently before the House Judiciary Committee Subcommittee on Commercial and Administrative Law. In her remarks, she emphasized that Federal enforcement

[2] Sangree, Susan, "Oral Testimony before the United States House Judiciary Committee Subcommittee on Commercial and Administrative Law," United States Congress, September 9, 2009.

of the nation's civil rights laws, especially the Fair Housing Act is critical. Though the act provides cities legal standing to sue, it relies heavily on the Federal Government to play a leading role in enforcement. I agree and look forward to a renewed focus in this arena.

Maryland's efforts are continuing. We are looking at innovations and efforts being undertaken by other states like Connecticut which has implemented a mandatory mediation program helping force servicers to the table to make more timely decisions on loan modifications. We are continuing to support our housing counseling network providing ongoing training. Maryland is also putting housing back to work and is proud to be a national leader in implementing American Recovery and Reinvestment Act funds. DHCD is in the process of administering nearly $160 million in Recovery Act resources. We are working hard to sustain homeownership but today as the crisis continues, we find ourselves at the limits of our legal authority – plainly, we need federal help.

1. The mortgage servicers who control this industry are by and large federally regulated and supervised. Over 2/3 of all Maryland mortgages are serviced by entities supervised - and, in many cases, subsidized - by the federal government. Citibank, Wells Fargo, Bank of America etc – they dominate our mortgage markets. Due to federal pre-emption, we have no jurisdiction over these companies despite their impact on our communities every day. As a state official, I urge you to recognize that limitation. As you consider new regulatory authorities such as the Consumer Financial Protection Agency, I ask you not to further pre-empt our abilities to protect our citizens. These rules should be a floor not a ceiling. And as you press forward with actions on the foreclosure front be sure to be cognizant of state interests. As an example, Maryland collects data on mortgage servicers – the few under its jurisdiction. Thru that data we have been able to identify trends in modifications including those that have actually raised borrower's monthly obligations. But as 2/3 of the mortgages in Maryland are not under our jurisdiction, we must rely on national data gathered by Treasury and the Office of the Comptroller of the Currency. Despite our state's requests, however, these entities have refused to provide their data on a state by state basis. Access to the data will help Maryland better monitor foreclosure mitigation efforts.

2. More information is also needed about the lending practices in our communities. The Home Mortgage Disclosure Act (HMDA data) helps track bank loans by demographic, location, and amount but it does not provide the other factors that contribute to the lending rate such as credit score and existing debt. Expanding data requirements is the key to strengthening the use of HMDA data as an enforcement mechanism of fair lending practices.

3. Sustainable homeownership can also be advanced by strengthening housing counseling requirements, capacity, and financial literacy. Financial literacy, which goes beyond purchase counseling to incorporate a broader understanding of personal financial management skills, has been a topic of focus in Maryland. Through the work of a task force, financial literacy standards for secondary education are being developed and will be making their way into Maryland's high school curriculum. In addition, in Maryland, our mortgage loans and downpayment assistance resources also require counseling to better equip buyers with the knowledge to make good choices about home purchases and

household budgets. However, no counseling requirements are in place for federally subsidized homeownership programs including the First Time Homebuyer's Tax Credit, FHA insured loans, VA loans, USDA loans or any other federally backed homeownership program, and they should be. Such a requirement would protect not only lenders and borrowers, but the financial position of the federal government as well. Similarly, expanding support for housing counselors for both pre-purchase and foreclosure mitigation counseling is essential. Maryland's counselors have played a very critical role working one-on-one with homeowners facing foreclosure. Sustainable ongoing support for housing counselors is needed.

4. One of the biggest challenges homeowners that are in danger of foreclosure face is getting a response from their mortgage servicers. Participation in Marking Home Affordable is voluntary and there no financial damages associated with unfair or unreasonable actions on the part of servicers towards borrowers. Many servicers fail to be responsive and suffer from an apparent lack of staff or infrastructure to handle the volume despite the financial incentives the Federal Government is providing. The Real Estate Settlement Procedures Act is very clear on its expectations and penalties for infractions but there is nothing that compensates a borrower if mistakes, lack of action or response by a servicer results in the loss of a property. The Federal Government should move towards mandatory participation. Standards must be set and consequences must be developed for inappropriate actions by servicers working to mitigate delinquency or foreclosure.

5. Lastly, State Housing Finance Agencies can play a crucial roll in both assisting new first time homebuyers, including minority homebuyers, purchase their first homes, as well as assist homeowners facing foreclosure avoid the loss of their homes through the new authority Congress provided to HFAs under HERA. However, to do that we need the support of the federal government in strengthening and supporting HFAs with continued expanded bond authority and supporting the purchase of bonds HFAs issue to refinance homes for owners facing foreclosure.

Thank you for giving me the opportunity to testify before you today. I would be happy to answer any questions you have.

Chairman TOWNS. Thank you very much.
Mr. Carr.

STATEMENT OF JAMES H. CARR

Mr. CARR. Good morning, Chairman Towns, Ranking Member Issa and other distinguished members of the committee.

On behalf of the National Community Reinvestment Coalition, I am honored to speak with you today about the racial dimensions of the current economic crisis.

Despite talk of a recovery, the U.S. economy remains mired in the worst economic crisis in more than half a century and even the most optimistic economists are expecting a jobless recovery. For most people, a jobless recovery is a meaningless statistic in the real world where families are struggling to pay their mortgage, buy food, afford health care, pay the college tuition for their children, or save to ensure that they can retire in dignity.

Already median income has fallen to the lowest level in more than 10 years and poverty is growing at an alarming rate. In fact, a close examination of the fine print of the positive earnings news of many firms further dampens the enthusiasm for the coming recovery. Recent positive earning reports, for example, for large financial firms reveals that creative accounting, massive Federal subsidies and one-time asset sales are largely responsible for a lot of the good news. In fact, at the current pace, the total number of bank failures this year will likely be the worst year in the industry's history.

The reason for the disappointing nature of the recovery is that foreclosures, which was the problem that imploded the financial and credit markets and the economy, continue to rise. More than 1.5 million families have faced foreclosure this year and at least another 1.5 million are heading that way. In fact, the Center for Responsible Lending estimates that as many as 12 million more foreclosures may occur by the year 2012.

This is not an equal opportunity economic crisis. The current crisis is having a disproportionately negative impact on communities of color in two ways.

First, communities of color were the disproportionate targets for the most abusive and reckless predatory loans and, as a result, they are experiencing much higher levels of concentrated foreclosures.

Second, they are the most negatively impacted by rising unemployment. Unemployment rates for Latinos, African Americans and Native Indians living on Native reservations, as was stated earlier, are either close to, or more than twice that for non-Hispanic White households.

Because African Americans and Latinos have comparatively few savings, they are poorly positioned to survive long-term unemployment. Potentially millions of African Americans and Latinos could find themselves falling out of the middle class and into poverty before this crisis is over.

Current wealth disparities are not the result of market forces or the invisible hand of Adam Smith. Rather, they are the consequence of the very visible hand of discrimination and its legacy.

The peddling of high cost and irresponsible loans disproportionately to communities of color is only the most recent manifestation of continuing bias against minorities in the financial markets. Excessive subprime lending in lower income communities was not the result of pressure placed on financial firms through the Community Reinvestment Act. It had nothing to do with lenders attempting to increase homeownership among minority families.

The subprime market collapsed because regulation of that market was woefully inadequate and, in many respects, non-existent. Almost every institutional actor in the home mortgage finance process played a role in the collapse, including the brokers, lenders, appraisers, credit rating agencies and investment banks. Together, these institutions created a toxic mix that percolated for years until it boiled over and overwhelmed not just the mortgage markets, but the entire financial system.

Five specific remedies should be pursued to address this crisis and I address them in detail in my written testimony.

First, more must be done to stem the foreclosure crisis. The administration's "Making Home Affordable Program" has a number of important incentives to encourage intransigent servers to participate. But it lacks sticks. It needs some sticks, such as bankruptcy reform that would cost the American public nothing but potentially save millions of households from foreclosure.

Second, we need to restructure the financial system regulation to focus on the protection of consumers. Protecting consumers' rights is the best way to ensure avoiding systemic risk to the system. In addition, we need to make sure that the Community Reinvestment Act is expanded so as to ensure that all communities receive access, equal access, to safe, sound products.

Third, communities that have borne a disproportionate impact of the current crisis should be prioritized for funding. That is not happening currently.

Fifth, the Federal Government must more actively combat discrimination which is the largest barrier to economic mobility.

In conclusion, let me just state that within the next 35 years, minorities will constitute half of the American population. Yet, this fastest-growing share of the Nation's population are among the most least well-housed, have the most limited access to labor and financial markets, and are disproportionately isolated from quality education and healthcare, which are key to economic mobility.

Globalization represents a competitive challenge for America in this century that we have never had before. If America is to continue to be an economic, political and intellectual superpower, it must move further into the 20th century by eliminating the old paradigm of discrimination.

All Americans must be prepared for and allowed to compete. Succeeding in a new, globalized, highly competitive world is not just an option. It is an imperative.

Thank you.

[The prepared statement of Mr. Carr follows:]

James H. Carr
Chief Operating Officer
National Community Reinvestment Coalition

The Silent Depression: How are Minorities Faring in the Economic Downturn?

Presented to the
United States House of Representatives
Committee on Oversight and Government Reform
at the hearing on The Silent Depression

September 23, 2009

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Introduction

Good morning, Chairman Towns, Ranking Member Issa, and members of the committee. On behalf of the National Community Reinvestment Coalition, I am honored to speak with you today about the racial dimensions of the economic crisis.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families. NCRC is also pleased to be a member of a new coalition of more than 200 consumer, civic, labor, and civil rights organizations – Americans for Financial Reform – that is working to cultivate integrity and accountability within the US financial system. I serve on the executive committee of that coalition.

Despite recent talk of recovery, the U.S. economy remains mired in the worst economic crisis in more than half a century. And while it appears we have avoided the second Great Depression, today's economy has earned the status of the "Great Recession." The pace of the deterioration of the economy has moderated and we are no longer in free fall. A growing number of economists are looking forward to modest growth in GDP in the third quarter of this year.

Yet, despite the early positive signs of a turnaround in the economy, even the most optimistic economists are expecting a "jobless recovery." That phrase is an acknowledgement that unemployment will likely remain high throughout 2010 in spite of positive GDP numbers. In fact, the Open Market Committee of the Federal Reserve estimates that the unemployment is unlikely to return to pre-recession levels in the next six years.[1]

For most people, a "jobless recovery" is an oxymoron, since rising GDP, without job growth, is a meaningless statistic in the real world where families are struggling to pay the mortgage, buy food, afford decent health care, pay college tuition for their children, or save to ensure they can

[1] Minutes of the Federal Open Market Committee, April 28-29, 2009. Federal Reserve Board. Published May 20, 2009. Accessed online at http://www.federalreserve.gov/monetarypolicy/fomcminutes20090429.htm.

retire in dignity. Mark Vitner, a senior economist at Wells Fargo, sums it up this way: "It's going to be a recovery only a statistician can love."[2]

Without improving employment, sluggish growth will likely linger for some time. Consumer spending, for example, which accounts for more than 70 percent of all economic activity, will not recover until consumers stop fearing they could lose their homes, their jobs, or both. A *Bloomberg News* survey of economists found that consumer spending is not expected to grow at a rate of more than 2% per year until sometime in 2011. This July, consumer credit fell at a 10 percent annualized rate, which was five times greater than the drop anticipated by economists.[3] As Ryan Sweet, an economist for Moody's Economy.com sees it, "consumers… won't be leading us out of this recession."[4]

Consumers are in no position to stage a comeback. Poverty figures released just over a week ago by the Census Bureau highlight the tenuous position in which American households find themselves. From 2007 to 2008 the poverty rate rose from 12.5 percent to 13.2 percent. The additional 2.6 million Americans who fell into poverty last year brings the total to 39.8 million people.[5] Median income also sank to the lowest level in more than ten years. As Harvard University economics professor Lawrence Katz put it, "We've basically seen a lost decade."[6]

Experts anticipate that these dismal statistics will only get worse in 2009. Consider that the total number of jobs lost in the first six months of 2008 was 291,000, while the total number of jobs lost in the first six months of 2009 was more than ten times greater, at 3.3 million. Furthermore, as of July, the National Employment Law Project anticipated that 1.5 million Americans will

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[2] Shin, Annys. "A Recovery Only a Statistician Can Love." *Washington Post*. August 12, 2009. Accessed September 4, 2009 at http://www.washingtonpost.com/wp-dyn/content/article/2009/08/11/AR2009081100988.html?hpid=topnews.
[3] Willis, Bob and Vincent Del Giudice. "Record Plunge in U.S. Consumer Debt Signals Weakened Spending." *Bloomberg News*. September 9, 2009. Accessed online at http://www.bloomberg.com/apps/news?pid=20601087&sid=avvE5aNtrCfc#.
[4] Furthermore, consumer borrowing decreased by a record $26.1 billion. See: Willis, Bob and Vincent Del Giudice.
[5] Morello, Carol and Dan Keating. "Millions More Thrust Into Poverty." *Washington Post*. September 11, 2009.
[6] Morello, Carol and Dan Keating.

exhaust their unemployment benefits by the end of 2009,[7] including 400,000 at the end of September alone.[8] Persistent long-term unemployment and the possibility that millions will exhaust benefits and have little to nothing on which to fall back has led the House of Representatives to consider a bill to extend benefits to 79 weeks in states with unemployment above 8.5 percent.[9] Due to the increases in long-term unemployment and the accelerated pace of job losses, analysts anticipate that the 2009 poverty figures will be far larger.[10]

The financial services sector remains in a precarious state despite recent positive earnings news. In fact, a close examination of the fine print and footnotes to the positive earnings reports of many large financial firms reveals that creative accounting, massive federal subsidies, and one-time asset sales have replaced innovative finance as primary sources of profits for many firms within the financial services industry.

Lending by large banks continues to fall despite improved earnings reports. The total amount of loans held by the 15 largest banks decreased by nearly 3 percent in the second quarter of this year,[11] and more than half of the loan volume in April and May came from refinancing mortgages and renewing credit to businesses—not issuing new loans—according to an analysis by the *Wall Street Journal*.

In fact, according to FDIC records, more than 28 percent of banks were unprofitable in the second quarter of 2009—an all-time second quarter record. [12] At the current pace of bank

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[7] Delaney, Arthur. "1.5 Million to Exhaust Unemployment Benefits by the End of the Year." *The Huffington Post*. July 17, 2009. Accessed September 4, 2009 at http://www.huffingtonpost.com/2009/07/17/15-million-to-exhaust-une_n_238281.html.

[8] Luhbi, Tammi. "Unemployment Benefits: Bill Could Help More than 1 Million Jobless." *CNN Money*. September 22, 2009. Accessed online at: http://money.cnn.com/2009/09/22/news/economy/extending_unemployment_benefits/?postversion=2009092205.

[9] Luhbi, Tammie. "Unemployment Benefits: Bill Could Help More than 1 Million Jobless."

[10] Homan, Timothy and Mike Dorning. "U.S. Poverty Rate Rises, Median Income Falls." *Bloomberg News*. September 10, 2009.

[11] Enrich, David and Dan Fitzpatrick. "Loans Shrink as Fears Linger." *Wall Street Journal*. July 27, 2009. Accessed September 4, 2009 at http://online.wsj.com/article/SB124865259057482435.html.

[12] Data is tracked and records are set by the quarter in order to account for seasonal adjustments in bank incomes. Nasripour, Shahirien. "Percent of Money-Losing Banks Set An All-Time High in Second Quarter." *Huffington Post*. August 31, 2009.

failures, this year will greatly exceed those of 2008, which was the worst year in the industry's history.

And while non-financial businesses are generally slowing their pace of contraction or even growing again, much of the improved earnings are the result of increased productivity achieved in part through payroll reductions. Moreover, many corporations that reported profits so far in 2009 are multinational firms that are finding profitable markets overseas and creating jobs outside of the United States. In short, they are succeeding in spite of—not because of—the health of the U.S. economy.

The Foreclosure Crisis Continues

Perhaps the most interesting aspect of the economic data pointing to a modest recovery is that it ignores the fact that foreclosures—the problem that imploded the financial markets and economy in the first place—continue to rise.

Already this year, more than 1.5 million families experienced foreclosure in the first six months of the year and at least another 1.5 million foreclosures are expected to occur by the end of 2009.[13] Just in the month of August, a total of 358,471 properties went into default or foreclosure, according to RealtyTrac, Inc. That was the sixth month in a row that new foreclosure filings surpassed 300,000.[14] Although the pace of new foreclosures slowed between July and August, this rate is up 18 percent year-over-year,[15] and the Mortgage Bankers Association reports that the national delinquency rate is at an all-time high.[16] With 9.24% of borrowers behind in payments by at least thirty days, the foreclosure crisis is nowhere near its end.

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[13] Schreiner, Bruce. "Last minute Negotiations Ease Some Foreclosures." *Associated Press*. August 21, 2009. Accessed September 4, 2009 at http://www.google.com/hostednews/ap/article/ALeqM5gTeK2vmeqJb-G5ewsuKgk9AnktOQD9A7EJ080.

[14] Taub, Daniel. "U.S. Foreclosure Filings Top 300,000 for Sixth Straight Month." *Bloomberg News*. September 10, 2009.

[15] Pisani, Joseph. "Foreclosures Up From Last Year; Remain Near Record Levels." *CNBC*. September 10, 2009. Accessed online at: http://www.cnbc.com/id/32766055.

[16] Wasik, John. "Housing's 'Poverty Effect' Fouls Up Recovery." *Bloomberg News*. September 2, 2009.

Foreclosures continue to grow as the nature of the crisis has evolved. The first wave of foreclosures was driven by reckless loan products, but the crisis is now fueled by unemployment and loss of income. In 2009, nearly 60% foreclosures are triggered by unemployment.[17] Other factors that are contributing to the foreclosure crisis include inadequate loan modifications and the coming wave of resets on the second generation of risky loan products.

Research by Professor Alan White of Valparaiso University shows that loan servicers are failing to modify significant numbers of loans to achieve long-term sustainability. In recent testimony before Congress, Professor White notes that in June 2009, three months into the government's Making Home Affordable program, there were roughly ten times as many liquidated foreclosure sales as there were loan modifications with debt reduction.[18] Yet, debt reduction is the more important characteristic of a sustainable loan modification.

Professor White finds that the most common voluntary loan modification involves adding unpaid interest and fees to the balance, so that the homeowner owes more, rather than less, after the modification. While about 60% homeowners who receive loan modifications through the Home Affordable Modification Program achieve reduced mortgage payments, many of these modified loans will revert to the original terms in three to five years. While these types of modifications may allow homeowners and lenders to avoid foreclosures now, over the long term, "homeowners will have no incentive to continue struggling to make payments."[19]

Moreover, lenders are studiously ignoring the next wave of foreclosures looming on the horizon. From 2004 to 2007, pay-option adjustable rate mortgages, known as option ARMs, totaled $750 billion of lending activity, and those teasers and introductory periods are about to expire.[20] The

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[17] "Not Out of the Woods: A Report on the Jobless Recovery Underway." The New America Foundation. June 14, 2009. Accessed online at http://www.newamerica.net/files/TheJoblessRecoveryJune2009.pdf.
[18] White, Alan. "Testimony on Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?" Submitted to the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Commercial and Administrative Law. July 9, 2009.
[19] White, Alan.
[20] Leland, John. "Loans that Looked Easy Pose Threat to Recovery." *New York Times*. August 28, 2009. Accessed September 4, 2009 at http://www.nytimes.com/2009/08/27/us/27arms.html?_r=1&ref=business.

average reset on option arms will increase monthly payments by an average of $1,053—and these loans were so poorly underwritten that many have already failed before the introductory periods end.[21] In total, there are roughly 2.8 million outstanding interest-only mortgage loans valued at $908 billion, which will reset to fully amortizing loans over the next few years.[22]

The net impact, according to the Center for Responsible Lending, is that as many as 12 million homes will be lost to foreclosure by the end of 2012.[23]

It is difficult to understand how a meaningful recovery can develop without first more aggressively addressing the foreclosure crisis.

Not an Equal Opportunity Economic Crisis

The current crisis is having a disproportionately negative impact on communities of color in two ways. First, communities of color are experiencing higher levels of foreclosures than their non-Hispanic white counterparts, and second, they are more negatively impacted by rising unemployment. Since the recession began in December 2007, more than 6.9 million jobs have been eliminated, bringing the national unemployment rate to 9.7 percent in August of 2009.[24] The rate of job loss for African Americans is now more than 15 percent, and for Latinos it is 13 percent.[25] The black unemployment rate had not fully recovered from the 2001 recession before the start of the current economic downturn. Unemployment for American Indians living on reservations is at 22 percent, scarcely lower than the Depression-era national unemployment rate

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[21] ElBoghdady, Dina. "Another Wave of Foreclosures Looms." *Washington Post*. September 9, 2009. Accessed online at http://www.washingtonpost.com/wp-dyn/content/article/2009/09/08/AR2009090803507.html.
[22] Streitfeld, David. "Interest-only Loans Start to Backfire." *New York Times*. September 8, 2009. Accessed online at http://www.nytimes.com/2009/09/09/business/09loans.html?ref=business.
[23] McGraine, Victoria. "White House's $50 Billion Foreclosure Plan a Bust So Far." *Politico*, July 17, 2009.
[24] Homan, Timothy. "Job Losses in U.S. Slow as Unemployment Hits 26-year High." *Bloomberg News*. September 5, 2009. Accessed online at http://www.bloomberg.com/apps/news?pid=20601087&sid=aVmZJLQoKv2g.
[25] "The Employment Situation—August 2009." Bureau of Labor Statistics, U.S. Department of Labor. September 4, 2009. Accessed online at http://www.bls.gov/bls/newsrels.htm#OEUS.

of 25 percent.[26] Furthermore, while the national poverty rate is 13.2 percent, the African-American poverty rate is 24.7 percent, the Hispanic poverty rate is 23.2 percent.[27]

Thus, the Kirwan Institute at Ohio State University has concluded that "people of color have been in a recession for five years and have entered a depression during the current economic crisis."[28] The overrepresentation of minorities in unemployment has compounding long-term effects on wealth; many households never fully catch up from the financial impacts of the current wave of unemployment. A recent study reported in *The New York Times* indicates that it can take as long as twenty years for workers laid off during a recession to overcome earnings losses.[29]

Because African Americans and Latinos have comparatively few savings, they are poorly positioned to survive long-term unemployment. In fact, for every dollar of net worth held by white Americans, African Americans hold ten cents, and Latinos hold slightly less than five cents. Home equity represents a much larger share of net worth for African Americans and Latinos. When housing wealth is omitted from the comparison, for every dollar that whites hold, African Americans hold only a penny and Latinos hold less than one cent.[30] Because African Americans and Latinos have so few resources on which to fall back in a crisis, potentially millions of minority households could find themselves falling out of the middle class and into poverty by the time the economy recovers. United for a Fair Economy, a Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction, with more than 33 percent of African-American households and 41 percent of Latino households at risk of falling out of the middle class and into poverty.[31]

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[26] Johnson Pata, Jacqueline. "Testimony on the Subject of the Silent Depression: How are Minorities Faring in the Economic Downturn." Presented to the U.S. House of Representatives, Committee on Oversight and Government Reform. September 23, 2009.
[27] "Income, Poverty, and Health Insurance Coverage in the United States: 2008."
[28] "Preliminary Report of the Impact of the Economic Stimulus Plan on Communities of Color." Kirwan Institute for the Study of Race and Ethnicity. February 25, 2009.
[29] Luo, Michael. "Income Loss Persists Long After Layoffs." *New York Times*. August 4, 2009. Accessed September 4, 2009 at http://www.nytimes.com/2009/08/04/us/04layoffs.html?hp.
[30] Wolff, Edward. "Recent Trends in Household Wealth in the U.S.: Rising Debt and the Middle Class Squeeze." Levy Economics Institute of Bard College. 2007. Accessed online at: http://www.levy.org/pubs/wp_502.pdf.
[31] Rivera, Amaad, Jeannette Huezo, Christina Kasica, and Dedrick Muhammad.

Add to that reality the impact of the foreclosure crisis on African Americans. More than half of all home loans made to African Americans in recent years were high-cost, subprime loans associated with the most deceptive and irresponsible lending behavior. Those loans also represent a disproportionately large fraction of the loans that failed in the first wave of the foreclosure crisis[32] African Americans have already experienced a full three-percentage point drop in their homeownership rate since the foreclosure crisis began.[33]

The community and family impacts of foreclosure

When an individual or family loses a home to foreclosure, the effects are devastating beyond the financial loss to that household. A study published recently by the Urban Institute documents multiple negative impacts resulting from foreclosure. The challenge of finding a new place to live, for example, can be particularly difficult. The study notes, for example, that most people displaced by foreclosure move in with family and friends. Many others go to emergency shelters or find themselves on the streets. Because foreclosure causes a person's credit rating to plummet, it can be difficult to rent an apartment even if the prospective tenant has the requisite income and security deposit.[34]

Foreclosure has a particularly harmful effect on children. If a family loses its home to foreclosure and cannot find a suitable apartment in their neighborhood, children may be forced to leave their schools, social networks, and familiar community surroundings, all of which can hinder their educational performance and long-term socioeconomic wellbeing. Families experiencing foreclosure may also face serious blows to the mental and emotional health of both adults and children. The stress and confusion of the situation can affect people physically as they are less

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[32] Rivera, Amad, Jeannette Huezo, Christina Kasica, and Dedrick Muhammad. "Silent Depression: State of the Dream 2009." United for a Fair Economy. January 15, 2009. Accessed online at http://www.faireconomy.org/files/pdf/state_of_dream_2009.pdf.

[33] African-American homeownership peaked at 49.1% in 2004 and declined to 46.1% as of 2007. Source: U.S. Census Bureau. Housing Vacancies and Homeownership Annual Statistics 2007. Table 20: Homeownership by Race and Ethnicity of Householder. Accessed online at http://www.census.gov/hhes/www/housing/hvs/annual07/ann07ind.html.

[34] Kingsley, Thomas, Robin Smith, and David "The Impacts of Foreclosure of Families and Communities." The Urban Institute. July 1, 2009. Accessed online at: http://www.urban.org/UploadedPDF/411910_impact_of_foreclosures_primer.pdf.

able to attend to their health. Elderly Americans face especially daunting challenges as they seek to overcome foreclosure. Studies show that they are especially vulnerable to physical and emotional difficulties when they experience forced relocation. Seniors also have limited time and income to recover.

Given that foreclosures are disproportionately occurring in minority communities, the long-term effects of the foreclosure crisis on African-American and Latino neighborhoods and families is not only destroying African-American and Latino wealth, it is also creating conditions that will further limit their abilities to accumulate assets and achieve upward economic mobility.

America's History of Discrimination

Current wealth disparities are not a result of market forces of the invisible hand of Adam Smith. Rather, they are the consequence of the visible hand of discrimination and its legacy. America has a long and complex history of government-sponsored discrimination, much of which continued a full century after slavery was abolished.

Starting in 1896 with the Supreme Court's decision in *Plessy v. Ferguson*, which established the "separate but equal" doctrine, public policy was crafted with the intent to isolate black communities and deny those communities access to credit and services. This continued during the New Deal with the Home Owner's Loan Corporation (HOLC), which was established to help homeowners facing foreclosure. HOLC explicitly refused to approve loans in African-American communities and institutionalized the practice of redlining.[35]

After World War II, discrimination against African Americans continued with the Federal Housing Act and the G. I. Bill. Although these programs were enacted to make homeownership affordable for the majority of American families, including returning veterans, they purposefully reinforced residential segregation through their lending practices. As isolated minority

[35] For further information, see: Carr, James H. "Testimony on the Subject of Fair Housing and Equal Oppportunity." Presented to the National Commission on Fair Housing and Equal Opportunity. Atlanta, Georgia. October 17, 2008. See also: Carr, James H. and Nandinee K. Kutty, Eds. *Segregation: The Rising Costs for America.* Routledge: New York, 2008.

communities struggled to thrive in the face of redlining and lack of basic services, they became targets of government deconstruction programs. The Urban Renewal program, for example, literally bulldozed entire neighborhoods of working-class African Americans. Entire struggling communities were leveled and residents moved into bleak concrete towers that were unfit for human habitation.

These policies achieved their goal of encouraging the segregation and marginalization of black communities. The importance of this history of discriminatory government policy cannot be understated. The challenges that minority communities face today in terms of housing, employment, and wealth accumulation are a direct result of the compounding and cumulative effects of discriminatory policies and institutionalized barriers to opportunity.

Predatory Lending

Predatory lending, the explicit peddling of high-cost loans to vulnerable communities through deceptive, is only the most recent manifestation of continuing discrimination against communities of color in the financial markets.

In the wake of the collapse of the subprime mortgage market, many critics have blamed laws that were enacted to ensure that minority communities are no longer discriminated against in the housing market or denied access to fair, responsible credit. They charge that the Community Reinvestment Act (CRA), a law that requires banks to meet the credit needs of the communities they serve, forced lenders to make bad home loans to unqualified low-income consumers. They also defend lenders' abusive and predatory behaviors, saying that lenders were pressured by policymakers to increase homeownership by minorities who could not legitimately afford to own. Neither argument is based in fact or logic. According to the Federal Reserve Board, only 6 percent of high-cost subprime loans to low- and moderate-income households originated by

banks were subject to CRA regulation.[36] The vast majority of reckless, irresponsible lending was carried out without regard to CRA.

The growth in origination of predatory, high-cost loans had little to do with legitimate financial qualifications of the borrowers. A 2008 study by the *Wall Street Journal* found that more than 60 percent of borrowers with high-cost subprime loans had credit scores sufficient for them to have qualified for a prime market home loan. The Center for Responsible Lending released an analysis of loan outcomes that controlled for income and credit history, and found that minorities were significantly more likely than whites to receive high-cost loans.[37] Moreover, racial disparities in lending increase as the income level of borrowers increases.[38]

The disproportionate issuance of high-cost loans to minorities also had nothing to do with benevolent lenders attempting to increase homeownership rates among minority families. According to the Center for Responsible Lending, less than 10 percent of subprime loans originated between 1998 and 2006 were for first time homeownership.

In reality, the subprime mortgage market collapsed because regulation of the mortgage markets and financial services sector was largely absent and, where it did exist, inadequate. This lack of oversight allowed deceptive, reckless, and irresponsible predatory lending to grow unchecked. This crisis percolated for years until it boiled over and overwhelmed not just the mortgage markets, but the entire financial system.

Almost every institutional actor in the home mortgage financing process played a role in the collapse. Brokers steered borrowers into risky high-cost loans regardless of their incomes or credit scores. They were allowed to collect kickbacks in the form of yield spread premiums if they could mislead borrowers to accept loans offered at higher than required interest rates.

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[36] Krozner, Robert. "The Community Reinvestment Act and the Recent Mortgage Crisis." *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*. Joint publication of the Federal Reserve Banks of Boston and San Francisco. February 2009.
[37] Boccian, D., K. Ernst, and Wei Li. "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages." Center for Responsible Lending. 2006.
[38] "Race and Recession: How Inequity Rigged the Economy and How to Change the Rules." Applied Research Center. May 2009. Accessed online at http://arc.org/downloads/2009_race_recession.pdf.

Lenders offered high-risk products (such as the well-known exploding 2/28 and 3/27 mortgages) that required refinancing within the first two-to-three years in order to remain affordable to borrowers. They pursued inadequate and irresponsible underwriting standards that included excessive levels of low- or no-documentation loans, failure to establish escrow accounts for taxes and insurance, prepayment penalties, and the use of second liens in lieu of down payments.

Appraisers inflated home valuations, driving prices to unsustainable record highs. Credit ratings agencies indiscriminately stamped "investment grade" on securities backed by subprime bonds regardless of their actual risk level. Investment banks paid premium prices for those high-risk loans without regard for the real value of the mortgages that backed those bonds. In the end, the entire system was converted into a massive Ponzi scheme that collapsed almost immediately as home prices began to soften in 2006.

Rebuild, Not Stabilize, Communities

In order to build healthy, sustainable, thriving communities, and ensure that all Americans are able to benefit from economic recovery, five specific issues must be addressed.

First, ending the foreclosure crisis is a critical challenge.

Second, restructure financial regulation with an emphasis on consumer protection.

Third, implement innovative programming to stimulate growth in communities that have been hardest hit.

Fourth, create a national housing policy.

Fifth, improve enforcement of the Fair Housing Act.

1. Stem the Rising Tide of Foreclosures

The Obama Administration's "Making Home Affordable" (MHA) is the most comprehensive government plan to address the foreclosure crisis. It aims to provide relief to 3 to 4 million homeowners over several years through a combination of mortgage refinancing and modification. But the program is off to a slow start for a variety of program design and implementation challenges. The best estimates to date are that 360,000 homeowners have received loan modifications since the program was launched six months ago.[39] That is only 12% of all homeowners who are eligible.[40]

The Administration has been aggressive about responding to program weaknesses and tightening guidelines to improve performance. But the program continues to struggle due largely to an intransigent servicing industry whose financial interests not aligned with investors or the public interest.

Servicer Misbehavior

Professor Alan White notes that within the pool of subprime and alt-A mortgages that he tracks, "the foreclosure losses on each mortgage were about ten times the amounts of the write-offs on modifications." Specifically, data for June 2009 shows that the average loss on a liquidated foreclosure is $143,987, while the average write-off on loan modifications is only $14,353.[41] In short, although it is far more financially advantageous for lenders to deliver long-term sustainable loan modifications,[42] they continue to disregard the severity of the foreclosure crisis that has destroyed more than $7 trillion in housing equity.[43]

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[39] Taub, Daniel. "U.S. Foreclosure Filings Top 300,000 for Sixth Straight Month." *Bloomberg News*. September 10, 2009.
[40] Luhby, Tami. "12% of Eligible Borrowers Helped by Obama Plan." *CNN Money*. September 9, 2009. Accessed online at http://money.cnn.com/2009/09/09/news/economy/Obama_foreclosure_rescue/?postversion=2009090912.
[41] White, Alan.
[42] Bank capital could be impared in the instances where modifications involve discounts far exceeding current write-downs on mortgage loans.
[43] Willis, Bob and Vincent Del Giudice.

Loan servicers also remain tone deaf to the needs of the American public, even though there are significant subsidies available to them under the Administration's Home Affordable Modification Program. A major problem with Making Home Affordable is that while it offers plenty of carrots, it has no meaningful sticks to compel more responsible actions by servicers.

In Congressional testimony this month before the House Committee on Financial Services, Alys Cohen of the National Consumer Law Center detailed how problems and inconsistencies in servicers' implementation of HAMP have hurt homeowners in need of loan modifications.[44] She documents that many servicers remain understaffed and much of the existing staff is undertrained and unable to provide the necessary level of support. Cohen finds that homeowners and housing counselors report waiting for several months after submitting applications, only to be given a prohibitively short time frame to submit further documentation.

According to Cohen, in addition to the "alarming ignorance of HAMP" displayed by many servicers, others are violating the program's basic requirements. Many servicers, for instance, charge fees to homeowners who receive modifications, while other participating servicers refuse to offer HAMP modifications to some homeowners, and many servicers are continuing to initiate foreclosures and sell homes at foreclosure sales while HAMP reviews are in progress, in direct violation of HAMP regulations.[45]

Cohen's findings on the widespread non-compliance by servicers participating in Making Home Affordable are repeated in an August 2009 report by the *Associated Press*. The *AP* analysis found that 30 of the 38 servicers it studied have been sued by homeowners and fair housing advocates for legal violations and failure to comply with MHA rules and regulations.[46]

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[44] Cohen, Alys. "Testimony on the Subject of Progress on the Making Home Affordable Program: What are the Outcomes for Homeowners and What are the Obstacles to Success?" Presented to the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Housing and Community Opportunity. September 9, 2009.

[45] Cohen, Alys.

[46] Wagner, Daniel. "Mortgage Servicers Accused of Harassing Borrowers, Illegal Fees." *Huffington Post*. August 5, 2009. Accessed September 4, 2009 at http://www.huffingtonpost.com/2009/08/05/mortgage-servicers-accuse_n_252081.html.

In her testimony, Cohen presented the National Consumer Law Center's recommendations to improve HAMP. Highest on her list of priorities is increased transparency, including making public the model for determining a home's Net Present Value. Mechanisms for enforcement and compliance, such as providing an independent review process to homeowners who are denied HAMP modifications and the establishment of an ombudsman to hear and address complaints about the process and specific servicers' actions. Cohen also makes clear that HAMP must provide principal reductions, not forbearance, if it is to provide meaningful, sustainable relief.[47]

Even under the best circumstances, however, Making Home Affordable has significant limitations. Cohen estimates that at best, HAMP could address only one third of the foreclosure crisis.

Solutions

The bottom line: A more robust response to the foreclosure crisis is needed. A new version of the Great Depression-era Homeowners Loan Corporation (HOLC) is warranted. The new entity would more aggressively pursue loan modifications using exceptional powers, such as eminent domain, to secure toxic loan products from investors and modify as many loans as possible to make them affordable and sustainable.[48] NCRC first proposed such an entity in January 2008 in testimony before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law.[49] Under the NCRC proposal, loans would be purchased at a reasonable discount (between current market value and face value). Discounts secured through the purchase process would be applied to modify the loans, including principal forgiveness. This process would greatly reduce the cost to taxpayers of broad-scale loan modification.

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[47] Cohen, Alys.
[48] For more detail see: Carr, James H. "Responding to the Foreclosure Crisis." *Housing Policy Debate*, Vol. 18, Issue 4. 2007. Pages 837-860.
[49] Carr, James. "Testimony on the subject of Responding to the Foreclosure Crisis." U.S. House of Representatives, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law. January 29, 2008. Accessed online at:
http://www.ncrc.org/images/stories/mediaCenter_testimony/responding%20to%20the%20foreclosure%20crisis.pdf.

A new HOLC could also be used to address the multiple problems created by unemployment-driven foreclosures. This could include tying foreclosure moratoria to unemployment benefits. In instances where foreclosure is imminent, families could be allowed to remain in their homes with rental agreements in order to avoid further stress and disruption for families and additional vacant and abandoned properties that exacerbate declining home prices.

More homeowners could be given access to funding for emergency grants and/or loans that allow them to continue paying their mortgage while they are unemployed.[50] This measure could provide a safety net for the one out of every six American workers who are unemployed, "partly employed, [or] who have given up on hunting for jobs because there are so few jobs to be had,"[51] many of whom are or soon will be at risk of foreclosure.

Reform of the bankruptcy code is also warranted. It was proposed as part of the President's Making Home Affordable Program but defeated by Congress. Similar legislation should be reintroduced and passed into law. Currently, bankruptcy courts can modify repayment terms on the outstanding debt on a luxury yacht or investment property, but not the family home. This disparity in treatment is unfair, inequitable, and serves no public policy goal. Furthermore, expanded bankruptcy protection could address as much as 30 percent of loans heading to foreclosure and at no cost to the American taxpayer. The prospect of repayment terms being determined in bankruptcy court would also encourage more servicers to preclude homeowners' access bankruptcy relief.

2. Refocus Financial System Regulation on the Interests of Consumers

Nobel prize-winning economist Joseph Stiglitz sums up the financial crisis this way: "our financial system discovered there was money at the bottom of the [wealth] pyramid and made a

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[50] Pennsylvania's Home Emergency Mortgage Assistance Program, for example, provides a two-year loan of up to $60,000 for homeowners who become involuntarily unemployed to use for mortgage payments. For more information, visit the program website: http://www.phfa.org/consumers/homeowners/hemap.aspx

[51] Meyerson, Harold. "Unhappy Labor Day." *The Washington Post*, September 7, 2009. Accessed September 16, 2009. http://www.washingtonpost.com/wp-dyn/content/article/2009/09/06/AR2009090601194.html.

concerted effort to make sure the money did not remain there."[52] For more than a decade, financial institutions have increasingly engaged in practices intended to mislead, confuse, and otherwise limit a consumer's ability to judge the value of financial products offered in the market and make informed decisions. Stated otherwise, for many financial firms, deception became the operative business model.

Elizabeth Warren, a Professor of Law at Harvard University and Chair of the Congressional Oversight Panel on the Troubled Asset Relief Program, has developed a detailed list of the "tricks and traps" that financial institutions use to make unsafe financial products appear attractive to consumers. She also adds that these financial institutions build unjustified and unethical fees and penalties into the terms and conditions of such products to turn a profit at the expense of trusting borrowers.

Only a few years ago, for example, the typical terms and conditions statement for a credit card was only a single page. Today, terms and conditions sheets are steeped in complex legal jargon and can number up to 30 pages. Warren asserts that this is an unjustifiable burden on the average consumer, and is in fact so onerous that she herself has difficulty understanding them. Says Warren: "I teach contract law at Harvard Law School and I can't understand my credit card contract."[53]

In response to deceptive business practices, Congress has had to go so far as to mandate that at a minimum, contracts should be printed "in not less than twelve-point type,"[54] because in addition to the complex and confusing legal terminology, credit card companies were printing their required disclosures to consumers with such small print it could barely be read by the human eye. The "tricks and traps" used to market high-cost, unsustainable home loans greatly complicated, if not impaired, the ability of a consumer to make an informed decision about the most appropriate mortgage product for his or her individual needs and financial circumstances.

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[52] Stiglitz, Joseph. "Testimony on Too Big To Fail or Too Big to Save? Examining the Systemic Threats of Large Financial Institutions." Presented to the U.S. House of Representatives Joint Economic Committee. April 21, 2009.
[53] Warren, Elizabeth. Televised interview, *NOW on PBS*. January 2, 2009. Transcript available at: http://www.pbs.org/now/shows/501/credit-traps.html.
[54] Sec. 14 (d)(1) " Credit Card Holders Bill of Rights Act of 2009." H.R. 627. 111th Congress, First Session. 2009. Available online at: http://thomas.loc.gov/cgi-bin/query/C?c111:./temp/~c111W5U0s9.

Eliminating these "tricks and traps" requires a multi-pronged response including: (1) enacting a consumer financial protection agency with broad power over the nation's consumer financial protection laws; (2) enacting a strong national anti-predatory mortgage lending law; and (3) modernizing the Community Reinvestment Act to encourage and ensure access to safe and sound lending equitably across communities.

The Role of Consumer Protection in the Financial System

The Obama Administration has proposed the establishment of a Consumer Financial Protection Agency[55] that would consolidate the highly fragmented system of consumer financial protection laws currently enforced by six separate agencies. That new agency would have broad authority to oversee products like home mortgages and credit cards, and services including real estate appraisals, tax preparation, and debt collection. It would promote clear and understandable terms in contracts, and fair, safe, and reliable financial products and services.

The proposed CFPA would not be susceptible to the same regulatory arbitrage that has characterized the current regulatory regime. Regulatory arbitrage allowed financial firms to select their regulator. The regulator offer the most lax consumer protection was the favored regulatory institution. This reality fueled a race to the bottom for consumer protection that eventually imploded the financial system. Competition is an essential element of a free market, but oversight and enforcement of the law is not, nor should it be, available for purchase in a free market.

Opponents of a consumer financial protection agency have argued that such an agency would undermine the safety and soundness of the financial system. Yet, the safety and soundness of the financial system begins with and relies heavily on the safety and soundness of the products offered to the public. If the extension of credit by a financial firm promotes the economic wellbeing and financial security of the consumer, the system is at reduced risk of failure. If,

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[55] Section 3. "Financial Regulatory Reform: A New Foundation." U.S. Department of the Treasury. June 2009. Accessed online at: http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

however, financial products exploit consumers – even if they are highly profitable – the financial system is in jeopardy.

Arguments against the creation of a CFPA also include the notion that product innovation would be stifled and that consumers would lack access to financial services that meet their unique consumer needs. These propositions are without merit, as NCRC President and CEO John Taylor made clear in testimony before the House Financial Services Committee last week.[56] The CFPA, as conceived by the President, would provide consumers with relevant and understandable information that will enable them to make better financial decisions in their best interests.

Some critics speak about standard products as if they are anathema to the private market. However, standard products were the hallmark of the housing industry prior to the "product innovations" that imploded the financial system. The 30-year fixed-rate mortgage has been, for decades, the gold standard of mortgage products, and was responsible for America's extraordinarily high rate of sustainable homeownership. It is this mortgage product that allowed homeownership to become the cornerstone of wealth attainment for the typical American household.

In short, sometimes the best "product innovation" is a quality standard product.

Another argument against a proposed CFPA is that it might cost the American taxpayer too much money. However, the current economic crisis demonstrates that a failure to adequately regulate the financial marketplace will result in far higher costs than managing an agency. To date, $13.9 trillion in household wealth has been lost since 2007,[57] and the government has extended a total of $23.7 trillion in investments, loans, and guarantees to prop up the financial sector. It is not clear how much of that sum taxpayers can expect to recoup.[58]

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[56] Taylor, John. "Testimony on Proposals to Enhance the Community Reinvestment Act." Presented to the United States House of Representatives, Committee on Financial Services. September 16, 2009. Accessed online at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/taylor_ncrc.pdf.
[57] Willis, Bob and Vincent Del Giudice.
[58] Kopecki, Dawn. "U.S. Bailout May Cost $23.7 Trillion, TARP Inspector Says." *Bloomberg News*. July 20, 2009.

Recently, the House Financial Services Committee Chairman Barney Frank proposed a similar consumer financial protection agency. That bill, the Consumer Financial Protection Agency Act of 2009 (H.R. 3126), reinforces the President's proposal in many key areas.[59] But unlike the President's proposal, it leaves primary regulation for the Community Reinvestment Act with the Federal Reserve Board. This is a mistake.

The principal argument against transferring CRA enforcement to the proposed CFPA is that the new agency should address the targeting and sales financial products to individuals only. It is argued that expansion of its mission to incorporate financial services at the community level would overwhelm the agency and undermine its effectiveness. This argument ignores the fact that financial services providers have historically and routinely offered products at a community level. Many firms use race as a proxy for financial vulnerability to concentrate their use of high-cost, deceptive and predatory financial products. The excessive concentration of subprime loans in African American and Latino communities is one example of this phenomenon.

Moreover, geographically targeted predatory lending practices are not limited to the housing market. Payday lenders, check cashers, rent-to-own establishments, title lenders and other alternative financial services institutions also concentrate in communities of color. Until hyper-segregation of communities of color is no longer a common feature of the American residential landscape, lending discrimination by geography will continue. CRA is the single most powerful tool to purge predatory financial practices at a community level.

Limiting the offering of deceptive and high cost products is only half the battle of ensuring adequate and reasonable access to safe and responsible financial products. America has a long history of redlining, or the complete and deliberate failure to meet the legitimate financial services needs of all communities. The absence of competition for mainstream financial services creates the vacuum in which subprime mortgage, payday and other high cost lenders establish themselves. CRA is the most comprehensive law designed to ensure the extension of mainstream financial services in a safe and sound manner.

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[59] "Consumer Financial Protection Agency Act of 2009." H.R. 3126. 111th Congress, First Session. Introduced July 8, 2009. Accessed online at: http://thomas.loc.gov/cgi-bin/query/C?c111:./temp/~c111pzNGRY.

Stated otherwise, failure to include CRA enforcement in the CFPA might result in improvements in the design of payday loans, for example, but payday lenders could still disproportionately target their services to minority communities. In that case, the agency's work would do little to ensure that banks affirmatively serve those communities with high quality, mainstream financial products and services.

Finally, similar to other consumer protection laws with similarly dismal track records for enforcement, CRA has suffered from a lack of commitment from its regulators. Leaving CRA under its current regulators will simply guarantee continued failure to protect the rights of consumers under CRA.

Strengthen and Expand CRA

Strengthening and expanding CRA is also essential. According to the Federal Reserve, nearly 10 million households have no relationship with a mainstream financial institution. And, a recent report by the Center for Financial Services Innovation estimates that there are 40 million under-banked households in the United States.[60] In fact, an *Associated Press* analysis of Census Bureau data reveals that only about ten percent of all new full-service bank branches opened between 2003 and 2008 were located in the urban, minority neighborhoods.[61] Those neighborhoods are already the least well-served by bank branches.

Despite the large numbers of unbanked households and the failure of depository institutions to address that lack of access, 97 percent of banks pass their CRA exams. Regulation of CRA under CFPA should improve the rating system for CRA so that assessments of the banking industry better reflect the reality of access to viable financial services by the American public.

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[60] Herrmann, Michael J. "CFSI Underbanked Consumer Study Fact Sheet." Center for Financial Services Innovation. Updated February 2009. Accessed online at: http://www.cfsinnovation.com/underbanked-study-detail.php?article_id=330525.

[61] Frank and Linda Stuart Ball. "Banks Added 10,000 Branches During Boom but Left Inner Cities Behind." *Huffington Post*. August 17, 2009. Accessed on September 4, 2009 at http://www.huffingtonpost.com/2009/08/17/banks-added-10000-branche_n_261267.html.

Finally, CRA should be expanded to cover non-depository institutions as well as banks. Investment banks, for example, were a principal funder of irresponsible subprime loans. Moreover, the loopholes, exceptions and opt-outs that allow current CRA-covered banks to exempt the activities of their affiliate financial institutions on CRA exams must be eliminated. Loopholes and exceptions have allowed CRA-covered banks to exclude their subprime lending activities from CRA review. In a recent op-ed, Elizabeth Warren cited a Center for Public Integrity study that "found that 21 of the 25 largest subprime issuers leading up to the [foreclosure] crisis were financed by large banks."[62]

Finally, even if CRA is strengthened and expanded, failure to relocate it to the new CFPA in order to ensure enforcement of the law would make that legislation a Pyrrhic victory.

3. Rebuild Communities Harmed by the Crisis

The Kirwan Institute at the Ohio State University has performed a comprehensive examination of the potential impact on communities of color of both the economic crisis and the stimulus programs implemented to spur recovery.[63] The most fundamental conclusion of the Kirwan Institute's report is that neither the American Recovery and Reinvestment Act (ARRA) nor the Neighborhood Stabilization Program (NSP) is targeted to prioritize funding to protected class communities in a manner that reflects the disproportional damage they are suffering as a result of the current crisis.

The report recommends crafting recovery implementation policies in a proportional manner that takes into consideration the diverse challenges faced by different segments of the population. In fact, they argue that policies that fail to prioritize the hardest hit communities will likely *increase* inequities. Instead, policies should be "inclusive, yet…target those who are the most marginalized."[64]

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[62] Warren, Elizabeth. "Real Change: Turning Up the Heat on Non-Bank Lenders." *Huffington Post*. September 4, 2009. Accessed online at http://www.huffingtonpost.com/elizabeth-warren/real-change-turning-up-th_b_276887.html.
[63] "Preliminary Report of the Impact of the Economic Stimulus Plan on Communities of Color."
[64] "Preliminary Report of the Impact of the Economic Stimulus Plan on Communities of Color."

Channeling dollars to the individuals and communities that need them most will immediately stimulate the economy and save and create jobs for both the neediest households and the U.S. population generally. Families that live on the edge of survival will pour these recovery dollars immediately back into the economy through spending on groceries, medicine, clothing, child care, energy, transportation, and other basic necessities. That spending would support multiple sectors of the economy and have positive impacts far outside of the communities where dollars are immediately spent.

Prioritizing areas hardest hit by widespread unemployment and mounting foreclosures would also more directly stabilize the housing market and steady falling home prices. Finally, investing in areas most in need of infrastructure improvements would provide a needed enhancement of the quality of life in communities long-neglected. Earlier this year, the Obama Administration has signaled its desire to fund long-neglected infrastructure investments. This would be an important contribution to rebuilding the economy while investing in communities. Dollars appropriated for infrastructure should be linked to and coordinated with other efforts to rebuild communities that have been damaged by the foreclosure crisis.

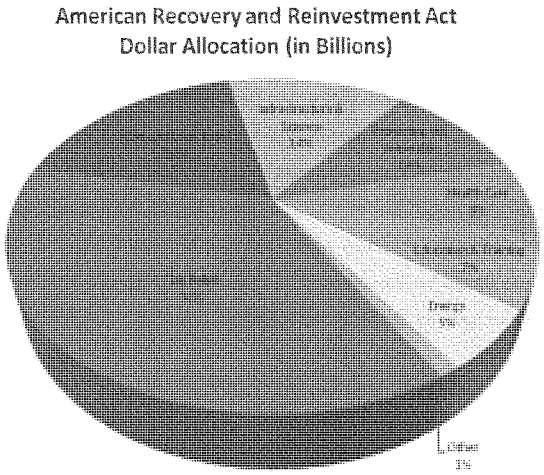
Federal Recovery Efforts: ARRA and NSP

An overall review of the funding priorities in ARRA reveals that, by overall dollar allocation, the largest expenditure category is tax relief, which is a one-time initiative with no long-term impact. Most of the funding for job preservation and creation will not be disbursed until 2010.

Furthermore, ARRA has few requirements regarding targeting the communities hardest hit by the foreclosure and unemployment crises. Particularly in comparison to the massive tax relief benefits, the Kirwan Institute argues that some of the most important programs for communities hardest hit by the recession (and facing the worst foreclosure crises) have comparatively modest allocations.[65] The requirement, for example, that only ten percent of rural infrastructure grants be

[65] "Preliminary Report of the Impact of the Economic Stimulus Plan on Communities of Color."

"targeted to persistent poverty counties… with a special priority on areas that have suffered from excessive job loss and foreclosures" is insufficient to overcome the vastly larger barriers to recovery in communities that have long experienced recession-like conditions and continue to suffer disproportionately.[66]



Source: Preliminary Report of the Impact of the Economic Stimulus Plan on Communities of Color." The Kirwan Institute, February 25, 2009.

The Department of Housing and Urban Development's (HUD) Neighborhood Stabilization Program is more targeted than the larger ARRA. NSP attempts to target funding to high-need communities. Its total level of funding under ARRA, however, is too modest to ensure that the hardest-hit communities will receive the funding and investment that they need.

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[66] American Recovery and Reinvestment Act of 2009. H.R. 1. U.S. House of Representatives. January 17, 2009. Available online at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ5/html/PLAW-111publ5.htm.

With regard to comprehensive redevelopment, NSP seeks to fund "programs and projects that will revitalize targeted neighborhood(s) and reconnect those targeted neighborhoods with the economy, housing market, and social networks of the community and metropolitan area as a whole." Activities beyond housing stabilization, however, are not eligible for support through NSP grants. In particular, HUD can "not consider requests to allow foreclosure prevention activities."[67] Furthermore, while areas of high vacancy and decline are likely to be disproportionately low-income, there are no direct requirements that targeted neighborhoods must be low-income.

Comprehensive Redevelopment Solutions

America needs a wide-ranging approach to neighborhood redevelopment that is comprehensive and sustainable. Foreclosure prevention, neighborhood stabilization, affordable housing development, and job creation must be linked together as components of a comprehensive redevelopment plan.[68]

Comprehensive redevelopment strategies should simultaneously address housing options for vacant and abandoned properties, identify green building opportunities as a source of job creation, invest in quality infrastructure, and provide community assets such as parks and community gardens. Housing programs should stabilize abandoned properties while implementing strategies to return properties to productive use and rebuild the housing market.

Funding should prioritize programs that would enhance residents' economic mobility by capitalizing on their existing financial and housing resources, and connect them to mainstream banking services. This crucial step will ensure that existing residents have the tools and ability to participate in and benefit from redevelopment efforts as they enhance their financial assets and gain an ownership stake in redevelopment initiatives.

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[67] "Notice of Fund Availability (NOFA) for the Neighborhood Stabilization Program 2 under the American Recovery and Reinvestment Act, 2009." Department of Housing and Urban Development. May 4, 2009.
[68] See the forthcoming work: Carr, James H. "Providing a Context for Community Economic Development." *Community Economic Development: A Legal Guide for Advocates, Lawyers, and Policymakers*. Roger Clay and Susan Jones, Eds. American Bar Association: Washington, 2010.

Funding should also prioritize comprehensive redevelopment plans that include local job requirements in housing market and construction activities. Job requirements should ensure a living wage, offer apprenticeship programs, and include opportunities to advance along a career ladder. Federal programs should allow profits from rebuilding and redevelopment projects to be recycled into job programs and business development.

The cornerstone of community revitalization efforts should be investment in safe, affordable, efficient housing. Two specific housing issues of relevance to community economic development demand attention. First, federal funding should support nonprofits and local governments as they develop and enhance initiatives that identify vacant and abandoned properties, allowing for early intervention and preventive efforts to limit vandalism and crime. Second, communities should prioritize expanding affordable rental housing through ownership of foreclosed properties. Households that have lost their properties and moving to rental units are driving up demand for affordable rental housing.

Adding to the pressure are those families already living in rental housing who find themselves evicted as their landlords allow rental units to go through foreclosure. Federal programs should more aggressively support the ability of community and economic development professionals to work with communities, particularly those with concentrated pockets of foreclosure, to facilitate the transfer of ownership of foreclosed properties into housing trusts or similar vehicles for renovation and return to affordable-housing use.

Another issue is rebuilding the affordable housing market with safe and sustainable loan products. Lease purchase products are promising, particularly in the current environment where the credit scores of potentially millions of consumers have been damaged and savings have been exhausted. Despite blemished credit histories, millions of household may, nevertheless, be fully prepared to own under reasonable financial circumstances. Lease purchase products might be the way to bring those consumers back into the homeownership market.

Shared-equity mortgages also hold great promise for bringing consumers into the housing market who are unable to make large down payments but are otherwise ready for homeownership. Under a shared-equity arrangement, an investor contributes some or all of the down payment for a home purchase in return for a fixed share of the future home price appreciation. Shared-equity mortgages would also be an important antidote to the market's abuse of financially vulnerable borrowers. Shared-equity mortgages ensure that an investor's equity is on the line and therefore bring the borrower's and investor's interests into alignment. Shared-equity mortgages can enhance affordability by reducing the debt obligation for homebuyers by as much as 20 to 30 percent relative to a no- or very low-down payment product.

Job Creation and the Role of Small Businesses

Recovery dollars for job training programs and job creation should prioritize proposals to create comprehensive training programs. Such training programs should include skills training for jobs in growing industries as well as adult education and GED classes. They should also offer supportive services to overcome common barriers to participation (i.e. transportation, child care), and provide support for formerly incarcerated individuals.

Training and investment dollars should also target green industries and the emerging green economy. There is evidence that jobs created from investment in green projects (such as green infrastructure, energy conservation, renewable energy, and building rehab and reuse) are more likely than non-green jobs to be unionized and to provide benefits and higher wages.[69] Furthermore, green jobs are expected to be a growing sector of the labor market, and it is an area in which nonwhite workers are underrepresented.

Recovery funding for job creation should give priority support to small businesses (those with fewer than 500 employees) because they account for the majority of economic activity in America. In fact, small businesses employ more than half of the American labor force, produce

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[69] Bivens, Josh, John Irons, and Ethan Pollack. "Green Investments and the Labor Market." Economic Policy Institute. April 7, 2009.

more than half of the country's nonfarm private GDP, make up 99.7 percent of employer firms, and have "created 60% to 80% of the nation's net new jobs each year" over the past decade.[70]

Over the past decade, minority-owned enterprises have accounted for more than half of the two million new small businesses in the United States.[71] Despite this recent growth in entrepreneurship, minorities continue to own a disproportionately small number of America's small businesses and a disproportionately small share of profits:

> African Americans make up over 12 percent of our population, but under 6 percent of our businesses and 1 percent of profits; Hispanics are over 13 percent of the population, but only 7 percent of businesses and fewer than 3 percent of profits; and women make up a majority of our population, but account for less than 30 percent of our businesses and just over 10 percent of profits.[72]

The racial disparities in business ownership rates and profits are largely attributable to the fact that minority business owners have historically had significantly less access to capital. In the Small Business Association's two largest programs, for example, "the share of dollars of loans to African Americans has been about 5 percent and 2 percent. For women, they've remained about 22 percent;" women and minorities also received "less than 5 percent of the venture capital investments made over the past 40 years."[73]

During the current economic crisis, small businesses face considerable challenges, including restricted access to credit, diminished consumer spending, and price increases on goods and materials. To support small businesses and promote small business lending, ARRA designated $730 million to the Small Business Administration (SBA) for bridge loans to small businesses

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[70] Covel, Simona. "Slump Batters Small Business, Threatening Owners' Dreams." Wall Street Journal, December 26, 2008. Accessed September 16, 2009. http://online.wsj.com/article/SB123025114273834377.html

[71] Scott, Betsy. "Making their Mark." The News-Herald, January 11, 2009. Accessed September 16, 2009. http://www.news-herald.com/articles/2009/01/11/news/nh225069.txt

[72] Senator John Kerry. "Statement of Senator John F. Kerry on Business Start-up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training." U.S. Senate Committee on Small Business and Entrepreneurship, September 11, 2009. Accessed September 16, 2009. http://sbc.senate.gov/press/record_statement.cfm?id=302832

[73] Senator John Kerry.

and guaranteed backing of loans to small businesses made by private financial institutions.[74] Despite the fact that, according to Senior Advisor to the Secretary of Commerce Rick Wade, minority-owned businesses are suffering disproportionately,[75] neither ARRA nor the SBA's implementation policies require lending to target historically undercapitalized or marginalized business owners.

One alternative to increased targeting of SBA loans and job creation funding would be to expanding Community Reinvestment Act (CRA) examination criteria to include the collection of data by race and gender for small business owners. This would encourage lending to minority- and women-owned businesses just as lending to minority and women homebuyers increased when the Home Mortgage Disclosure Act (HMDA) was amended in 1988 to require the reporting of race and gender of the borrower"[76]

In summary, to establish a sustainable recovery plan that benefits all Americans, solutions need to be comprehensive, flexible, dynamic, and targeted. Policies need to address "communities hardest hit by the economic recession and most in danger of falling permanently out of the fabric of American society."[77] To that end, the Center for Social Inclusion recommends that recovery spending be built around the following five principles:

1. Ensure that those most in distress benefit meaningfully
2. Support infrastructure projects that benefit distressed communities, not solidify inequities
3. Address access to credit in communities disproportionately harmed by the collapse of the mortgage market and the job market

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[74] "SBA's Economic Recovery Efforts and Impact." U.S. Small Business Administration. September 15, 2009. Available online at:
http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_recvry_aara_imp_factsheet.pdf.
[75] "Minority Businesses Fight to Stay Afloat." National Public Radio, August 25, 2009. Accessed September 16, 2009. http://www.npr.org/templates/story/story.php?storyId=112200627
[76] "Access to Capital and Credit for Small Businesses in Appalachia." National Community Reinvestment Coalition. May 2007.
[77] The Center for Social Inclusion. "Economic Recovery for Everyone: Racial Equity and Propserity." *Poverty and Race*, March/April 2009. 18 (2). Accessed September 18, 2009.

4. Recognize differences in labor segmentation by race and gender to ensure an equitable distribution of the stimulus' benefits

5. Provide for data collection on the race, ethnicity, and gender of those served by stimulus money for evaluation purposes[78]

4. Create a National Housing Policy

America has no national housing policy. While successive administrations have had the general goal of increasing homeownership, and some have occasionally expressed the desire to promote mixed-income or supportive-services housing, there are few meaningful national housing goals or objectives against which federal housing programs are measured.

Rather than a defined policy, there is a hodgepodge of programs—many that date back to the Great Depression—which are in need of serious overhaul. The U.S. population has changed dramatically over the past half-century and continues to change rapidly. Moreover, energy and other environmental concerns are now major factors in housing policy considerations. These issues present a host of challenges and opportunities for the nation's housing infrastructure.

Policymakers should have a focused discussion about the goals of housing policy in order to determine how the financial system can better support the achievement of those goals. Questions to be asked include: What is the role of housing policy in promoting vibrant communities and ensuring the economic interests and social wellbeing of the population? And, based on how we answer that question, what are the relationships between housing policy and energy, transportation, education, and other national priorities?

Given the significant housing challenges facing communities of color both before and as a result of the foreclosure crisis, a serious revamp of housing policy is warranted in order to help

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[78] The Center for Social Inclusion. "Economic Recovery for Everyone: Racial Equity and Propserity." *Poverty and Race*, March/April 2009. 18 (2). Accessed September 18, 2009. http://www.prrac.org/pdf/MarApr2009PRRACstim.pdf

compensate for the legacy of decades of discriminatory actions and its disproportionately negative repercussions currently undermining minority neighborhoods.

In a 2003 lecture at Harvard University, former HUD Secretary Henry Cisneros suggested that housing should be viewed as an ascending continuum. The lowest step is homeless shelters, moving next to supportive housing, and ultimately to long-term homeownership. Viewing housing as a continuum encourages policymakers to think of households as moving up along a chain of housing successes, rather than approaching housing in a static context. This housing staircase can also be used as a tool to examine federal housing subsidies at each level—to determine where the allocation of public resources might be more effectively and appropriately redirected to channel subsidies to those most in need, and to leverage housing investments to promote upward mobility.[79]

The cost of producing housing is also a critical issue to be addressed in the context of a new national housing policy. Prior to the foreclosure crisis, America was suffering from rapidly growing affordability problems that reached from coast to coast. When the current inventory of unsold homes is off the market and the U.S. economy begins to grow in earnest, those problems may return unless they are effectively addressed now.

The availability of affordable rental housing is a key ingredient of a national housing strategy. Renters need to be able to save money toward a down payment on a mortgage if they are to become homeowners. Yet, half of all renters spend more than 30 percent of their income on housing,[80] and a single minimum wage earner does not make enough money to pay for decent rental housing in any metropolitan area in the nation.[81] These problems will only be exacerbated by record unemployment rates and the foreclosure crisis, as homeowners transitioning to lower

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[79] Cisneros, Henry. "Homes for Americans in the Twenty-First Century: Challenges and Opportunities for the Nation." Fifth Annual Dunlop Lecture, Joint Center for Housing Studies, Harvard University. September 29, 2003. Accessed online at: http://www.jchs.harvard.edu/publications/homeownership/m03-2_cisneros.pdf.
[80] Mishel, Lawrence, Jared Bernstein, and Heidi Shierholz. "The State of Working America, 2008/2009." Economic Policy Institute. Ithaca: Cornell University Press, 2009.
[81] "Race and Recession: How Inequity Rigged the Economy and How to Change the Rules."

cost rental properties will squeeze supply, and 40 percent of all foreclosure evictions have been on rental units.[82]

Another strategy to address affordable housing is to incentivize correcting inefficient land-use patterns. One silver lining of the energy price shock of 2008 was the wake-up call to the American public that our current land-use practices are counterproductive to the public interest. Although energy prices have fallen dramatically from those record highs, they are likely to rebound when the global economy recovers.

As a result, federal policies should tie HOME, Community Development Block Grants (CDBG), and other housing subsidies—along with highway, mass transit, and other infrastructure funds—to communities' sustainable planning and construction practices. This would reduce the need for public subsidies to buy down rents on unnecessarily over-priced housing. Fundamental weaknesses in land-use regulations can also be addressed with programs that encourage greater reliance on new and innovative building technologies; determine the benefits and costs of alternative green technologies; update building codes; and streamline permitting-and-approval processes.

5. Enforce the Fair Housing Act

More than 40 years after the passage of the Fair Housing Act (FHA), the laws protecting the rights of minority families in the housing market remain poorly enforced. Many of today's housing problems result from chronic patterns of discrimination.

Discrimination undermines the economic and social wellbeing of communities and limits access to key opportunities that are essential to upward mobility.

A study released this past July by the Pew Charitable Trusts, on the subject of downward economic mobility, finds that children of middle income families that live in high-poverty

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[82] "Renters in Foreclosure: Defining the Problem, Identifying Solutions." National Low Income Housing Coalition. 2008.

neighborhoods (defined as having a poverty level that exceeds 20 percent), compared with middle-income children living in low-poverty neighborhoods (poverty of less than 10 percent), have a greater than 50% chance of downward mobility.[83]

According to the study, more than half of black children born between 1985 and 2000 whose families were at least middle-income were raised in high-poverty neighborhoods. On the other hand, only one percent of middle-income white children were raised in high-poverty neighborhoods. The study concludes that neighborhood poverty levels explain at least one-quarter to one-third of the black-white gap in downward mobility, more than the *combined* effects of parental education, family structure, occupation and labor force participation. These powerful and important findings drive home the significance of removing artificial barriers to housing choice that will only be achieved by purging discrimination from the housing markets.

There are three key implications for the future of fair housing that result from the current situation:

1. The wealth of millions of families of color is being destroyed, which will limit their ability to seek housing in non-segregated communities.

2. The credit scores of people of color are being undermined disproportionately, which will intensify the lack of access to a range of opportunities not limited to housing.

3. The damage to communities of color will further fuel segregation and unjust assumptions and myths about the livability of communities of color.

Better FHA enforcement is necessary. The Federal Reserve has had regulatory jurisdiction over fair housing as it relates to financial institution lending activities, but its record on investigating and prosecuting potential fair housing violations is dismal. In fact, between 2004 and 2006, the

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[83] Sharkey, Patrick. "Neighborhoods and the Black-White Mobility Gap." Economic Mobility Project, Pew Charitable Trusts. July, 2009. Accessed online at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/PEW_SHARKEY_v12.pdf?n=1399.

Federal Reserve identified approximately 470 lenders whose practices were possibly in violation of civil rights and fair lending laws. Instead of investigating the lenders to determine the presence and extent of actual violations, the Federal Reserve referred all 470 cases to other regulatory agencies, and did not follow up when the other agencies similarly declined to investigate.[84] This is a dereliction of duty, particularly considering that the National Fair Housing Alliance estimates that more than four million acts of housing discrimination occur each year.

Lack of funding is a major contributor to poor oversight of fair-housing practices, but money is not the only cause. A lack of appropriate coordination among various agencies responsible for enforcing civil rights and equal opportunity, along with an inconsistent commitment to robust civil rights enforcement, has undermined progress on this essential national mandate. In fact, the Government Accountability Office reported in August that "[f]ederal enforcement agencies and depository institution regulators face challenges in consistently, efficiently, and effectively overseeing and enforcing fair lending laws due in part to data limitations and the fragmented U.S. financial regulatory structure."[85]

For these reasons, NCRC recommends the establishment of a cabinet-level agency focused on civil-rights enforcement. Empowering one agency to supervise the enforcement of all civil rights laws could greatly improve access to opportunities for millions of Americans whose only impediments are artificial walls and unfair and illegal impediments.

The secretary or chairperson of such an agency should report directly to the President of the United States and be responsible for measuring, monitoring, and eliminating discrimination from the public and private sectors. The agency would promote financial inclusion and racial equality by coordinating the civil rights offices that currently act without cohesion or unity across the different Cabinet departments. This would not usurp the role of agency-specific civil rights offices, but enable them to better achieve their missions by providing the tools, resources, and

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[84] Inside Regulatory Strategies. November 14, 2005, Page 2. See also: Adler, Joe. "Big Increase in Lenders with Suspect HMDA Data." *American Banker*. September 11, 2006.
[85] "Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts." U.S. Government Accountability Office. August 2009. Accessed online at: http://www.house.gov/list/press/financialsvcs_dem/gao.pdf.

leveraging collective responsibility. Neither would this new agency supplant state-level civil rights agencies, with which it would work as a strategic partner.

The major advantage of a Cabinet-level civil rights agency would be to create cross-departmental exchanges of ideas, expertise, information, and goals. When a department fails to carry out civil rights enforcement mandates or does so haphazardly, the new agency would be able to compel improved enforcement. Finally, the symbolic value and ability of a civil rights agency to influence national attitudes about and behaviors regarding fair lending, fair housing, and civil rights in general should not be underestimated.

HUD, the Department of Justice, and all other federal agencies with fair housing responsibilities would be required to report to the new agency annually the number of fair housing and fair lending investigations, types of investigations, and outcomes. Annual reporting should include information on fair lending compliance exams conducted in conjunction with CRA exams.

The proposed Consumer Financial Protection Agency to consolidate the regulation of consumer financial products models many of the principles of NCRC's recommendation for a Cabinet-level civil rights agency to enforce the nation's civil rights laws. We continue to feel, however, that a dedicated civil rights enforcement coordinator is necessary in addition to a consumer rights coordinator.

Equality is Not Only about Justice

The issue of discrimination has been traditionally argued solely on the basis of fairness, equality, and justice. While those are important grounds, there is increasingly another critical reason to level the playing field by race and ethnicity. Within the next 35 years, half of the U.S. population will consist of people of color. This has particular implications for the American economy overall since people of color, the fastest-growing share of the nation's population, are the least well-housed, have diminished access to the labor and financial markets, and are

disproportionately isolated from quality education and health care, and earn relatively low levels of wealth.

Globalization represents competitive challenges that America has never previously experienced. Growing concern over the considerable domestic job losses and the tenuous nature of the economic recovery in the U.S. are raising critical discussions on where job growth will occur in the U.S. in coming years.

Increased investments in training and higher education are the keys to the emerging knowledge economy. But as President Obama stated in a speech delivered March 10, 2009 before the National Hispanic Chamber of Commerce, "despite resources that are unmatched anywhere in the world, we've let our grades slip, our schools crumble, our teacher quality fall short, and other nations outpace us…and year after year, a stubborn gap persists between how well white students are doing compared to their African American and Latino classmates."[86]

If America is to continue to be an economic, political, and intellectual superpower as it moves forward into the twenty-first century, the old paradigm of discrimination and inequality must fall. Americans must continue the open dialogue on race that began last year and fully understand the historical implications for our nation's future. Succeeding in a new, globalized, highly competitive world is not an option; it is an imperative.

Laying the Foundations for the Next Crisis

Rather than honestly identifying and directly addressing the causes of the financial system meltdown, there are signs that current interventions are simply laying the foundations for the next crisis before we emerge from the crisis in progress. Although Federal Reserve interventions have been successful in avoiding a more damaging financial system meltdown, the extraordinary

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[86] Transcript available online at: http://www.nytimes.com/2009/03/10/us/politics/10text-obama.html.

financial support for the banking system, with so few restrictions on financial firms' activities, may create an even larger crisis down the road.

On the first anniversary of the fall of Lehman Brothers, rather than actively examining how best to address the challenges of "too big to fail" the financial system rescue has made too big – bigger. Four of the largest banks today, for example, issue half of all home loans and issue two of every three credit cards according to an analysis of federal data by the *Washington Post*.[87] Similarly, the government is financing ninety percent of all new mortgages.[88]

Even financial analysts and bankers themselves recognize the dangers of our current path. In a recent *Bloomberg News* interview, Richard Bernstein, CEO of Bernstein Capital Management LL, said "one year later, policymakers haven't learned the lesson of the [Lehman Brothers] bankruptcy." He went on to critique the government's response of allowing large firms to continue operating at their current size without implementing new regulatory processes to manage systemic risk. It "practically invites another catastrophe," he said.[89]

Jeff Rosenberg, the chief credit specialist at Bank of America Securities, said in an interview with Bloomberg Television that "there are parts of the credit markets that are back to the peak of credit bubble pricing." He went on to say that, "an unintended consequence of the Federal Reserve's actions to stabilize markets [is that] you end up just simply reflating the bubble for the next term."[90]

Joseph Stiglitz voiced a similar view last week, saying, "The problems [in the banking system] are worse than they were in 2007 before the crisis."[91]

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[87] Cho, David. "Banks too Big to Fail Have Grown Even Bigger." *Washington Post*. August 28, 2009.
[88] Andrews, Edmund L. and David Sanger. "U.S. is Finding Its Role in Business Hard to Unwind." *New York Times*. September 13, 2009.
[89] Ivry, Bob, Christine Harper, and Mark Pittman. "Missing Lehman Lesson of Shakeout Means Too Big Banks May Fail." *Bloomberg News*. September 8, 2009. Accessed online at http://www.bloomberg.com/apps/news?pid=20601170&sid=aX8D5utKFuGA.
[90] "Bank of America's Rosenberg Interview on Credit Markets." *Bloomberg Television*. Aired August 10, 2009. Accessed August 14, 2009 at www.bloomberg.com/tvradio/tv.
[91] Deen, Mark and David Tweed. "Stiglitz Says Banks Face Problems Bigger Than Pre-Lehman." *Bloomberg News*. September 13, 2009.

Conclusion

In conclusion, this is a distinct moment in history. The question is: Will we use it productively or will we squander it?

The answer to this question is not inconsequential. Much is at stake with respect to how honest we are in (1) analyzing what happened, (2) adopting immediate remedies to mitigate the damage, and (3) instituting long-range measures to ensure this type of crisis does not again occur.

Unfortunately, in all three areas, the early results are not promising. Despite a massive bailout of the financial institutions, the system remains precariously balanced on the edge of failure. Consumers continue to struggle through a virtual sea of deceptive debt and financial firms remain unaccountable to the American public.

Now is the time to enact strong legislation that will more directly and substantially help families avoid foreclosure on their homes.

Now is the time to enact meaningful legislation to ensure that financial firms work to promote the economic well being of the American public.

Now is the time to rebuild communities harmed by excessive foreclosures and severe levels of unemployment.

Now is the time to enforce the nation's civil rights laws.

Now is the time for the American people to demand that this moment in history not be squandered.

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Chairman TOWNS. Thank you very much, Mr. Carr.
Dr. Weller.

STATEMENT OF CHRISTIAN E. WELLER

Mr. WELLER. Well, thank you very much Chairman Towns, Ranking Member Issa and members of the committee for inviting me here today to speak to you.

I will make three points in my testimony.

First, minorities have experienced sharper drops in economic security during the recession and those drops occurred from lower levels of economic security than was the case for Whites.

Second, there are economic structures and not just personal differences that can explain the worst experience minorities have had in this recession relative to Whites.

Third, public policy can help in many ways to level the playing field for minorities by pursuing strong and sustained growth in good jobs, support for wealth creation and greater efficiencies in key markets such as credit markets.

The economic experience of almost all families during the recession has been dismal. The experience of minorities generally has been worse than that of Whites. The unemployment rate of Whites increased by 4.2 percentage points from the end of 2007 through the middle of 2009. In comparison, the unemployment rate of African Americans and Hispanics rose by more than 6 percentage points at the same time, 50 percent faster than for Whites.

We also see family incomes and employer benefits disappearing faster for minorities than for Whites during this recession. Minorities are losing access to good jobs at a faster rate than Whites during the Great Recession.

This faster decline came after minorities were already in a weaker economic position than Whites before the recession occurred. The unemployment rate for African Americans at the end of 2007, for instance, was 8.6 percent or more than twice the rate for Whites, who had an unemployment rate of 4.2 percent at that time. The unemployment rate of Hispanics at the end of 2007 was also substantially higher than that of Whites, sitting at 5.8 percent.

Incomes and earnings were generally much lower, poverty rates much higher and health insurance coverage rates lower for minorities than for Whites before the crisis even began.

These compensation-related differences were further exacerbated by larger differences in household wealth. Minorities, for instance, have much lower homeownership rates than Whites, before and during the current crisis. In 2008, the homeownership rate for Whites was 75 percent compared to 47.4 percent for African Americans and 49.1 percent for Hispanics. This is the lowest level since 2002 for Whites and African Americans and since 2004 for Hispanics. We also just learned that the homeownership rates during the crisis dropped the fastest for Asian Americans.

We also see large differences in other forms of wealth, most notably in employer-provided retirement plans. African Americans had a pension coverage rate of 46 percent in 2008, Hispanics had a participation rate of 30 percent, compared to 56 percent for Whites.

Finally, the evidence also indicates that minorities regularly face obstacles when building wealth. This is especially true for African

Americans. My colleague, Andrew Jakabovics, just published a study on the origination of highest-priced mortgages at the Nation's largest banks. He finds that 32 percent of African Americans with incomes above twice their areas median income had higher priced mortgages in 2006 compared to 29 percent for Hispanics and 11 percent for Whites.

This confirms my own findings that loan applications for minorities are more likely to be denied than those of similarly situated Whites, and that African Americans paid more for their loans than similarly situated Whites. Minorities enjoyed less economic security before the crisis started and their economic security deteriorated more quickly since the end of 2007.

These differences are unlikely to be fully explained by differences in other characteristics such as age, education or occupation. In a new report that we released today from the Center for American Progress, we find the changes in the unemployment rate for minorities and Whites in smaller sub samples, for instance by education, age and gender, the changes in the unemployment rate are almost universally larger for minorities than for Whites. These figures do not tell the whole story, but they are indicative of continued structural problems in the labor market.

What are those structural problems? Structural problems can include segmented labor markets whereby minorities are disproportionately represented in occupations and industries that pay less than occupations and industries where Whites are more prevalent, and similarly segmented housing markets and transportation.

Structural problems can also include heavy reliance on education levels and wealth where, again, minorities tend to have larger obstacles than Whites to building wealth and obtaining an education.

The final structural problem is racially biased practices such as credit steering and discrimination in hiring, housing markets and other services.

Policymakers thus can pursue three separate policy goals to create a level playing field for minorities with respect to economic security.

First, pursue income opportunities through, for instance, the continuation of the economic stimulus, speeding up some of the "spend out" of the money, but also the extending of unemployment insurance benefits which stabilize the loss of income among minorities.

Long-term structural policies to help income would mean an inflammation-indexed minimum wage, an improvement to the earned income tax credit, and labor law reform to make it easier for minorities to join a union. Minorities would particularly benefit from unionization rates since they tend to benefit larger from unionization rates than Whites.

Wealth building policies. This would make it easier for people to save money through, for instance, automated retirement savings plans, progressive tax benefits and lower cost savings options.

And finally, emphasis on market efficiencies to eliminate some of the practices that we see in terms of credit steering. I think a first step would be to audit the banks that have received TARP money for their credit practices to see if credit steering is a persistent problem. Such an audit could be a condition before banks are allowed to return the TARP money.

Thank you very much for this opportunity. I am happy to answer any questions you may have.

[The prepared statement of Mr. Weller follows:]

Written Testimony for the U.S. House of Representatives
Committee on Oversight and Government Reform

Leveling the Playing Field

How to Ensure Minorities Share Equitably in the Economic Recovery and Beyond

September 23, 2009

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Introduction and summary

Thank you Chairman Towns, Ranking Member Issa, and members of the Committee for this opportunity to speak to you today. It is a pleasure to address you about minorities' experience in the recession, an issue that policymakers must pay special attention to as we move into a recovery. In my testimony today, I would like to focus on the lessons that can be learned from the recession for minorities' economic security, with particular attention paid to the labor market.

The Great Recession, now in its 21st month, has affected many people and many sectors of the economy. Businesses are hurting and laying off workers, who in turn are having a harder time finding a new job than at any point since 1948 due to this being the longest recession since the Great Depression. The very weak labor market thus feeds troubles elsewhere: Foreclosures and credit card defaults are at record highs, while the personal bankruptcy rate—the number of bankruptcies per 1,000 households—has risen by 64.5 percent since the end of 2007 when the U.S. economy entered the recession.

Some groups have felt more economic pain than others. The past 21 months are not much different in this regard than prior recessions, except that the length of the economic pain is lasting longer than before. African Americans and Hispanics have lost more economic ground and done so more quickly than their white counterparts from the end of 2007 to the summer of 2009, and the economic fortunes of minorities have fallen from lower levels than those of whites to begin with. This means that the gap in the economic security between minorities and whites is widening in this recession, as it has in previous ones.

The following pages examine annual, quarterly, and monthly data on the different economic experiences of whites, African Americans, and Hispanics during this recession and prior ones, where appropriate comparisons can be made.[1] The data show that there are apparent structural problems such as labor market segmentation, credit market steering, and discrimination in the U.S. economy and particularly in the labor market that present an unlevel playing field for minorities. Policymakers need to pay closer attention to these problems.

We cannot simply rest our hopes on an eventual economic recovery. Concrete policy steps must be taken to make sure that the U.S. economy can finally erase the gulf in economic security and economic opportunities between whites and minorities. These concrete steps

start with the continuation of a substantial economic stimulus to get the U.S. economy out of its worst recession since the Great Depression, but they also require energy security and health care reform. These additional steps can both enhance long-run economic growth and immediately buffer the economic security of society's most vulnerable. Only with the help of such supporting policies can the county truly move forward into a strong and sustained expansion that will benefit all Americans.

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Eight years into the 21st century we've seen little progress in reducing economic disparities between minorities and whites

It's clear that minorities' economic experience continues to notably differ from whites'. Their economic security lags behind whites' in good times and often falls faster than whites' in bad times,[2] regardless of whether we consider data on employment, wages, income, health insurance coverage, retirement plan participation, homeownership, or poverty rates.

For this report we analyzed annual data from the Bureau of Labor Statistics and the Census to examine the different experiences of whites, African Americans, and Hispanics in both the previous business cycle, which lasted from 2000 to 2007, and the current recession, for which we compared data for 2008 to data for 2007. We also supplemented our analysis of annual data with quarterly data, where available, which allowed us to extend our analysis into 2009. Our analysis of quarterly data also used the quarterly start and end points of the past business cycle—from March 2001 to December 2007—and of the current recession, from December 2007 to June 2009.

Almost without exception the data show two clear trends. First, the severity of the recession has erased most of the modest gains that families experienced in a few areas during the past business cycle from 2000 to 2007, such as homeownership. And second, the decline in economic security during the recession is much sharper for minorities than for whites.

The previous business cycle featured few gains and lost ground for minorities

Unemployment

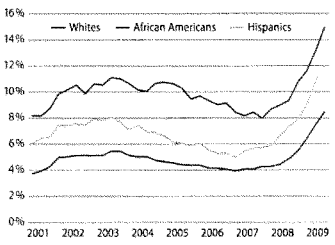
The unemployment rate fell for all groups during the last business cycle, but the unemployment rates for minorities remained substantially higher than that of whites (Figure 1). The unemployment rate for whites stood at a healthy 3.7 percent at the start of the business cycle in the first quarter of 2001. Meanwhile, the unemployment rate for African-American workers was more than two times as high as that of whites at 8.1 percent, and the unemployment rate for Hispanic workers was also much higher than that of whites at 6.0 percent.

The differences in unemployment rates by race persisted for the entire previous business cycle. The unemployment rate for both white and African-American workers grew at an average annualized rate of 0.07 percentage points each quarter throughout the cycle. This means that in December 2007 African Americans' unemployment rate was still more than twice as high at 8.6 percent as the unemployment rate of whites, which was 4.2 percent.

The experience of Hispanic workers differed from African Americans and whites. The unemployment rate of Hispanics was actually lower in December 2007, at 5.8 percent, than in March 2001, because of the construction boom and expanding employment in hotels and restaurants during the last business cycle. However, since the current crisis started in the construction sector, Hispanics have quickly lost ground and their labor market experience once again resembles that of African Americans, as we discuss below.

Figure 1: Unemployment rates for whites, African Americans, and Hispanics for the previous business cycle

The differences in unemployment rates persisted throughout the cycle



Notes: All unemployment rates are seasonally adjusted. Authors' calculations based on Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009).

Employment growth

The flip side of the rising unemployment rates of the last business cycle was the meager employment growth. The average monthly job growth rate (on an annual basis) from March 2001 to December 2007 totaled 0.6 percent, less than one-third of its historical average in the business cycles before the last business cycle. Both African Americans and whites saw comparatively weak job growth during this period. White employment grew on average by 0.6 percent per quarter from March 2001 to December 2007 and African Americans' employment grew hy 0.9 percent.

Hispanics' employment experience differed markedly due to the aforementioned construction boom and the expansions of hotels and restaurants. The job growth rate of Hispanics from March 2001 to December 2007 totaled 3.6 percent. But the fact that the fate of Hispanics was tied so closely to the construction boom also meant that they were particularly vulnerable to the fallout of the bursting housing bubble.

Earnings

Vast earnings gaps between whites and minorities also persisted over the entire previous business cycle. Whites' usual weekly earnings were flat between March 2001 and December 2007. African Americans' earnings, however, declined at an average annualized rate of 0.03 percent per quarter during this period. Their usual median weekly earnings were $150.51 (2008 dollars) lower than whites' at the start of the business cycle in March 2001, and hy the close of the business cycle in December 2007, this disparity had grown by $1.24 (2008 dollars). As a result the usual median weekly earnings of African Americans workers only amounted to 79.5 percent of whites' earnings at the end of 2007.

In comparison, in the fourth quarter of 2007 the usual median weekly earnings of Hispanic workers were $220.46 (2008 dollars) lower than whites' earnings, even though this gap had shrunk by $20.61 (in 2008 dollars) since the first quarter of 2001. By December 2007 the usual median weekly earnings of Hispanic workers equaled only 70.2 percent of whites' earnings.

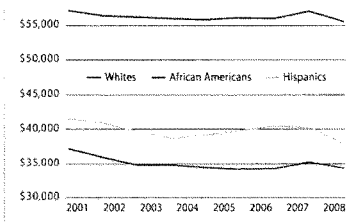
Income

Minorities' incomes lagged considerably behind whites' during the last business cycle as Figure 2 shows. The gap between whites' and minorities' incomes actually widened from 2000 to 2007. In 2000 African Americans' median family income was already less than two-thirds (65.0 percent) the level of whites' while Hispanics' was less than three-quarters (72.7 percent) of whites'.

Median family incomes fell in inflation-adjusted terms between 2000 and 2007 for whites and minorities, but incomes for minorities shrank at a faster pace. African Americans' incomes fell at an average annual rate of 0.7 percent and Hispanics' at 0.5 percent, while whites' income declined at an average annual rate of 0.003 percent throughout the previous business cycle. Consequently, between 2000 and 2007 the income gap between whites and African Americans widened by $1,862 (2008 dollars) and the gulf between whites' and Hispanics' median family incomes grew by $1,293 (2008 dollars).

Figure 2: Median family income, 2000-2008

Median family incomes for all groups fell in inflation-adjusted terms between 2000 and 2007, but minorities' incomes fell faster.



Notes: Authors' calculations based on DeNavas-Walt, Carmen, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

Health insurance coverage

Differences in health insurance coverage by race and ethnicity are similar to the differences in employment trends among these groups. The health insurance coverage for minorities tends to be substantially lower than that of whites. This was unchanged during the past business cycle, even though Hispanics saw some gains in health insurance coverage, while both African Americans and whites lost ground between 2000 and 2007.

The share of both whites and African Americans with any type of health insurance coverage declined at an average annual rate of 0.2 percentage points between 2000 and 2007, while Hispanics' coverage increased at an average rate of 0.1 percentage points per year. Approximately one in five (19.5 percent) African Americans and just under one-third of Hispanics (32.1 percent) lacked health insurance at the end of the previous business cycle in December 2007, compared to roughly 1 in 10 (10.4 percent) whites.

What seems at first like good news for Hispanics turns out to be bad news in disguise. Health insurance coverage through an employer dropped for Hispanics, just as it did for

whites and African Americans. The health insurance coverage rate for whites who had employer-provided insurance declined annually from 2000 to 2007 by 0.6 percent, compared to 0.7 percent for African Americans and 0.6 percent for Hispanics. The fact that the share of Hispanics with health insurance fell slightly, even though employers cut back on their health insurance coverage of minorities and whites, is likely a result of comparatively low earnings for Hispanics. These lower earnings made it easier for Hispanic families to qualify for Medicaid—the share of Hispanics with Medicaid coverage increased from 18.2 percent in 2000 to 22.5 percent in 2007[8]—but it also highlights the continued economic insecurity for Hispanic families compared to that of whites.

Retirement savings plans

Access to employer-sponsored retirement savings plans is uneven in the United States, with minorities' participation rates significantly less whites'. Minorities were already less likely than whites to participate in an employer-sponsored retirement plan in 2002, the earliest year for which data are available, when only 31.1 percent of Hispanic workers and 47.5 percent of African-American workers participated in a plan compared to 58.8 percent of white workers.

As of 2007, all three groups had lower participation rates than they did in 2002, even though slight gains were made for several years during the previous business cycle. Between 2002 and 2007, whites' participation rates in employee-sponsored retirement plans declined at an average rate of 0.2 percentage points each year while African Americans' and Hispanics' declined at an average rate of 0.1 percentage points each year. Consequently, in 2007, 57.6 percent of whites participated in an employer-sponsored retirement savings plan, compared to less than half of African Americans (47.1 percent) and less than one-third (30.6 percent) of Hispanics.

Homeownership

The homeownership rates for whites, African Americans, and Hispanics increased slightly over the course of the previous business cycle, but by 2007, all groups' homeownership rates had begun to fall from their peaks in this cycle.

In 2000 nearly three quarters (73.8 percent) of whites could call themselves homeowners, while less than half of African Americans (47.2 percent) and Hispanics (46.3 percent) could do the same. Homeownership rates began to decline after making modest gains in the early to mid-2000s, leaving whites and Hispanics with slightly higher rates than at the start of the business cycle while African Americans' rate returned to the same level as in 2000. Whites' homeownership continued to dwarf minorities' rates in 2007, standing at 75.2 percent, compared to 47.2 percent for African Americans and 49.7 percent for Hispanics.

African-American and white homeownership rates in 2007 were down from highs recorded in earlier years. African Americans were the first to see their homeownership rate decline after reaching a peak of 49.1 percent in 2004. The homeownership rate of whites peaked in 2006 at 75.8 percent. In comparison, the homeownership rate for Hispanics did not start to decline until 2008, as we discuss below.

Poverty

The previous business cycle did not end on a high note for poverty. At the start of the previous business cycle in 2000, just 9.1 percent of whites were below the poverty line compared to nearly one-third (31.2 percent) of African Americans and more than one-quarter (28.4 percent) of Hispanics.

Poverty rates increased for both whites and minorities over the course of the previous business cycle, even though all three groups also made modest employment gains during this period.[12] The poverty rate for whites increased at an average annual rate of 0.1 percentage points between 2000 and 2007, while the rate for African Americans grew at an average rate of 0.3 percentage points each year and Hispanics' rate increased at an average of 0.003 percentage points each year. Consequently, the poverty rate for African Americans (24.5 percent) was more than three times that of whites (8.2 percent) in 2007 and Hispanic's poverty rate (21.5 percent) was nearly three times larger than whites'.

Table 1: Average annualized changes in quarterly employment and earnings data for whites, African Americans, and Hispanics

Minorities continue to struggle in the labor market when compared to whites

	Employed			Unemployment rate			Median usual weekly earnings (2008 $)		
	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics
2001-I to 2007-IV	0.6%	0.9%	3.6%	0.07	0.07	-0.03	0.00%	-0.03%	0.6%
2007-IV to 2008-IV	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1.9%	1.7%	3.8%
2007-IV to 2009-II	-2.5%	-3.8%	-2.9%	2.8	4.2	4.1	n.a.	n.a.	n.a.

Notes: All data are average annual rate percent or percentage point changes. All data except earnings are seasonally adjusted. Authors' calculations based on Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009) and U.S. Department of Labor, Bureau of Labor Statistics, "Updated CPI-U RS: All-Items and All-Items less food and energy, 1978-2008" (Washington, 2009).

Table 2: Average changes in annual data on health insurance, homeownership, poverty, retirement, and income for whites, African Americans, and Hispanics

Minorities continue to trail whites in all areas

	Health insurance coverage			Homeownership rate			Percent below the poverty line			Participation in Retirement Plans			Median Family Income (2008 $)		
	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics	Whites	African Americans	Hispanics
2000 to 2007	-0.2	-0.2	0.1	0.2	0.00	0.5	0.1	0.3	0.00	n.a.	n.a.	n.a.	-0.003%	-0.7%	-0.5%
2002 to 2007	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.2	-0.1	-0.1	n.a.	n.a.	n.a.
2007 to 2008	-0.4	0.4	1.4	-0.2	0.2	-0.6	0.4	0.2	1.7	-1.0	-1.7	-1.5	-2.7%	-2.9%	-5.8%

Notes: All data except earnings are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics "Current Employment Statistics" (Washington, 2009); U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009); U.S. Bureau of the Census, "Housing Vacancies and Homeownership (CPS/HVS)" (Washington, 2009); and DeNavas-Walt, Carmen, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

The recession has heightened losses and widened gaps between minorities and whites

Unemployment[2]

Overall unemployment was at its highest level in 26 years as of August 2009 after growing by 4.5 percentage points between the fourth quarter of 2007 and the second quarter of 2009. The unemployment rates for minorities, however, have grown faster and to higher levels than those of whites during the current recession. The unemployment rate for white workers doubled between the fourth quarter of 2007 and the second quarter of 2009, rising from 4.2 percent to 8.4 percent at an average annualized rate of 2.8 percentage points each quarter.

Despite this marked increase, the climb for the African-American rate has been steeper, increasing at an average annualized rate of 4.2 percentage points each quarter, from 8.6 percent at the end of 2007 to 14.9 percent in the second quarter of 2009. The unemployment rate for Hispanic workers has climbed nearly as fast, averaging an annualized growth of 4.1 percentage points each quarter in the recession. Twelve percent of Hispanic workers were unemployed in the second quarter of 2009, an increase of 6.2 percentage points since the fourth quarter of 2007 and 3.6 percentage points higher than whites (Figure 1).

Importantly, these jarring differences by race and ethnicity are not unique to this recession but occur every time the labor market plunges.

Employment losses[3]

The flip side of rising unemployment is falling employment. Nonfarm payrolls have declined in the United States every month since the end of 2007, with more than 6.4 million jobs lost between the fourth quarter of 2007 and the second quarter of 2009 alone. Yet again, minorities have been disproportionately affected by the labor market's downturn, with their employment levels falling at a faster pace than the level for whites. The white employment level declined at an average annualized rate of 2.5 percent each quarter between the fourth quarter of 2007 and the second quarter of 2008, but African-American employment has fallen at an average annualized rate of 3.8 percent each quarter and Hispanic employment by 2.9 percent over the same period.

Earnings[4]

Companies haven't just laid off workers during the recession—they have also instituted furloughs, reduced employees' hours, and given across-the-board pay cuts. While we only examined inflation-adjusted earnings data through the end of 2008, it is reasonable to

assume that 2009 earnings data will further reflect the impact of measures employers have taken to deal with the recession.

The usual median weekly earnings of all three groups increased between the fourth quarter of 2007 and the fourth quarter of 2008, but minorities' earnings have a long way to go before they catch up to whites'. African Americans' usual weekly earnings increased at a slower rate (1.7 percent) than whites' (1.9 percent) during this period, leaving a gap of $156.43 between the two in the fourth quarter of 2008. Hispanics' usual median weekly earnings actually increased at a faster pace (3.8 percent) than whites' between the fourth quarter of 2007 and the fourth quarter of 2008. Nevertheless, Hispanics' usual median weekly earnings were $214.96 less than whites' at the close of 2008.

Income

Incomes, which had already declined in the previous business cycle, took a beating in the first year of the recession. Families overall experienced a larger one-year percent decline in their incomes than any year since 1947.[17] This decline should come as no surprise given the dramatic downturn in the labor market. Yet again, minorities' incomes declined at a faster rate than whites' and fell from lower levels to begin with.

The median income for white families declined by 2.7 percent between 2007 and 2008, while African-American families' incomes fell by 2.9 percent and Hispanic families incomes dropped by 5.8 percent during the same period. The gap between the median income for white families and African-American families had increased by $499 just one year into the recession, to nearly $22,000 (2008 dollars) and African-American families totaled less than two-thirds (61.6 percent) of whites' income. While the difference between the median income of white families and Hispanic families was not as large, this gap also increased during the first year of the recession, growing by $752 to $17,617, meaning that the median income for Hispanic families comprised just over two-thirds (68.3 percent) of the median income for white families in 2008.

Health insurance coverage

The already large disparities between racial groups in heath insurance coverage persisted in the first year of the recession. Health insurance coverage for African Americans and Hispanics increased somewhat between 2007 and 2008 at an average annualized rate of 0.4 and 1.4 percentage points, respectively. Whites' coverage declined by 0.4 percentage points, but they continued to have markedly higher insurance rates than minorities. Nearly 90 percent (89.2) of whites were covered by either private or government-provided health insurance in 2008 compared to just over 80 percent (80.9) of African Americans and slightly less than 70 percent (69.3) of Hispanics.

Retirement savings plans[19]

Not surprisingly, participation in employer-sponsored retirement savings plans declined in the first year of the recession. Minorities remained far less likely to participate in an employer-sponsored retirement savings plan than whites, even though Hispanics' participation rates declined at a slower rate than whites—by 0.3 percentage points and 1.0 percentage points, respectively between 2007 and 2008—while African Americans' participation rate declined at a faster pace than whites'—by 1.5 percentage points between 2007 and 2008. But less than half (45.6 percent) of African Americans and less than one-third (30.3 percent) of Hispanics participated in an employer-sponsored retirement savings plan in 2008, compared to more than half (56.6 percent) of whites.

Poverty[20]

The percentage of Americans living in poverty increased in the first year of the recession. Although the percentage of African Americans living below the poverty rate increased less than the rate for whites—climbing by 0.2 and 0.4 percentage points, respectively—the poverty rate for African Americans (24.7 percent) remained nearly three times as large as that of whites (8.6 percent) in 2008. Meanwhile, the share of Hispanics living in poverty jumped by 1.7 percentage points in the first year of the recession, resulting in a poverty rate of 23.2 percent.

Discrepancies in the labor market remain even when controlling for gender, age, and education[21]

The economic security of different demographic groups is closely related to their experience in the labor market. Anybody will struggle to find economic security for a prolonged period if they don't have or can't hold a good job with good benefits—or any job for that matter.

As previously mentioned, minorities' unemployment rates are persistently higher than whites' and begin to rise more quickly in a recession.[22] This is true even if we control for educational achievement, gender, and age. The data thus indicate that the differences in the employment security of minorities compared to that of whites cannot be fully explained by differences in demographic characteristics, such as age, gender, and education.

Minorities' unemployment rates were already higher than whites at the start of the recession, regardless of gender, age, or educational attainment. The overall unemployment rate for African-American workers stood at 8.4 percent in the fourth quarter of 2007 and Hispanics' at 5.8 percent, while whites' was merely 4.0 percent. The unemployment rate for white workers increased 4.3 percentage points between the fourth quarter of 2007 and the second quarter of 2009. However, minorities' rates grew more, with Hispanics' rising 5.8

percentage points and African Americans' growing 6.4 percentage points. This means that while whites' unemployment rate remained in the single digits (8.3 percent) in the second quarter of 2009, minorities' unemployment levels had jumped to double digits—11.6 percent and 14.8 percent for Hispanics and African Americans, respectively (Table 3).

When we control for gender we see that like the overall workforce, the unemployment rate for minority men has risen much more than that of minority women.[23] But both minority men and minority women have continued to have higher unemployment rates than whites and their rates have increased more than white men's and women's rates. The unemployment rate for white men was just 4.1 percent in the fourth quarter of 2007, while the rate for African-American men stood at 9.2 percent and for Hispanic men at 5.5 percent (Table 3).

The unemployment rate for African-American men has increased 3.7 percentage points more than the rate for white men since the recession began, standing at an astonishing 18.0 percent in the middle of 2009. The unemployment rate for Hispanic men rose 1.1 percentage points more than that of whites during the same period, to stand at 11.7 percent in the fourth quarter of 2009. White men have certainly been affected by the recession, reaching a 9.2 percent unemployment rate in the second quarter of 2009, but minority men continue to struggle more in the labor market (Table 3).

Even among women, who have faired better than male workers in the recession,[24] the unemployment rates for minorities are higher and have increased more than the unemployment rate for white women. The unemployment rate for white women was just 3.9 percent in the fourth quarter of 2007, while 7.6 percent of African-American women were unemployed along with 6.1 percent of Hispanic women. And between the fourth quarter of 2007 and the second quarter of 2009, the unemployment rate for African-American women grew 1.2 percentage points more than that of white women while the share of unemployed Hispanic women increased 2.0 percentage points more than that of white women. Unemployment rates for minority women were therefore in the double digits in the second quarter of 2009—12.1 percent for African Americans and 11.4 percent for Hispanics—while the unemployment rate for white women remained a single digit (7.2 percent) (Table 3).

Older workers enjoy lower unemployment rates than older younger workers in both good times and bad and this is true among whites, African Americans, and Hispanics. It also holds that regardless of age, minorities' unemployment rates are higher than whites' and have grown by a larger amount in the current recession. For example, among workers ages 35 to 44, African Americans' unemployment has increased by 2.0 percentage points more than whites' and Hispanics' unemployment has increased 0.6 percentage points more than whites' (Table 3).

Perhaps the most telling indication of the difference between minorities' and whites' experiences in the labor market is that the gap persists regardless of educational achievement. Generally speaking, the higher one's level of educational attainment is in the United States,

the greater one's sense of security in the labor market will be. Even though the unemployment rate for college graduates, for instance, has increased during the recession, it has remained lower than for workers lacking a high school diploma (Table 3).

Yet even among more highly educated workers, unemployment rates have generally risen faster and reached higher levels for minorities than for whites. For example, the unemployment rate for African-American college graduates grew by 2.3 percentage points more than it did for white college graduates between the fourth quarter of 2007 and the second quarter of 2009. The unemployment rate for Hispanic college graduates grew by 0.4 percentage points more than white college graduates during the same period (Table 3).

On the opposite end of the spectrum, the unemployment rate of minority workers lacking a high school diploma has also grown faster than that of their white counterparts during the recession. The unemployment rate of African-American workers lacking a high school diploma increased by 0.3 percentage points more than that of their white counterparts between the fourth quarter of 2007 and the second quarter of 2009. During the same period, the unemployment rate of Hispanic workers who did not graduate from high school increased by 0.2 percentage points more than the unemployment rate of white workers who did not graduate from high school. And even though the unemployment rate for Hispanic workers who attended college but did not graduate has actually increased less than that of their white counterparts, their unemployment rate still remains higher than their white counterparts, standing at 8.8 percent and 7.5 percent, respectively, in the second quarter of 2008 (Table 3).

While we are only midway through the third quarter of 2009, it's reasonable to assume that minorities' unemployment rates will remain higher and grow faster than whites' in this quarter as well. The most recent monthly data available from the Bureau of Labor Statistics supports this prediction. The unemployment rate for white workers stood at 8.8 percent in August 2009, well below the unemployment rate for the overall workforce (9.6 percent). The rates for African Americans and Hispanics, on the other hand, were considerably higher, standing at 15.0 percent and 13.0 percent, respectively (Table 3).

Again, minorities' unemployment rates remained notably higher than whites' in August, regardless of gender, age, or educational achievement. For example, the unemployment rate for white high school graduates who hadn't attended college was 8.6 percent in August, well below both the 13.5 percent unemployment rate of their African-American peers and the 10.4 percent for their Hispanic counterparts (Table 3).

Table 3: Changes in unemployment rates by race and ethnicity, gender, and educational achievement in the recession

Minorities still have higher unemployment rates when controlling for these factors

	2009-II unemployment rate	2007-IV unemployment rate	Percentage point difference between 2007-IV unemployment rate and whites' 2007-IV rate	Percentage point change in unemployment rate between 2007-IV and 2009-II	Percentage point difference of the group's unemployment rate between 2007-IV and 2009-II and that of the same subgroup of whites
OVERALL					
White	8.3	4	n.a.	4.3	n.a.
African American	14.8	8.4	4.4	6.4	2.1
Hispanic	11.6	5.8	1.8	5.8	1.5
GENDER					
White					
Male	9.2	4.1	n.a.	5.1	n.a.
Female	7.2	3.9	n.a.	3.3	n.a.
African American					
Male	18	9.2	5.1	8.8	3.7
Female	12.1	7.6	3.7	4.5	1.2
Hispanic					
Male	11.7	5.5	1.4	6.2	1.1
Female	11.4	6.1	2.2	5.3	2.0
AGE					
White					
16-19	21.9	13.7	n.a.	8.2	n.a.
35-44	6.9	3.1	n.a.	3.8	n.a.
45-54	6.3	3.0	n.a.	3.3	n.a.
African American					
16-19	39.9	27.3	13.6	12.6	4.4
35-44	12.2	6.4	3.3	5.8	2.0
45-54	9.6	4.8	1.8	4.8	1.5
Hispanic					
16-19	29.6	16.3	2.6	13.3	5.1
35-44	9.0	4.6	1.5	4.4	0.6
45-54	8.5	5.1	2.1	3.4	0.1
EDUCATION					
White					
Less than a high school diploma	13.6	6.8	n.a.	6.8	n.a.
High school graduates, no college	8.5	3.9	n.a.	4.6	n.a.
Some college, no degree	7.5	3.3	n.a.	4.2	n.a.
College graduates	4.1	1.8	n.a.	2.3	n.a.
African American					
Less than a high school diploma	20.7	13.6	6.8	7.1	0.3
High school graduates, no college	13.9	7.3	3.4	6.6	2.0
Some college, no degree	11.7	5.9	2.6	5.8	1.6
College graduates	7.6	3.0	1.2	4.6	2.3
Hispanic					
Less than a high school diploma	13.3	6.3	-0.5	7.0	0.2
High school graduates, no college	9.7	4.6	0.7	5.1	0.5
Some college, no degree	8.8	5.9	2.6	2.9	-1.3
College graduates	5.7	3.0	1.2	2.7	0.4

Notes: Unemployment rates are non-seasonally adjusted. Authors calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009).

The discrepancies in employment experiences by race and ethnicity during the recession persist even when we account for demographic factors, such as age, gender, and education. Structural obstacles contribute to the differential labor market experiences of minorities and whites. The beginning of an economic recovery alone will not necessarily create a level playing field of economic security and economic opportunities for minorities. A strong and sustained recovery is the first condition to create the resources necessary to build such a level playing field. But additional policy measures, such as minority contracting requirements for government contracts, among others, may be necessary to give all families of similar background the same economic security and economic opportunities.

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Minorities are the last to be hired during recoveries and the first to be fired in recessions[25]

Economics literature has long documented that the employment and earnings histories of minorities and whites vary over the course of a business cycle.[26] Specifically, minorities tend to experience greater volatility in their employment than whites. We have already shown that this is the case in the current recession as well.[27] The unemployment rates for minorities have risen faster than for whites. This is the case for almost all subsamples of minorities and whites and thus is not just a result of the individual characteristics of whites and minorities.

The other part of the story is that these differences in job fluctuations are tied to swings in the economy: When the economy turns south, minorities regularly experience larger increases in unemployment rates than whites.

And finally, the evidence also suggests that minorities experience the pain of a recession a little longer than whites. Their unemployment rates may rise earlier, their incomes fall sooner, and their benefits disappear more quickly than whites. The opposite is also true when the economy improves again. Minorities typically have to wait longer than whites to share the benefits of an expanding economy.

Consider the last recession, for instance, which lasted from March 2001 to November 2001. The unemployment rate for African Americans hit its lowest point before the recession in September 2000 at 7.3 percent. The unemployment rates for Hispanics and whites hit their lowest points one month later in October with 5.1 percent and 3.4 percent, respectively.

By the end of the recession in November 2001, the unemployment rate for minorities had risen more sharply than for whites. The unemployment rate for African Americans had grown to 9.8 percent, an increase of 2.5 percentage points; the Hispanic unemployment rate had grown by 2.3 percentage points to 7.3 percent; and the white unemployment rate had increased by 1.5 percentage points to 4.9 percent.

The unemployment rate for minorities also stayed high longer than it did for whites. The last recession was particularly noteworthy since the unemployment rate continued to rise after the recession had ended. Whites and Hispanics finally saw their unemployment rate fall after June 2003. In comparison, African Americans had to wait until October 2003 before their unemployment rate started to drop.

Hispanics saw stronger gains in employment than African Americans after the last recession because much of the job growth during the last recovery was driven by a construction boom, a sector where Hispanics are disproportionately employed. The construction boom has clearly come to an end and the fate of Hispanics in the labor market is thus much more uncertain than after the past recession.

The data for the current recession, which started in January 2008, highlights this particular challenge that Hispanics share with other minorities. The unemployment rate for Hispanics started to rise in April 2007 from a low of 5.2 percent in March 2007 and that of African Americans from a low of 8.0 percent in January 2007.[28] Minorities, especially Hispanics, experienced labor market troubles earlier than whites in this recession.

The positive effect of the construction boom for Hispanics is also reflected in the data on family income. Income for the typical white, African-American, and Hispanic family declined after 2000. For Hispanics, this slide ended in 2003, after the median family income had decreased by 6.8 percent in inflation-adjusted terms since 2000. The income slide lasted an additional year for white families, although their total income loss for the period from 2000 to 2004 amounted to only 1.1 percent. The median income for African-American families continued to fall for another year until 2005 for a total loss of 7.1 percent since 2000.

The end of the construction boom, however, put these trends in reverse. The median income of Hispanic families began to fall after 2006, while white and African-American family incomes started to fall a year later in 2007.

The bottom line is that income declines in a recession tend to last longer and be deeper for minorities than for whites. There can be extenuating circumstances, such as an unprecedented construction boom, that can occasionally dampen these trends. But public policy cannot rely on the luck of unprecedented booms to level the playing field for minorities.

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Policy recommendations and conclusion

Significant discrepancies persist between the economic experiences of whites and minorities in the United States. The last business cycle and the current recession are no exception. These disparities between minorities and whites have been exacerbated since the start of the recession at the end of 2007 after little to no headway was made in the previous business cycle.

Policymakers have focused on moving the United States out of the recession throughout 2009, addressing the plight of families who have lost their jobs, incomes, and homes—and they are also dealing with health care and energy policy reform. This attention is certainly warranted considering the severity of the economic crisis, but policymakers need to also concentrate on the larger economic insecurity of minorities, who have been disproportionately affected by the recession.

But first things first. The economy is still officially in a recession and efforts to end the economic decline will especially help minorities since they have been disproportionately impacted by it. The American Recovery and Reinvestment Act continues to pour billions of dollars into communities across the country to spur employment and economic growth. Policymakers should continue putting an end to massive job losses, creating new jobs for America's unemployed and underemployed workers, and ultimately reducing unemployment to put the country securely on its way to long-term, broadly shared economic growth. Ending the stimulus now would particularly hurt minorities since the economy will likely shrink further and unemployment rise faster than otherwise would be the case.

An economic recovery will take time, and millions of workers, especially minorities, will be out of a job for a substantial period. The median duration of unemployment was 15.4 weeks in August 2009, which is more than three weeks longer than the previous peak in the 1980s recession, and last month one-third of unemployed workers had been out of work and looking for a new job for at least six months.[29] The National Employment Law Project estimates that at the end of September 2009, nearly half a million Americans will exhaust their unemployment benefits, and by the end of 2009 that number will skyrocket to 1.5 million.[30]

The American Recovery and Reinvestment Act extended unemployment insurance benefits for workers who had been out of work longer than 26 weeks to up to 50 weeks.

An additional extension of benefits this fall would go far to help those hardest hit by the recession.[31] Bills have been introduced in both the House of Representatives (H.R. 3404) and the Senate (S. 1647) that would extend the key provisions from the Recovery Act and add 13 more weeks of benefits on top of the weeks added in the act.[32] Minorities could be greatly affected by such a measure, especially as their unemployment rates continue to stand head and shoulders above those of whites.

But addressing the short-term challenges of the Great Recession's fallout is only the first step in a sustained and strong recovery. The experience of the last decade makes clear that structural issues, including labor market segmentation and discrimination, among others, remain in the labor market and must be addressed in order for minorities to begin catching up to whites—especially in terms of employment levels. African Americans' employment levels have fallen at an average annualized rate of 3.8 percent each quarter during the current recession and Hispanics' have declined by 2.9 percent each quarter and whites' by 2.5 percent.[33] We must reverse this trend and see minorities' employment gains at least match if not exceed whites' as we move forward in the recovery.

One step to support this goal would be for policymakers to support the creation of "green jobs" in low-income communities since many of these jobs don't require a college degree but still provide opportunities for advancement and pay good wages.[34] To help combat discrimination that may be placing obstacles in the way of minority workers, active protections for equal opportunity, including antidiscrimination laws, should be in place and enforced in the workplace.[35] Additionally, policymakers should work to improve education from early childhood through high school and strengthen mentoring and high-school based programs that encourage young adults to pursue higher education.[36]

Policymakers also need to create a level playing field on wages and benefits and not just with respect to employment. Minorities' median family incomes and weekly earnings have always lagged behind whites', and they've equaled between just under two-thirds to just over three-quarters of whites' in the recession.[37] Congress could pass the Employee Free Choice Act to give workers more bargaining power with employers by making it easier to join a union. Doing so would also encourage stronger income and earnings growth as well as increased access to and more generous benefits. And Congress could expand the Earned Income Tax Credit, a measure that would directly boost the incomes of lower-income families.

More jobs, better wages, and higher benefits won't fall from the sky. A strong and sustained recovery that benefits all groups of society and helps to shrink the gaps in economic security between whites and minorities requires substantial economic resources. These resources will have to be generated through business investments that fuel innovation and economic growth. That's why another integral step is lowering the costs of doing business, which would make the U.S. economy more vibrant and competitive in the global economy, it easier for employers to hire workers, and to offer those workers the wages and benefits they need to maintain and even improve their economic security.

Unpredictable costs, however, discourage businesses from making increased investments in their companies, including human capital.[38] These uncertain cost components are especially apparent with energy and health care costs.

Energy reform data from the Bureau of Economic Analysis show that large swings in energy prices have a measurable effect on individuals' and businesses' future consumption and investment choices.[39] Policymakers should help create an environment with fewer large fluctuations to help businesses deal with energy price volatility. They can do this by promoting investment in and the use of renewable energy sources—and reducing dependence on imported oil—which could help domestic energy prices become less susceptible to pressures that cause oil prices to spike and plummet.

Similarly, enacting comprehensive health care reform would also lower the cost of doing business. Implementing comprehensive health care reform could both save families money by making the system more efficient and lessen the daunting and potentially crushing strain that rising health care costs places on families, especially the growing share of African Americans and Hispanics—19.1 percent and 30.7 percent, respectively in 2008, along with 10.8 of whites— who lack health insurance coverage.[40]

But economic security is not only tied to income from and benefits at work—it also includes the ability of a family to build wealth. Homeownership remains the most important form of wealth for most American families. A gap of more than 25 percentage points existed between whites' and minorities' homeownership rates as of 2008, and given the ongoing turmoil in the housing market, these level have likely worsened.[41] Additionally, the collapse in home prices and the increasingly stringent lending rules continue to prevent families from accessing credit to the extent they were able to prior to 2007.

As a recent Center for American Progress report pointed out, at the height of the housing boom in 2006 minorities were far more likely to receive a higher-priced mortgage.[42] This analysis of Home Mortgage Disclosure Act data found that 30.9 percent of Hispanic borrowers and 41.5 percent of African-American borrowers were given higher-priced mortgages when borrowing from large banks in 2006, compared to just 17.8 percent of white borrowers.[43]

Further, the report found that among borrowers who earned at least twice their area's median income in 2006, "African Americans were three times as likely as whites to pay higher prices for mortgages—32.1 percent compared to 10.5 percent [and] Hispanics were nearly as likely as African Americans to pay higher prices for their mortgages at 29.1 percent."[44]

Additional examination of lending practices for minority borrowers is more than warranted as we continue to restructure and make changes to the regulation of our financial, mortgage, and credit markets in the coming months and years—particularly as much of their current lending is being financed with public funding. For example, the Center

for American Progress recommends that Congress "establish an independent regulator focused on consumer protections such as the independent Consumer Financial Protection Agency the Obama administration has recommended to prevent recurrence of banking regulators' failures to protect consumers from unfair lending practices."[45]

Families build wealth through employer-provided retirement savings plans, too. But there are large discrepancies in the participation rates in employment-based retirement savings vehicles by race and ethnicity.

Policymakers can take several steps to make it easier for workers to save, including automatically enrolling all eligible workers and letting them decide to opt out of a savings plan if they choose. Another step would be adding progressive savings incentives, so that workers who have the hardest time saving on their own due to low incomes get the most public help in saving for retirement.[46] Finally, policymakers can help to lower the costs of saving for retirement, which can add up to substantial amounts over a career, by increasing competition in the market for retirement savings plans.[47]

As we approach the end of 2009 many areas of the economy continue to be vastly different—and commonly worse off—than they were at the start of the recession nearly two years ago. The recession that began in December 2007 followed a business cycle of lackluster employment, income and earnings growth, and declining benefits coverage and homeownership for many Americans.

Policymakers' to do list is long and growing as the nation attempts to move beyond this economic low point. However, addressing the disparities between minorities' and whites' economic experiences should be added to that list. Without making a renewed and committed effort to address these disparities African Americans and Hispanics will continue to have less economic security than whites and be more susceptible to fluctuations in the economy. In short, policymakers must do more than simply hope that minorities rise alongside whites in the coming years. For the benefit of minorities and the overall economy, a prosperous expansion should include all Americans and ensure everyone reaps the benefits equitably.

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Endnotes

1 The data sources used for this paper have here have different categorizations, but the authors did their best to keep the data comparable over the years.

2 Arloc Sherman, "African American and Latino Families Face High Rates of Hardship" (Washington: Center on Budget and Policy Priorities, 2006).

3 All unemployment rates in this section are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009).

4 All employment data in this section are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Employment Statistics" (Washington, 2009).

5 All earnings data in this section are in non-seasonally adjusted terms. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009); and U.S. Department of Labor, Bureau of Labor Statistics, "Updated CPI-U-RS, All Items and All items less food and energy, 1978-2008" (Washington, 2009).

6 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

7 Ibid.

8 All groups saw increasing Medicaid coverage rates during the last business cycle, highlighting the increasing reliance on public support during times of growing private economic insecurity. The levels of reliance on Medicaid, though, varied sharply between whites and minorities. The Medicaid coverage rate for African Americans rose from 21.7 percent in 2000 to 23.8 percent in 2007, but this increase was not enough to compensate for declining private health insurance coverage for African Americans. In comparison, the Medicaid coverage rate for whites rose from 7.1 percent in 2000 to 9.0 percent in 2007.

9 Authors' calculations based on Purcell, Patrick, "Pension Sponsorship and Participation: Summary of Recent Trends" (Washington: Congressional Research Service, 2009).

10 Authors' calculations based on DeNa U.S. Bureau of the Census, "Housing Vacancies and Homeownership (CPS/HVS)" (http://www.census.gov/hhes/www/housing/hvs/hvs.html [August 27, 2009]).

11 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

12 Authors' calculations based on seasonally adjusted employment data from the U.S. Department of Labor, Bureau of Labor Statistics, "Current Employment Statistics" (Washington, 2009).

13 All unemployment rates in this section are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009).

14 All employment data in this section are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Employment Statistics" (Washington, 2009).

15 All earnings data in this section are non-seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009) and U.S. Department of Labor, Bureau of Labor Statistics, "Updated CPI-U-RS, All Items and All items less food and energy, 1978-2008" (Washington, 2009).

16 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

17 Heather Boushey, "Family Income Free Fall" (Washington: Center for American Progress, 2009).

18 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

19 Authors' calculations based on Purcell, Patrick, "Pension Sponsorship and Participation: Summary of Recent Trends" (Washington: Congressional Research Service, 2009).

20 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

21 All data in this section are non-seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009).

22 Mark McArdle and Valerie Rawlston Wilson, "2008 Annual Jobs Report: A Review of 2008 with a Glance at the 2009 Economy and Beyond" (Washington: National Urban League Policy Institute, 2009); and Rakesh Kochhar, "Unemployment Rises Sharply Among Latino Immigrants in 2008" (Washington. Pew Hispanic Center, 2009).

23 Heather Boushey, "Interactive Graphic: Equal Work Without Equal Pay" (Washington: Center for American Progress, 2009) available at http://www.americanprogress.org/issues/2009/09/august_gender_interactive.html.

24 Ibid.

25 All data in this section are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009).

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27 Rakesh Kochhar, "Latino Labor Report, 2008: Construction Reverses Job Growth for Latinos" (Washington: Pew Hispanic Center, 2008).

28 Only the 12 months before the start of a recession are considered. The unemployment rate for Hispanics was actually lower in October 2006 with 4.6 percent. The early rise reflects the mounting troubles in the construction sector starting in 2006.

29 U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" Washington, 2009).

30 National Employment Law Project, "Talking Points: Immediate Action Needed to Extend Unemployment Benefits" (Washington, 2009).

31 Heather Boushey, "A Good Job is Hard to Find" (Washington: Center for American Progress, 2009).

32 Ibid.

33 All unemployment rates are seasonally adjusted. Authors' calculations based on U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009).

34 Alexandra Cawthorne, "Weathering the Storm: Black Men in the Recession" (Washington: Center for American Progress, 2009).

35 Ibid.

36 Ibid.

37 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009), seasonally adjusted data from the U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey" (Washington, 2009); and U.S. Department of Labor, Bureau of Labor Statistics. 2009. "Updated CPI-U-RS, All Items and All items less food and energy, 1978-2008." Washington.

38 Amanda Logan and Christian E. Weller, "Signals on the Fritz: Energy Price Volatility Impedes Investment by Creating Uncertainty" (Washington: Center for American Progress, 2009).

39 Ibid.

40 Authors' calculations based on Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Poverty, Income, and Health Insurance Coverage in the United States: 2008" (Washington: U.S. Bureau of the Census, 2009).

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42 Andrew Jakabovics and Jeff Chapman, "Unequal Opportunity Lenders: Analyzing Racial Disparities in Big Banks' Lending" (Washington: Center for American Progress, 2009).

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44 Ibid.

45 Ibid.

46 Gene Sperling, "A Progressive Framework for Social Security Reform" (Washington: Center for American Progress, 2005).

47 Christian E. Weller and Shana Jenkins, "Building 401(k) Wealth One Percent at a Time: Fees Chip Away at People's Retirement Nest Eggs" (Washington: Center for American Progress, 2007).

Chairman TOWNS. Thank you very much.

Let me thank all of the witnesses for their testimony.

Let me begin with you, Dr. Weller, and then come back to Mr. Carr.

As we work toward economic recovery, certain minority groups are being left behind at a shockingly disproportionate level. Why is this occurring?

Mr. WELLER. Well, I think we are still trying to understand some of these problems. But, as I said in my testimony, there is a whole range of what I call structural problems. As Mr. Carr already indicated, discrimination is certainly one part of it. Segmented housing markets and lack of access to adequate transportation plays a role. Unequal access to education tends to play a role. There is a whole host of obstacles for minorities to participate equally in the labor market and I think we need to take a larger view of this.

Let me give you one example. I think in the past we just simply crossed our fingers and said like, well, OK, if job growth happens, good things will come out of it. But if you look at the data from 2001 to 2007, Hispanics, for instance, had stronger job growth than, for instance, African Americans or Whites. But what happened was those were often very low paid jobs with a lot of insecurity and very low levels of benefits.

So, job growth by itself does not necessarily create a good level playing field for minorities. We do have to address the unequal access to good jobs and I think that has to happen through structural policies. For instance, by passing the Employee Free Choice Act to make it easier for people to join a union.

Chairman TOWNS. Thank you very much, Dr. Weller.

Mr. Carr.

Mr. CARR. Sure. I would agree with all of those statements and just add that those structural problems go beyond just education. They also include mobility, and physical mobility. The ability to access areas where employers are hiring.

And when I say that, I talk about the fact that it is important to recognize how highly segregated African Americans are, and Latinos as well, and, therefore, isolated from the growth opportunities.

So, it is the structural in terms of the education, the training, the marginal jobs that they hold which are many of the first eliminated when the economy turns down. But it is also economic mobility and it is one of the reasons why purging and breaking the back of discrimination in housing is so important so as to allow individuals to actually access opportunities for which they are prepared right now. They simply just cannot live in the neighborhoods of their choice.

And let me just build on that because one of the things that is interesting about this foreclosure crisis is it is going to create ripple effects in terms of lack of access. So, for example, it is unfairly damaging the credit scores of individuals who were prepared for home ownership and now have lost their homes because of predatory products. And, as you know, credit scores are now used for everything from getting a home to getting a job. And, in addition, much of the wealth has been stripped from Black and Latino neigh-

borhoods which now enhances or further erodes their ability to actually move to areas of opportunity.

So, there are multiple repercussions of the current crisis.

Chairman TOWNS. Thank you very much.

Let me just sort of switch to you, Dr. Skinner, I mean Mr. Skinner. I want to call everybody Doctor this morning for some reason. I guess because the problem is so serious.

To all witnesses, but I will start with you, Mr. Skinner. Are the current recovery initiatives targeted enough to help the communities that really are affected by this most? Are they targeted enough?

Mr. SKINNER. Well, the Recovery Act included a host of dollars going to different programs, including some programs like the extension of unemployment, food stamps and so forth that, I think, for the most part probably did target a number of minority communities.

On the other hand, more of the jobs-related, the programs that are related to construction jobs, for example, and transportation and, in my area, in housing, those, as one of my colleagues indicated, are probably not likely to be the areas where there are a concentration of minorities where minorities really have access to those jobs.

So, I think we can probably do a better job in terms of things like training programs and so forth to make sure that the minority communities in fact have access to the jobs that will be created through the recovery program.

Chairman TOWNS. Thank you very much, Secretary Skinner.

I now yield to the ranking member, Congressman Issa.

But before I do that, let me just make an introduction. We have with us today from the Job Corps Chanika Disney. She is here. Raise your hand. And, of course, Thomas Ash is also with us and, of course, Sherrie Jonas is also with us. Thank you for attending, the Job Corps, and now I yield to my colleague.

Mr. ISSA. Thank you, Mr. Chairman.

Secretary Skinner, the stimulus that was passed out of Congress here earlier this year, the Recovery Act, is covered under Section 3 for hiring and reporting. Do you feel that it is being strictly adhered to? In other words, could it be doing more to ensure that the numeric reporting and hiring is being strictly adhered to so that the stimulus would get into the minority communities and employ in the minority communities?

Mr. SKINNER. Well, I mean I can only speak for what we are doing in Maryland.

Mr. ISSA. Just speak to Baltimore. I am happy. [Laughter.]

Mr. SKINNER. In terms of the reporting, you know, we are just starting to actually get the Recovery Act money out on the street to hire the workers, for example, in the weatherization program. We have $60 million in the weatherization program. We have set up both training programs and programs working with our community colleges to target certain communities in terms of the ability to identify folks who are unemployed, underemployed, that we can sort of target into those jobs.

And, I think so far, in terms of what we have done in particular, I believe that it is working. It is working well. The reporting re-

quirements are just kicking in. The first report is due to OMB on the job creation numbers on October 1st, and we have, in fact, created several hundred jobs at this point, the majority of those, at least in Maryland, again, and in Baltimore, have been to minority hires.

Mr. ISSA. Mr. Carr, could you maybe make it a little broader. Nationally, is that an area, a shortfall, that in fact Congress has mandated that all of our spending covered by Section 3, but particularly the stimulus, disproportionately, or at least proportionately, be targeted and historically that has not been the case. What about this time?

Mr. CARR. Congressman, to my knowledge the best analysis of this subject was performed by the Corwin Institute at Ohio State University that focuses on race and poverty. And they make an excellent review of the bill.

One of the things that they highlight is that when you look proportionally at the types of jobs that are likely to get funded with the Economic Stimulus Package, and then look at the types of jobs historically occupied by people of color, you see that there are vast variations by race ethnicity.

And the point that they make is that, without specific targeting to specific neighborhoods, to specific communities, you just will not achieve any significant disproportionate increase in employment among disaffected minority——

Mr. ISSA. So, if I can followup, what I think I hear you saying is that even though Section 3 of the HUD act may be in use, ultimately, if the type of money in this or future stimulus is not targeted to those communities of highest unemployment. We can comply, but we are going to comply with jobs that tend not to benefit those communities.

Mr. CARR. That is right. And what they point out is a host of support mechanisms also needed in order to create and sustain jobs and that is job training, basic education, access to jobs and creation of jobs in the green economy which are sustainable jobs.

So, one of the points that they make is there is a difference between a job that pays you today and a job that pays you in the future. So, the recovery spending could stand a lot more targeting around jobs of the future, targeted on neighborhoods that are most disaffected and specifically around communities of color because there is not any specific targeting in that way that would lead that money——

Mr. ISSA. Following up one more time before I run out of time. What I think I hear you saying is, if we do another round of stimulus, we probably would be better off having a year's worth of training for people who are unemployable for the current jobs as a disproportionate amount of the stimulus.

In other words, spend that year and those dollars getting people able to take the job the next year, not simply find some "we piddle around" jobs for them to do for 1 year the way we are right now at our National Parks, where we have a huge amount of money, but it is just going to cause people to put hats on for the summer and then they are back to where they were. Is that a fair assessment?

Mr. CARR. I would say a more coordinated training program. Some might last a year, some might last longer, but some might last a significantly less amount of time to gear up people for more sustainable jobs.

Mr. ISSA. Dr. Weller, I am going to take issue with one thing. I just want to understand, from a standpoint of today's hearing, dramatically increasing unionization in the inner city of hardcore unemployed individuals who lack skills is going to, in fact, benefit them? Is it not true that, in fact, if you want to create enterprise zones and bring people into the inner city, you have to attract people by competing favorably and if I heard you, you were simply saying unionization is a panacea?

If that is the case, then auto, steel and rubber would not have, in fact, left Cleveland, Pittsburgh and the cities where I grew up where that used to be an alternative but they have gone to the non-unionized areas of the country and left behind my friends and classmates unemployed in Ohio.

Mr. WELLER. Well, there is——

Mr. ISSA. I am not disagreeing with your unionization pitch. I am just saying as to getting jobs to the urban America for minorities——

Mr. WELLER. There are many examples of good unionized companies. Harley Davidson, Southwest Airlines, Boeing, many of the television stations are unionized companies that do extremely well.

The evidence, though, rather than talking about individual cases, if you look at the literature from the World Bank and you look at the economics literature, generally, unionization tends to go along with higher benefits, better benefits. It also tends to go with stronger productivity, largely because unions create a channel between employers and employees to talk about professional development and training.

Mr. ISSA. I have to stay on subject, "The Silent Depression: How Are Minorities Faring in Economic Downturn?" We are trying to focus on that today. I certainly want to focus on the economic model, but I just want to know, are you, how would you equate that to getting, encouraging people to make investments in areas and job training and new employees that historically they have not? Is it not true that, in fact, although unionization has its place, it has not been a panacea for these communities?

Mr. WELLER. Well, generally if you look at the data for minorities when it comes to unionization it is actually a huge bonus. In particular, Hispanics tend to gain the largest from unionization rates, specifically with the aspects of training.

If you look at the construction industry, where Hispanic men, for instance, are disproportionately represented, they tend to have successful training programs, long-term stick training programs. They have the ways to bring people from unskilled jobs into a career track in that industry.

Mr. ISSA. Mr. Carr, my time is up, but you look like you want to answer your view on how we might encourage urbanization, urban employment in the future.

Mr. CARR. Yes, I think that one of the things that we should be doing is gearing up much more aggressively for jobs of the future in a green economy. We have talked a lot about it, but I believe

we are a long way from having actually identified what those growth sectors are and thought through how to connect communities, disenfranchised communities, to the job training and the education that is necessary to promote that.

And many of the most distressed communities in America are the areas in which some of the most important green investments should be made. They have been overlooked. They are struggling with deteriorated infrastructure, Brownfields and other things.

So, I believe a much more coherent policy around green jobs is essential and specifically focusing on what is the job training and the technical skills needed to employ individuals as well as, I will add, to actually own those jobs in the future. Not just to have a job, to own jobs which would also lead to promoting small business lending. So, it is not all about bringing companies in. It is about incubating and building jobs.

Chairman TOWNS. The gentleman's time has long expired. [Laughter.]

The gentleman from Texas, Congressman Cuellar.

Mr. CUELLAR. Mr. Chairman, thank you very much for having this meeting. I certainly want to thank our witnesses for being here.

I agree, when you look at the numbers, they certainly are a telling story. White unemployment is 8.8 percent, Hispanic unemployment is 13 percent, African American unemployment is 15 percent. You go with the same numbers. Also, one of the areas that I always look at is the dropout rate in our schools.

In Texas, if I can use Texas as an example because I used to do the budget there for both public and higher education, for students to go in the ninth grade and as soon as they get to the 12th grade for Anglos or for Whites it was 27 percent dropout rate. For the African Americans, there was a 34 percent dropout rate. And then for the fastest growing minority in the State of Texas, the Hispanics, there was a 49 percent dropout rate. So, you have those large numbers who are dropping out.

We are looking at current situations here but if you look at what is happening in our schools, then we can see that if we do not make some of those long-term and certainly some of the short-term structural changes, we are not going to get out of this particular situation.

My question is, and I know that the family, parents have a role in making sure that our kids go out and go get an education and become productive citizens, and I know the role of the private sector, I am a big supporter of that, but looking at the Federal Government, could you all give me three things that are doable? You know, keep in mind, let us say that we want to get a good friend like Mr. Issa on board, something that is doable, because I know that some of the things are very difficult.

What could we pass here in a bipartisan way that is doable? Could you all, Mr. Secretary, we will start off with you, could you give me three things that Congress could do to help address this; whether it is short term or long term, whether it is structural changes. Same thing, Mr. Carr and Dr. Weller, or whoever wants to go first.

Mr. WELLER. I am not sure whether I can say three things, but I think one of the education outcomes are intrinsically linked to housing situations, stability of housing. So, I think focusing on stopping the foreclosure crisis, the sharp rise that we have seen in foreclosures, and ultimately maintaining equal access to sustainable housing solutions, I think, is ultimately going to feed into better education outcomes.

That goes back to what Mr. Carr and I have been saying about leveling the playing field through access to lower cost and sustainable mortgages, for instance. I think those kinds of financial regulations can ultimately feed into a more stable housing situation and more stable education outcomes.

Mr. CARR. I would say that there are three things. One is, and I will go back to something that Congressman Issa said when he started his conversation about education being the primary tool for upward mobility which I completely agree with. But what I would say is this issue of concentrated property in segregation is really important.

The Pugh Charitable Trust just released a study which really was mind-boggling. It concluded that individuals who live in high-concentrated poverty areas, even if they are middle or upper income, have a 50 percent chance for their children to experience downward mobility compared to people who are living in areas with low concentrated poverty. And concentrated poverty was defined as simply 20 percent or more.

They found that between 1985 and 2000, almost half of African Americans lived in neighborhoods with more than 20 percent concentrated poverty, which predisposes them heavily to downward mobility. That compares to 1 percent for non-Hispanic White households.

So, dealing with this issue of residential segregation is really important and it is often missed in conversations on the economy. But it is absolutely essential. And it costs us nothing except to regulate fairness in the system.

The other thing I would say is that I completely agree on the issue of connecting housing policy and education policy and I have written about it pretty extensively in my testimony. I believe particularly in an area of scarce resources, now is the time to actually leverage our investments in housing and in education so as to make sure that when we are spending on those expenditures, including transportation policy, that we are doing so in a way that gives adequate access to all three of those resources so as to promote economic development. And as I said, in my testimony I have discussed it at some length.

And the third thing, I would go back to small business development. Most people think of big corporations and Fortune 500's, but most Americans do not work for Fortune 500 corporations. So, helping individuals become more entrepreneurial, I think, is one of the easiest steps to promoting economic vibrancy in distressed communities. And that means opening the doors to finance individuals who are already qualified, as well as giving additional training and support to individuals who could be qualified with little additional help.

Mr. SKINNER. I agree with my colleagues and just want to add that I think transportation is also very important in that mix. The nexus of housing, education, and transportation in terms of access to better opportunities, community access to jobs, and educational opportunities all kind of fit together.

Mr. CUELLAR. Thank you. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much, gentleman from Texas. Mr. Luetkemeyer from Missouri.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I would like to start with Mr. Carr this morning. You mentioned the Community Reinvestment Act, I believe, in your testimony. Otherwise, I think I picked up something like that. I was just kind of curious. The Community Reinvestment Act has been around for about 30 years and is supposed to be intended to help folks in disadvantaged areas of their cities and their communities to be able to have access to credit.

What has been your experience? Has it been working? Does it need to be tweaked? Is it a total disaster? Is it a monumental success? Where would you classify it and what kind of grade would you give it and where would we need to go to improve it or do something different?

Mr. CARR. Sure. Thank you for the question.

I think that law is one of the most critical laws on the books to ensure fair access to safe and sound credit. And one of the things that I think is important in this current foreclosure crisis is to recognize that, according to the Federal Reserve Board, only 6 percent of these high-cost reckless loans that were the center of this foreclosure crisis, 6 percent were attributable to loans that were regulated under CRA. The vast majority, almost 95 percent, were non-CRA regulated. And so I think that speaks volumes about the power of that law to make sure that lending is done in a safe and sound way.

What I would say, however, is that a major weakness with the law is actually not the legislation itself, it is the enforcement of the law, which was very poorly enforced and, in fact has, going beyond the poor enforcement, has a lot of loopholes and exceptions and opt outs and, again, in my testimony I go through those.

So, for example, lots of financial institutions that are covered under CRA get to choose, almost like they get to choose their regulators, they get to choose which products they actually report under CRA. This makes no sense at all. So, it allows them to establish affiliates and do the same kinds of reckless things that Wall Street firms were doing, and implode not just the credit markets, but destroy the wealth of American communities. So, we need to eliminate those.

We need to bring under control of CRA institutions, the full range of institutions, bring under control credit unions, bring investment banks, bring all these institutions under, at a minimum to report what and how they are doing things because one of the things we have found is that when you shine a light on misbehavior, a lot of that misbehavior ends right there.

So, a big part of expanding CRA is to expand the data that we are looking at so we can be able to better understand and detect where disparities are occurring. And so we can eliminate a lot of

the debates that happen back and forth as to is discrimination occurring, no your statistics say this, ours say that, but you are not including credit score. Let us eliminate the debate. Let us put good data in place. Let us regulate those institutions in law and then let us require that the financial regulatory agencies actually do their jobs, which is not happening now.

One of the reasons, I was just going to say, the Consumer Financial Protection Agency, one of the reasons we are very strongly supportive of that and supportive of including CRA in that entity, is so that you will have an agency whose whole focus and mission in life is to focus on making sure that consumers get products that help to promote their economic mobility.

It seems that the financial system should be all about promoting the economic mobility of the American public. But instead, it really is about, and has been for now increasingly a decade, making profits regardless of what the impact is on the American public. And those days really must come to an end.

Mr. LUETKEMEYER. OK, my question is going to be, where is the, you know, your criticism is that it is not being enforced correctly and where do we need to go to get that more well done? I assume you said that to the new regulatory agency. Do you want to empower it? Is that, do I understand you correctly?

Mr. CARR. That is right. It is currently under the authority of the Federal Reserve Board.

Mr. LUETKEMEYER. Right.

Mr. CARR. And, similar to their authority under the Homeowner Equity and Protection Act, which was enacted in 1994, and the final regulations were not issued until 2008, it is the same kind of regulation for the Community Reinvestment Act where it is lax oversight and not significant review of banks.

For example, 97 percent of all financial institutions get a passing grade under CRA. But 10 million American households are unbanked and as many as 40 million are underbanked. So, how can we have all banks doing such a great job?

We are in the middle of the worst financial, the worst housing crisis since the Great Depression, yet 97 percent of the banks are passing their ratings right now. And there are no fair lending or discrimination cases that have been brought forward by those Federal agencies in the middle of this crisis wherein everyone knows unfair and deceptive lending in minority communities against persons of color is a major cause of the origins of this crisis.

Mr. LUETKEMEYER. OK, thank you. I can see that I have to ask shorter questions here.

Chairman TOWNS. We will give you a second round, OK? We will give you a second round.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. Thank you for conducting this hearing.

Secretary Skinner, as noted in your opening statement, the State of Maryland reacted to the foreclosure crisis by passing legislation in 2007 including the Homeownership Preservation Task Force and the Homeowners Preserving Equity Initiative. Despite these pro-

grams, Maryland was recently ranked as having the 12th highest rate of foreclosure in the Nation.

What is working and not working within Maryland to prevent foreclosures and at what point are your hands tied in providing assistance to troubled homeowners? Essentially, is there a certain point where the State can no longer help, but instead aid must come from the Federal Government or the lending institution itself?

Mr. SKINNER. Thank you for your question. I think, first of all, that we in Maryland have really done a terrific job in focusing on the issue and putting tools in place to help homeowners to stay in their homes.

We started out by funding a network of housing counseling agencies. We advertised to get people who were behind in their mortgage to come forth and set up a hot line that they could call. And through that hotline we referred them to this network of housing counseling agencies to help provide advocacy for them in working with these services in trying to get their loan modified.

I think that program has been very successful. We have counseled over 12,000 families over the last year and a half or so. We have actually saved and can document close to 7,000 families from going into foreclosure.

What is happening now, and certainly we are troubled by what we see, is the increase in the number of foreclosures in the State, but we really attribute that more to what is happening in the larger economy as opposed to what was happening originally and that is the subprime mortgages that were adjusting where the payment went up and so forth.

But now, people are losing their jobs. People are getting cut back on overtime, they are losing second jobs and you know that margin is enough to make them not be able to pay their mortgage. So we are starting to see that effect. In fact, the mortgage bankers' data shows that prime mortgages are now, the majority of the foreclosures have gone from the subprime to prime mortgages. And again, I think that can be primarily attributed to the unemployment or reduction of income through various sources.

Mr. CLAY. Well, that will take me to my next question for Mr. Carr and Mr. Weller and each of you can try to answer it.

According to recent reports by the Center for American Progress, the foreclosure crisis is estimated to affect close to 9 million homeowners over the next 4 years. An additional one in eight mortgages are currently delinquent or are in the process of foreclosure. That statistic does not include a number of homes that are in default but have not reached foreclosure status.

The magnitude of the foreclosure crisis has gone beyond the realm of the subprime predatory lending market and has affected homeowners with prime mortgages who have lost jobs and income. What practical policy measures are needed to establish a floor for home foreclosures and slow the rate of the crisis? And, are loan modification programs working?

Dr. Carr, you try to answer as briefly as possible and then we will get Mr. Weller to also respond.

Dr. CARR. Sure. The loan modification programs are not working largely because servicers and incentives, financial incentives, are at

odds with both the investors and the borrowers. And so, despite the fact that the Making Home Affordable Program has a number of incentives, those incentives do not begin to rival the financial incentives the servicers have to taking a loan into foreclosure.

Most servicers get a fee based on the outstanding principal, I mean, based on the total loan volume that they are servicing. So, for example, one of the things that is not done is forgiving principal balances. That is one of the major things that would create a sustainable loan but it is done in less than 10 percent of all cases.

I say it is out of step with the interests of the investors because the loss of severity now in foreclosed loans is more than 60 percent. The loss is 10 times greater on a loan that goes to foreclosure versus that modified. So we need some sticks.

One of the sticks would be to reform the bankruptcy code, as least on a temporary basis, to allow consumers to go to Bankruptcy Court to deal with that problem. That would serve as an incentive not just for those who actually go, but it would serve as an incentive for servicers to understand that a third party will have an opportunity to modify the loan in a reasonable way if they choose not to. So, that is one of the quickest things, I think, that could be done.

Beyond that, I would just say that a nuance problem with this crisis is that more than 60 percent of the foreclosures now are actually being driven by unemployment and loss of income which makes modification much more difficult, and that suggests an even broader role for Federal intervention.

Mr. CLAY. Thank you.

Dr. Weller.

Mr. WELLER. Well, I think clearly that bankruptcy reform is the first step. I think that is the quickest way of wielding that stick that Mr. Carr talks about.

But I think we are losing a little sight of the fact that we now have a credit quality problem and that is largely driven by what we see in the labor market and that requires us to focus on strong and good job growth, that means continuing the stimulus, extending unemployment insurance benefits, but then also making sure that we make sure that the new jobs that are created are good jobs either through job training programs, through a higher minimum wage, through earned income tax credits, and through an easier way to join a union.

Mr. CLAY. Thank you so much.

Mr. Chairman, I yield back.

Chairman TOWNS. Thank you very much.

I now yield to the gentleman from Ohio, Congressman Kucinich.

Mr. KUCINICH. Mr. Chairman, thank you very much for holding this hearing.

I think it is really important to ask how minorities are faring in the economic downturn because those of us who represent constituencies of many different races and ethnic groups have seen the pervasive effects of policies on Wall Street. There is a certain amount of unemployment that is necessary for the proper functioning of the economy, which has seen the systematic discrimination against people of color on lending issues, it goes back a few generations.

And now we are starting to see the effects of economic policies that, for those who have generally been struggling at the lower end of the social economic strata, this economy has increased its brutality.

I just want to go back over some territory here, Mr. Chairman.

Many of you will remember, especially those of you who started in politics many years ago, there was systematic redlining going on, that all across America there were people who did not get access to loans. And it was because it was based on color more often than not. When that was discovered, the Community Reinvestment Act was brought forward.

Now, when I was mayor of Cleveland, we were one of the first cities to use the Community Reinvestment Act to force lending institutions to put money back into the communities it got the money from. Because communities were being strip-mined. People would put their money in local institutions, and then those local institutions would take their money not only out of their community, but out of the country. And people would wonder, why could we not get money to fix up our homes or to fix our businesses? This was going on.

So, the Community Reinvestment Act passed. But then a few decades later someone figured out, well, they could increase their community reinvestment profile with subprime loans. And they shopped those subprime loans in the black community in Cleveland. And they did it in a way that was extraordinary because when the subprime loans finally went belly up, you had vast areas in neighborhoods across my community where people lost their homes.

Now, let me speak to this for a minute from a personal standpoint. I grew up in a family of seven children. My parents never owned a home. We were renters. And we kept moving as the family expanded.

There was a lot of discrimination against big families who were renters because, if you did not own a home and you rented as a family group, people would just, they would even have ads in newspapers that said two children only. We had seven. So we kept moving as the family expanded. My parents could not afford a home. We ended up living in 21 different places by the time I was 17, including a couple of cars.

I understand what that dream of home ownership is about. Because the biggest day in my life came when I was able to have my own home. I understand what it is like for people who finally say well, this is the biggest day in our life as a family. We are going to finally have our home.

And then they find that dream is just pulled out from under them by somebody who is gaming the system and making a lot of money on it, and then the people lose their home as a result and then they are thrown into a rental market where they are paying more money often for substandard housing.

So, you have a housing crisis as part of the economic crisis. You have a massive unemployment crisis. Unemployment in the inner city, I would guess, Mr. Chairman, that we do not even know what it is, because people stop reporting. I was in my sister Marcia Fudge's District for a Labor Day parade and people were calling

from the street corners, "Hey, help me get a job." I would venture to say that in some areas of the inner city the unemployment is probably over 30 percent.

So, there is talk about a recovery. For whom? Who is recovering? Wall Street? Jobless recovery? What is a jobless recovery? I want someone to tell me, what is a jobless recovery? We have at least 15 million Americans out of work. You have massive numbers of people who are underemployed. And it is hitting the communities of color the hardest.

So, we need to penetrate the truth of what is going on here and call it for what it is, a systematic economic discrimination. And if we do not address it here, we cannot address it for anyone.

Mr. Chairman, we need a massive job program, put all of America back to work, and I am still a believer that a rising tide lifts all boats. But this tide, at this point, is not coming back.

Mr. CUMMINGS [presiding]. Thank you very much.

Let me just ask this. Dr. Weller, you know, we are in this health debate right now trying to get health insurance and take care of the American people. And whenever I go to a meeting where I have a majority of African Americans and I ask them this question, how many of you all have attended a funeral or know of someone who died within the last year who, when you walked out of the funeral, you said to yourself "they should not have died, if they had had health insurance" or "if they had been treated properly they would still be here." I guarantee you that I have never gotten less than 70 percent of the people to raise their hand. Ever. And I ask that question all the time.

How important do you see this health insurance, health reform debate, I mean, this getting health insurance for folk?

It is interesting; just let me throw this out. In the movie "Sicko," one of the things that they said in that movie that I will never forget, they said if you can leave some people hopeless, helpless and unhealthy, you do not have to worry about them rising up. And there will always be a divide between those who have and those who have not.

And with that, would you answer that question?

Mr. WELLER. Sure. I think health care reform is critically important on many levels. The first one is, if you reform health care, meaning you make the system more efficient, you increase coverage, you actually reduce the cost increases, you do a number of things. The first thing you do is you improve economic security because people have to worry less about losing their homes, losing their limited savings, if there is a health emergency. So that is the first step.

The second part is it will ultimately help to create more jobs because you make the cost of health care substantially more predictable and that is one of the things that entrepreneurs are looking at, the predictable costs of business into the future. So, by reining in the cost increases of health care, I think you are ultimately going to boost job creation through business creation.

And, ultimately, you free up some resources at the government level, both at the State and the Federal Government level, because you are putting the government on the path to fiscal responsibility

and thereby can focus on other priorities such as wealth creation, such as education and so on and so forth.

Mr. CUMMINGS. Dr. Carr, when you appeared before the Joint Economic Committee a month or two ago, you spent some time talking about foreclosure and this issue of bankruptcy reform. You are of the opinion that, and it sounds like you still are, that is the way to go.

Does that really help people? Secretary Skinner and I had a forum, we have done it twice now, and it seems that we have been able to help a lot of people, literally hundreds, by bringing them together with their bankers. But we started running into problems when people have no job.

I think somebody else, I think it was Dr. Weller, one of you all said that. And so, when you have the person who has no job and is just getting unemployment benefits, do you see that as a source for them? I mean, does that work?

Mr. CARR. That is a really good question. It is a difficult sort of crisis which we are heading into because, even though the bulk of these foreclosures now are unemployment, it is worth recognizing that we have a whole new generation of problematic loans that will begin to reset next year called Pay Option and Interest Only.

So we are not out of the woods on the old fashioned product driven foreclosure. We are just sort of, in some respects, in the eye of a hurricane. We are in a new phase, and the old phase is about to come back with yet a new generation.

Let me go to that question. The reason I say we need more than bankruptcy is you are correct. Some people will lose their jobs but they will only lose their jobs for a month or two or three, not everyone will be long-term unemployed.

We need a program that actually provides some type of moratorium as a bridge for people who are temporarily unemployed rather than having them thrown out of their houses during unemployment. And rather than focus on them being reemployed, they are focused on what do they do about this foreclosure that is pending. So we need a bridge, a moratorium for foreclosure.

In other cases, people who are long-term unemployed for whom, you just cannot help them. Well, we need some type of rental intervention. Because one of the problems with the economy is not just the foreclosures, it is the loss of the value of the home that comes as a result of using foreclosure as a trigger for abandonment of that home.

So, we need to find a way to keep people in their homes so that we are not having a twofold impact from the foreclosure of destroying home prices further because that is the real heavy hammer on this economy and on individual wealth.

And then finally, we need a program that is more comprehensive, that gets those toxic loans out of the bowels of financial institutions. Because that is why they are continuing to fail, despite the fact that it is estimated that we are standing, the American taxpayers are standing, behind those financial institutions with $23.7 trillion. That is the estimate by the Special TARP Inspector General. And they are still failing.

So, we need a way to pull those toxic assets out and, unfortunately, it cannot be voluntary now. We need a process that literally

does that so that we can modify those loans in a sustainable way because we have millions more on the horizon.

Mr. CUMMINGS. Thank you.

Mr. Tierney. I see my time is up.

Mr. TIERNEY. Thank you, Mr. Chairman.

Mr. Carr, just to followup on what you were saying. Do you have a vision on what that rental program would look like in the instance where you cannot save the foreclosure necessarily, but you want to find a way to keep people in there as tenants?

Mr. CARR. Yes. Years ago, the Homeowners Loan Corp. in the Great Depression was established and I think that we need an entity that is very similar to that which would allow, for example, HUD to potentially take over and manage or have a master servicing contract for renters to allow individuals to remain in those homes until such time as they can be sold at a reasonable price and those individuals themselves are ready to relocate and/or to purchase a new home.

But I think that the real key here, I have not thought about the details of it, but the real key is to avoid that abandonment of that property.

Mr. TIERNEY. I appreciate that. It is the details that we are always looking for on that.

Mr. Weller, let me ask you a question. I do a lot of work on credit cards which, I think the evidence shows are pretty much putting a squeeze on all communities and certainly not the least minority communities.

On that, I think some of the research that we were looking at here shows that the average credit card interest rate for low income households and people of color are around 22 percent, which is a full 10 percent greater than Caucasian families in many instances, at least the high income families. Eighty percent of African American households have credit cards that are indebted versus about half, 50 percent, of Caucasian households and the Latino communities falling right along in that 80 percent area.

So, interest rates are keeping low-income people in this trap. We did some legislation recently which took care of some of the more egregious practices of credit card companies in terms of fees being added and things of that nature. But at that time, several of us made the argument that unless you do something on capping interest rates you are going nowhere because whatever the banks and lenders lose on reforming one aspect they are going to make up by jacking up the interest rates.

Do you have an opinion as to whether or not a good usury rate would be in order here and that we ought to try to establish it and enforce it?

Mr. WELLER. Let me talk about consumer credit generally. What we find when we look at consumer credit generally, for Whites versus minorities, we find that there is credit steering in two ways. One is geared more toward minorities, who steer more toward the higher cost products such as credit cards, installment loans and others, such as pay day lending. And then once they are in that category, they tend to pay more even in that category than Whites, so there is a double whammy here.

I think I am a little bit cautious on the usury side because it is very hard to legislate and regulate even just one aspect of the cost of a credit card. So what you end up playing is a game of "Whack-a-Mole" where you cannot raise the credit card interest rate, but then the credit card company will lay on different fees, shorten the grace periods and other cost items——

Mr. TIERNEY. That end we took care of in the last piece of legislation. All they did was shift the costs over onto the interest rates. So, I get your drift there. But I think you have to close all the doors.

Mr. WELLER. Right. Well, one thing we have learned is that the credit card industry and other financial service providers are extremely innovative when it comes to making a buck off people. So, I think ultimately what we want to go for is some sort of comprehensive legislation and regulation and I think the Consumer Safety Product Commission idea is the right way to go because it is a more flexible tool to regulate credit products and actually create the economic mobility that credit is meant for in that role.

Mr. TIERNEY. Well, I do not want to get into an argument with you about that. I hear what you are saying and I have talked to the people that are responsible for that legislation and the administration, and they are missing the boat. No matter what you do in terms of that type of regulation, they are going to make it all up on the interest rates unless you do something there.

It looks to me, and you can tell me if I am wrong, it looks to me that these credit card companies just are not doing any underwriting anymore. The reason they steer them into the credit card thing is that they have it figured out. I can jack the interest rates up on you over there and I can then force you, bludgeon you, in Bankruptcy Court because you can no longer get out on that side.

So, I just make that point. I will not belabor much longer than that. But, if we do not do something there, and we had laws related to that until 1978.

Mr. WELLER. Well, I think——

Mr. TIERNEY. We go back to the Babylonian ages when we used to think that this was a bad thing to do, just to let people just keep jacking up the interest rate all they want and in 1978 it was knocked down just because it was not similar from State to State.

Mr. WELLER. You can probably do a number of things, in particular on transparency. Just before you start a commission or something like that, you have to say on the credit card statement as a company, this is how much we charged to a total dollars last month, or something like that, rolling it all together in one——

Mr. TIERNEY. They make disclosure laws on transparency.

Thank you very much, Mr. Chairman. I yield back.

Mr. CUMMINGS. Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman, and thank you for holding this hearing today.

Welcome. I apologize that I was not able to be here for your full testimony but I have read it and we thank you for your service to our people.

Let me ask you, what mechanisms or plans have you heard about or are involved with that would bring justice to the American people in the situation we are facing? That is the big question.

The housing market meltdown is really at the heart of our financial crisis. And, as you have indicated, it is going to just continue to unwind. And the commercial real estate bust has not even hit yet. That will happen next year.

The megabanks had a plan, a massive plan to exploit the American people and they did it masterfully. They made billions and billions and billions and billions of dollars, a lot of it tucked away in anonymous hedge funds and offshore accounts. None of those people are being brought to justice right now.

Meanwhile, they did this by raiding home equity through high risk schemes which, as we know, are very imprudent, very irresponsible and fraudulent in large numbers of cases. They are now dumping their paper on the American people. The FHA, at Fannie Mae, and Freddie Mac and, even though they have gotten hundreds and hundreds of billions of dollars in TARP funds from the people of the United States, they are not doing mortgage workouts.

Only about 15 percent they claim of the millions and millions of mortgages that are out there, you know, they are biting at the edges, but they do not really want to resolve it because the Government big basket will be there to absorb their bad paper.

The workouts have been occurring, those that have been, the few that have been, at a snail's pace purposefully because these same institutions can make more money off of delinquencies. And tax losses, and short sales, and by rigging the auction process, as you have probably seen in your communities, by taking a home that is worth $80,000 and then auctioning it off for $10,000 or $20,000 and then keeping it on their books and booking the losses in the next tax year.

So, you know, they did some of the worst things. They preyed upon people's hopes and many times people without attorneys getting involved in mortgage loans that were fraudulent. So, my big question is, are you; my problem is I am worried about our country. I do not see a big enough force out there that is an idea of the magnitude that they came up with to hold them accountable and bring justice.

So, my question to you really is, are you aware of groups of mayors getting together or aggrieved parties in our country, and bringing forth litigation, aggressive litigation, before judges in several jurisdictions? Are you aware of civil rights cases being brought to the Federal court system to rein them in and to bring them to justice? Are you aware of what can be done? Are there ideas that are cooking out there through our State attorneys general or our State Departments of Housing and Community Development to rein in the securitization process?

Are you aware of ideas that are out there bubbling up across our country to force accountability and restructuring of our banking system itself in order to bring accountability and to create a system that is more prudent and more favorable to prudent home lending in the future?

What I am not hearing from the country, I am not hearing an idea big enough to offset what they are doing and what they have done. So I am kind of pushing you a little bit in the questioning. It is not enough just to say, well, the Federal Government will do some more affordable housing. I am for that. I keep thinking, is

there any amendment we can offer to the CRA, the Community Reinvestment Act, where we get dozens of attorneys general, dozens of Housing and Community Development directors across this country, dozens of mayors to come together and say, this is what we need, this is not enough?

We have to bring justice to the system. How do we get that justice? I wish I could say I believe this institution will bring it. I have my doubts. Maybe I will be surprised.

What is bubbling up out there on the outside that is a sufficient counterforce to meet the real challenge before us? Are you aware of anything like that?

Please, Mr. Skinner?

Mr. SKINNER. I will start. We talked about a number of things today including financial reforms and so forth. Let me just give you one specific example.

You talked about lawsuits. The city of Baltimore has filed a lawsuit against Wells Fargo, essentially alleging what you might call reverse redlining. Instead of not doing loans in a certain area, what is alleged is that Wells Fargo, and not only Wells Fargo but many of the other lenders, did was really target minority communities for these bad loans, the subprime, exotic loans.

And the data that the city has come up with, for example, shows that in 2006 Wells Fargo made high cost loans to 65 percent of its African American customers versus only 15 percent of its White customers. And I think you can see examples of that all over the country.

So, this is kind of, I guess, the first "shot over the bow," if you will, in terms of a city actually filing suit against a lender seeking some recompense in terms of what this has done, the cost to the city in terms of foreclosures, deteriorated, vacant, boarded up houses that you see spotted all over the city of Baltimore in Congressman Cummings' district. We see it all over. So, I think that is one example of a local government being very aggressive and going after one of these lenders.

Ms. KAPTUR. So have other local governments joined you in that suit as affiliated parties?

Mr. SKINNER. Not as far as I know. It is the city of Baltimore right now.

Ms. KAPTUR. I want to compliment you on that. That is the level of idea that needs to come forward and, even though justice will be meted out slowly in the court system, we need the best minds in the country. We need civil rights lawyers. I am so upset about the Department of Justice and the lack of civil rights staffing there. I can tell you in the white collar financial crimes division we should have over 1,000 agents. We have 140 over there right now.

I tried to get an amendment, an Appropriations bill. I am just putting this on the record so people know, in order to increase it to 1,000. We had 1,000 white collar crime prosecutors over there and agents when we had the savings and loan crisis. Now we have 140 with this level of fraud and abuse and gaming of the system? That Department of Justice has to wake up. And I am sharing this because perhaps you will be in audiences where you can help make this happen.

But I am very concerned that, I am hoping that the judicial system will be able to help us get justice as we tried to get it through here, the legislative branch. So, I compliment you on that.

I know in our State, in Cleveland, Judge Boykle has thrown out several cases because, when individual plaintiffs have come forward, the large banks cannot produce the note, the mortgage note. And most people are leaving their homes without even understanding that they have legal rights to that, having that note produced, and that they do not have to leave their houses.

It is hit and miss. There are a few places where this is happening, but systemically it is not happening.

Mr. Chairman, I know my time has expired. But if any of the other witnesses wish to comment, I would greatly appreciate it.

Mr. CARR. Congresswoman, the challenge you put before us in that question is extraordinary. And it is hard to know where to start.

I would start by saying, first of all, much of what you describe, I think we should recognize that while it was bad behavior on the part of the financial institutions, they were allowed to do it. We have a regulatory system that is just allowing them to do it. And by allowing them to do it, it is actually incenting them to misbehave against the interest of the American public.

To the extent that it is still happening, the first thing I would say is that we need to enact meaningful regulation of the financial system now. Today. This afternoon. We really need to do it, because the misbehavior continues. It is not like it is all in the past.

Second of all, it is important to recognize that everything that those institutions did was not fraud. As bad as it may have been, if it is legal, it is not fraudulent. And that is one of the problems with a lot of the laws in that they allow for financial institutions to exploit, legally exploit, the public.

A third thing is that, to the extent that they did exploit the public illegally, there is insufficient and inadequate data for individuals to partake in legal actions in any significant way. I mean, bringing a legal suit against a financial institution for discrimination in lending is extremely time consuming and very costly. Where do non-profit organizations get those resources? We just simply do not. Unless Congress decides they want to start appropriating them specifically for that action, which I think would be a very good idea.

Ms. KAPTUR. You come and see me on that.

Chairman TOWNS [presiding]. Let me say to the gentlewoman, your time has expired.

I think that what has been pointed out here is that as we look for reform for the financial system that we need to look at a structure that is going to give us some feedback because, whatever we do, they find a way to do something different.

And I think we need to look at a structure that gives us information, as a board of some type, because whatever we do, they just find a way to do whatever they want to do and, of course, it is legal. And that is the issue that we have to address because we cannot continue to let this thing move along without being checked because people are being hurt.

So, I want to thank the gentlewoman for her comments and I want to thank you for your statements and we look forward to continuing to work with you on making certain that the money gets to where it is supposed to go and help the people that it is supposed to be assisting. There is $787 billion out there floating, and we need to make certain that the money does what it is supposed to do, and that is our concern.

So, I want to thank you, Dr. Weller, I want to thank you, Mr. Carr, and Secretary Skinner for your testimony. Thank you so much.

We will now move to our second panel.

We welcome our distinguished second panel. As with the first panel, it is committee policy that all witnesses are sworn in. So would you please stand and raise your right hands as I administer the oath?

[Witnesses sworn.]

Chairman TOWNS. You may be seated. Let the record reflect that all of the witnesses answered in the affirmative.

Let me introduce all of the witnesses. We have Ms. Janet Murguía, president and chief executive officer of the National Council of La Raza, the largest national Hispanic civil rights and advocacy organization in the United States of America, which serves millions of people in education, health care, immigration, civil rights and economy policies and services.

Of course, prior to joining La Raza as president and CEO in 2005, she served in the White House from 1994 until 2000 as deputy director of legislative affairs and, ultimately, became deputy assistant to the President of the United States, which was Bill Clinton at that time.

We welcome you, Janet.

Mr. Marc Morial is the president and chief executive officer of the National Urban League, the Nation's largest and oldest civil rights group. He is the director of that organization. Prior to becoming President of the National Urban League in 2003, Mr. Morial previously served for 8 years as the mayor of New Orleans and was the president of the U.S. Conference of Mayors.

Welcome.

Ms. Jacqueline Johnson-Pata is the executive director of the National Congress of American Indians, the oldest and largest tribal representative organization which coordinates with other 250 tribal governments to inform the Federal Government and the public on policy issues affecting American Indians' tribal communities.

Prior to joining the NCAI, Ms. Johnson-Pata served as Deputy Assistant Secretary of Housing and Urban Development in the Office of Native American Programs.

Let me welcome you, Ms. Johnson-Pata.

Ms. Lisa Hasegawa has been the executive director of the National Coalition for Asian Pacific American Community Development, for many years and we are delighted to have her with us as well. We look forward to your testimony today.

Also on the panel is Mr. Harry Alford. He is the president and chief executive officer of the National Black Chamber of Commerce, which was incorporated in Washington, DC, in 1993 and, we are delighted to have you on the panel today as well.

So, what I will do is just go right down the line. I will start with you, Mr. Mayor, and just come right down the line, I think, just right down. So we start with you.

Thank you so much.

STATEMENTS OF MARC H. MORIAL, PRESIDENT AND CEO, NATIONAL URBAN LEAGUE; JANET MURGUÍA, PRESIDENT AND CEO, NATIONAL COUNCIL OF LA RAZA; LISA HASEGAWA, EXECUTIVE DIRECTOR, NATIONAL COALITION FOR ASIAN PACIFIC AMERICAN COMMUNITY DEVELOPMENT; JACQUELINE JOHNSON–PATA, EXECUTIVE DIRECTOR, NATIONAL CONGRESS OF AMERICAN INDIANS; AND HARRY C. ALFORD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL BLACK CHAMBER OF COMMERCE

STATEMENT OF MARK H. MORIAL

Mr. MORIAL. Thank you very much.

Good morning, Mr. Chairman, and I want to thank you and the committee for the opportunity to testify on behalf of the National Urban League this morning, to talk to you about the disparate impact that this current economic crisis is having on African Americans and to share with you recommendations on how to address them.

In the past year, this Nation came face-to-face with a real enemy, an almost unprecedented economic crisis of the likes the Nation has not seen in more than half a century. Our economy does have a certain elasticity built into it that gives many people the room they need to survive tough times. However, because of decades of disparities, many African Americans do not have the benefit of that elasticity.

In plain language, there is no more give to give and many of our communities across the country are at the breaking point and face desperate circumstances if we do not take swift and certain action now.

I do not say this to alarm or inflame. I am just stating a plain fact based upon experience that includes decades of service delivery in 100 communities across this Nation and verifiable research.

We see in the faces of the people who come to us for help each year the pain that this economic crisis has wrought. We hear it in the voices of the men and women and families who seek jobs that are just not there. We feel it in the pain of those who come to us for help keeping a roof over their heads. And this experience is amplified and supported by empirical research.

Our "State of Black America" Report demonstrates that the typical Black family in this Nation possesses less than 10 percent of the net worth of the average White family. That almost one-third of all African American families have zero or negative net worth. And far, far, far fewer African Americans than Whites benefit from inherited wealth or assets.

This is a snapshot. But what it illustrates is that African Americans, by and large, do not have the economic cushion that protects many from catastrophe when times get tough and the economy goes into a freefall.

We are starting to see some hopeful signs that indicate a turning around. However, even if this is the case, it does not mean that the African American community is out of the woods. In fact, we believe, and our research shows, that there is a troubling trend which must be recognized and reversed.

So, I share with you today the following. Median household income during the 1991 expansion, after the recession in 1991, increased. After the recession of 2001, even though there was an economic recovery, median household income of African Americans declined. So what I want to emphasize is that in the recovery in the 1990's, median household income increased. In the recovery of this decade, median household income decreased, declined.

And, the 6-year decline in unemployment for African Americans during the 1991 expansion, or rather the increase in employment of African Americans during the 1991 expansion, was six times greater than that during the post-2001 expansion.

Here is the point. African Americans made great strides in employment in the 1990's. In the recovery of the last decade, that improvement was, for the most part, nonexistent.

The economic downturn of today has exacerbated those circumstances. So the unemployment rate in August rose to 9.7 percent across the board. For African Americans, it exceeds 15 percent.

Our economists believe that the real unemployment rate, when you factor in those who are not looking, those who may be working part-time, those who were recently laid off and not yet looking for a job, is far higher than that. We could, in the Black community today, we think face a real unemployment rate of over 20 percent and in the White community exceeding 10 percent.

In fact, the current recorded unemployment rate for White Americans of 8.9 percent is extremely serious. But it is the same as the unemployment rate for Black Americans during the so-called recovery of the last several years that preceded this recession.

When I released our Homebuyer Bill of Rights 2 years ago, the subprime crisis was stripping wealth from our communities and victimizing our most vulnerable citizens. I am not talking about deadbeats. We are not talking about people who are trying to get something for nothing. These were people who did everything they were asked to do. They work hard, they saved their money, they bought homes and they were victimized by unscrupulous lenders who pillaged their hard-earned dollars.

Chairman TOWNS. Mr. Mayor, can you summarize? Your time has expired.

Mr. MORIAL. Yes. Unfortunately, there are those who, instead of focusing on solutions, have tried to deflect blame, obfuscate the truth, and delay fixing the problem by claiming that the Community Reinvestment Act, Fannie Mae and Freddie Mac were somehow solely responsible for the subprime crisis. That is flat out false and we call it a weapon of mass deception.

Just quickly, recommendations. I urge the Congress to focus on the upcoming reauthorization of the Workforce Investment Act to ensure that job training maximizes the opportunity for those who have been locked out and left out to enter into the new economy of the future.

We recommend that the discussions about the green economy and the alternative energy expansion, that policies and incentives, be placed in the law so that those jobs do not by-pass urban communties and inner city America.

We also believe that the CRA, the Community Reinvestment Act, needs to be strengthened. Its enforcement needs to be taken seriously as a mechanism and as a tool for increasing the flow of capital, private capital, back into urban communities.

I will be happy to share other recommendations with the committee later on or at any time in the future. Thank you.

[The prepared statement of Mr. Morial follows:]

National Urban League | *Empowering Communities. Changing Lives.*

Prepared Testimony of

MARC H. MORIAL
President and CEO
National Urban League

Before the
House Committee on Oversight and Government Reform

"The Silent Depression: How Are Minorities Faring In the Economic Downturn?"

September 23, 2009

Thank you for the opportunity to testify today on behalf of the National Urban League about the disparate impact the current economic crisis is having on the African American community in the United States, and to offer our recommendations on how to address them.

Established in 1910, the National Urban League is the nation's oldest and largest civil rights and direct services organization serving 2 million people each year in over 100 urban communities. Economic Empowerment – assisting clients to attain economic self-sufficiency through job training, good jobs, homeownership, entrepreneurship and wealth accumulation – leads the five-pronged strategy to advance the mission of the Urban League Movement and is imperative to an improved *"State of Black America."*

Over the past year, our nation came face to face with a real enemy –an almost unprecedented economic crisis of the likes the nation has not seen in more than half a century. Our economy has a certain elasticity built into it that gives many people the room they need to survive tough times. Unfortunately, because of decades of well-documented economic, educational and social disparities, many African Americans do not have the benefit of that elasticity. In plain language,

there is no more "give to give" and many in our communities across the country are at the breaking point and face desperate circumstances if we do not take swift and certain action now.

The State of Africans Americans in Our National Economy

I do not say this to alarm or inflame. I am just stating a plain fact based upon our experience that includes decades of service delivery and research. We see it in the faces of the people who come to us for help each year. We hear it in the voices of the men and women seeking jobs that just aren't there. We feel it in the pain of those who come to us for help in keeping a roof over their heads.

And our direct experience is borne out by our empirical research.

Each year, the National Urban League publishes the *Equality Index* as part of our annual *State of Black America* report. *The Equality Index* is an indicator of the relative status of blacks and whites in America. It consists of five sub-indices: economics, education, health, social justice and civic engagement. Equality is indicated by an index of 100%, therefore an Equality Index less than 100% suggests that blacks are doing worse relative to whites, and an Equality Index greater than 100% suggests that blacks are doing better than whites.[1]

According to our 2009 *Equality Index,* African Americans are at about 71% compared with white Americans. The Economic Index is 57.4%.

According to our 2009 *State of Black America Report*: nationally, the typical African-American family today possesses less than 10 percent of the net worth of the average white family; almost 30 percent of black families have zero or negative net worth; and far fewer blacks than whites benefit from inherited wealth or assets. [2]

While this is but a snapshot, it paints a dire picture. Among other things, it illustrates that African Americans just don't have the cushion that protects us from economic catastrophe when an economy goes into freefall.

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[1] "Introduction to the 2009 Equality Index," by Valerie Rawlston Wilson, Ph.D., National Urban League Policy Institute, in *The State of Black America 2009*, National Urban League, pp. 15-24.

[2] "Wealth for Life," by Early G. Graves, Jr., *Black Enterprise Magazine*, in *The State of Black American 2009*, National Urban League, pp. 165-170, 2009.

We are starting to see some hopeful signs in other areas of the economy that indicate we may be turning course. Of course, the job numbers are a lagging indicator, so we hope that they will begin to improve as other areas of the economy begin to point to recovery.

However, even if this is the case, it does not necessarily mean that the African American community will be out of the woods. In fact, our long-term research indicates a troubling trend that must be proactively reversed.

Catching Up From the End of the Line

According to our *State of Black America 2009,* African Americans have been doing progressively worse in each economic expansions. For example, median household income *increased* during the *1991* expansion, but *declined* in the *2001* expansion.

During the first six years of the 1991-2001 recovery, real median income for African-American households grew by 15.6 percent while the real median income of white households grew by 8.9 percent. Poverty rates declined by 19 percent and 8.5 percent, respectively. For the duration of the 1992 expansion, real median household income grew by 23.6 percent for African Americans and by 13 percent for whites, while poverty rates declined by 30.6 percent and 17 percent, respectively.

Although unemployment declined for both groups during each of the most recent expansions, the six-year decline for African Americans during the 1991-2001 expansion was nearly six times greater than the decline during the 2001-2007 expansion. For whites, the magnitude of the difference was thirteen times.

Between 2001 and 2007, whites saw a net gain in the rate of homeownership (1.2 percent) while African Americans experienced a net loss (-1.0 percent)

Canaries in the Coal Mine – African Americans and the Subprime Crisis

When the home foreclosure crisis finally made it to the national headlines, the subprime housing crisis had long been front page news in the black community. We saw it coming and warned about it well before the issue started to trigger shockwaves in international credit markets and sending hedge fund analysts to the unemployment line.

We warned of the impending crisis two and a half years ago when I released our "Homebuyer's Bill of Rights. At that time, policy makers and government officials were reluctant to support greater regulation to give the market a chance to correct itself. So nothing happened.

The subprime crisis was already looming, stripping wealth from our communities and victimizing our must vulnerable citizens. We're not talking about deadbeats. We're not talking about people trying to get something for nothing. These are people who did everything they were supposed to do. They worked hard, saved their money and bought homes, only to be victimized by unscrupulous lenders who pillaged their hard earned dollars. And we are still not out of the woods yet as we continue to grapple with the home foreclosure crisis and its disproportionate impact on African Americans.

According to Realty Trac, foreclosure activity remained near record level in August (2009). They reported that foreclosure filings — default notices, scheduled auctions and bank repossessions — were reported on 358,471 U.S. properties during the month, a decrease of less than 1 percent from the previous month but still an increase of nearly 18 percent from August 2008. The report also shows one in every 357 U.S. housing units received a foreclosure filing in August. [3]

While data is not readily available nationwide, a recent *New York Times* article documents the racial impact of the foreclosure crisis in the state of New York. [4] The article informs that predominantly minority areas are bearing the brunt of the foreclosure pain in New York. That defaults are occurring in mostly minority census tracts at three times the rate of mostly white tracts; and 85 percent of the hardest-hit neighborhoods are inhabited primarily by black and Latino homeowners. In particular, the African-American middle class is struggling under the weight of foreclosures – a reversal from the past several years, when homeownership among the race was on the rise. [5]

Our analysis of 2007 Home Mortgage Disclosure Act (HMDA) data found that although high-priced (often referred to as subprime) lending

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[3] "Foreclosure Activity Remains Near Record Level in August," by RealtyTrac Staff, September 10, 2009.

[4] "Minorities Affected Most As New York Foreclosures Rise," by Michael Powell and Janet Roberts, *The New York Times*, May 16, 2009.

[5] Ibid.

has decreased across the board (from 28.7% of all loans in 2006 to 18.3% in 2007), racial and ethnic disparities persisted in 2007. Indeed, just over 34% of conventional home purchase loans to blacks were high priced in 2007 compared with only 10.6% for whites. [6]

Adding Insult to Injury – African Americans Experience with Unemployment Runs Deeper and Longer than Whites

The economic downturn with its tremendous job loss has exacerbated the already dire economic status of African Americans. The latest unemployment figures for blacks is simply staggering. In August (2009) the unemployment rate rose to 9.7%, with the black unemployment rate at a whopping 15.1%; adult black men saw their unemployment rate increase significantly from 15.8% to 17%, and adult black women saw an increase from 11.7% to 11.9%. [7]

To dramatize the depth of the disparity between blacks and whites with regards to unemployment, it must be noted that the current unemployment rate for white Americans of 8.9% (August 2009) which is deemed extremely serious, *is the same as the black unemployment rate at the beginning of this recession (8.9% in December 2007)!*

National Urban League Recommendations

The current crisis should come as no surprise. The present regulatory system has failed to effectively manage risk, require sufficient transparency, and ensure fair dealings. Financial markets are inherently volatile and prone to extremes. The government has a critical role to play in helping to manage both public and private risk. Without clear and effective rules in place, productive financial activity can degenerate into unproductive gambling, while sophisticated financial transactions, as well as more ordinary consumer credit transactions, can give way to swindles and fraud.

A well-regulated financial system serves a key public purpose: if it has the power and if its leaders have the will to use that power, it channels savings and investment into productive economic activity and helps prevent financial contagion. Like the management of any complex hazard, financial regulation should not rely on a single magic bullet, but

[6] "2007 Home Mortgage Disclosure Act Data," by National Urban League Policy Institute, National Urban League, October 17, 2008.

[7] "August 2009 Monthly Employment Report," National Urban League Policy Institute, September 4, 2009.

instead should employ an array of related measures for managing various elements of risk.

Moreover, just as markets and financial products evolve, so too must efforts to provide understanding through genuine transparency. It is in this vein that the National Urban League supports the Administration's recommendation for the formation of "a single federal regulator for consumer credit products." We believe such an action would isolate the activity of creating and enforcing consumer protection standards from oversight of safety and soundness in financial institutions. The regulation of any federal financial firm requires the balancing of multiple policy choices and should be done by one institution. Experience has shown us with the GSE model that having two stated goals, one for safety and soundness and one for social policy, inherently will lead to conflict.

Since the new consumer product regulator would be able to affect all financial institutions, eventually those rules will conflict with a bank's profitability, capital levels, and ultimately, solvency. Under this proposal, an independent agency would have power to impose regulations that could well undermine the health of banks, but would not be responsible for the safety and soundness of those banks. This balance is of particular significance within institutions that have been provided with explicit taxpayer funded guarantees, such as FDIC insurance. By placing both responsibilities with the same regulator, greater assurance is provided that taxpayer interests will not be placed in jeopardy by regulations that unnecessarily weaken capital or competitive position.

In addition, we recommend several other critical steps to ensure that the next recovery does not leave African Americans behind:

1. Enact of the "Community Reinvestment Modernization Act of 2009" (H.R.1479), which, combined with financial regulatory reform, will strengthen our economy and local urban communities will enhance and expand the CRA and the end strengthen our economy and local urban communities;

2. Increase funding for proven and successful models of workforce training and job placement for under-skilled workers between the ages of 16 and 30 by utilizing national intermediaries and non-profit organizations;

3. Direct a percentage of all infrastructure monies to job training, job placement and job preparation for disadvantaged workers;

4. Strengthen and enforce federal minority business opportunity goals in government contracting;

5. Fund infrastructure development for public building construction and renovations of schools, community centers, libraries, recreation centers, parks, etc., that will rebuild and revitalize urban communities;

6. Re-establish a temporary Public Service Employment (PSE) program aimed at creating 150,000 – 200,000 jobs in urban areas to forestall a reduction in public services and an increase in job losses.

7. Because an important component of any recovery effort is the protection of current and potential homebuyers. Therefore, we recommend that Congress pass a "Homebuyers' Bill of Rights" that, among other things:

a. Funds homeownership education and counseling, financial literacy workshops, credit counseling, fair housing advocacy and foreclosure prevention assistance that uses national minority housing intermediaries with a track record of providing effective counseling assistance in underserved minority urban communities;

b. Creates a HUD Task Force to vigorously investigate and prosecute violations of fair-housing laws and authorize congressional oversight hearings to hold HUD accountable;

c. Demystifies the credit reporting system;

d. Reauthorizes and improves HOPE VI.

Thank you for this opportunity to share with you our views and recommendations. We at the National Urban League look forward to working with you to overcome this crisis and to ensure full economic opportunity for all Americans.

Chairman TOWNS. Thank you very much, Mr. Mayor.

Janet Murguía, yes.

STATEMENT OF JANET MURGUÍA

Ms. MURGUÍA. Thank you. Good morning.

NCLR has been committed to strengthening America by promoting the advancement of Latino families for more than four decades now and I would like to thank Chairman Towns and the committee for inviting me to participate in this timely and important hearing.

The number of Americans losing their jobs, homes and financial safety net is tremendously unsettling. Circumstances for Latino, Black, Asian and Native American families are even more disheartening. Without a targeted strategy, our communities are in danger of falling further behind the mainstream.

Since the recession began, more than 1 million Latinos have lost their jobs. That is the largest increase in unemployment of any group. And the worst is yet to come. Greater than 400,000 Latino families are predicted to lose their homes to foreclosure this year alone. These are staggering figures that call for a bold response.

We urge Congress to provide relief to families and advance strategies that will help communities of color emerge from these tough economic times. Market forces and voluntary programs alone will not correct inequality. They will not end discrimination or close the gaps in service that minorities and underserved communities face. Instead, we need a targeted strategy that will close racial, wealth, and income gaps.

Today, I just want to discuss briefly programs that Congress and the administration have put forth to improve economic conditions including Hope for Homeowners, TARP, American Recovery and Reinvestment Act and Making Home Affordable.

Each of these programs has positive elements that could help communities of color. However, design flaws are preventing our families from receiving the assistance they need, which I will briefly summarize today. In my written statement, you can find detailed recommendations to improve these programs.

I will start with the Hope for Homeowners. This program offers as much as $300 billion in Government guaranteed loans. It was supposed to help as many as 400,000 families at risk of foreclosure. Unfortunately, owners' restrictions and fees have made this program virtually unusable. In fact, only one person has successfully saved their home from foreclosure through this program. Even with proposed improvements, Latino families will still face barriers to accessing this program.

TARP. TARP was established with two key goals: reduce foreclosures and increase lending activity that could have helped the Latino community. From where we stand, working with thousands of families every day, TARP has failed these goals. Treasury should have required TARP recipients to implement a systemic loan modification program and used funds to increase lending to communities. Instead, Treasury relied on voluntary efforts that have proven ineffective.

Later, Congress invested nearly $800 billion in the American Recovery and Reinvestment Act. One of its primary purposes is to assist those most impacted by the recession. NCLR is concerned that

this act is falling short of achieving this goal. Targeted policies are necessary to ensure that assistance and jobs reach hard hit communities. However, the final legislation lacked any such targeting.

What we did was "re-upped" the appropriations formula that was already out there, instead of addressing some of the specific needs that we knew were being created by this downturn. As a result, the majority of funds have flowed through existing channels, leaving out our service providers in underserved communities.

And finally, I will turn to President Obama's Making Home Affordable Program. While we applaud the comprehensive approach, processing delays and insufficient enforcement mechanisms keep this program from being as effective as possible.

For example, the program allows servicers to start foreclosure on eligible families before their modification application has been processed. Those lucky enough to avoid foreclosure still end up owing thousands of dollars in legal fees.

However, NCLR-funded foreclosure counselors report that some families have been foreclosed upon while still waiting on the results of their application. So, we will not be able to get our economy back on track until we get the hardest hit families in a position to secure high quality jobs and mortgages. It is that simple.

To this end, I offer just to the following recommendations. Include the needs of Latino families and families of color, workers and homeowners, in federally funded relief programs. But that will require intentional strategies to address those communities and not reliance on the same formulas that do not take into account the new circumstances that we find ourselves in and the new challenges.

We need support proven community based organizations involved in recovery and foreclosure prevention efforts. We are in the communities. We are close to these families. We can engage them with as much credibility as anyone else. Hold Federal programs publicly accountable for spending and performance.

We have to tie more strings to this. There have to be performance benchmarks on these programs or else there is no accountability.

Finally, restore stability to financial labor markets through consumer protections and investments in our communities.

We look forward to working with all of you toward this goal. We think that many of these programs were well-intentioned and some are having some effect. But we can improve these programs and we definitely need more oversight, more regulation, and more enforcement.

I thank you and I would be happy to answer any questions.

[The prepared statement of Ms. Murguía follows:]

NCLR
NATIONAL COUNCIL OF LA RAZA

Putting Our Communities on the Map:

The Road to Economic Recovery for Latinos and Other Communities of Color

Presented at:

"The Silent Depression: How Are Minorities Faring In the Economic Downturn?"

Submitted to:

U.S. House of Representatives Committee on Oversight and Government Reform

Submitted by:

Janet Murguía

President and CEO

National Council of La Raza

Raul Yzaguirre Building

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September 23, 2009

Good morning. My name is Janet Murguía. I am the President and CEO of the National Council of La Raza (NCLR)—the largest national Hispanic[1] civil rights and advocacy organization in the United States. For the last four decades, NCLR has been committed to improving opportunities for the nation's nearly 47 million Latinos. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of issues that impact the ability of Latinos to access quality jobs and build and maintain wealth. I would like to thank Chairman Towns and Ranking Member Issa for inviting me to participate in this timely and important hearing.

NCLR is gravely concerned that the economic downturn is disproportionately impacting communities of color. Together, Latino, Black, Asian, and Native communities make up a significant portion of the economy and are among the hardest-hit. Congress and the administration must work together to establish tailored strategies that will help communities of color realize financial security and long-term sustainability. NCLR is dedicated to these issues and we look forward to working with you.

Since NCLR was founded in 1968, the body of NCLR's Affiliate Network has grown to nearly 300 community-based organizations. Together, NCLR and these organizations provide services to millions of Hispanic Americans. For example, the NCLR Homeownership Network (NHN) is a network of 52 community-based housing counseling providers working with more than 38,000 families annually. The NHN produced more than 25,000 first-time homebuyers in its first decade. These families were matched with safe and affordable mortgages and are much less likely to be at risk of foreclosure then families who did not receive housing counseling prior to purchasing their home. NCLR also has a network of Affiliates that work to reduce the education and skills gap to advance Latino workers from low-wage, low-skill occupations to more advanced, upwardly mobile careers. One of our workforce development Affiliates, Instituto del Progreso Latino in Chicago, received a Recognition of Excellence Award from the U.S. Department of Labor in 2008 for its Health Care Career Pathways Initiative, which uses a collaborative model to help Latinos at various educational levels advance to higher-paying jobs in the health care field. Through these programs and partnerships, NCLR has developed specialized knowledge and understanding of how to connect community members to local employers, direct service providers, and safe financial products.

Working with our partners and Affiliates, NCLR has moved quickly to respond to the economic and financial crisis. NCLR has invested nearly $10 million in community-based organizations (CBOs) to expand foreclosure prevention counseling services. Last year we provided foreclosure prevention advice to more than 7,500 families and we estimate that this year we will double that number. We joined forces with the National Urban League (NUL) and the National Coalition for Asian Pacific American Community Development (National CAPACD) to host dozens of Home Rescue Fairs[2] nationwide and distribute a tool kit of resources on foreclosure prevention strategies.[3] NCLR has also partnered with other think tanks, civil rights, and worker

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

[2] A Home Rescue Fair is a one-day outreach event that offers individuals facing foreclosure the opportunity to receive free advice and resources from housing counselors, attorneys, and loan servicers.

[3] *Community Responses to the Foreclosure Crisis: An NCLR Tool Kit* may be found at http://www.nclr.org/content/publications/detail/59463.

rights organizations such as Center for American Progress, Economic Policy Institute, and NAACP to draw attention to the persistent disparities in employment facing communities of color.[4] Finally, we plan to expand our collaborative efforts to target communities in need with improved access to broadband and green jobs.

We urge Congress and the administration to move swiftly to provide relief to families in financial distress and advance strategies that will help communities of color emerge from these tough economic times. Market forces alone will not correct inequality, end discrimination, and close gaps in service and access to services experienced by minority and underserved communities. The federal government has a responsibility to develop and administer public services in a way that is fair and provides equal access to all Americans. Without a specific strategy, we are in danger of widening racial and ethnic gaps in wealth and income.

In my testimony today, I will discuss how the federal government's response to the economic and financial crisis has impacted Latinos. Specifically, I will provide recommendations to improve recovery programs and put Latinos and other underserved communities back on the path to middle class security.

Background

Despite positive signs that our overall economy is emerging from the deepest recession since the Great Depression, the socioeconomic status of Latino families and workers has not improved and continues to lag behind that of other Americans. More than one million Latino workers have lost their jobs, and Latinos have experienced the largest increase in unemployment of any group since the recession began in December 2007.[5] Still, the worst is yet to come; it is estimated that more than 400,000 Latino families may lose their homes to foreclosure in 2009 alone.[6] NCLR, along with a number of experts and advocates, has long warned of the consequences of ignoring the structural flaws in the mortgage markets[7] and the lack of investment in the low-wage labor market.[8]

The recession hit Latino families and workers just as they appeared to be on the brink of an economic breakthrough. Employment and homeownership trends were on the rise. However, perverse market incentives led to Latinos being steered toward the mortgage products most likely to run the risk of foreclosure. In fact, Latino homebuyers were 30% more likely than

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[4] National Council of La Raza "Minority Workers: Recession, Stimulus, Recovery" (teleconference, National Council of La Raza, June 18, 2009); National Council of La Raza, "Increasing Job Quantity Without Improving Job Quality Won't Fix Rising Latino Unemployment," news release August 10, 2009; National Council of La Raza, "Record-High Unemployment More Drastic for Minority Workers," news release, July 7, 2009.

[5] U.S. Bureau of Labor Statistics, "Data Retrieval: Labor Force Statistics," *Current Population Survey*, Table A-2 and Table A-3, http://www.bls.gov/webapps/legacy/cpsatab2.htm (accessed September 2009).

[6] *Projected Foreclosures to Latinos by State* (Durham, NC: Center for Responsible Lending, 2009).

[7] Janis Bowdler, *Challenges to Building Sustainable Homeownership in Latino Communities* (Washington, DC: National Council of La Raza, 2007), http://www.nclr.org/content/publications/download/45391 (accessed September 2009).

[8] For relevant publications and information from NCLR's Employment and Economic Policy Project, please visit www.nclr.org/wfd.

Whites to receive a high-cost loan when purchasing their home.[9] Latino workers saw employment gains, but the erosion of job quality in the low-wage labor market left millions without basic health or retirement benefits or even sufficient income to keep a family of four out of poverty.[10] Few low-skilled and limited-English-proficient workers were unable to improve their career prospects because they were not well-served by public workforce development programs.[11]

The failure of regulators and Congress to respond to the housing and job market inefficiencies in a timely manner has produced unsettling results. The national unemployment rate stands at 9.7% and is expected to reach double digits by the end of the year. Yet Black unemployment has already been in the double digits for nearly one full year and the Latino unemployment rate passed the 10% mark in February 2009, the same month President Obama signed the American Recovery and Reinvestment Act (ARRA) into law.[12] Record-high foreclosure rates are projected to cost Black and Hispanic households between $164 and $200 billion of wealth.[13] Nearly 70 million families will see their homes lose value, even if they make their mortgage payments on time.[14] Cities and states will lose billions in local taxes, putting the squeeze on budgets that pay for teachers, fire and police departments, and other community services.

The federal government must act to stop the steady unraveling of Latino economic security and pave the path to economic success for the next generation. An economic recovery that leaves out minority communities robs all Americans of prosperity and widens racial and ethnic disparities in economic and financial security. Together, Hispanics and Blacks make up more than 25% of the population and nearly $2 trillion in buying power. Latinos alone make up 15.4% of the population and will reach a purchasing power of 1.2 trillion by 2012.[15] Any initiatives to revive the economy must also be paired with deliberate efforts to rebuild the crumbling foundation of protections that American workers and consumers have come to expect: decent wages, safe working conditions, and fair and safe financial products.[16] In the next section, I will discuss four

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[9] Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on Price of Subprime Mortgages* (Durham, NC: Center for Responsible Lending, 2006).

[10] Maude Toussaint-Comeau, Thomas Smith, and Ludovic Comeau Jr., *Occupational Attainment and Mobility of Hispanics in a Changing Economy* (Washington, DC: report to the Pew Hispanic Center, 2005), http://pewhispanic.org/files/reports/59.1.pdf (accessed September 2008).

[11] *Make the Workforce Investment Act Work for Latinos: Principles for WIA Reauthorization* (Washington, DC: National Council of La Raza, 2009), http://www.nclr.org/content/publications/detail/57826 (accessed September 2009).

[12] U.S. Bureau of Labor Statistics, "Data Retrieval: Labor Force Statistics," *Current Population Survey*, Table A-2 and Table A-3, http://www.bls.gov/webapps/legacy/cpsatab2.htm (accessed September 2009).

[13] Amaad Rivera et al., *Foreclosed: State of the Dream 2008* (Boston, MA: United for a Fair Economy, 2008).

[14] Center for Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 billion in 2009 alone; 69.5 million homes lose $7,200 on Average* (Durham, NC: Center for Responsible Lending, 2009).

[15] Reuters, "Hispanics Are the Largest Minority in the U.S. with Purchasing Power Projected to Exceed...," news release, March 31, 2008, http://www.reuters.com/article/pressRelease/idUS124765+31-Mar-2008+BW20080331 (accessed January 9, 2009).

[16] For more information on how Latinos have been marginalized from these basic worker and financial protections, see National Council of La Raza, *Fractures in the Foundation: The Latino Worker's Experience in an Era of Declining Job Quality* (Washington, DC: National Council of La Raza, 2009), www.nclr.org/fractures (accessed September 2009).

major federal relief initiatives and their progress in improving the economic conditions for Latino families and workers.

Federal Initiatives to Improve the Economy

Well into the decline of the mortgage, credit, and job markets, Congress and the administration created four major programs designed to improve conditions, stabilize the housing market, and reduce foreclosures: HOPE for Homeowners, Troubled Asset Relief Program, ARRA, and Making Home Affordable. In each case, the authors intended swift and efficient execution for maximum effect. While each of these programs has solid, positive elements that could help Latino communities, their implementation is fraught with problems that hamstring their success.

HOPE for Homeowners

HOPE for Homeowners (H4H) was designed to offer as much as $300 billion in government-guaranteed home loans to people whose current mortgages exceed the value of their houses. This program was launched by the Bush administration after its FHA Secure refinance option proved unsuccessful, helping less than 4,000 homeowners. H4H also produced poor outcomes due to issues with the structuring of the program.

Design:

- **Restrictions and eligibility criteria are overly burdensome.** Onerous requirements for the lender and eligibility criteria for the homeowner have made this program virtually unusable. Latino families face significant barriers to applying for H4H because many have multiple wage earners or some cash income and savings that cannot be used to qualify for H4H.
- **Fees and equity sharing are expensive for the homeowner.** Homeowners are required to pay costly fees, including an upfront mortgage insurance payment of 3%, a 1.5% annual mortgage insurance premium, and closing costs. In addition, when the property is sold or refinanced, homeowners must pay at least 50% of the equity created by the refinance and 50% of the appreciation accumulated after the refinance.
- **Participation by lenders is voluntary.** H4H relies on lenders to voluntarily participate and encourages lenders to write down the principal balances, but lenders have been unwilling to do so.

Practice:

- **H4H has helped only one family save their home from foreclosure.** In May 2009, President Obama signed the Helping Families Save Their Homes Act (S. 896) into law, which includes improvements to H4H. The program was estimated to benefit 400,000 homeowners–but it has only helped one family. The Department of Housing and Urban Development has yet to release new program guidelines.

Outcome:

- **No Latino families have been able to save their homes from foreclosure using H4H.** Foreclosure rates continue to rise in our communities. Even with the proposed legislative improvements, Latino families will face barriers that remain unaddressed in the proposed changes.

Troubled Asset Relief Program

While the overarching purpose of the Troubled Asset Relief Program (TARP) was to stabilize the U.S. financial system, the legislation established two key objectives of critical importance to Latino families: mitigate rising foreclosure rates and increase the flow of consumer credit. We are severely disappointed that while banks seem to be stabilizing, struggling families have not seen the same benefits.[17]

Design:

- **The Treasury did not require TARP recipients to provide loan modifications to homeowners at risk of foreclosure.** Instead, it relied on voluntary loan modification programs that have proven ineffective.
- **The Treasury did not require TARP recipients to increase credit flow to hard-hit communities.** It could have helped Latino and other underserved communities by increasing access to affordable and safe financial products, which are critical to stabilizing communities and building wealth.

Practice:

- **Homeowners continue to face difficulties getting loan modifications.** Housing counselors and homeowners report numerous challenges in securing affordable and sustainable loan modifications.
- **Consumers continue to face high barriers to accessing credit.** Credit card companies have reduced card limits and raised interest rates, student loans are drying up, and flexible mortgage products have disappeared. Flexible mortgage products, such as those that accept nontraditional credit, are critical for Latino homebuyers.

Outcomes:

- **TARP has not reduced foreclosures for Latino and other hard-hit communities.** Latino foreclosure rates continue to rise and housing counselors continue to experience difficulties helping families save their homes from foreclosure.
- **TARP has not increased the flow of credit to Latino and other impacted communities.** This results in less consumer spending overall and prevents qualified homeowners from purchasing excess housing stock, a significant portion of which is in Latino, minority, and modest-income neighborhoods.

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[17] Janet Murguía, *Rethinking TARP Implementation: Strategies to Reduce Latino Foreclosures*, presented to 111th Cong., 1st. sess., 2009, http://www.nclr.org/content/publications/detail/55452 (accessed September 2009); National Council of La Raza, "NCLR Urges Congress to Include Homeowners in Bailout Bill," news release, September 23, 2008, http://www.nclr.org/content/news/detail/54073 (accessed September 2009); National Council of La Raza, "Civil Rights Groups Call on Congress to Assist Homeownership in its Economic Recovery Package," news release, September 30, 2008, http://www.nclr.org/content/news/detail/54252 (accessed September 2009).

American Recovery and Reinvestment Act

NCLR is concerned that ARRA is falling short of achieving one of its primary purposes: "to assist those most impacted by the recession." Major flaws in ARRA's design have impeded its effectiveness in the hardest-hit communities, with potentially long-term consequences for Latinos and other communities of color.

Design:

- **ARRA did not include specific language to target hard-hit communities.** Despite efforts from NCLR and other advocates to incorporate provisions in ARRA for targeting worker training resources and job-generating projects to distressed communities, the final legislation lacked any such targeting.[18]
- **"Shovel-ready" and formula-based criteria prevent funds from reaching essential service-providers.** For many Latinos facing unemployment or foreclosure, community-based organizations are the first line of defense. Yet just when demand for their services was sky-rocketing, many CBOs were barred from accessing ARRA funding. This was a byproduct of ARRA's design, which gave priority to projects from service providers that were already receiving federal funds or that were well-connected with local and state policymakers.
- **ARRA did not include funding for housing counseling.** ARRA includes requirements for families to seek housing counseling prior to purchasing properties through the Neighborhood Stabilization Program. However, it failed to create a new funding stream to support this provision.
- **ARRA's reporting requirements lack equity metrics.** The Office of Management and Budget (OMB), which is in charge of issuing guidance for how recipients of ARRA funds should report the use of their funds, has neglected to require recipients of funds to report demographic data—race, ethnicity, and nativity—of the beneficiaries.

Practice:

- **Hard-hit communities struggle to make the case for ARRA resources.** In the absence of specific language directing funds to areas with the highest rates of foreclosure and unemployment, states and local service-providers implementing ARRA programs have had to double their outreach to these communities. Their efforts have been further hampered by inadequate information regarding funding opportunities.[19]

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[18] *Recommendations for the American Recovery and Reinvestment Act of 2009* (Washington, DC: National Council of La Raza and Mexican American Legal Defense and Educational Fund, 2008), http://maldef.org/employment/public_policy/MALDEF-NCLR%20Stimulus%20Recommendations.pdf (accessed January 2009); Letter from MALDEF and NCLR to ARRA Conferees, February 11, 2009, http://maldef.org/employment/public_policy/Conferees%20Letter.pdf (accessed February 2009).

[19] Despite the progress the Recovery Accountability and Transparency Board has made to track federal ARRA spending and funding opportunities through www.recovery.gov, many NCLR Affiliates and other CBOs remain confused or unaware of requests for proposals and other funding opportunities. This is an indication that federal agencies and state governments do not consistently follow OMB guidance that requires posting of information regarding contracts larger than $500,000. Memorandum, "Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009," February 18, 2009, Office of Management and Budget, http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-10.pdf (accessed September 2009).

- **Service-providers in underserved communities have been largely shut out from accessing ARRA resources.** Within NCLR's Affiliate Network, the organizations that have successfully accessed ARRA funds tend to be those already connected to public funding sources. Other national organizations have observed a similar trend. Meanwhile, other equally deserving communities that lack an established and sophisticated nonprofit or economic development infrastructure were left out of recovery efforts.[20]
- **Housing counseling agencies continue to struggle to meet the high demand for services.** Without the monetary support to carry out their services, agencies are struggling to provide foreclosure prevention counseling and homebuying services. Many times counselors are forced to turn families away.

Outcome:

- **Some Latino communities have been further marginalized amidst recovery efforts.** The aforementioned barriers in design and implementation have prevented several community-based organizations in high-need areas from accessing the resources they need to meet the demands of their constituents, which is turning back the clock on economic and financial progress in communities of color.
- **Inadequate performance measures prevent stakeholders from assessing ARRA's impact or abuse in communities of color.** Decision-makers and service-providers are at a loss for assessing whether ARRA-funded programs have moved the needle on unemployment, foreclosure, poverty, food insecurity, and a host of other indicators of economic distress. Lack of demographic data also mires any efforts to root out discrimination in employment or service provision.

Making Home Affordable

In March 2009, the Obama administration introduced the Making Home Affordable (MHA) loan modification program, which created a series of incentives for servicers to provide loan modifications to troubled borrowers. While we applaud the administration for its efforts in developing the most comprehensive response to the foreclosure crisis to date, design flaws in the program[21] are forcing eligible homeowners to lose their homes to foreclosure.

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[20] National Council of La Raza, "The Economic Recovery Act: What's in it and What Did we Learn?" (presentation at MAFO (National Partnership of Rural and Farmworker Organizations of Rural and Farmworker Organizations) Conference, March 30, 2009); National Council of La Raza, "Impact of State Budget Deficits on Organization Operations" (conference call with NCLR Affiliates, April 3, 2009); National Council of La Raza, "Future Forecast: Latino Priorities in the 2010 Federal Budget" (special presentation and discussion with NCLR Affiliates at the 2009 NCLR Annual Conference, Monday, July 27, 2009).

[21] Letter from NCLR to Timothy Geithner, U.S. Department of the Treasury, Shaun Donovan, U.S. Department of Housing and Urban Development, and Lawrence Summers, National Economic Council, July 28, 2009, http://www.nclr.org/content/publications/download/59288 (accessed September 2009).

Design:

- **MHA allows servicers to start foreclosure proceedings on eligible homeowners.** Regulations prohibit lenders from sending families to foreclosure sale if they have applied for a loan modification but they do not stop foreclosure proceedings, which allow struggling homeowners to incur thousands of dollars in legal fees.
- **Servicers do not face consequences for violations of MHA.** TARP recipients are required to participate in MHA. Fannie Mae- and Freddie Mac-owned and guaranteed mortgages are also subject to MHA. However, the Treasury has not implemented the enforcement mechanisms necessary to ensure that participants are complying with the rules.
- **MHA relies on voluntary principal forgiveness.** If the interest rate reduction is not enough to make the mortgage payment affordable, then, at minimum, a portion of the principal will be placed at the end of the loan as a balloon to be paid when the house is sold or the mortgage is paid off. MHA encourages servicers to forgive a portion of the principal but most servicers are not doing so.
- **MHA is not streamlined or transparent.** Servicers have refused to accept client authorization forms and workout packets electronically, which would make the loan modification process quicker and easier to track.
- **No support was included to provide foreclosure prevention counseling services.** Provisions require families with debt equal to 55% or more of their income to enter a HUD-certified counseling program as a condition for a modification, but funds were not set aside to assist counseling agencies that were already struggling to meet demands of the community.

Practice:

- **Servicers took months to fully implement MHA.** The program was slow to start and some servicers still say that they need more time to adjust their internal systems.
- **Families are being foreclosed on while waiting for applications to be processed.** Housing counselors are asked to fax client authorization forms and workout packets to servicers multiple times and documents are often lost by servicers. In the meantime, families are racking up late payments and legal fees, many are turning to foreclosure rescue scammers, and many are losing their homes while in the loss mitigation process—a clear violation of MHA.
- **Servicers are not offering loan modifications with principal forgiveness.** NHN counselors report that they have not been able to secure any loan modifications with principal forgiveness.
- **Latino families and other families with limited English proficiency have difficulties securing loan modifications.** Our families turn to counseling services that are provided by trusted community-based organizations in Spanish and other languages, which are critical to helping them reach out to their lenders and secure loan modifications. Funding is not available for these agencies to hire and train more staff to meet the growing demand.

Outcome:

- **Latino and other communities of color continue to suffer record rates of foreclosure.** Delays in processing applications, lack of additional counseling services, and lack of true consequences for violations of MHA are allowing eligible homeowners to lose their homes to foreclosure.

Recommendations

NCLR recognizes that revitalizing the economy is no small task. The rapid decline of credit and housing markets followed by record-high foreclosure and unemployment rates created a sense of urgency and demanded action from Congress and two administrations. The programs established in response to the crisis contain strong elements that could provide much-needed relief to millions of families and workers of color. However, design or implementation flaws prevent these initiatives from reaching as many families, workers, and neighborhoods—especially those of color—as would otherwise be possible.

NCLR has offered detailed recommendations to Congress and the federal agencies charged with implementing these programs, which have been cited throughout this written statement. Summarized below are four recommendations common to all of the programs.

- **Include the needs of Latino families, workers, and homeowners in federally funded relief programs.** Members of Congress should urge their state ARRA Recovery Boards to convene a diverse cross-section of stakeholders at the state and local levels to help identify local needs. Members should also urge Treasury officials and servicers to meet with housing counseling intermediaries that provide language services and jointly develop strategies to provide foreclosure prevention information to minority and underserved communities.

- **Support community-based organizations involved in recovery and foreclosure prevention efforts.** Not only should community-based service providers be involved in local needs assessments, they must also be considered legitimate and necessary candidates for funding under ARRA. Some federal agencies, such as the Department of Labor, have made reasonable efforts to prioritize funding for partnerships that include CBOs. However, there must be adequate oversight of awardees to ensure that CBOs are actually funded, rather than simply consulted. Moreover, the Department of the Treasury must ensure that housing counseling providers are more fully integrated into efforts to secure loan modifications. This can be accomplished straightforwardly by paying counseling agencies for their work in a similar fashion as they pay servicers for loan modifications.

- **Hold federal programs publicly accountable for spending and performance.** Given the significant investment of taxpayer funds in each of the four programs discussed, there must be appropriate enforcement and oversight mechanisms to ensure that homeowners and workers do not fall through the cracks and that recipients of funds are implementing programs in a manner that equitably serves all eligible participants. As part of the Coalition for an Accountable Recovery, NCLR has joined with other national

organizations to offer recommendations for improving access to information and reporting requirements for ARRA.[22] These metrics should be bolstered by efforts to measure changes in key indicators of economic distress, including public assistance caseloads, and unemployment, foreclosure, and poverty rates. Similarly, mortgage servicers are required to provide data on loan modification approvals and denials by race and ethnicity to U.S. Department of the Treasury. At the request of the servicers, however, the Treasury has agreed to not publicly release disaggregated performance data. This decision must be reversed.

- **Restore stability to financial and labor markets through protection and investment.** As Congress makes major adjustments affecting both the housing and labor markets, it must capitalize on the opportunity to modernize protections in the areas of home finance, consumer and worker protection, and language access.[23] Policymakers should also support homebuyers and workers by fully funding key federal programs, such as the Housing Counseling Program and the Workforce Investment Act.

[22] The Coalition for an Accountable Recovery was formed to promote accountability policies for both government agencies and companies that contract with or benefit from recovery spending. Coalition for an Accountable Recovery, "Coalition for an Accountable Recovery ," http://www.coalitionforanaccountablerecovery.org (accessed September 2009).

[23] For recommendations on restoring protections to workers, see National Council of La Raza, *Fractures in the Foundation: The Latino Worker's Experience in an Era of Declining Job Quality* (Washington, DC: National Council of La Raza, 2009), www.nclr.org/fractures (accessed September 2009).

Chairman TOWNS. Thank you very much.
Ms. Hasegawa.

STATEMENT OF LISA HASEGAWA

Ms. HASEGAWA. Good morning, Mr. Chairman. Thank you to all of the members of the House Oversight and Government Reform Committee for inviting me here today. I add my recommendations and support to my colleagues from NCAI, the National Council of La Raza and the National Urban League.

In particular, I would like to thank you, Chairman Towns, for recognizing that communities of color have been disproportionately impacted by the foreclosure crisis and the economic downturn.

Oftentimes, organizations like National CAPACD, we do play a unique role, particularly because we serve low-income Asian Americans and Pacific Islanders and Native Hawaiians. Oftentimes, Asian Americans and Pacific Islanders are considered the model minority and so, for us, it is a pleasure to be here to really talk about the disparities that some segments of our population do face.

My name is Lisa Hasegawa and, again, I am the executive director for the National Coalition for Asian Pacific American Community Development. We go by National CAPACD for short, so when I say National CAPACD, I am talking about my organization.

Again, we are dedicated to meeting the housing and community economic development needs of low-income Asian Americans and Pacific Islanders across the country. We have over 100 community-based organizations in our network. We are in 17 States and, again, focusing on those that are the most vulnerable in our communities.

We have a network of groups that do job training programs, housing counseling programs, etc. and what is unique about them is that they do address the needs of limited English proficient, low-income and immigrant communities in particular and then also Native Hawaiians in Hawaii.

I just also wanted to make sure that it was understood here today that what will help African Americans, Latinos and Native Americans will also help low-income Asian Americans and Pacific Islanders who have experienced discrimination, who have been targeted by predatory lenders and by subprime lending.

Families are suffering from the worst recession since the Great Depression. Asian Americans, Native Hawaiians and Pacific Islanders are no exception. The rate of unemployment among Asian Americans has more than doubled since the fourth quarter of 2007. We believe that this is because of the high rates of self-employment in our communities and because of the broader economic recession, small business owners and those who are self-employed, are particularly hurting.

Although trends in unemployment are unavailable for Asian American and Pacific Islander subpopulations, the American Community Survey did reveal that many AAPI groups faced high levels of unemployment before the recession.

According to the 2005 through 2007 American Community Survey data, the rate of unemployment, just as an example, among Cambodians, Laotian and Hmong communities was around 6 percent, which is higher than the national average, and among

Samoans, Tongans and some Pacific Islander communities, the rate of unemployment was even greater at two times the national average. Those are the kinds of stories you do not see when you look at the data in the aggregate.

Also, many of the Federal programs, I used to work at the White House Initiative on Asian Americans and Pacific Islanders to really look at how Federal programs needed to improve to serve particularly the needs of limited English proficient communities, and one of the things is that a lot of the programs, like the Workforce Investment Act that Mr. Morial mentioned, those programs before oftentimes did not meet the needs of our community because there was not a lot of support for those who, for example, needed to take English language classes in order to be able to successfully have a well-paying job.

The crisis has particularly presented challenges for, again AAPIs who are self-employed and own small businesses. I wanted to also mention, we talked a little bit about credit cards. We are hearing from our member organizations that are working a lot with small businesses, particularly in California, that many times if you are a small business owner you purchase inventory based on the amount of credit that you have. Many of the banks now are decreasing the credit limits in their credit cards up to two-thirds, which is particularly many small businesses in a bind. So, we have heard that from our members who work with small businesses.

Similar to what Janet just mentioned from La Raza, we did look also at the American Recovery and Reinvestment Act and TARP and have many detailed recommendations in our testimony. So, I think I am going to just going to basically go to some of our recommendations.

There was an article that just came out from the Associated Press, on Monday. So, we were trying to pull together this testimony and so it was very timely. It basically stated that home ownership has dropped for Asian Americans in 2008 at a higher rate than any other ethnic group.

Now, that is not usually a statistic that we see. So, if this is, again, and in the aggregate, so that to us is just a signal that things are not so good also in the Asian America and Pacific Islander community, particularly those that are low income.

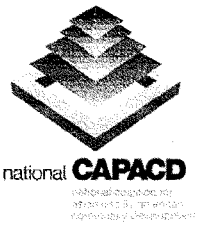
So, just in terms of my recommendations, I think that capacity building programs are very important for the vast array of nonprofit groups that have a lot of expertise working in low-income AAPI communities. Many of the foreclosure and housing counseling programs that were put out to assist these communities did not fund the additional support and case management. You had to actually be a housing counseling organization that was certified. Many AAPI community organizations did not have that certification, were not eligible for the funds, and now are actually turning housing counselors away from their doors because they are going to have to do all of the translation, all of the outreach, without any resources.

So, my recommendations are in terms of capacity building and direct funding for community based organizations to mobilize the expertise that they do have to help with the economic recovery. Those recommendations are listed here.

I also have additional recommendations around data, in particular, and holding of the financial institutions and Federal agencies accountable to what is going on in low-income AAPI communities.

So, thank you very much.

[The prepared statement of Ms. Hasegawa follows:]



House Oversight and Government Reform Committee

Statement of Lisa Hasegawa, Executive Director of the National Coalition for Asian Pacific American Community Development (National CAPACD)

"The Silent Depression: How Are Minorities Faring In the Economic Downturn?"

September 23, 2009

Thank you, Chairman Towns, Ranking Member Issa, and members of the House Oversight and Government Reform Committee, for inviting me to testify on the "The Silent Depression: How Are Minorities Faring in the Economic Downturn?"

I want to particularly thank Chairman Towns and members of this Committee for your leadership on ensuring that communities that have faced disproportionate impacts of the foreclosure crisis and economic downturn receive equitable attention, support and resources, and for acknowledging the unique role that organizations such as National CAPACD and our members have in reaching those that are most vulnerable – recent immigrants and refugees, people who are limited English proficient and Native Hawaiians and Pacific Islanders.

My name is Lisa Hasegawa and I serve as the Executive Director of the National Coalition for Asian Pacific American Community Development, (National CAPACD). Founded ten years ago, National CAPACD is the first national policy advocacy organization dedicated to addressing the housing and community development needs of the diverse and growing Asian American and Pacific Islander (AAPI) communities in the United States. Our mission is to be a powerful voice for the unique community development needs of AAPI communities and to strengthen the capacity of community-based organizations to create neighborhoods of hope and opportunity.

The strength of our policy analysis and advocacy comes from the knowledge and insight of our network of over 100 member organizations, including community development corporations, preservation agencies, social service providers and advocacy groups, as well as national intermediaries and financial institutions. Working in over 17 states, our members implement innovative affordable housing, community development and community organizing strategies to improve the well-being of low-income AAPI communities. Our network is comprised of local community based agencies representing a diverse constituency including the wide diversity of

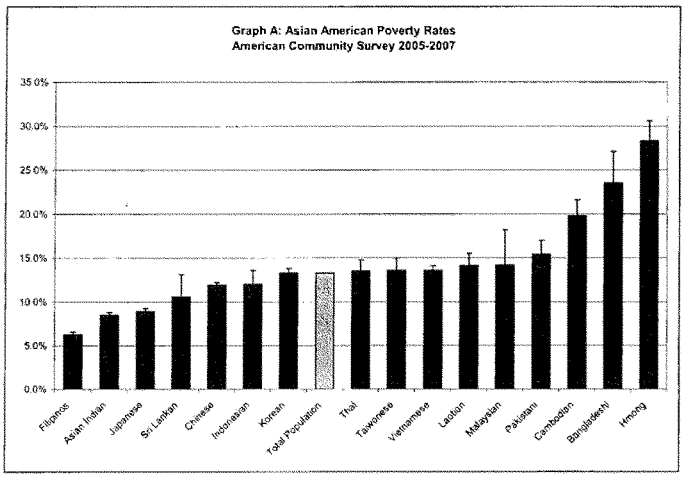
Asian Americans, Pacific Islanders, Native Hawaiians, refugees, immigrants, and low-income families of all ethnicities.

I am here today, joining my colleagues from NUL, NCLR and NCAI, to discuss ways to address the disproportionate impact of the foreclosure and economic crisis on communities of color. Specifically, I will bring attention to the fact that the Asian American, Native Hawaiian and Pacific Islander communities have also been negatively impacted by the current recession. In particular, rising foreclosure rates and the drop in homeownership within our communities is a signal that serious attention must be paid to the special needs of this diverse and rapidly growing population. We believe that structural and implementation barriers will continue to limit the success of key initiatives in responding to the needs of the AAPI communities unless they are rapidly addressed. We stand ready to partner with federal agencies to overcome these barriers.

Growing Insecurity: *Unemployment, Underemployment and Job Stability*

Families are suffering from the worst recession since the Great Depression and Asian Americans, Native Hawaiians, and Pacific Islanders are no exception. The rate of unemployment among Asian Americans more than doubled since the fourth quarter of 2007. Although trends in unemployment are unavailable for AAPI subgroups, data from the American Community Survey reveal that many AAPI groups faced already high levels of unemployment before the recession. According to the 2005-2007 ACS, the rate of unemployment within Cambodian, Laotian, and Hmong communities was 5.5%, 6.2%, and 6.6%, while the rate among Samoans (8.1%) and Tongans (8.7%) was even greater, at nearly two times the national average (4.2%).

Others factors suggest that a substantial number of AAPIs are at risk of even greater economic insecurity as a result of the recession. With poverty rates at or above the national average before the recession (see graph below), many AAPI groups had few resources to turn to after the loss of a job. The lack of linguistically and culturally appropriate job training programs for AAPIs relegated many low-skilled and limited English proficient AAPIs to low-wage work without opportunities for advancement.



The crisis has also presented new challenges for the large percentage of AAPIs who are self-employed or own a small business. AAPI-owned small businesses are struggling to access credit as even previous sources of capital such as home equity lines of credit have dried up with the decline in housing prices. This lack of working money/capital has put AAPI families at even greater risk of losing their homes and their businesses, and further reduces employment, income, and revenue in the AAPI communities.

Addressing Economic Insecurity in AAPI Communities

- **American Recovery and Reinvestment Act:** The American Recovery and Reinvestment Act (ARRA) provided new investments in education, workforce training, and other key areas, that could benefit AAPI communities and the broader economy, yet much of this funding has not been accessible to communities most in need. To respond rapidly to the loss of jobs and deteriorating economy, Congress distributed ARRA funds through existing formulas and programs. While this strategy allowed activities to be implemented quickly, in some cases, it subjected funds to longstanding policies that limited access to services for AAPI and immigrant communities before the economic crisis. For example, the Workforce Investment Act funding provided by ARRA is being administered under the current WIA performance-based system which discourages job training providers from serving clients who may require more intensive services such as persons with limited English proficiency or multiple barriers to work.

  Given the immediacy of the crisis, ARRA also distributed stimulus funds to states and entities/organizations with demonstrated experience, support, and funding. Unfortunately, this has had the unintended consequence of excluding many community-based organizations best positioned to work in underserved communities and deliver linguistically and culturally appropriate services. Criteria that prioritizes larger projects

and broader outcomes can also limit the ability of organizations working in AAPI or immigrant communities to access recovery funds, particularly when the community being served is smaller, faces greater barriers to employment, and often needs additional services. For example, our member organizations in Seattle, Washington reported that AAPI communities were not able to assess green retrofits and green jobs programs because only one project in the city met HUD's criteria for funding larger properties with more than 75 units. The design of ARRA funds also fails to meet the support and services needed by AAPI communities, such as the cost of translation/interpretation services, case management, and other wrap around services, which can be difficult for community based organizations operating on thin margins to shoulder on their own. Finally, ARRA funds have provided AAPI organizations with few opportunities to partner with key stakeholders on initiatives, build capacity, or apply directly for funds. These restrictions are impacting communities and community-based organizations at an especially challenging time when demand for services has increased but funding for benefits and programs have been cut, and could result in the loss of critical safety net programs in many communities of color.

- **Troubled Assets Relief Program:** Created by the Emergency Economic Stabilization Act of 2008, the Troubled Assets Relief Program (TARP) played an important role in stabilizing financial markets during the credit crisis, but this has not been accompanied by the increase in credit availability needed by so many small businesses. According to the Pacific Asian Consortium in Employment, a National CAPACD member organization in Los Angeles, the number of loans they have been able to fund for small businesses has declined by 87 percent. Although not traditionally considered a workforce development strategy, small business programs are critical to creating opportunities for self-employment and self-sufficiency in AAPI communities in particular due to language barriers. Oftentimes, limited English proficient workers are unable to find living-wage jobs through traditional workforce development program placement. It is essential to hold financial institutions who received taxpayer money accountable, yet the Treasury Department has not required TARP recipients to increase credit to communities.

The Subprime Crisis, Housing Stability and Foreclosures

The loss in economic insecurity has also been made worse by rising rates of foreclosures in AAPI communities. An Associated Press article released on September 21st shows that homeownership rates throughout the country have fallen in 2008, and Asians were the hardest hit among all racial groups (see Attachment). Researchers and economists from New York University analyzed data from the American Community Survey, just released by the U.S. Census this week, and concluded that homeownership rates for Asians fell the sharpest by 1.24 percent. For African Americans, the drop was 0.88 percent, and for Latinos, the decline was by 0.80 percent. What is perhaps most compelling about this information is that income levels for AAPI communities, as an aggregate, is higher than other minority groups. So what has happened to cause such a steep decline in the rates of homeownership?

According to data prepared by the Center for Responsible Lending, subprime loans among Asian Americans almost tripled between 2004 and 2005. Native Hawaiians and Pacific Islanders have significantly higher percentages of high cost loans than the general population. Lending disparities for Asian Americans and Pacific Islanders have also been documented across the country. In specific metropolitan statistical areas in California, Massachusetts, Nevada, Wisconsin, New Jersey, Hawaii, Minnesota and Washington, Asian American and Pacific Islander borrowers were significantly more likely to receive a high cost loan than White borrowers. Based on HMDA data of 2006, we estimated that $6,446,424,000 in loans is at risk of foreclosure in AAPI communities.

A report created by the Federal Reserve Bank of San Francisco, entitled *The Untold Costs of Subprime Lending: Examining the Links among Higher Priced Lending, Foreclosures and Race in California,* examines the factor of race in subprime lending amongst California borrowers. We find this study of value to us in that one-third of all Asian Americans and one-fourth of all Pacific Islanders live in the state of California, according to 2005-2007 American Community Survey data. One of their conclusions, in addition to the fact that communities of color were disproportionately impacted and targeted by the subprime lending market, also concludes that borrowers with higher-priced loans (as a result of the subprime market) were 15.7 percent more likely to be in default, even after controlling for loan-to-value, FICO scores, and house price change.

In regards to the Asian American and Pacific Islander communities, the study in particular points out that there were certain characteristics within the communities that make the population more vulnerable to receiving high-cost loans, and were therefore more susceptible to foreclosure. These characteristics include immigration status, the presence of language barriers, limited knowledge of the financial system in the US, and/or other cultural differences that may influence the likelihood of default. The study concludes that there clearly remains a segment of the Asian population that is vulnerable to higher rates of default, and suggests the need to develop culturally and linguistically relevant foreclosure prevention resources for multiple market segments, and to conduct outreach through a much larger network of nonprofits and community-based organizations.

Though some trend data is readily available by sub-population to at minimum identify API communities that are likely at higher risk of foreclosure, little has been done by federal programs to conduct outreach in API languages, nor have internal systems been built to develop a mechanism for limited English proficient (LEP) borrowers to receive help from federally-funded housing counseling programs. Nonprofit community-based organizations, often a first line of defense for LEP individuals and families, were left with few resources to develop their counseling, translation and/or case management abilities in order to meet the needs and demand for housing and foreclosure counseling services. In many communities of color and neighborhoods hit hardest by foreclosures, there are many community based organizations that can play an important role in addressing the crisis, however no funds have been available to support their critical role in culturally and linguistically appropriate case management, education and outreach. In many AAPI communities, there are few if any established housing counseling agencies with any type of foreclosure/default counseling experience. HUD's housing counseling programs and other federally-funded foreclosure

prevention programs such as the National Foreclosure and Mitigation Counseling program (administered by NeighborWorks America) were designed to support mainly established programs. There were gaps in the HUD housing counseling and foreclosure counseling delivery system for AAPI and other LEP communities before the crisis hit, and government agencies, GSEs and intermediaries did not design initiatives or strategies to sufficiently address these gaps. While HUD's certification process is important to ensure some standard of quality assurance, the requirements for certification combined with the application process, takes more than a year to complete before an organization is even eligible for any of the existing sources of funding. While we do not fault this priority or system of certification, federal agencies and organizations tasked to lead the government's response to foreclosure crisis could have taken more proactive steps to address known gaps and created strategies to support the mobilization of existing capacity of CBOs with expertise in serving LEP, immigrant, refugee and other underserved communities.

National CAPACD has partnered with Bank of America, Freddie Mac, the National Urban League and the National Council of La Raza to invest resources into strengthening the work and networks of local, community-based service organizations to provide such culturally and linguistically competent housing counseling services. This year alone, National CAPACD will invest nearly $500,000 (one-third of the organization's entire budget) of its resources into work that is being done to bring needed services to communities in need. Through a separate report generated by the Federal Reserve Board in 2008, we found that some of the hardest hit communities within the Asian American and Pacific Islander population were those communities that had either more recently immigrated or were already economically vulnerable. The report used data that incorporated information gathered from the Census and the First American Loan Performance Data, a source that tracks subprime loan performance. The study looked at highly populated API zip codes across the country and overlayed this information with loan performance data. The data that was produced helped us to see the great disparities even within the AAPI rubric, and we use this data as the basis for our advocacy because it allows further analysis into the overall set of statistics around a very general AAPI category. For example, the Federal Reserve Bank of San Francisco may report that the default rate for AAPIs is 3.8 percent, but data that is disaggregated by ethnic origin tells a different story. Specifically, the correlated data from the report compiled by the Federal Reserve Board highlighted the Pilipino and Chinese communities of California's Riverside-San Bernadino-Ontario MSA were at-risk for foreclosure, as well as the Hmong community of Minneapolis-St. Paul where there were high instances of defaults and high concentrated populations within the zip code. Other communities at risk and of note included the South Asians residing in Queens County, New York; Koreans living in Orange County, California; Pilipinos in multiple California counties, including San Diego; Chinese living in Los Angeles County; multiple ethnic groups throughout the state of Hawaii, including Native Hawaiians.

Ethnic groups that make up the very diverse Asian American and Pacific Islander category such as those cited above are often times unable to access housing and foreclosure counseling services due to language and cultural barriers. Mainstream nonprofit housing counseling organizations are already overwhelmed with their English-speaking client base, and it is unthinkable that they would stretch their own capacity to serve a new audience that they are unequipped to work with. It has been demonstrated in the County of Los Angeles that API-

speaking borrowers **with** culturally appropriate case managers still have difficulty accessing existing foreclosure services due to the existing burden on the current system. Because the nonprofit community-based organizations were left out of funding streams and programs such as the National Foreclosure and Mitigation Counseling program, it translated into thousands of LEP API families either not accessing services at all, or were delayed in receiving some sort of assistance. In either case, the results have come to the fact that Asians were the hardest hit racial group to experience a drop in rates of homeownership in 2008.

Improving Foreclosure Outcomes in AAPI Communities

- **Making Home Affordable program:** Despite commendable efforts by the Administration to provide incentives to services and lenders to modify loans for troubled homeowners, new data released by the Treasury Department in August show that lenders and services have made very slow progress, and their efforts continue to be dwarfed by the need. A New York Times editorial on August 10, 2009 noted that only 9% of almost three million troubled loans eligible for relief have been impacted by the program. This reflects the experiences of National CAPACD's member organizations who report that lenders and servicers are not competently or effectively responding to consumers seeking relief or foreclosure counselors. Furthermore, information on the MHA program was slow to reach housing counselors within AAPI-serving organizations, as well as borrowers and clients. Through a project recently commissioned by Freddie Mac and the Treasury Department, National CAPACD worked together with its member organizations to translate crucial documents that would help market the MHA program in AAPI communities. Brochures and posters were translated and printed into three Asian languages – Chinese, Korean and Vietnamese. These documents are helpful, but are again dependent on a delivery system that can adequately serve the cultural and linguistic needs of the communities we serve. on the front lines. Serious barriers in the loan modification process continue to frustrate homeowners and present particularly harsh challenges for clients with limited English language skills or other difficulties navigating this complex process. The slow progress highlights the need for greater enforcement, transparency, and accountability within the MHA program to ensure that lenders and servicers properly implement MHA in a timely and consistent manner across their entire loan portfolios. Borrowers should be given an opportunity to review decisions when denied a loan modification and seek recourse when decisions are rendered incorrectly. We also urge HUD and the Treasury Department to work with AAPI and minority communities in developing strategies to ensure that the MHA program and future initiatives are comprehensively accessible - not only through the translation of outreach materials, but through a service delivery system that It is not for lack of trying to make existing systems work..

- **Hope for Homeowners:** A program created in the previous presidential administration, the Hope for Homeowners has been unsuccessful, primarily due to the fact that participation by lenders is voluntary, which is a huge barrier since there are no incentives for lenders to participate. Key program goals, such as the reduction of principal on "upside down" loans is critical, especially in high cost areas like California that have seem home values plummet.

Recommendations

We support the recommendations of our colleagues with regards to addressing design and implementation challenges for ARRA, TARP, Making Home Affordable and Hope for Homeowners to ensure inclusion and equity for communities of color and those most underserved. Core to National CAPACD's advocacy work is ensuring that needs low income underserved AAPIs are adequately addressed by federal agencies and national initiatives. We stand with our colleagues in calling for the accountability for spending and performance, and the need to restore stability to financial and labor markets through consumer protection and investment. Specific recommendations include:

- Recovery efforts must recognize the needs of AAPI families, workers, very small business owners and homeowners, particularly those of underserved AAPI communities who live in poverty and are living in economically distressed neighborhoods and neighborhoods hit hardest by foreclosures.

- Assess each new federal initiative that is investing in existing systems and infrastructure and require that government agencies, GSEs and entities such as Neighborworks proactively address known gaps in existing delivery systems.

- Support capacity-building programs as well as direct funding for case management, translation, interpretation and culturally competent outreach for community based organizations serving communities of color. As we move into the second year of ARRA's implementation, we urge Congress and the Administration to provide communities of color with opportunities to build capacity, partner with key stakeholders on initiatives, and apply directly for funds. Funding for these activities would build on the strengths of community based organizations - they are an essential bridge between all communities of color, and government programs and economic stimulus initiatives, certainly for immigrant, refugee, limited English proficient Asian American communities and Native Hawaiians and Pacific Islanders.

- Direct HUD, Neighborworks America, Treasury, Freddie Mac and Fannie Mae to coordinate foreclosure mitigation efforts and resources to develop a comprehensive capacity building and outreach effort targeted at Native Hawaiian and Pacific Islander communities in states with high rates of foreclosure and unemployment and significant AAPI populations - these states might include California, Nevada, Minnesota, Washington, Florida, New York and Hawaii.

- Establish a working group of community representatives expert in the fields of housing, neighborhood stabilization and employment training, representatives of the states with significant concentrations of underserved Asian American, Native Hawaiian and Pacific Islander communities to advise on design of economic and housing programs and to identify areas of need and effective implementation strategies.

- Ensure that data that is being collected to assess the effectiveness and impact of economic stimulus include large enough samples of AAPI populations so that data can be disaggregated and tracked over time. Often, data on AAPIs at the national level does not illuminate areas of unmet need, so more focused analysis on data from states that have significant concentrations of AAPIs needs to be conducted during the design, implementation and monitoring of initiatives addressing the recession, foreclosure and employment.

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Homeownership fell in '08; Asians hit worst

ALEX VEIGA, Associated Press
Posted: 09/21/2009 04:00:35 PM PDT

LOS ANGELES - Asians, many of them living in foreclosure-ravaged California, suffered the sharpest drop in homeownership last year, eclipsing declines felt by whites, blacks and Hispanics, according to new Census data.

The decline was surprising, because Asians tend to earn more than other minority groups and have less debt. But one out of three Asian homeowners lives in California, which has seen foreclosure rates skyrocket and home values plummet since the housing bubble burst. And that appears to have disproportionately exposed them to the effects from the housing collapse, experts suggested.

The U.S. homeownership rate fell to 66.6 percent last year, the lowest in six years, after hitting a peak of 67.3 percent in 2006, according to figures from the American Community Survey, which was released Monday by the U.S. Census Bureau.

Homeownership for Asians fell 1.24 percentage points last year to 59.4 percent.

The decline was 0.88 percentage points for blacks to 45.6 percent. Hispanics experienced a similar decline, down 0.80 to 49.1 percent. Whites suffered the smallest decline, down 0.40 to 73.4 percent.

But because Asians only represent 3.3 percent of all U.S. homeowners, the decline in the number of black and white households was greater. The number of Hispanic homeowners actually rose, reflecting trends in immigration and higher birth rates.

Nevertheless, as a population group, Asian homeowners fared far worse than others.

That revelation surprised some experts such as Edward Wolff, an economist at New York University.

"Based on their income and relatively low debt, one would expect that they would have a smaller decline in homeownership," Wolff said.

The median annual household income for Asians was just over $70,000 last year, higher than for any other racial group.

"It's possible that it's a regional effect," Wolff suggested. "There's a high concentration of Asian-Americans in California, and California got particularly hard hit by property (price) declines and high foreclosure rates."

While foreclosures have been declining on a monthly basis in California this year, the state continues to have the most foreclosures in the country and one of the highest rates of foreclosure-related filings, according to RealtyTrac Inc.

The drop in homeownership is a reversal after the housing boom years, when minorities in the U.S. took advantage of easy access to financing and became homeowners.

Minorities haven't lost all the gains reaped during the housing boom years, but data from 2009 could begin to show otherwise, said demographer Mark Mather with the Population Reference Bureau in Washington D.C.

"So far these rates are still higher than they were back at the beginning of the decade, but it could be that this data are too young," he said. "We need to wait for the 2009 data because we're really just capturing part of the recession at this point. And the really high double-digit unemployment didn't hit until earlier this year."

Jennifer Nguyen and her husband Mike Truong are among this year's once-again renters, who will be counted in the 2009 Census survey that will be released next year.

The couple owned a townhome and sold it in 2004, making a $200,000 profit that they put toward a $555,000, three-bedroom, two-bath house in Anaheim two years later.

But financial problems mounted after Troung, a truck driver, saw business slow along with the economy. The couple fought to hang on to their home, but couldn't refinance because the property's value had dropped sharply. Attempts to get their mortgage loan modified also failed.

In June, the bank took possession and sold it at auction.

"At that moment my body was numb," Nguyen, 30, wrote in an e-mail. "Our first chapter of our life has been shredded and we are now ready for a new fresh start."

Chairman TOWNS. Thank you very much.
Ms. Johnson-Pata.

STATEMENT OF JACQUELINE JOHNSON–PATA

Ms. JOHNSON-PATA. Thank you. And I would like to join with the rest of the panel in thanking you, the chairman, and the members of the committee for including us in this particular hearing.

On behalf of our country's tribal nations, the National Congress of American Indians is pleased to offer our recommendations gleaned from the experience of the Native American communities.

Tribes offer unique innovations that can make significant contributions to the policy debate regarding the economic crisis. The title of this hearing is particularly relevant to our communities. Depression-like economic conditions have been evident in our Native American communities for decades and Federal policy responses have often been ineffective.

Many of our recommendations directly address the fact that reliable data is not available to adequately assess the impact of economic crisis in our communities.

While the national unemployment rate climbs closer to 10 percent, on-reservation unemployment rate in the 2000 census was 22 percent, just 3 percent less than the unemployment rate during the Great Depression. Put simply, economic crisis in our community is not an occasional disaster, it is a daily reality.

However, the Bureau of Labor Statistics does not include on-reservation unemployment rates in their monthly reports. Rates well above 50 percent, in some cases. The absence of this reliable current data is of significant concern to tribal leaders and should be that of those representing their States.

Tribal governments can serve as significant incubators of economic and job growth. In spite of this potential, tribes were excluded from many job creation provisions in the Recovery Act, including many of the Department of Labor's initiatives.

Green jobs represent an important new employment opportunity for disadvantaged communities. Tribal lands are a potentially rich source of renewable energy. The Department of Energy estimates that tribal alternative energy could meet 20 percent of this Nation's energy needs through wind energy and up to 450 percent through solar energy.

Tribes are positioned to prepare Native people and other rural residents to participant in the new green economy, but they have been left out of the Federal efforts.

While the United States faces one of the most significant housing crises in our Nation's history, many forget that Indian housing has been a crisis for generations. Data related to the impact of the economic crisis on Native home ownership is weak, and we recommend that the Federal Government invest in quality data collection.

While there is some evidence of challenges with foreclosures in Native communities, the real problems our communities face is not of foreclosures, per se, but access to home ownership opportunities in the first place, something I think Mr. Carr in the first panel discussed a little about.

In 1999, there were a total of only 471 home mortgages on Indian lands. That represents only 1.2 percent of the households that had sufficient income to qualify for a mortgage. And that need for mortgages on reservations in a persistent problem.

There are challenges in accessing financing on tribal lands. The 2001 Native American Lending Study found that 86 percent of Native communities lacked a single financial institution within their borders, and 15 percent of Native Americans needed to travel over 100 miles to access a financial institution.

The expansion of the Native CDFI field has helped prepare our tribal citizens for mortgage lending and opportunities and offered cutting edge financial education programs that developed financial skills for the whole community.

Tribal governments have also played a role in regulating lending practices on tribal lands. Tribal jurisdiction must be protected in the same way as State government jurisdiction is protecting Federal statutes regarding things like predatory lending.

Economic revitalization in Indian country is closely linked to business development. Federal strategies to expand access to contracting services for minority owned businesses are particularly critical in reservation communities. Tribal communities are generally located in rural areas with very limited economic opportunities, and tribal governments have a severely limited tax base. Tribes cannot impose property taxes on trust land. And an additional income tax on a community dealing with multi-generational poverty is not feasible.

This means tribal citizens often have greater service needs than their non-Native counterparts. But their governments have fewer resources to serve their citizens.

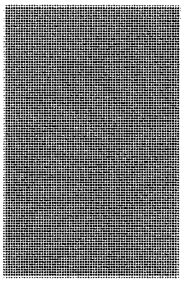
The Federal Government's Native 8(a) Contracting Program is one way entrepreneurs in Native communities build Native economies by helping our people secure government contracts. In a 2006 report, the GAO found that the management training programs were common among Native owned businesses. ADA Contracting Programs are vital strategies to raise both revenue and business sophistication in Indian country. The program also demonstrates Congress' commitment to promoting tribal self-determination and self-sufficiency.

In conclusion, we look forward to working with the committee to ensure that tribes have the same access to the Recovery Act resources and tools as other governments, unemployment data is available to measure the extent of the crisis and the recovery, and opportunities to partner with tribes are not missed.

And we look forward to a future where Native people have the same opportunities for home ownership as other Americans, and small business opportunities at the heart of our rural and reservation communities and economies that are supported and expanded through effective Federal investments.

I thank you for the opportunity of testifying today.

[The prepared statement of Ms. Johnson-Pata follows:]



NATIONAL CONGRESS OF AMERICAN INDIANS

Testimony for the

United States Congress

House Committee on Oversight and Government Reform

The Silent Depression: How Are Minorities Faring In the Economic Downturn?

Wednesday, September 23, 2009

National Congress of American Indians
Jacqueline Johnson Pata
Executive Director

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The National Congress of American Indians (NCAI) is the oldest, largest and most representative organization serving American Indian and Alaska Native people. We are the membership organization that represents the interests of the 562 federally-recognized tribes here in the United States. Since our inception in 1944, tribal governments have come together as a representative congress through NCAI to deliberate issues of critical importance to Native communities.

We come to this conversation convinced that – as one of the three types of government recognized in the U.S. Constitution – federal, tribal and state governments – tribes offer unique innovations that can make significant contributions to the policy debate regarding the economic crisis and the prospects for a fair and equitable recovery for all Americans.

Economic development in Indian Country lags behind the rest of the nation and impacts nearly every aspect of reservation life and tribal governance. For generations our communities have faced economic conditions that are even more pronounced than those of the current economic crisis. Eight of the ten poorest counties in America are home to Indian reservations. While economists worry as the national unemployment rate climbs closer to 10 percent, data shows that unemployment among Native people was 15 percent in 2003 and has not dropped below 10 percent for generations. To compare directly to the Great Depression, the 2000 Census recorded unemployment for American Indians on reservations at 22 percent compared to the unemployment rate during the Great Depression of 25 percent. Put simply, in many Native communities economic crisis is not an occasional disaster, it is a daily reality.

The 2000 Census reported the per capita income for American Indians and Alaska Natives living on reservations at $7,942, merely one-third the U.S. average for all races, which was $21,587. Low average income, coupled with high unemployment, means the poverty rate for Indian families on reservations is 36 percent, which is two and half times the national average.

Homes in Indian Country reflect the pronounced challenges of persistent poverty. Eleven percent of Native households lack kitchen facilities, 17 percent lack telephone service and 12 percent lack complete plumbing, while less than 1 percent of the U.S. population lack any of these facilities. Only half of reservation homes are connected to public sewer lines and our homes are almost three times more likely to be overcrowded than the national average.

More dire, in some ways, than simple statistics, are the stories from the ground. For example, many Alaska Natives are seeing the impact of the recession more than most. George Lamont, a tribal administrator in Tuluksak, Alaska, fears many tribal members may have their electricity shut off because of the crisis and the inability to pay their bills due to high fuel costs. They are having to choose between heating their homes and putting food on the table. Some say, the majority of their nutritional needs are being met by the school lunch program.

Hundreds of tribes suffer economic hardship and remain nearly invisible. They struggle to preserve their reservations, their culture, and their sovereignty. They are now feeling the full effects of the economic downturn and are even more vulnerable because governmental revenues are dependent on effective economic development (as discussed below). For some tribes, industries like timber production – once considered economic staples – are closing their doors. Even higher-profile gaming tribes around the country are currently laying off thousands of workers, affecting the economy of entire regions. The downturn is having a dramatic effect on tribal governments whose citizens already occupy the bottom end of the socio-economic scale.

Although Indian specific data is not available to analyze many aspects of the impact of the recession on Indian country, signs point to the downturn hitting low-income Americans hardest. Between September 2006 and October 2008, the unemployment rate for workers age 25 and over who lack a high school diploma, a very low income group, increased by 39 percent.[1] In 2007, 20 percent of American Indians aged 25 and over lacked a high school diploma, compared to 14 percent for the U.S. population.[2]

These substandard economic and quality of life indicators have a social toll as well. Health disparities are prevalent and suicide rates (a symptom of lack of opportunity) are high with over 60% more incidents than the average in America. Alcoholism on reservations and diseases like tuberculosis are both over 500% higher among Indians.

Despite the challenging social and economic conditions on reservations, there are examples of economic success that have resulted from tribal investments in infrastructure and use of available federal tools to grow their local economies and provide their citizens with a better quality of life – the goal of every government.

For example, in the 1960's, rural Neshoba County in Mississippi was once one of the country's most economically-depressed areas. Neshoba County is home to the Mississippi Band of Choctaw Indians who lived under miserable economic and health conditions. Nearly all houses on the reservation were considered substandard: 90 percent had no indoor plumbing; one-third had no electricity[3].

In the 1980's the Tribe worked hard to turn conditions around by building the infrastructure necessary to draw industrial jobs to the reservation. After completing an industrial park, the tribe

[1] Parrott, Sharon. (2008, November 24). *Recession Could Cause Large Increases in Poverty and Push Millions into Deep Poverty.* Washington, DC: Center on Budget and Policy Priorities.
[2] U.S. Department of Commerce, U.S. Census Bureau (2007). *2007 Annual Social and Economic Supplement.* Current Population Survey (CPS).
[3] NPR, All Things Considered, July 17, 2004

convinced a division of General Motors and the American Greetings company to locate on the remote reservation. Soon after, the tribe diversified its economy by creating service sector enterprises. Today, the tribe is the state of Mississippi's second largest employer with over 8,000 employees on its payrolls[4]. After generations of living in the worst economic conditions, the tribe has become a regional economic leader in the south.

Mississippi Choctaw is not an isolated example. Tribal governments, when given the right tools, can effectively lift their communities out of poverty and fully participate in the American economy. Not only can tribes raise their economic profile, but they have proven time and again that investing in tribes is an investment in rural America. Surrounding communities, and sometimes entire regions, are also beneficiaries of tribal success.

An analysis of socio-economic change between 1990 and 2000 showed that Indian Country economies grew at a faster pace than the economy as a whole. In fact, over the last 30 years the inflation adjusted per capita income of Indians on reservations grew by 83 percent compared to 64 percent for the U.S. population as a whole. While these gains are remarkable, our per capita income remains one-third of the U.S. average. If incomes were to continue to grow at their 1990s rate, the gap would not close for another 55 years.

These positive trends – for individual and communities – are at the heart of our testimony. The leaders of NCAI – elected tribal leaders from many of the states represented in this room – are regularly here on Capitol Hill to remind policymakers that self-determination works, but it needs more investment to work at a reasonable pace! Those conversations are about the simple reality that investments in tribal governments support policy innovations that can be – and have been – replicated to deal with some of America's toughest economic problems. The data presented in this statement demonstrate that it is both essential and mutually beneficial for the federal government to partner with tribes to address the economic challenges facing our communities.

The statement will address our work on the American Recovery and Reinvestment Act (ARRA) and will then deal with three particular areas where challenges – and opportunities – exist for economic recovery in tribal communities. Those areas are: unemployment, the foreclosure crisis and minority business development.

1. Indian Country and ARRA

Understanding the ongoing need for economic recovery

[4]Neshoba County Website, Community Development Partnership, Mississippi Band of Choctaw Indians Timeline

In the early days of the Obama administration our policy team worked to ensure that the most pressing challenges facing Indian Country were on the table as the Recovery Act was being written. We effectively communicated the needs of Indian Country, identifying more than $6 billion in unmet needs with the potential to lift Native communities out of poverty and substantially stimulate local, regional and the national economy. Our efforts helped to secure $3 billion in direct tribal funding. In addition to this funding, tribes are eligible for some general funding allocations related to broadband and other infrastructure focused investments.

After the Act became law, NCAI was one of the first organizations in the nation (and well ahead of many states) to set up a clearinghouse of information on ARRA. Our website, IndianCountryWorks.org provides up-to-date information on funding opportunities and provides other technical assistance through webinars, email updates and other resources.

However, while $3 billion is an unprecedented one-time investment in Indian Country, it is really just a drop in the bucket to addressing the economic needs of tribal communities. Many of the "shovel ready" projects in Indian Country have been that way for over a decade. For example, two health facilities will be constructed in Alaska and Oklahoma using more than $200 million in recovery funding, providing much needed health services to Native people in Alaska and Oklahoma. However, those facilities have been on the Indian Health Service's Healthcare Facilities Construction Priority List since the mid-1990s. (Clearing the priority list, alone, is estimated to cost $2.6 billion).[5]

Advocating for a fair and equitable recovery

Our work to advocate for a fair and equitable recovery is about making sure shovel ready projects are funded in areas of the most need – including Native communities and other communities of color. While tribal-state partnerships have worked very effectively on a range of policy issues, direct tribal funding and set-asides tend to work more efficiently to meet the unique needs of Native communities. This is particularly true with respect to housing and infrastructure.

For example, the Recovery Act provided $510 million in increased investments in Indian housing programs that have already proven effective. The Indian Housing Block Grants recognize and support the authority of tribes to make their own decisions to meet the pronounced housing challenges in reservation communities. Over the past decade, the Native American Housing and Self Determination Act has provided support for tribes to halve the number of homes that lack plumbing and are overcrowded. There is still a lot of work to do, but tribes are

[5] Senator Byron Dorgan, Opening Statement to Senate Committee on Indian Affairs Hearing "The State of Facilities in Indian Country: Jails, Schools, and Health Facilities," March 6, 2008

successful in meeting the needs of their communities when they are provided with sufficient resources to do so.

Beyond housing, economic mobility requires access to basic infrastructure. While tribal leaders are concerned about access to broadband – which stands at only 10 percent on reservation lands – the more immediate problem is that tribal members are almost 15 times more likely to lack access to electricity than the general population and one in every three Native homes lacks basic telephone service. As we detail below, the irony is that tribal lands are home to significant traditional and alternative energy sources, yet tribes have been overlooked as partners in meeting the energy needs of tribes, states and the nation as a whole.

Measuring the Impact of the Recovery

We are heartened by the commitment of the federal government – along with tribal (and many state governments) – to ensuring we can measure the impact of government investments like the Recovery Act. However, the absence of reliable data collection is a significant barrier. Specific examples of the paucity of data to guide tribal policymaking is outlined in the next section.

To specifically measure the impact of the Recovery, we are working with tribes to collect data that assesses four key areas:

1. The experience of the federal grantmaking process from the recipient/applicant perspective (e.g., How did the money get out the door? Were the intended uses of funds/programs a good match for tribal communities? What evaluation process was used for competitive grants? How did tribes fare in competitive grant pools in which they were one of several potential applicant groups- that is, in a pool with state and county governments and/or nonprofit organizations?)
2. The impact of Recovery dollars from an infrastructure building standpoint (e.g., How many jobs were preserved? How many new temporary jobs were created? How many new permanent jobs were created? What was the quality of jobs created- salaries, benefits, etc.? How many miles of new road were created? What new governmental and community institutions- schools, hospitals, jails- were built? What is the impact of having these services available in the community?)
3. The impact of Recovery dollars in creating the future that tribal communities desire (e.g., Building institutions and infrastructure that allow people to live in the community and stay in the community to receive services: increasing the availability of culturally-appropriate services: increasing the "sense of community" by building institutions and infrastructure that connect people and places: in the long-term, facilitating the creation of the economic opportunities that the community wants)
4. The ongoing economic development and infrastructure needs in Indian Country that remain untouched by the Recovery effort

Working with tribes to ensure the federal government understands the impact of ARRA is a critical strategy to ensure the recovery does not leave some of America's most vulnerable citizens behind.

2. Unemployment in Indian Country

Unemployment is rightly a key focus of this hearing. The story of unemployment in Indian Country is one of a paucity of data and some egregious missed opportunities for the federal government to invest in economic revitalization in some of America's most economically challenged communities.

Unemployment data – the story it tells, and what is missing

Unemployment data is an increasingly important lens in assessing the extent of the economic crisis and our recovery from it. It is therefore, particularly concerning to us that the Bureau of Labor Statistics does not include on-reservation unemployment rates (often at levels well beyond 50 percent) in their monthly employment reports. This absence means that the unemployment rate for states with high Native populations is likely considerably understated, whether states with higher than average unemployment rates (as in Michigan or Oregon at 14.1 and 12.1%, respectively) or lower than average (as in Arizona or Montana, at 8.2 or 6.2% respectively). The role of this data in directing federal appropriations and guiding federal, tribal and state policymaking underscore the importance of remedying this situation.

Furthermore, data from the Census Bureau identifies American Indians and Alaska Natives as the population facing both the most pronounced socioeconomic disadvantage and the least accurate Census data. The annual Census report on poverty and health insurance in America consistently reports Native data as a footnote with the three most frustrating words for policymakers who care about tribal communities – "insufficient sample size."

The paucity of data makes analysis of contemporary data sources very difficult, however the data table below, comparing state-by-state unemployment data from March 2009 to the most reliable Native/non-Native rates (from the 2000 Census) show that it is overwhelmingly likely that Native communities are being hit very hard by the economic downturn.

Table 1: A comparison of Native unemployment to the national picture[6]

	Q2 2009 (All races)	2000 Census Unemployed (All races)	2000 Census Unemployed (AI/AN Alone)	2000 Census (AI/AN Alone on Reservation/Trust Land)
USA	9.30%	3.70	12.4	21.9
Alabama	9.60%	6.2	5.8	14.9
Alaska	8.20%	9	11.7	21.8
Arizona	8.20%	5.6	9.5	25.6
Arkansas	6.90%	6.1	4.4	
California	11.40%	7	6.8	18.6
Colorado	7.50%	4.3	6	14.9
Connecticut	8.00%	5.3	5.8	4.8
Delaware	8.00%	5.2	4.5	
District of Columbia	10.50%	10.8	7.3	
Florida	10.20%	5.6	5.6	7.7
Georgia	9.60%	5.5	5.6	
Hawaii	7.20%	6.3	7	
Idaho	7.70%	5.8	10.4	18.6
Illinois	9.90%	6	6.6	
Indiana	10.40%	4.9	5.3	
Iowa	5.70%	4.2	6.5	19
Kansas	6.80%	4.2	5.1	11.6
Kentucky	10.50%	5.7	7	
Louisiana	6.50%	7.3	5.4	5.7
Maine	8.20%	4.8	7.4	20.6
Maryland	7.10%	4.7	4.5	
Massachusetts	8.30%	4.6	5.1	
Michigan	14.10%	5.8	7.2	16
Minnesota	8.20%	4.1	9.3	18.4
Mississippi	9.30%	7.4	8	14.4
Missouri	8.80%	5.3	6.2	
Montana	6.20%	6.3	11.9	23.7
Nebraska	10.90%	3.5	9.5	23.3
Nevada	4.20%	6.2	7.1	14.1
New Hampshire	4.80%	3.8	3.7	

[6] Data for these tables derived from U.S. Census Bureau, Census 2000 Summary File 4. Q2 2009 data is from Economic Policy Institute estimates available at: http://www.epi.org/page/-/unemployment_by_quarter%20%282%29.pdf

Table 1 (continued)

	Q2 2009 (All races)	2000 Census Unemployed (All races)	2000 Census Unemployed (AI/AN Alone)	2000 Census (AI/AN Alone on Reservation/Trust Land)
New Jersey	11.30%	5.8	6.6	
New Mexico	6.50%	7.3	9.5	21.4
New York	8.80%	7.1	7.5	10.9
North Carolina	6.40%	5.3	5.2	9.3
North Dakota	8.20%	4.6	10.9	21.4
Ohio	10.70%	5	5.9	
Oklahoma	6.30%	5.3	5.2	9.3
Oregon	12.10%	6.5	8.3	17.2
Pennsylvania	8.10%	5.7	6.7	
Rhode Island	11.90%	5.6	6.5	
South Carolina	11.80%	5.9	5.6	
South Dakota	5.00%	4.4	13.1	27.9
Tennessee	10.50%	5.5	4.5	
Texas	7.10%	6.1	5.4	21.7
Utah	5.40%	5	9.2	28.6
Vermont	7.30%	4.2	6.5	
Virginia	7.00%	4.2	4.1	
Washington	9.10%	6.2	9.2	21.3
West Virginia	8.40%	7.3	8.6	
Wisconsin	8.80%	4.7	8.4	14
Wyoming	5.10%	5.3	12.2	27.4

If federal data collection is really about effective policy interventions, it is critical to ensure that accurate data is available for federal, tribal and state policymaking. NCAI has launched an aggressive campaign to ensure Indian Country Counts in the 2010 Census. We are partnering with a range of tribes and Native organizations to ensure the Native population is accurately counted. Our work in this area is not only directed by our concern about available data, it is driven by our concern for the *quality* of available data. The significant undercount of American Indians and Alaska Natives is a significant concern. According to the Census Post-Enumeration Survey, the 1990 census undercounted American Indians/Alaska Natives by an estimated 12.2 percent on reservations and 4.5 percent in all geographies. A National Academy of Sciences panel concluded that while undercounts among these communities were likely lower in the 2000 Census, the challenges persisted. Dramatically high undercounts on reservations were documented in the 1980 Census as well – there was a 24 percent undercount at the Pueblo of Santo Domingo in New Mexico, and an undercount between 13-23 percent on the Colville

Reservation in Washington state.[7] Furthermore, Native people are dramatically overrepresented in areas defined as "hard-to-count."

Missed opportunities to invest in tribal communities

Tribal governments can serve as significant incubators of economic growth in relation to job growth in general, and in cutting edge areas of alternative energy development specifically. This section will address those opportunities (significantly underutilized at this point) in the areas of green jobs, job programs at the Department of Labor, and the potential of tribal colleges and universities to spur job growth to the benefit of a range of rural communities.

Green jobs represent a significant new employment opportunity for disadvantaged communities – particularly communities of color. Tribal lands comprise over 10% of the nation's traditional energy resources and 5% of the land base. Furthermore, tribal lands are a potentially rich source of renewable energy. According to the Department of Energy, wind energy potential on tribal lands can provide more than 20 percent of the nation's electric power generated in 2004. Solar energy potential on tribal lands can provide 4.5 times the current annual U.S. electric generation.

Despite these opportunities, tribes have been left out of federal efforts to support domestic energy development. The recovery act provides $3.1 billion to support state renewable energy and energy efficiency programs but nothing for tribes. In fact, only $16.5 million has been allocated to tribes since 2002. Furthermore, tribal governments were excluded from the green jobs title of the Energy Independence and Security Act of 2007 and tribes are not eligible to apply for recently announced funding opportunities under the Pathways out of Poverty program. To exclude tribes and their members from accessing these critical tools for economic revitalization will only increase the socioeconomic gap that exists between many Native people and their fellow Americans.

Beyond green job investments, tribes were also excluded from many other Department of Labor initiatives in ARRA. These initiatives, that seek to encourage job growth, are almost exclusively delivered through direct state funding or funding to nonprofit entities that are very scarce in reservation communities. While tribal-state partnerships have worked very effectively on a range of policy issues, direct tribal funding and set-asides tend to work more efficiently to meet the unique needs of Native communities. Given the pronounced nature of the unemployment crisis in Indian Country, dedicated tribal funding from the Department of Labor seems to be particularly warranted.

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[7] Lujan, C. (1990). As Simple as One, Two, Three: Census Underenumeration Among the American Indians and Alaska Natives

Tribal Colleges and Universities – Job training hubs in rural communities

Higher education is one of the main drivers of economic development in the United States, and particularly for American Indian communities. Higher levels of education correlate with higher earnings, lower employment rates, and lower poverty rates. For example, in 2005, a typical year-round worker in the United States with a bachelor's degree earned 62 percent more than someone with a high school diploma.[8] A college degree has a positive ripple effect on the well-being and economic strength of tribal communities and society as a whole.

While the number of American Indian and Alaska Native students enrolled in colleges and universities and the number of postsecondary degrees awarded has more than doubled in the past thirty years, only slightly more than a quarter (26 percent) of American Indian and Alaska Native 18- to 24-year-olds were enrolled in college in 2006.[9] Increasing access to college for our American Indian and Alaska Native populations is essential in fighting the poverty and unemployment rates that have affected American Indian communities for centuries.

To provide increased higher education opportunities for their citizens, 36 Tribal Colleges and Universities located in 14 states, have been established by tribal governments over the last 40 years. These tribally-run colleges, many of which are located on reservations or nearby neighboring communities, serve geographically isolated populations that have limited access to nearby colleges. These institutions serve students from more than 250 federally recognized tribes and more than 80 percent of their students are eligible to receive federal financial aid. According to the American Indian Higher Education Consortium (AIHEC), which collectively represents tribal colleges and universities, tribal colleges provide students with a college education grounded in culturally relevant traditions and curriculum and graduate students with degrees in high need areas on the reservation, such as health services, primary and secondary education, and rural farm and business development. According to 2009 AIHEC report, of the 15,795 certificate and degree-seeking students enrolled at tribal colleges and universities in fall 2006, the most popular discipline was liberal arts, followed by business, vocational/career programs, and social sciences.[10]

Tribal Colleges and Universities also play an important role in workforce and skills development, family support, and community education services. They are true community-based institutions, providing the education and skills development needed for entrepreneurship and job creation. According to a 2007 report from the Institute for Higher Education Policy, an

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[8] Baum, S. & Jennifer M. (2007). *Education Pays: The Benefits of Higher Education for Individuals and Society.* Washington, DC : College Board.

[9] DeVoe, J.F. & Darling-Churchill, K.E. (2008). *Status and Trends in the Education of American Indians and Alaska Natives.* Washington, DC: U.S. Department of Education. National Center for Education Statistics. (NCES 2008-084).

[10] American Indian Higher Education Consortium. (2009). *AIHEC-AIMS Fact Book 2007: Tribal Colleges and Universities Report.* Alexandria: American Indian Higher Education Consortium.

associate's or bachelor's degree on a reservation may enable a person to create jobs by starting a business, foster the spirit of leadership and entrepreneurship, and alter negative cultural perceptions of education for future generations.[11] The economic and social benefits of one tribal citizen receiving a college degree are experienced throughout a community.

The federal funding needs of Tribal Colleges and Universities

A significant source of funding for tribal colleges and universities is the federal government. The provision of higher education funding for American Indians by the federal government is bound by treaty obligations and the trust responsibility between sovereign Indian nations and the United States government.

Title I: Institutional Operations

In particular, tribal colleges and universities receive funds from the Bureau of Indian Affairs through the Tribally Controlled College or University Assistance Act of 1978, particularly under Title I. Despite the much appreciated increases that Congress has appropriated over the last several years, tribal colleges and universities remain chronically underfunded. According to the American Indian Higher Education Consortium, in Fiscal Year 2009, Title I tribal college and universities (of which there are 25) received $5,494 per Indian Student Count (distribution of funds under Title I of the Tribal College Act is enrollment driven) towards their institutional operating budgets. However, since the Tribal College Act was first funded in 1981, the number of Title I funded tribal college and universities has nearly quadrupled and enrollments have increased by more than 300 percent. If inflation is factored in, twenty-eight years later the program's buying power is $1,115 less per Indian student than it was in the programs initial Fiscal year 1981 appropriation, which was $2,831. It is also important to add that tribal colleges and universities do not receive any funds for non-Indian students, who make up approximately 20 percent of enrollment. Without adequate funding that keeps pace with inflation, these colleges are hindered from providing the best college education to Native and non-Native students in reservation and surrounding communities.

Tribal Colleges and Universities Title III Grants Program

In addition, the majority of tribal colleges receive funding from Title III under the Higher Education Act's Aid for Institutional Development program. This critical program provides tribal colleges and universities with grants to develop infrastructure, facilities, faculty, curriculum, and student services. By increasing and improving these functions, these colleges are able to improve chronically underserved American Indian communities. However, federal appropriations for both basic development grants and facilities/construction grants have remained stagnant over the past three fiscal years. In fiscal year 2007, $23,570,000 was

[11] Institute for Higher Education Policy. (2007). *The Path of Many Journeys: The Benefits of Higher Education for Native People and Communities*. Washington, DC: Institute for Higher Education Policy.

appropriated for both programs under Title III. In fiscal year 2008 and fiscal year 2009 (continuing resolution), the federal appropriation was nearly identical at $23,158,000.

Increasing the enrollment and degree attainment of American Indians is crucial to the economic and social well-being of individual American Indians and their communities. Without increased investment in American Indians and tribal colleges and universities, it will be difficult to increase job opportunities, economic mobility, and the overall health of American Indian nations.

Recommendations related to unemployment and job creation

Congress can partner with tribes in addressing challenges posed by unemployment through the following strategies:

- Investing in data collection methods that ensure timely and accurate socioeconomic data for American Indian/Alaska Natives, particularly as part of the monthly BLS unemployment report and the 2010 Census
- Partnering with tribes to harness alternative energy potential on tribal lands
- Providing tribal access to and set-asides within Department of Labor programs to stimulate job growth and encourage the creation of green jobs
- Investing in tribal colleges to capitalize on their significant potential as economic engines in disadvantaged rural communities, particularly with respect to the Administration's strategies to invest in green job development and train the tribal workforce to meet this challenge

3. The Foreclosure Crisis and Native Communities

While the United States faces one of the most significant housing crises in the nation's history, many forget that Indian housing has been in crisis for generations. Forty percent of on-reservation housing is considered substandard (compared to six percent outside of Indian country), and nearly one-third of homes on reservations are overcrowded. Less than half of the homes on reservations are connected to public sewer systems, and 16 percent lack indoor plumbing.[12]

Data related to the impact of the economic crisis on Native homeownership is weak, at best. The Department of Housing and Urban Development (HUD) has reported some challenges with foreclosures in their 184 program (described below) – particularly in regions hard hit by the mortgage crisis (Southern California, Arizona, etc.). However those challenges remain a very low proportion of total loan volume (less than 1 percent). This can partially be explained by the

[12] US Commission on Civil Rights, *A Quiet Crisis, Federal Funding and Unmet Needs in Indian Country*, Executive Summary, July 2003, p. X and 50 available at http://www.usccr.gov/pubs/na0703/na0204.pdf (Last accessed February 1, 2007).

fact that exotic financial products cannot be guaranteed through the 184 program which will only guarantee traditional fixed rate mortgages.

Recent data related to non-184 loans on Indian lands is not available at levels that allow for detailed analysis. Upward trends in 184 lending, even in the past 18 months, imply tribal members may be reverting to the federally guaranteed product to purchase homes in a context where available credit is decreasing and access to capital is increasingly scarce.

Significant barriers to homeownership on Indian lands mean that many of the most qualified homeowners were still waiting to access homeownership opportunities when the mortgage crisis began. In fact, HUD data from 1999 reveals that less than 1.5 percent of households that could qualify for mortgage financing on Indian lands actually had a mortgage.[13]

The detail of this section of our statement, therefore, focuses primarily on barriers to homeownership and how Native communities are addressing those barriers. We encourage the federal government to partner with tribal governments to ensure opportunities to expand homeownership on Indian lands are maximized for the benefit of Native communities and the surrounding regional economies.

Context for the Housing Crisis – Unique Barriers, Unique History

The contemporary challenges for Indian housing find their source in successive federal policies that have undermined the availability of adequate housing on Indian lands for hundreds of years. The removal and allotment eras substantially altered both the volume and type of land available for the development of Indian housing. Proponents of homeownership look to the Homestead Act as a keystone moment in the history of "the American Dream" of homeownership. However, this view fails to acknowledge that the Homestead Act depended upon the allotment policy's confiscation of nearly two-thirds of Indian lands to provide a large amount of land for non-Indian settlement (framed as "surplus" land at the time).[14] In effect the policy operated as a confiscation of land owned by Indian people and the offer of that land to white males – excluding African Americans and women from opportunities to become stakeholders in America.

Progress in Indian housing policy in subsequent decades was slow but the 1990s offered a number of important innovations in Indian housing. The 1996 enactment of the Native American Housing Assistance and Self-Determination Act (NAHASDA) was rightly seen as a significant

[13] U.S. Department of Housing and Urban Development, U.S. Department of Treasury, *One Stop Mortgage Center Initiative In Indian Country, A Report to the President*, October 2000.
[14] Getches, Davis, Charles Wilkinson and Robert A. Williams, *Cases and Materials on Federal Indian Law, 4th Edition*, St. Paul, MN: West Group, 1998, pp93-99, 141-143.

event in the history of Indian housing.[15] NAHASDA consolidated a number of existing programs into the Indian Housing Block Grant (IHBG). This system empowered tribes to more effectively develop, implement, and manage strategies to meet the specific housing needs of their community.

Created in 1992, the Section 184 program provides 100 percent reimbursement to private lenders in case of default. Indian Tribes have been successful in participating in this program with an extremely low default rate. The program authorizes the BIA and HUD to approve borrowers and land leases in order to guarantee loans from private lenders to Native American families, tribes, and housing authorities. The home and the leasehold interest in the home site are mortgaged and are subject to liquidation in case of foreclosure, although eligible tribal members, the tribe, or the relevant Indian Housing Authority are first offered a chance to assume the leasehold interest and continue payments. In order to participate in HUD mortgage guarantee programs, HUD must review the tribe's legal ordinances which include: leasing, mortgage lending, eviction and foreclosure as well as the code enforcement process through the tribal courts system or another court of competent jurisdiction (designated by the tribe).

In 2004, HUD expanded the Section 184 program to allow tribes to petition the agency for the right to extend their service area or "Indian Area" to include Native-owned homes off-reservation. These off-reservation units exist in areas where a particular tribe traditionally resided or where significant members now live. As a result, certain tribes can now apply the Section 184 program to all of their members residing within a particular state instead of just within their reservation's borders.[16] These recent investments in and expansions of the Section 184 Program have encouraged expanded mortgage lending on Indian lands over the past few years. However, the lengthy time often required to generate Title Status Reports (TSRs) for many Native people poses a critical threat to homeownership on Indian lands. The TSR is a necessary precursor to issuing a mortgage for a property on trust land. Tribal members have reported waiting months and even more than a year for their TSRs to be processed. The National American Indian Housing Council (NAIHC) has reported that – even before the crisis struck – some major banking institutions abandoned the 184 program (or not utilized it in the first place) because of frustrations with the process for generating title reports on reservation lands.[17]

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[15] Native American Housing Assistance and Self-Determination Act of 1996, Pub. L. No. 104-330, 110 Stat. 4016 (codified as amended at 25 U.S.C. §§ 4101 4195 (Supp. IV 1998)).

[16] Mark Fogarty, *Liu adds to legacy though HUD 184 expansions*, Indian Country Today, May 9, 2005, available at http://www.indiancountrytoday.com/archive/28165849.html (Last accessed Feb. 28, 2007).

[17] Press Release, NAIHC, Barriers to the Pathway for Homeownership High for Native Americans, NAIHC Chair Testifies- Bureau of Indian Affairs Hindering Home Ownership with Slow Title Process (July 31, 2006) available at http://naihc.net/NAIHC/files/ccLibraryFiles/Filename/000000000894/073106-camp-verde.pdf (Last accessed Feb. 10, 2007).

As you may know, Indian land is generally restricted from sale or purchase, and the title to the land is held in trust by the federal government. Almost every development activity on tribal land requires some sort of action by the Department of Interior – whether to approve a lease or provide a record of title or transfer land into trust status. Underfunding and inefficiencies in the title process on Indian lands means that Native people who wish to build, improve on or purchase a home on Indian lands face a barrier to their dream that is not faced by any other person or community in America. While industry standards see title reports issued within 24-48 hours, Native people can wait months and even several years. There are – undoubtedly – barriers to homeownership for other Americans, but none that present such a persistent and pervasive challenge as the barriers created by the broken system for managing title on Indian lands.

Whether managed by state governments, local governments, or private contractors (on the behalf of state or local governments), title processing is almost universally faster and more efficient on non-Indian lands. Slow title processing on Indian land presents a significant challenge to economic development, the frustratingly long process for generating a title report leads some—both tribal leaders and citizens—to give up completely on dreams of home ownership for tribal members and on successful economic development for the tribe. This barrier also presents a fundamental inequity. Native people who wish to build, improve, or purchase a home on Indian lands face a barrier to their dream that is not faced by any other person or community in America.

What the barriers mean in the current context

These significant barriers to homeownership in Indian Country are readily apparent when one considers that in 1999 there was a total of only 471 home mortgages on Indian Lands, a mere 1.2 percent of 38,000 households that were estimated to have sufficient income to qualify for a mortgage. Given the Section 184 program is about to originate its 9,000th mortgage in 2009, this means less than a quarter of the Native citizens eligible for mortgage financing (10 years ago!) have been served through one of the federal government's most successful programs to promote Native homeownership. This is not only a fundamental inequity, it means tribal members that want to pursue homeownership are choosing to purchase homes off-reservation (by virtue of the barriers to on-reservation homeownership) resulting in a loss of talent and economic vitality in Native communities.

Access to capital is also a critical issue that pre-existed (and is exacerbated by) the current crisis. Conventional home mortgages were rated as "difficult" or "very difficult" to finance by 65 percent of tribal respondents to a survey of the 2001 Native American Lending Study. The study also found that access to financial institutions is a particular challenge for Native people. Eighty-six percent of Native communities lack a single financial institution within their borders and 15 percent of Native Americans need to travel over 100 miles to access a financial

institution. This challenge is even more remarkable when one considers the definition of 'financial institution' includes a bank or simple an ATM.[18]

The disconnect between Indian Country and the financial mainstream offers a wide open door to "fringe" financial companies that aggressively market predatory loans and risky mortgage products in all communities of color. Astronomical subprime lending in Native communities in states like New Mexico and South Dakota is pretty easily explained when you consider that many banks are simply not there to compete for Native communities. It is much easier to sell predatory products to Native consumers when banks are not competing for those customers.

Innovations to address contemporary challenges

In relation to financial service delivery, we have seen significant growth in the Native Community Development Financial Institution (CDFI) field over the past nine years. In 2000, there were just a handful of CDFI Fund certified Native CDFIs. Since the CDFI Fund created its Native Initiative, the number of certified Native CDFIs has grown to almost 50, with another 30-40 in the development or certification process. These institutions are partnering with tribal governments to transform Native economies through offering affordable financial services and supporting people in developing financial skills. They are also critical institutions to restart our nation's economy. To get credit markets moving again, community-based lenders who can effectively prepare borrowers to buy their home or start a business are critical partners. Community-based institutions ready to deliver free and affordable tax preparation services are critical to seeing communities of color benefit from the $100 billion in individual resources in ARRA. Without those institutions we cannot ensure these resources stay in the community and benefits working families. With specific reference to mortgage lending, Native CDFIs prepare Native borrowers and package responsible loan products to ensure a successful homeownership experience.

Even in the area of title processing, a handful of tribes have contracted with the federal government to manage the title process themselves. They have seen huge improvements in the title process – now measured in hours rather than years! They have also seen a significant change in the way the community thinks about its land, and the opportunities for homeownership and economic development.[19]

Tribal governments also have a role to play in regulating lending practices on tribal lands. In the same way as state government jurisdiction is protected in federal statutes regarding predatory lending, tribal jurisdiction must be protected. Tribes in states like Arizona, New Mexico, Oregon,

[18] Department of the Treasury, *Native American Lending Study*, 2001

[19] For more details on these successes (and remaining challenges), see First Nations Development Institute and NCAI PRC, *Exercising Sovereignty and Expanding Economic Opportunity through Tribal Land Management*, NCAI PRC 2009

and others are already partnering with state governments to ensure predatory lending does not adversely affect tribal members. Unless federal protections of tribal jurisdiction are included in bills regulating predatory lending, a key protection from inappropriate financial products will be lost.[20]

Another area where tribes are leading the way with regard to strategies for economic recovery is in the area of financial education. Facing depressed economic conditions, and realizing that avoiding predatory lending requires more than regulations alone, many tribes have implemented reservation-wide financial literacy programs.

On the Salt River reservation in Arizona, the tribe has implemented a coordinated strategy to develop the financial skills of their members. Calling it "Salt River University" the tribe offers classes in basic financial literacy, homeownership and investor education. This spring, the tribe launched a financial education for all of the youth in the community.

In one of the nation's poorest counties, the citizens of the Cheyenne River reservation in South Dakota are participating in a newly launched initiative called "Making Waves." The initiative provides every student in the schools on the reservation with basic financial education and entrepreneurship education. Launched by a tribal government resolution and implemented in partnership with Four Bands Community Fund, the initiative stands with the Salt River University, as one of the few financial education strategies in America that is designed to develop the skills of every citizen in the community.

Recommendations related to foreclosures and homeownership

Congress can partner with tribes in addressing challenges to homeownership and financial service delivery by:

- Investing in the gathering of quality data about Native homeownership rates – both loans originated through the Section 184 program and those accessed through mainstream lending
- Applying federal resources to implement the recommendations of the NCAI Policy Research Center's report into opportunities to expedite land title processing on tribal lands
- Continuing to invest in the Native Initiatives at the CDFI Fund and other strategies to expand financial institution access on reservations
- Ensuring the jurisdiction of tribal governments are protected – along with states – in the development of predatory lending regulation
- Learning from tribal financial edueation strategies and investing in similar strategies to expand financial skills among all Americans

[20] For further information on the impact of predatory lending on tribal lands see First Nations Development Institute...

4. Minority Businesses as Economic Engines in Rural and Reservation Communities

Economic revitalization in Indian Country is intrinsically linked to business development. We have identified a range of diverse strategies to expand access to business opportunities for Native people.[21] It is also clear that usable data is a key challenge as the federal government and tribes seek to encourage small business development on tribal lands. Partially in response to the definitional changes within the Census Bureau's 2002 Survey of Business Owners, the 2007 Native American Economic Policy Summit recommended that data be gathered to "understand the trends among Indian-owned businesses, tribal economic growth, industry participation, sector participation and growth, and general economic conditions."[22]

Many federal programs exist to encourage the development of Native-owned businesses. Several of them went un- or under-funded during the past Administration. The pronounced and unique challenges facing Native communities require the implementation of the most effective and promising strategies to ensure economic revitalization for Native people. These innovations include, the following recommendations from our FY 2010 budget request:

- Restoring adequate funding to the Native American Outreach Program at the Small Business Administration. The program has played an important role in overseeing and facilitating the implementation of small business programs administered by the SBA and funding for the SBA's Native American Outreach Program (NAOP) was slashed from $5 million in the 1990s to $1 million in recent years
- Funding the Office of Native American Business Development (ONABD) in the Department of Commerce, an office that was authorized in 2000, yet has received no significant or independent funding.
- Providing funding for the Minority Business Development Agency (MBDA) to establish at least eight Native American Business Centers (NABEC) at levels commensurate with the average funding levels of other MBECs.
- Increasing appropriations for the Bureau of Indian Affairs' Guaranteed Loan Program within the Office of Indian Energy and Economic Development and expand the program to guarantee surety bonding. One of the more successful programs in leveraging federal resources, assisting tribes and their members in accessing capital and encouraging lending to Indian-owned businesses.

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[21] National Congress of American Indians, *Indian Country FY 2010 Budget Request*

[22] The change by the Census Bureau excluded tribally-owned businesses from the definition of American Indian/Alaska Native businesses in their five yearly study, making the data impossible to compare to previous surveys. The recommendations of the Summit can be found in Department of Interior and NCAI, *Summit Report: National Native American Policy Summit*, 2007

Federal strategies to expand access to contracting services for minority owned businesses are particularly critical in reservation communities that are generally located in rural areas with very limited economic opportunities. When our children grow, they need to know that there will still be business and economic opportunities for them, like those offered by successful government contracting programs. The federal government's 8(a) contracting program is one way entrepreneurs in Native communities build Native economies by helping our people secure government contracts. This in turn increases jobs and business opportunities. Contracting has become a new and vital branch of enterprise development for tribes, villages and communities. 8(a) contracting programs are vital strategies to raise both revenue and business sophistication in Indian Country and Native Alaska.

The Native 8(a) program demonstrates Congress' commitment to promoting tribal self-determination and self-sufficiency. This business development program reflects the unique character of Native communities and their responsibility to provide governmental services and other benefits to their members.

In addition, tribal governments have a severely limited tax base. Tribes cannot impose property taxes on trust land, and an additional income tax on a community already facing high unemployment and poverty rates is not feasible. In sum, tribal citizens often have greater service needs than their non-Native counterparts, and at the same time, tribal governments have fewer resources with which to fulfill their governmental responsibilities to their citizens. Meaningful economic development is sorely needed.

Because of the high unemployment rates in tribal communities, Native capacity building is often the key goal of tribal governments. In its 2006 Report, the GAO found that management training programs were common among Native-owned businesses and sought to encourage the recruitment, training, and development of Native employees.[23] These businesses use internships, scholarships, on the job training, and subcontracting opportunities to build their own talent. This process can be slow and arduous as multi-generational poverty has taken its toll on worker preparedness, but success can be significant when it is achieved.

Benefits derived from Native-owned businesses go beyond developing local Native capacity through scholarships, internships, and employment. Other benefits, that are just as important, have begun to take hold and advance self-determination, ensure cultural preservation, and ameliorate dire social conditions. For example:

- Native people serve as role models for fellow tribal members and are valued for their contribution to community. Native-owned businesses provide an opportunity for

[23] US GAO, (GAO-06-09) 2006, 81.

American Indians and Alaska Natives to see one of their own go to college, get a job, or better still, work toward a career. These positive role models can increase community and individuals' hope for the future as well as provide inspiration.

- Business capacity is developed in the local community when tribal members and shareholders gain transferable business skills, like financial literacy, strategic planning, and management. These skills are necessary for all aspects of economic and community development. Native community members may choose to utilize their skills in variety of ways: to start a local business as a supplier, or provide a service that has been lacking in the community.
- Leadership capacity is developed when Native boards gain experience in making decisions that will directly affect the lives of their family, neighbors, and communities.

Similarly, Native-owned businesses can form joint ventures with large companies utilizing federal programs such as the Small Business Administration's (SBA) Mentor-Protégé Program. The use of teams and joint ventures are encouraged by the federal government as a means to stimulate growth, forge new business relationships, and develop expertise.

For example, Mandaree Enterprise Corporation faced bankruptcy in 1994. The tribal government owners, the Mandan, Hidatsa, and Arikara Nations of the Ft. Berthold Reservation in North Dakota hired a CEO to develop a turn-around strategy. Mandaree Enterprise became certified in the 8(a) Business development program and grew rapidly as it expanded into government contracting. Part of its success was due to its participation in Department of Defense's (DoD) Mentor-Protégé Program, which encourages major defense prime contractors to work in tandem with small disadvantaged businesses to develop their business and enhance their technical capabilities. The ultimate goal is to enhance the potential contributions of protégés, like Mandaree Enterprise Corporation, thus allowing them to more effectively compete for defense-related work. Through this program, Mandaree Enterprise Corporation developed a relationship with Northrop Grumman which contributed to their capabilities in manufacturing cables, wire harnesses, and circuit boards. Mandaree Enterprise Corporation and Northrop Grumman twice received special recognition from DoD by winning the Nunn-Perry award.

Recommendations related to Native-owned business development

Congress can partner with tribes in addressing challenges to business development by:

- Fully funding federal programs that support efforts to develop Native-owned businesses
- Continuing to support the importance of contracting opportunities for Native-owned businesses
- Providing support for management training programs and other strategies to develop human capital to run Native-owned businesses

- Funding data collection methods that clearly define the opportunities and challenges with respect to business development in Indian Country and clearly delineates Native participation in the 8(a) program

Conclusion and Recommendations

This testimony has highlighted the unique challenges tribes and their members have faced for generations. NCAI's member tribes, and their citizens, face significant challenges – particularly in the midst of the economic crisis. We look forward to working with the members of the Committee to ensure that:

1. The recovery is fair and equitable – especially for America's most vulnerable communities
2. Unemployment data is available to measure the extent of the crisis and recovery, and opportunities to partner with tribes and tribal colleges are not missed
3. We work toward a future where Native people have the same opportunities for homeownership that so many Americans take for granted
4. Small business opportunities – at the heart of rural and reservation economies – are supported and expanded through effective federal investments to expand the economic impact of Native-owned businesses

As we move forward in addressing these challenges, it is critical to realize that tribal communities offer unique innovations that can make significant contributions to the policy debate regarding the economic crisis and the prospects for a fair and equitable recovery for all Americans. We look forward to partnering with the Committee, as critical members of the federal policymaking community, to ensure tribes are included in developing and benefiting from a healthy economic future for all Americans.

Chairman TOWNS. Thank you very much, Ms. Johnson-Pata.
Mr. Alford.

STATEMENT OF HARRY C. ALFORD

Mr. ALFORD. Thank you, Mr. Chairman. And thank you, Mr. Chairman and Ranking Member Issa, distinguished members of the committee, my distinguished panelists, I am very honored to be here to discuss a very important part.

Please keep in mind that in terms of housing, you cannot have a house without a job. And 70 percent of all new jobs are created by small businesses. So, the National Black Chamber of Commerce feels its mission is noble.

When we were incorporated in 1993, there were 300,000 Blacked-owned firms doing revenues of $30 billion. Today, I am happy to say there are over 1 million Blacked-owned firms doing revenue of over $88 billion. Still, despite that growth in numbers and dollar volume, in capacity, being able to do the job, being ready, willing and able, our share of the Federal procurement dollar has been dropping year by year. That also goes for Hispanic businesses as well.

Why is that? One big reason. The SBA, when we were incorporated, had 5,000 employees with a budget of over $900 million. Today, they have 1,700 employees with a budget of less than $400 million. That is not giving enough emphasis to the development of small businesses in this country. They are emaciated.

So, we are happy to pick up that void with other associations. Section 3 of the HUD act, which has been mentioned here, HUD does not enforce Section 3 of the HUD act. It is being enforced in the State of Louisiana and in the city of New Orleans because your Members took it up after Katrina. That is the only place it is being enforced. There may be an exception here and there, but it is not being enforced in Maryland, it is not being enforced in Baltimore, it is not being enforced in any of your districts. That is true.

And if it was enforced, we could have an additional 100,000 jobs just in the Black community alone. This is a race-neutral program. It was written in 1968 after the Watts Riot. It was strengthened in 1992 after the Rodney King Riot by the late Jack Kemp. It is beautiful. It will hold the test in court, and it is a job creator. No training programs. Training programs do not work. You send kids to training programs, and then they do not get jobs. They never get connected to jobs. There is not a good training program unless there is a placement strategy.

This here Section 3 is on-the-job training. They come and learn as they get paid, to drive a nail through some wood, to pick up trash, to landscape, to day care at a housing facility. It is simple stuff. But for some reason, we have been avoiding it.

The Federal Highway Program, the DBE Program, was implemented in 1982 by President Reagan, written by the Honorable Harry Mitchell before that. In the 1980's, African American and Hispanic businesses through the Highway Program were doing about 8 percent of the volume. Today, African Americans do 1.1 percent of Federal Highway Fund volume, Hispanic businesses do 1.6 percent. That is 28 percent of the National population trying to come up with 2.7 percent of the volume.

That $27 billion that goes to these State programs is being abused through corruption. Tony Soprano "does well" but African Americans and Hispanics do not. And I have volumes. I have documentation that goes back to 1995 on this. I have seen bid rigging with my own eyes in the State of Indiana. We need to clean it up, and then be inclusive, according to the Civil Rights Act of 1964, Title 6.

Also, Executive Order No. 246, which is hiring, which enforces Title 7, Equal Opportunity in Hiring. The Federal Highways Program does not abide by Executive Order No. 11246. They canceled the reporting procedures. They do not even take the data.

The Department of Labor is supposed to have their hammer, but construction unions who do not hire Blacks and Hispanics, and women want this action and so the Government, back in 1998 and 1999, canceled Executive Order No. 11246, Reporting Procedures, in defiance of the law. It is illegal.

So, when the stimulus money comes down, double down on transportation from $27 billion to $54 billion, we are not going to get any of that. And the problem with the stimulus plan is that it is throwing food in the trough, but you have the same pigs at the trough. We are not in there.

So, maybe from the discretionary side, which is coming later, we can have some diversity and input and share in the stimulus bill. It is beautifully written.

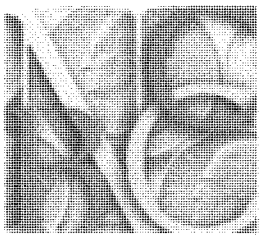
Project Labor Agreements. President George Bush canceled, forbade, Project Labor Agreements from Federal projects because "they discriminate against small business and minorities." So I am trying to figure out President Barack Obama's rationale to bring them back. I want to know the reason for that, other than letting construction unions, which discriminate against minorities and women, which cannot qualify under Executive Order No. 11246, to have exclusivity in Federal projects. Someone who discriminates should be banned from Federal projects. They should not give them exclusivity.

Finally, the Waxman-Markey Bill. If that goes into fruition, we are going to lose 3.6 million jobs, according to a jobs study by CRA. Of those areas who are going to pay the most, if you take a pin and put it in Nashville and draw a 700 mile radius around Nashville, you have territory that includes 86 percent of the Black population. Coincidentally, that is the same area that is going to pay the most for this Waxman-Markey bill. I suggest that we go back and rewrite a bill that is going to be less painful and have some benefits.

I was at a panel on Monday and we had people for, neutral and against the bill. No one could identify reasonable benefits of the energy bill. If we cannot realize reasonable benefits, why do we have it? I will reserve the housing remarks for question and answer.

Thank you, sir.

[The prepared statement of Mr. Alford follows:]



National Black Chamber of Commerce

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CONGRESSIONAL TESTIMONY

September 23, 2009

Presented To:

Committee on Oversight and Government Reform

Honorable Edolphus Towns, Chairman

Honorable Darrell E. Issa, Ranking Minority Member

Presented By:

Harry C. Alford

President/CEO

Honorable Chairman Towns, Ranking Minority Member Issa, the National Black Chamber of Commerce holds much gratitude that you have invited us to this hearing. As you know we are the largest Black business association in the world. We are nonpartisan, nonprofit with a mission to economically empower African American communities through entrepreneurship and good policy. The NBCC proudly represents the over 1 million small businesses that are Black owned. It is the fastest growing group per the US Census Bureau (45% growth over five years). We hope to begin making a significant milestone today.

In regards to unemployment there are a few serious things the federal government can do. It can cease supporting discrimination through non enforcement of some significant laws and it can prevent serious negative impact from some upcoming programs. Without doing this the recovery act and any other major initiative will have little if not negative impact on minority communities, in particular, Black communities.

Section 3 of the HUD Act (24 CFR part 135) became law in 1968 after the first Watts Riot. It was strengthened in 1992 after the Rodney King Riot. It is the Equal Opportunity Program involving HUD funds and is a great job creator and business developing tool. Under this law up to 30% of all new jobs created through HUD Funding are to go to people living in public housing facilities and others who live under the poverty level. They are considered Section 3 residents. Businesses who hire Section 3 residents are considered Section 3 businesses and are entitled to 10% of all contracts funded through HUD monies. This is a beautiful law and where we have applied it great results occurred. However, of the more than 5,000 HUD grantees less than 1 percent actually complies with the law. Less than a half of one percent actually even bother to send in their annual reports.

On the job training of minorities and women is anathema to construction unions and they have fought this fiercely. HUD does not enforce Section 3. They have never fined, banned nor held funds to any of the thousands of recalcitrant grantees. HUD has relented to the construction unions that discriminate freely against people of color and women. If Section 3 was enforced it would bring over 100,000 new jobs to African Americans alone each and every year. We need enforcement of Section 3.

Another big opportunity to ease the unemployment in minority communities is that of the Federal Highway Administration. The Disadvantaged Business Enterprise (DBE, 49 CFR part 26) is the enforcement mechanism for Title VI of the Civil Rights Act of 1964. It is to ensure against discrimination within the contract letting by divisions of USDOT. In the beginning, 1982, minority contractors were doing well in business development and volume increases. Now, despite significant growth by all ethnicities in construction capacity the volume of business done through our state departments of transportation via USDOT funding has been dropping since the middle of the Clinton Administration. Today it is almost nonexistent. Black contractors do no more than 1.1% of the volume while Hispanic contractors barely reach 1.6%. (A state by state breakdown of Black contracting is attached). That is 28% of the national population only

participating in 2.7% of a major federal program. This is clear disparate impact and it directly affects employment activity within the minority communities. This year with recovery dollars, the Federal Highway Administration will be funded by more than $54 billion. It's too bad that Blacks and Hispanics will have very little participation in the relief. There might as well be a sign saying "No Coloreds Allowed" as I remember visiting Louisiana in my early years. But this time it is not local governments doing it but the federal government.

Construction union shops that monopolize these highway contracts do not adequately employ minorities or women. In fact, they do not even comply with Executive Order 11246 (John F. Kennedy). State departments of transportation do not comply with Executive Order 11246 nor enforce it with their prime and subcontractors. In fact, in February, 1999, the Federal Highway Administration canceled Executive Order 11246. A copy of that cancellation is attached. Since then state departments and local contractors have become basically white male organizations. Dr. Martin Luther King and all of those other greats who gave their lives for equal opportunity have been betrayed.

If Title VI of the Civil Rights Act and Executive Order 11246 which ensures Title VII of the Civil Rights Act were enforced it would amount to 500,000 new jobs for African Americans each and every year. That would certainly address the "double the national average" unemployment Blacks, Hispanics and other minorities suffer. The above two programs (Federal Highways and Section 3) if implemented and enforced via the intent of Congress would bring 600,000 new jobs to the Black community each year. Should Congress hold itself responsible for doing this?

Those are the laws written decades ago. Now let's go to potentially lethal initiatives (job killers). It was a proud moment when President George W. Bush announced his executive order to ban Project Labor Agreements (PLA's) on federally funded projects. PLA's make a project basically union only or at least abide by union agreements. President Bush stated, "I cannot support Project Labor Agreements as they discriminate against small business and minorities." He was absolutely correct. 98% of Black owned contracting firms are not union. They are not welcomed nor would unions allow their employees into their trades. The only Black presence in union crafts is cement and general laborer. Everything else is practically exclusive to white males. If President Bush is correct then what is the rationale for President Barack Obama to cancel his executive order and reinstate Project Labor Agreements via his recent executive order.

Construction unions by nature of their employment roles cannot comply with Executive Order 11246. What is about to happen is Presidential endorsed discrimination. It is damaging, anti civil rights and human rights and definitely voids out the Civil Rights Act of 1964. I beg Congress to prevent this until construction unions integrate. They have had 45 years to integrate and still refuse. They should be banned rather than rewarded exclusivity for racist and sexist hiring patterns. They usually fool local officials with pre-apprentice training programs but they never lead to job placement – never.

The next potential negative initiative is the Waxman/Markey Bill which is headed for the Senate. Our study done by Charles River Associates has been accepted by many prestigious organizations. In that study, it clearly shows that certain geography will suffer the greatest impact from losing the estimated 3.3 million jobs as a result of this bill being enacted. Attached is a map showing a 700 mile radius around Nashville, Tennessee. This area accounts for 86% of the national Black population. As you will see the greatest job loss would land into this area. We pray that this bill is killed and we can start over with a responsible bill that doesn't target specific groups for pain.

In essence, we are most concerned about activity that feeds unemployment and will sustain it and activity that will, in fact, increase unemployment in Black and other minority communities. It doesn't have to be that way. The "ball" is in your court. Let's enforce the goods laws and prevent the bad ones from exacting their dirty deeds.

In regards to foreclosures we can enhance employment by attending to the above. Increasing employment would directly affect peoples' ability to pay their mortgages. There isn't much we can actually do but let the market take its course. Hopefully, we won't go down that avarice road of sub-prime mortgages again and reign in renegade investors. Banks have been bailed out for the most part but the individual mortgage holders have to feel the pain and take their losses.

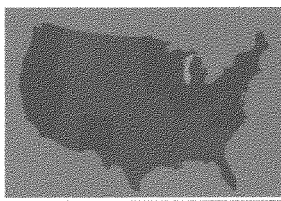
We are interested in the billions of dollars HUD has allotted under its Housing Stabilization Program. It is designed to provide technical assistance to citizens who have or are seeking mortgages. Where is this money going? Is it effective? We are having trouble identifying it at the street level. We are suspicious and ask for a thorough audit by Congress. Another question is: Why are many realtors and developers refusing FHA backed mortgages now? What can we do to make them more attractive to lenders?

Finally, we should manage the Community Reinvestment Act a lot better. We shouldn't let it be used to gentrify Black communities. Greed investors and institutions use the CRA credit process to quickly move and renovate a stable community. By doing so they drive up property values to the point that stable residents can no longer afford their homes and properties via increased property taxes, rent, etc. They are pushed out with the assistance of housing authorities who provide Section 8 rental vouchers to the residents provided that they move clearly out of their neighborhoods. Victims have been transplanted from Washington, DC to Hagerstown, MD; from Chicago to Danville, IL, etc. As opposed to empowering a community they transform it and orchestrate complete gentrification. The very people we are supposed to be helping become worse off than ever.

Once again, thank you for this great opportunity. We hope we have provided information that can be helpful in your leadership. Please don't hesitate to seek more information from us or to ask for more data.

Federal Highway Administration: African American Business Participation (2008 Fiscal Year)

State	First Half of 2008 Fiscal Year		Second Half of 2008 Fiscal Year		Black Contracts	Total Contracts	Percentage of Black Participation
	Number of Contracts	Dollar Value	Number of Contracts	Dollar Value	Total Dollar Value	Total Dollar Value	
AL	18	$1,580,413	27	$3,607,291	$5,187,704	$390,456,454	%1.33
AK	0	$0	0	$0	$0	$200,582,736	0
AZ	0	$0	0	$0	$0	$515,487,918	0
AR	23	$3,380,063	42	$5,687,211	$9,067,274	$279,764,747	%3.2
CA	12	$2,256,905	5	$910,516	$3,167,421	$2,303,616,727	%0.1
CO	3	$49,811	3	$282,500	$332,311	$174,452,186	%0.2
CT	8	$1,852,394	14	$1,781,051	$3,633,445	$550,514,942	%0.7
DE	5	$84,737	5	$525,785	$610,522	$67,600,111	$0.9
DC	6	$3,441,955	10	$8,254,448	$11,696,403	$78,056,538	$14.98
FL	10	$340,988	31	$4,660,737	$5,001,725	$868,564,488	%0.6
GA	63	$8,142,042	42	$3,350,652	$11,492,694	$322,093,516	%3.6
HI	0	$0	0	$0	$0	$22,082,644	0
ID	0	$0	0	$0	$0	$224,961,344	0
IL	51	$3,656,428	99	$7,961,589	$11,618,017	$793,976,836	%1.5
IN	75	$2,623,315	44	$2,558,597	$5,181,912	$701,324,924	%0.7
IA	6	$395,418	11	$743,149	$1,138,567	$636,106,399	%0.2
KS	14	$972,679	25	$1,258,462	$2,231,141	$293,636,590	%0.8

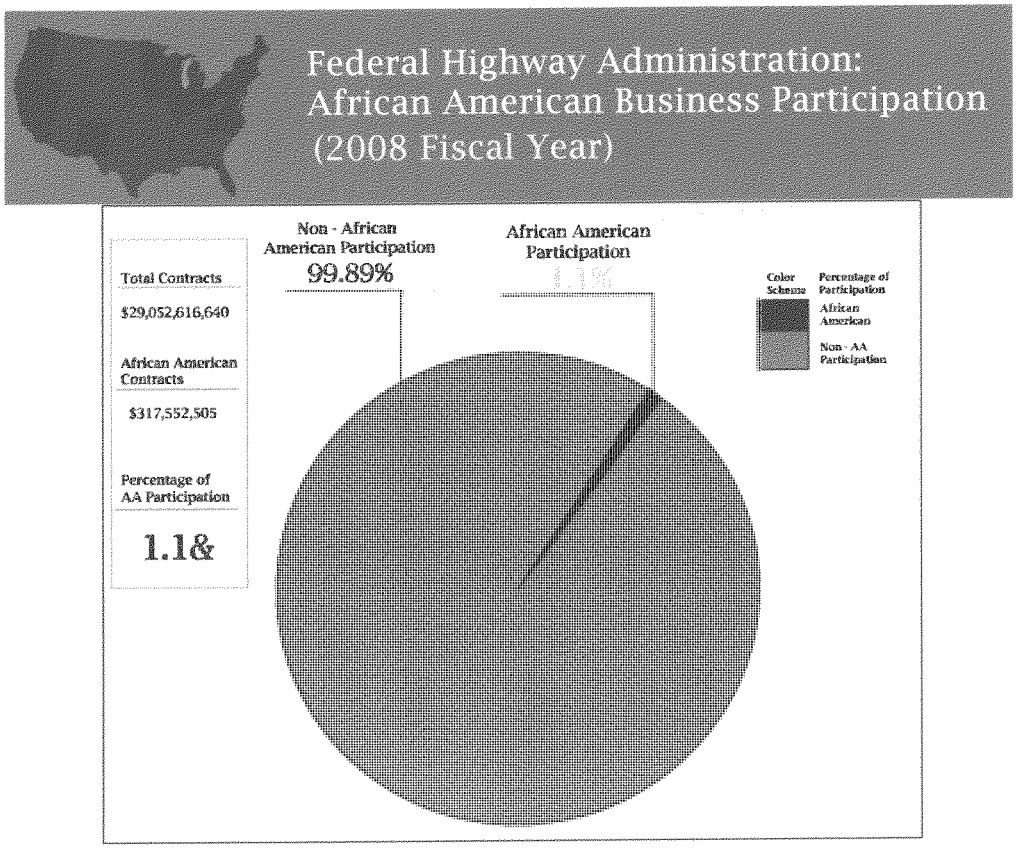


Federal Highway Administration: African American Business Participation (2008 Fiscal Year)

State	First Half of 2008 Fiscal Year		Second Half of 2008 Fiscal Year		Black Contracts	Total Contracts	Percentage of Black Participation
	Number of Contracts	Dollar Value	Number of Contracts	Dollar Value	Total Dollar Value	Total Dollar Value	
KY	2	82,503	10	$3,448,243	$3,530,746	$502,568,300	%0.7
LA	42	$4,886,175	76	$8,732,717	$13,618,892	$485,674,287	%2.8
ME	0	$0	1	$1,000	$1,000	$173,601,541	0
MD	46	$5,004,888	70	$9,673,803	$14,678,691	$444,230,492	%3.3
MA	13	$2,074,984	15	$3,419,124	$5,494,108	$519,556,933	%1.1
MI	125	$7,715,832	182	$11,618,026	$19,333,858	$1,840,730,378	%1.1
MN	2	$112,910	5	$544,078	$656,988	$290,801,443	%0.2
MS	5	$610,499	4	$671,633	$1,282,132	$418,478,250	%0.3
MO	58	$9,093,969	19	$9,559,253	$18,653,222	$2,379,557,734	%0.8
MT		$0	0	$0	$0	$273,647,429	0
NE	21	$1,435,692	40	$1,696,656	$3,132,348	$188,231,557	%1.7
NV	0	$0	0	$0	$0	$188,938,520	0
NH	0	$0	1	$4,590	$4,590	$82,562,529	0
NJ	4	$564,231	6	$18,300,401	$18,864,632	$462,860,033	%4.1
NM	0	$0	0	$0	$0	$303,555,539	0
NY	12	$2,157,498	21	$3,252,055	$5,409,553	$1,126,205,810	%0.5
NC	50	$2,400,572	100	$5,758,109	$8,158,681	$979,538,701	%0.8

Federal Highway Administration: African American Business Participation (2008 Fiscal Year)

State	First Half of 2008 Fiscal Year		Second Half of 2008 Fiscal Year		Black Contracts	Total Contracts	Percentage of Black Participation
	Number of Contracts	Dollar Value	Number of Contracts	Dollar Value	Total Dollar Value	Total Dollar Value	
ND	0	0	0	0	0	336,225,800	0
OH	80	8,612,987	90	13,515,024	22,128,011	1,013,409,541	2.2
OK	1	10,400	3	303,412	313,812	829,274,079	0.04
OR	0	0	0	0	0	196,538,276	0
PA	53	3,695,960	0	0	3,695,960	785,969,030	0.5
PR	0	0	0	0	0	113,662,391	0
RI	7	3,822,925	11	3,890,486	7,713,411	111,130,177	6.9
SC	36	2,653,411	35	2,200,029	4,853,440	279,418,134	1.7
SD	3	40,691	4	53,170	93,861	344,410,866	0.03
TN	26	5,163,370	26	39,744,459	44,907,829	995,290,878	4.5
TX	76	12,351,512	59	8,928,131	21,279,643	1,984,081,620	1
UT	1	246,409	2	996,931	1,243,340	290,604,877	0.4
VT	0	0	0	0	0	149,857,008	0
VA	13	4,548,063	15	2,315,636	6,863,699	507,768,963	1.4
WA	8	457,255	19	984,451	1,441,706	539,438,642	0.3
WV	8	1,368,422	12	3,803,444	5,171,866	525,674,026	1
WI	99	4,746,588	155	9,920,762	14,667,350	566,180,165	2.6
WY	0	0	0	0	0	399,659,591	0


Federal Highway Administration:
African American Business Participation
(2008 Fiscal Year)
Total Contracts
$29,052,616,640
African American Contracts
$317,552,505
Percentage of AA Participation
1.1&
Non - African American Participation
99.89%
African American Participation
Color Scheme
Percentage of Participation
African American
Non - AA Participation

U.S. Department of Transportation
Federal Highway Administration

FHWA Home | Feedback

U.S. Department
of Transportation
Federal Highway
Administration

Order

Subject
CLARIFICATION OF FEDERAL HIGHWAY ADMINISTRATION (FHWA) AND STATE RESPONSIBILITIES UNDER EXECUTIVE ORDER 11246 AND DEPARTMENT OF LABOR (DOL) REGULATIONS IN 41 CFR CHAPTER 60

Classification Code
4710.8

Date
February 1, 1999

Par.1. Purpose
2. Background
3. Applicability
4. Authority and Responsibilities
5. Cancellation

1. **PURPOSE**. To define FHWA's authority and responsibility concerning Executive Order (EO) 11246, as amended, and DOL regulations, set forth in 41 CFR Chapter 60.

2. **BACKGROUND**. Under EO 11246, "Equal Employment Opportunity," the FHWA is required to include certain nondiscrimination and equal employment opportunity provisions in direct Federal contracts and federally assisted construction contracts. The provisions have been established by the DOL, Office of Federal Contract Compliance Programs (OFCCP) and are set forth in 41 CFR Part 60-1, "Obligations of Contractors and Subcontractors," and 41 CFR Part 60-4, "Construction Contractors Affirmative Action Requirements."

3. **APPLICABILITY.** This Order applies to all direct Federal contracts and federally assisted construction contracts and subcontracts.

4. **AUTHORITY AND RESPONSIBILITIES**

   a. Department of Labor: Under Section 303 of EO 11246, only the DOL has the authority to determine compliance with EO 11246 and its implementing regulations. The FHWA and the State highway agency do not have independent authority to determine compliance with EO 11246, 41 CFR Chapter 60, or the minority and female participation goals established by OFCCP, pursuant to 41 CFR Chapter 60.

   b. State highway agencies and FHWA:

      (1) The State highway agency and FHWA have responsibility to ensure that recipients of Federal-aid funds include the required contractual language relating to equal employment opportunity, as set forth in 41 CFR Parts 60-1 and 60-4, either explicitly or by reference.

      (2) The State highway agency and the FHWA have the authority and the responsibility to ensure compliance with 23 USC Section 140 and Title VI of the Civil Rights Act of 1964, as amended, and related regulations, including 49 CFR Parts 21 and 23, and 23 CFR Parts 200, 230, and 633. Pursuant to this authority, the State highway agency and the FHWA may conduct compliance reviews of contractors on federally funded highway projects to determine compliance with these laws and related regulations. State highway agencies shall prepare complete, written reports of findings of the compliance reviews. These reports, and the evidence on which they are based, shall be available for FHWA analysis.

(3) If the State highway agency or the FHWA becomes aware of any possible violations of EO 11246 or 41 CFR Chapter 60, each has the authority and the responsibility to notify the OFCCP.

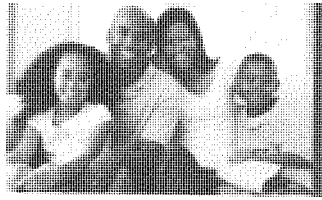
(4) The FHWA and the State highway agency shall not make any determinations regarding compliance with EO 11246 or 41 CFR Chapter 60.

5. **CANCELLATION**. The FHWA Form 86, Compliance Data Report, is hereby canceled.

Original signed by:
Kenneth R. Wykle
Federal Highway Administrator

Related Sites:

Leadership Conference on Civil Rights - The Executive Order on Affirmative Action (E.O. 11246): One of Our Nation's Most Successful Civil Rights Programs

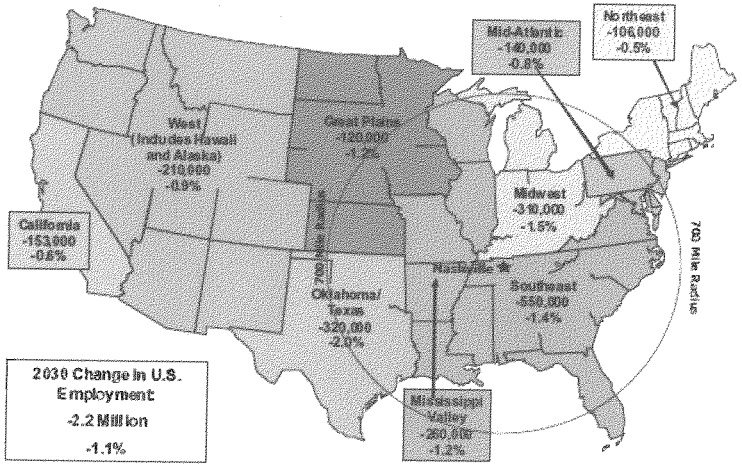


United States of America African American Population:

Area of Population lives within 700 mile Radius of Nashville, Tennessee

How does this effect African American Communities?: Due to their Geographic proximity, AA Communities will lose jobs at a much higher rate than the National Average.

Figure 3.9: Projected regional distribution of changes to employment in 2030 due to ACESA



Source: CRA Model Results, 2009

Mr. ISSA. Mr. Chairman.

Chairman TOWNS. Yes?

Mr. ISSA. Because it is appropriate to his testimony, I would like to ask unanimous consent to have the Black Chamber of Commerce study on the impact of the cap-and-trade bill entered into the record.

Chairman TOWNS. Without objection. So ordered.

[The information referred to follows:]



Prepared for:

National Black Chamber of Commerce

Impact on the Economy of the American Clean Energy and Security Act of 2009 (H.R.2454)

Prepared By:

David Montgomery, Robert Baron, Paul Bernstein, Scott Bloomberg, Kenneth Ditzel, Lee Lane, Anne Smith, Sugandha Tuladhar, and Mei Yuan

CRA International
1201 F Street, N.W., Suite 700
Washington, D.C. 20004

Updated: August 2009

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LIST OF ACRONYMS

ACESA - American Clean Energy and Security Act of 2009	FTE - Full-Time Equivalent
ACP - Alternative Compliance Payment	GDP - Gross Domestic Product
AEO - Annual Energy Outlook	GHG - Greenhouse Gas
BAU - Business As Usual	GW - Gigawatt
CAGR - Compound Annual Growth Rate	HHV - Higher Heating Value
CCS - Carbon Capture and Storage	kWh - Kilowatt-hour
CGE - Computable General Equilibrium	MMBtu - Million British Thermal Units
CRA - CRA International	MRN - Multi-Region National Model
EIA - Energy Information Administration	MS-MRT - Multi-Sector, Multi-Region Trade Model
EISA 2007 - Energy Independence and Security Act of 2007	NEEM - North American Electricity and Environment Model
EPA - Environmental Protection Agency	RES - Renewable Electricity Standard
EU-ETS - European Union Emissions Trading Scheme	VMT - Vehicle Miles Traveled
FOM - Fixed O&M	VOM - Variable O&M

DISCLAIMER

This report describes the conclusions of the individual authors and does not necessarily represent a position of CRA International or of its clients.

1. EXECUTIVE SUMMARY

CRA International (CRA) is a global consulting firm that has provided economic, financial, strategy and business management advice to public and private sector clients since 1965. CRA serves clients from offices on three continents.

As requested by the National Black Chamber of Commerce, CRA has used its proprietary, state-of-the-art MRN-NEEM and MS-MRT modeling systems to analyze the potential economic impacts of the energy and climate legislation (hereafter referred to as American Clean Energy and Security Act of 2009, ACESA or H.R.2454)[1] that was passed by the U.S. House of Representatives. This report is intended to help decision makers and the public understand some of the impacts the legislation could have on the U.S. economy and energy markets. These costs in turn need to be compared to the benefits of the specific proposal, and to the costs and benefits of alternatives, in order to make an informed policy choice.

To help with this comparison of approaches, the report also discusses alternative approaches that could increase or decrease the costs of meeting comparable environmental objectives. All projections in this analysis are based on the aforementioned CRA models, using publicly-available data for key input assumptions. The study examines key sections of the bill included in Title I – Clean Energy and Title III – Reducing Global Warming Pollution, particularly those provisions related to greenhouse gas (GHG) cap-and-trade, renewable energy, and offsets. The analysis focuses on how these could affect performance of the U.S. economy.

The most important conclusion is that, contrary to some claims that have been made recently, policies such as ACESA will have a cost.[2] Therefore the judgment about what action to take cannot be made simply on the grounds that a cap-and-trade program will create additional jobs and stimulate economic growth – it will not – but on whether the benefits are worth the cost. And it needs to be recognized that the benefits of any action by the United States alone are limited because of the relatively small share that the United States will contribute to global emissions over the next century.

This analysis reveals that businesses and consumers would face higher energy and transportation costs under ACESA, which would lead to increased costs of other goods and services throughout the economy. As the costs of goods and services rise, household disposable income and household consumption would fall. Wages and returns on investment

[1] Bill released May 15, 2009.

[2] Claims to the contrary include, for example, House Speaker Nancy Pelosi's statement, "There should be no cost to the consumer." *Wall Street Journal*, April 24, 2009, in "Democrats Weigh Break for Utilities in Climate-Change Bill," Greg Hitt and Stephen Power, available at http://online.wsj.com/article/SB124050061773748291.html.

would also fall, resulting in lower productivity growth and reduced employment opportunities. Impacts would differ across regions of the economy, depending on how local energy costs will change, whether local industries will be favored or harmed, and allocation formulas.

It is not possible to avoid these costs through any free distribution of carbon allowances.[3] Although the wise use of revenues from an auction or carbon tax can ameliorate impacts to some segments of the economy, the cost of bringing emissions down to levels required by the caps cannot be avoided. It is this cost of bringing down emissions that the present analysis estimates, in terms of reductions in GDP and household consumption. Allocations do shift who bears the burden across industries, regions, and income groups, as do decisions about how to spend or return to taxpayers the revenues from allowance auctions.

Just as it is impossible to eliminate the cost of reducing emissions to levels consistent with the cap through allocations or revenue recycling, it is impossible to bring about a net increase in labor earnings through measures that impose a net cost on the economy. The present study finds that the cap-and-trade program would lead to increases in spending on energy efficiency and renewable energy, and as a result that significant numbers of people would be employed in "green jobs" that would not exist in a no carbon policy world. However, any calculation of jobs created in these activities is incomplete if not supplemented with a calculation of the reduced employment in other industries and the decline in the average salary that would result from the associated higher energy costs and lower overall productivity in the economy. This study finds that even after accounting for green jobs, there is a substantial and long-term net reduction in total labor earnings and employment. This is the unintended but predictable consequence of investing to create a "green energy future."

The costs estimated in this study would be much higher if it were not for the assumed use (and *availability*) of international offsets authorized by the bill. Full use of these international offsets would allow U.S. total emissions over the period from 2012 to 2050 to exceed the cap by about 30%.[4] The difference would be made up by paying for offsets that are deemed to represent emission reductions occurring in other countries. However, in light of the difficulties in measuring, verifying, and ensuring the permanence of these offsets, international negotiations have stressed domestic sources of emission reductions over international offsets. The actual rules to be developed for international offsets might allow far fewer than the authorized amount. This would drive costs up substantially.

---

[3] Estimates of impacts on consumers are based on the assumption that all auction revenues are returned to households on a per capita basis and that the value of allocated allowances is also returned in the form of utility rebates and increased investment income from companies receiving allocations.

[4] If domestic offsets are not fully utilized thereby allowing international offsets to increase to as much as 1.5 billion tons per year then the effective increase in the cap from international offsets would exceed 30%.

An important set of provisions in the bill, some of which neither this analysis nor any other has been able to model fully, are regulatory measures that go beyond the cap-and-trade program to require a certain percentage of electricity generation to come from renewable sources (included in this analysis) and mandate specific improvements in a number of standards for building energy efficiency, lighting and appliances. This analysis includes extensive improvements in energy efficiency, consistent with the amount of efficiency improvement implicit in these mandates. However, much of that efficiency improvement may come from a different mix of actions than the specific mandated actions in ACESA. ACESA's mandates approach will constrain the options of households and businesses as to how best to reduce their carbon footprints in light of the incentive provided by the cap-and-trade system. Therefore, the energy user (and electricity generator) may not be able to choose the most cost-effective technology or method to reduce their emissions. To the extent that the consumer and business person are the best judges of how to manage their own affairs and choose ways of dealing with higher energy prices, the regulatory measures in ACESA will increase costs to the U.S. economy beyond what we have estimated.

No model can capture all these costs, because to do so would require as much information as the individual household or business has about its own affairs. Thus any attempt to quantify the costs of command-and-control regulations of this type is likely to significantly underestimate their costs, though even these regulations can be designed in ways that do more or less harm. Indeed, if it were possible to model all the costs of regulatory measures, there would be enough information centrally available that government regulators might actually have sufficient information to tell households and businesses how to do better jobs of managing their affairs. But government agencies do not, in fact, have any better information than analysts trying to assess costs of new legislation, so that neither is likely to understand the impacts of the kinds of mandates included in ACESA. In contrast, a program that puts a uniform and predictable price on GHG emissions provides the incentive for households and businesses to use their own information and judgment to choose the most cost-effective ways to reduce emissions, and thereby to achieve the lowest possible cost for the economy as a whole.

1.1 Economic Impacts

Specific economic impacts resulting from ACESA include the following:[5]

- Carbon Allowance Costs – ACESA would reduce GHG emissions through decreased use of conventional energy. As the cap progressively tightens with time, the cost of reducing emissions becomes more expensive and as a result, the cost of CO_2 allowances increases. In 2015, the cost of a CO_2 allowance is estimated to be $24

[5] All costs in this report are expressed in terms of 2008 dollars, unless otherwise specified. In this report, when carbon or CO_2 allowance prices are discussed these prices are measured as dollars per metric ton of CO_2 equivalent (CO_2e). For GHG emissions the relevant measure is metric tons of CO_2e.

per metric ton of CO_2. By 2030, the allowance cost could increase to $49 per metric ton of CO_2 and by 2050, the allowance cost could reach $131 per metric ton of CO_2.

- Utility Rates and Utility Bills – Energy cost impacts consider the combined effect of changes in the prices of the fundamental energy commodities and the added cost of limiting carbon emissions. In the case of electricity and natural gas supplied through companies regulated by utility commissions, free allowance allocations will mitigate some of the total cost borne by retail customers. ACESA provides free allocations to such local distribution companies, but requires that the full cost of carbon still be reflected in the rates per unit of energy each customer uses. Relative to energy costs in the *Annual Energy Outlook (AEO) 2009* Baseline level, retail natural gas rates would rise by an estimated 11% ($1.30 per MMBtu) in 2015, by 17% ($2.40 per MMBtu) in 2030, and by 36% ($5.70 per MMBtu) in 2050. Retail electricity rates are estimated to increase by 12% (1.3 cents per kWh) relative to baseline levels in 2015, by 24% (2.7 cents per kWh) in 2030 and by 48% (5.8 cents per kWh) in 2050. To the extent that utilities return the value of their free allocations under ACESA to customers through reductions in fixed charges, actual total *bills* for electricity and natural gas will not rise as much as the *rates*. Total utility bills may even decline in the first years of the policy if there is also substantial investment in end-use efficiency and/or conservation in response to the higher energy rates. We estimate that given the allocations in ACESA, average U.S. electricity utility bills would decline by about 0.6% in 2015, and then rise by about 4% to 5% in the 2020 to 2025 time period. Post-2025, as the allocations are phased out bills would rise more dramatically. We estimate that given the allocations in ACESA, average U.S. natural gas utility bills would increase by about 3.5%, and then rise by about 5% to 6.5% in the 2020 to 2025 time period, and then rise more dramatically as the allocations are phased out.

- Transportation Fuel Costs - After an estimated 19 cents per gallon increase in 2015, costs of using motor fuels are estimated to increase by 7% (38 cents per gallon) in 2030 and increase by 16% (95 cents per gallon) in 2050, relative to baseline levels. These cost impacts consider the combined effect of changes in the market prices of the fundamental energy commodities, the added cost of limiting carbon emissions, and projected shifts towards a lower-carbon mix of energy sources used to fuel the average vehicle.

- Employment – A net reduction in U.S. employment of 1.5 million job-equivalents in 2015 increasing to 2.2 million in 2030 and 3.6 million in 2050. These reductions are net of substantial gains in "green jobs." While all regions of the country would be adversely impacted, Oklahoma/Texas, the Southeast and the Midwest regions would be disproportionately affected.

- Wages – Declines in workers' wages will become more severe with time. The earnings of an average worker who remains employed would be approximately $250 less by 2015, $510 less by 2030, and $1,250 less by 2050, relative to baseline levels.

- Household Purchasing Power - The average American household's annual purchasing power is estimated to decline relative to the no carbon policy case by $760 in 2015, $880 in 2030, and by $1,070 in 2050. These changes are calculated against 2010 income levels (the median U.S. household income in 2007 was approximately $50,000). They would be larger if stated against projected future baseline income levels.

- Overall Economic Activity - In 2015, gross domestic product (GDP), a commonly-used measure of total economic activity, is estimated to be 0.7% ($110 billion) below the baseline level driven principally by declining consumption. In 2030, GDP is estimated to be roughly 1.0% ($250 billion) below the baseline level. In 2050, GDP is estimated to be roughly 1.5% ($630 billion) below the baseline level.

1.2 Related Issues

Implementation of ACESA would result in a number of other significant issues:

- Uncertainty - Rigid caps on GHG emissions achieve certainty in the precise amount of emissions reductions over several decades, at the cost of large uncertainties about long-run carbon prices and costs to the economy, as well as short-term volatility in carbon prices. Policymakers have to decide how tightly to set a cap while the best estimates of cost to constituents differ by about a factor of two. The uncertainty and volatility also are deterrents to investment, because under different and equally plausible scenarios for carbon prices, investors will want to make different investment choices (*e.g.*, about new electric generation capacity). Potential volatility in carbon prices will impose risk-bearing costs on companies with a compliance obligation, and for industries like utilities and refineries the costs of managing trading risk could erode a significant percentage of their profit margin. Businesses and consumers already have to live with substantial volatility in commodities markets, such as for fuels. Companies are generally able to cope with unavoidable volatility in natural commodities; but that is no reason to intentionally create volatility in a new, major input (i.e., allowances) given that policymakers can establish the same carbon price incentive without any volatility at all. No matter how manageable carbon price volatility is, it has a cost, and no benefits are derived from that cost. Therefore, it is desirable to minimize carbon price volatility wherever possible. Carbon policy is one of the rare situations where carbon price volatility can be eliminated altogether while still having a clear price signal.

- Green jobs versus effects on total employment - Despite the promise of green jobs, ACESA would, if enacted, inevitably depress total employment from baseline levels. The bill would divert resources now used to produce additional goods and services into the work of obtaining energy from sources that are more costly than fossil fuels. It would, therefore, lower the sum of goods and services produced by the economy and hence the output per unit of labor. Worker compensation will decline as

productivity falls. Although part of the decline in total compensation will show up as a decrease in earnings per worker, many factors inhibit decreases in average compensation. Another result of lowered productivity is likely, therefore, to appear in the form of lower employment levels.

- R&D - Technology advances sufficient to achieve the Reference or Low Cost cases will only come with a much more effective commitment to R&D. The stimulus package and ACESA almost exclusively address deployment of known technologies and large-scale demonstration of well-developed new technologies, and do not provide the level of support for the types of basic and applied research necessary to create the breakthroughs on which game-changing technologies can be built.

- Costs of a duplicate regulatory system – ACESA establishes both a GHG cap-and-trade and a series of command-and-control mandates. In some cases, the regulations may not appear to be binding; *i.e.*, the cap might, by itself, motivate all of the actions needed to meet the standard. In these instances, the standards would waste resources on needless monitoring, measuring, enforcement, and compliance, but they would not affect the pattern of GHG reductions. In other cases, the standards would change the allocation of abatement resources by mandating different choices. However, the cap sets the total GHG cutback. If the regulations mandate more change in one area, less will take place somewhere else. Standards, therefore, will force the economy to substitute more expensive GHG emission decreases for decreases of the same amount that could have been made elsewhere at lower cost.

- Wealth transfers abroad - ACESA contains provisions that will transfer wealth from the U.S. to other nations. These include allocations of allowances to overseas entities for international adaptation and purchases of offsets from foreign projects. We estimate that these provisions of ACESA would result in a transfer of U.S wealth to other countries varying from $40 billion to $60 billion per year in the years 2012 through 2030. Some possible circumstances can cause these amounts to be even larger.

Overall, ACESA is designed to raise the cost of using conventional energy by requiring emission allowances for the use of that energy, which effectively restricts the use of lower cost energy in the U.S. economy. Higher energy costs would likely reduce total consumption, employment, and economic output. The link between energy supply and its cost, and economic performance is the key to understanding the pattern of the study results and central to an assessment of the implications of ACESA. Table 1-1 provides a summary of economic impacts.

Table 1-1: Summary of projected economic impacts (change from projected baseline)

	2015	2020	2030	2040	2050
CO_2 Allowance Price (2008$/Metric Ton)	$24	$30	$49	$80	$131
Change in U.S. jobs (Millions)	-1.5	-1.8	-2.2	-3.0	-3.6
Change to Average Worker's Annual Wages: *Assumes Partial Wage Adjustment* ($2008)	-$250	-$350	-$510	-$850	-$1,250
Change in U.S. Purchasing Power ($2008 per Household)	-$760	-$810	-$880	-$990	-$1,070
Percentage Change in U.S. GDP	-0.7%	-0.8%	-1.0%	-1.3%	-1.5%
Percentage Change in Natural Gas Retail Rates*	11% ($1.30/MMBtu)	13% ($1.60/MMBtu)	17% ($2.40/MMBtu)	25% ($3.80/MMBtu)	36% ($5.70/MMBtu)
Percentage Change in Motor Fuel Cost	4% (19¢/Gallon)	5% (24¢/Gallon)	7% (38¢/Gallon)	10% (59¢/Gallon)	16% (95¢/Gallon)
Percentage Change in Electricity Retail Rates*	12% (1.3¢/ kWh)	18% (2.1¢/ kWh)	24% (2.7¢/ kWh)	41% (4.7¢/ kWh)	48% (5.8¢/ kWh)

* Percentage increases in utility bills will be smaller to the extent that there are free allowance allocations to load-serving entities and natural gas local distribution companies and/or reduced energy consumption.

2. BACKGROUND

2.1 THE AMERICAN CLEAN ENERGY AND SECURITY ACT OF 2009

ACESA would, if enacted, impose sweeping changes on virtually all parts of the U.S. energy system. These changes would reverberate through much of the national economy. The two major provisions of the bill are a combined efficiency and renewable electricity standard and a greenhouse gas cap-and-trade system.

ACESA requires retail electric utilities to meet specified percentages of their annual load through renewable electricity generation and energy efficiency savings. The combined standard is initially set to 6% of load in 2012 and rises to a maximum of 20% by 2039. Up to one-quarter (or 5% of 2020 load) of the requirement can be met with savings from energy efficiency, and state governors can petition to increase the proportion of compliance met through energy efficiency to up to two-fifths of the combined percentage requirement. As an alternative to procuring renewable energy credits, retail electric utilities can purchase a $25 (adjusted for inflation) alternative compliance payment (ACP), the funds from which will flow back to state-led research and development of renewable electricity generation technologies and cost-effective energy efficiency programs.

Title III establishes a U.S. national cap on total GHG emissions. The cap would apply to electric utilities, oil companies, large industrial sources, and other covered entities. Entities covered by the act collectively contribute about 85% of U.S. greenhouse gas emissions, which are, in turn, approximately 17% of current global emissions. The program is designed to reduce covered emissions by 3% below 2005 levels in 2012, 17% below 2005 levels in 2020, 42% below 2005 levels in 2030, and 83% below 2005 levels in 2050.

Title III also provides for alternative compliance with the GHG emissions cap through offset credits and international emission allowances. However, it restricts the use of these measures. For international offset credits, an entity must submit five offset credits for every four tons of CO_2 that it emits, except for during the first five years of the cap. For international emission allowances, an entity may submit allowances issued by a foreign program that meets certain criteria. The total quantity of emissions that may be covered by rendering offsets to meet compliance obligations is limited to 2 billion metric tons of CO_2 in each year, split evenly between domestic and international offsets. Given the five offsets for four tons requirement for international offsets (after the first five years of the cap), this would mean that up to 2.25 billion offsets credits may be demanded under the cap each year.[6]

[6] In addition, if domestic offsets are not fully utilized, additional international offsets may be used (up to a total of 1.5 billion international offsets, but total offsets still cannot exceed 2 billion).

2.2 Provisions Modeled

The text of ACESA is more than 900 pages (the bill that passed exceeded 1,400 pages) in length. The Congress has yet to fully determine some key features, making it impossible to model their impact. Many provisions that are provided have too little an economic impact, or their effect is too speculative, to warrant modeling. In other cases, provisions are economically consequential, but modeling them would require time and resource constraints that exceed those available for this initial effort. Detailed energy efficiency standards and mandates are consequential and are likely to raise costs and economic impacts if they change the decisions that households and businesses would make in response to the incentives created by the cap-and-trade program. However, modeling the full costs of these provisions requires a more detailed representation of individual decisions than any comprehensive economic model can encompass.

Thus, it is important to understand which aspects of ACESA have been addressed, which will be addressed later, and which lie beyond the scope of the analysis. Table 2-1 summarizes the primary provisions included in this analysis

Table 2-1: ACESA provisions modeled

Provision	Details
Combined efficiency and renewable electricity standard	Required specified percentages of a baseline level of electricity sales to be met with qualified renewable resources; baseline level excludes certain existing hydroelectric generation, sales from small LDCs and generation from new nuclear and carbon, capture and storage units
Greenhouse gas cap & trade	Cap on covered emissions from 2012-2050, allows banking/borrowing, annually allows for up to 2 billion in offsets (split between domestic and international offsets)
Allowances for carbon capture and storage (CCS)	Funds from allowances are used to bring online 3 GW of new CCS in 2020
Allocations provisions and revenue recycling	Regional and U.S. welfare impacts reflect ACESA's provisions for free allocations to industries and for investments in CCS and adaptation. All auctioned revenues are recycled to U.S. consumers.

Our analysis of the cap-and-trade program includes offset provisions, banking and borrowing, and the strategic reserve, all measures meant to ease the burdens expected to result from allowance price fluctuations. We have not included any of the costs of volatility in our estimates of the economic costs of the cap-and-trade program, either with or without these measures. Therefore, we are unable at this time to estimate how much these measures could reduce volatility or the costs that any remaining volatility would add to those estimated in this study.

Our analysis also estimates the impact of allowance allocations on the regional distribution of impacts and on average utility bills. These allowance allocations include free allocations to the electric sector, energy-intensive industries, natural gas distributors, automotive sector and refining sector. In addition, there are allocations made to spur investment in CCS, prevent tropical deforestation and aid in domestic and international adaptation. Remaining allowances are auctioned with proceeds being used to assist low and moderate-income households, assist states in increasing renewable energy and energy efficiency, increase research and development, assist workers and maintain budget neutrality. Our analysis also accounts for the full recycling of auction revenues in these ways.

2.3 Study Objectives

This study evaluates the potential economic consequences of the key provisions of ACESA. Because these provisions interact and because different elements of the economy are interconnected, the task requires the use of comprehensive and detailed economic models. These models simulate the operations of major features of the economy, so that it is possible to trace the many pathways through which legislation can affect various economic sectors and activities. CRA used its proprietary, state-of-the-art MRN-NEEM and MS-MRT modeling systems to analyze the potential impacts from ACESA on domestic energy markets and the economy. The models are described more fully in Appendix D.

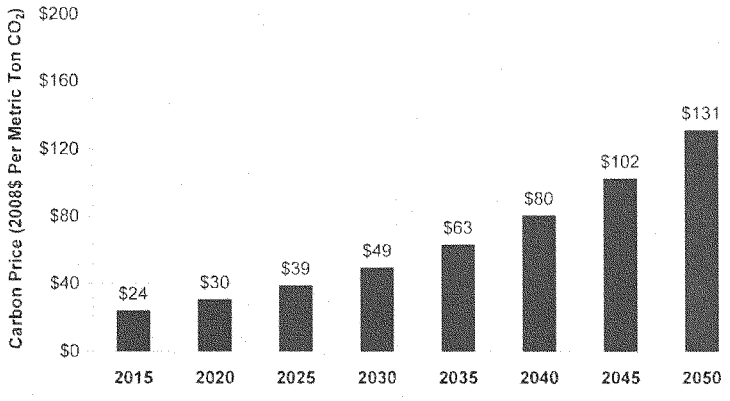
Like all other economic impact studies by EPA, EIA, and MIT, we assess only the costs of meeting the provisions of a policy, ACESA, in this case. These costs of the policy are to be compared to the benefits of whatever change in *global* atmospheric concentrations is projected to result from this single policy that affects U.S. emissions only. If a benefits calculation were to include emissions reductions from presently non-existent policies in other countries, then a different cost analysis would be required which would consider the additional costs on the U.S. economy of those additional assumed policies.

3. RESULTS

One of the primary objectives of ACESA is to implement a GHG cap-and-trade policy that would reduce greenhouse gas emissions by decreasing the use of conventional energy, which is carbon-emitting. This would be achieved by creating a limited supply of "allowances" required for the use of carbon-emitting energy, thereby increasing energy costs to the U.S. economy. As the cap progressively tightens with time (*i.e.*, allowances become scarcer), the marginal source of reducing emissions becomes more expensive as lower-cost sources of emissions reductions are exhausted. As a result, the price of an allowance increases with time as the cap becomes more stringent.

Figure 3.1 presents estimates of the CO_2 allowance price during the forecast period.[7] In 2015, the price of a carbon allowance is estimated to be $24 per metric ton of CO_2. By 2020, the allowance price would increase to $30 per metric ton of CO_2. By 2030, the allowance price would increase further to $49 per metric ton of CO_2. By 2050, the allowance price would reach $131 per metric ton of CO_2. The price pattern reflects the banking of permits that occurs in this policy. That is, permit prices increase by the annual discount rate of 5%.

Figure 3.1: Projected CO_2 allowance prices due to ACESA



Source: CRA Model Results, 2009

[7] All allowance prices are stated in terms of 2008 dollars per metric ton of CO_2e.

The economic impacts resulting from the increasing CO_2 allowance prices would be expected to cascade throughout the economy and would likely increase energy costs and decrease production and consumption across a wide array of goods and services. The size of the projected impacts varies by region but the direction does not. The projected impacts increase throughout the period analyzed (2010 through 2050) as the measures become more stringent, with the largest changes projected over the 2030 to 2050 time period.

3.1 Economic Impacts

3.1.1. Costs to consumers

Consumers ultimately bear the added costs projected to result from the cap-and-trade policy. The cap-and-trade provision is projected to result in fuel switching away from less costly conventional fuels (*e.g.*, coal), towards more costly lower carbon alternatives (including natural gas) due to tightening GHG emission caps. Further, costs for all carbon-based energy sources (*e.g.*, coal, oil, and natural gas) are projected to increase as allowances would need to be purchased for the emissions associated with the use of these fuels. In the case of electricity and natural gas supplied through companies regulated by utility commissions, free allowance allocations will mitigate some of the total cost borne by retail customers. ACESA provides free allowance allocations to such load-serving entities, but requires that the full cost of carbon still be reflected in the rates per unit of energy each customer uses. The ACESA allowance allocations are also accounted for in the impacts presented in this section.

Figure 3.2 reports how the cost per unit of energy consumed by businesses and households is projected to increase relative to energy costs in the AEO 2009 baseline level:[8]

- For transportation fuels, after an estimated 19 cents per gallon increase in 2015, costs of using motor fuels are estimated to increase by 7% (38 cents per gallon in 2030 and increase by 16% (95 cents per gallon) in 2050 relative to baseline levels. These cost impacts consider the combined effect of changes in the market prices of the fundamental energy commodities, the added cost of limiting carbon emissions, and projected shifts towards a lower-carbon mix of energy sources used to fuel the average vehicle.

- Retail natural gas *rates* (*i.e.*, the price consumers pay per unit of gas energy used) would rise by an estimated 11% increase ($1.30 per MMBtu) by the year 2015, by 17% ($2.40 per MMBtu) by the year 2030, and by 36% ($5.70 per MMBtu) by the year 2050.

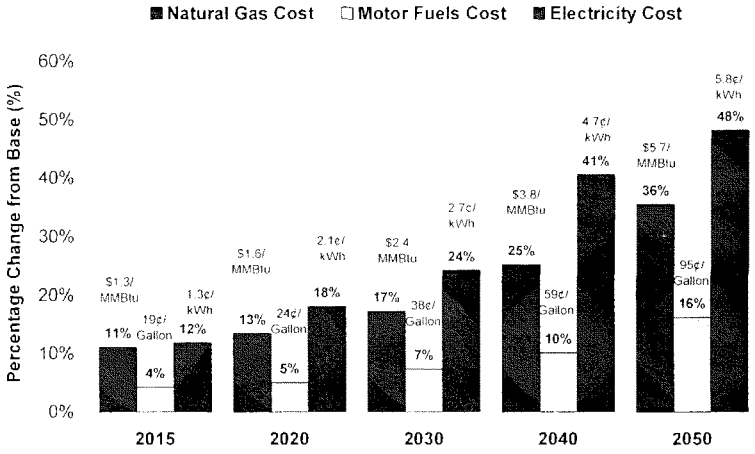
[8] Results herein are reported as changes from the EIA Annual Energy Outlook 2009 Early Release Reference Case.

- Retail electricity *rates* are estimated to increase by 12% (1.3 cents per kWh) relative to baseline levels in 2015, by 24% (2.7 cents per kWh) in 2030 and by 48% (5.8 cents per kWh) in 2050.

These increases in retail energy rates to customers of electricity and natural gas utilities are projected to occur even when accounting for ACESA's provision for free allocations of 30% of the allowances to electricity load-serving utilities, and 9% to gas utilities through 2025. This is because ACESA does not allow the value of those allocations to be returned to customers in proportion to the amount of energy that they use. The purpose of this provision is to ensure that consumers' incentives to conserve and to invest in energy efficiency are not undermined by attempts to mitigate their energy costs through free allocations. Instead, the allocation value will have to be returned to utility customers either through utility spending programs on energy efficiency or demand-side management, or through fixed rebates or credits on their bills. To the extent that utilities return the value of their free allocations under ACESA to customers through reductions in fixed charges, actual total *bills* for electricity and natural gas will not rise as much as the *rates* will. Total utility bills may even decline in the first years of the policy if there is also substantial investment in end-use efficiency and/or conservation in response to the higher energy rates.

We estimate that given the allocations in ACESA, average U.S. electricity utility bills would decline by about 0.6% in 2015, and then rise by about 4% to 5% in the 2020 to 2025 time period. Post-2025, as the allocations are phased out, bills would rise more dramatically. We estimate that given the allocations in ACESA, average U.S. natural gas utility bills would increase by about 3.5% in 2015, and then rise by 5% to 6.5% in the 2020 to 2025 time period, with more dramatic increases after that as the allocations are phased out.

Figure 3.2: Projected U.S. household increases in costs inclusive of carbon costs for natural gas, motor fuels and electricity due to ACESA, relative to baseline costs



Source: CRA Model Results, 2009

Claims that GHG cap-and-trade can boost total employment have become commonplace. This contention has become a central point in the national debate about climate policy. That it has is understandable; the U.S. economy is undergoing both a cyclical downturn and a structural adjustment. Unemployment is high, and so is political pressure to respond to both the short-term cyclical and to the long-term structural aspects of the challenge. Not surprisingly, this pressure has led to claims and hopes that GHG cap-and-trade might somehow solve both problems.

These claims are incorrect, and the hopes that spring from them are destined to lead to disappointment. ACESA can have no impact on the unemployment arising from the current cyclical downturn because its provisions will not take effect soon enough. In the longer run, its net effects on employment will be negative, for the reasons explained in this section.

Investment diversion and impacts to productivity growth

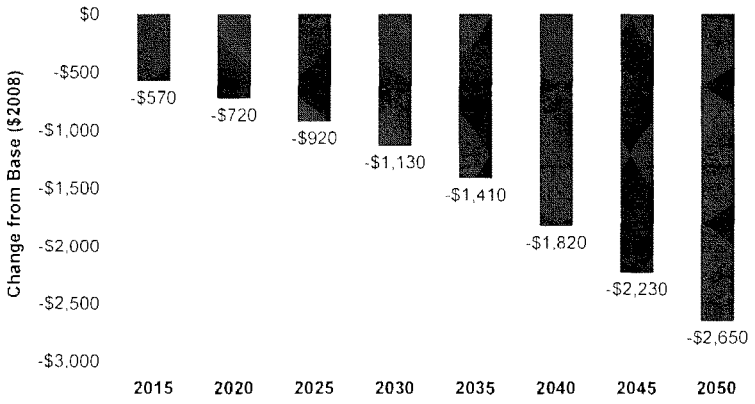
If enacted, ACESA would divert resources now used to produce goods and services into the task of obtaining energy from sources that are more costly than fossil fuels. If consumers and businesses are forced to spend more on energy due to its higher costs, they would have less

to spend on other goods and services causing decreases in demand for the quantities of goods and services produced by the economy. In addition, as the resources are diverted to more expensive energy sources, the productivity of labor will fall. Business activity is likely to contract relative to the levels that would have prevailed without policy-induced energy cost hikes. The demand for labor would weaken because employers would need to spend less on labor in order to supply the reduced amount of goods and services demanded by consumers. As a result, payments to labor are projected to decline relative to that which would have prevailed without the higher energy costs. This will be reflected in a combination of less employment, and lower wages for those workers not losing their job.

Reductions in employment and wages due to reduced productivity growth

If actual wages were to decline to their lower equilibrium level instantaneously when the equilibrium wage rate falls as a result of the lower productivity caused by the policy, then full employment would remain in effect, but workers would immediately experience reduced incomes. Figure 3.3 presents the decline in the average annual salary paid to workers that would occur under an assumption that actual wages are fully responsive to the new, lower equilibrium wage rate.

Figure 3.3: Projected impact on average annual wages due to ACESA, assuming wage rates decrease instantly to lower equilibrium



Source: CRA Model Results, 2009

Empirical experience suggests, however, that wages do not immediately respond to new equilibrium levels, particularly if that entails a decline in wages. If real wages do not immediately fall to the new, lower market-clearing level, then there will be an excess supply of labor in the economy relative to what employers are willing to hire at those overly-high wage

rates, and this leads to lay-offs and an increase in unemployment. The degree of unemployment that will occur depends on how much wages actually do fall towards the new market-clearing level. An exceedingly high amount of unemployment would be estimated under ACESA if we were to assume that there would be no decline at all in real wages to the levels shown in Figure 3.3 above. And, as noted, if we assume that workers would immediately absorb the full wage decline shown in that figure, there would be no involuntary job losses.

Figure 3.4 illustrates the employment impacts if only half of the decline in the market-clearing wage rate is absorbed by workers immediately. In this case, the other half of the reduction in payments to labor has to be achieved by eliminating job positions. The actual number of job positions that would have to be shed depends on whether higher-paying or lower-paying jobs are the ones that are eliminated. In our calculation in the figure, we assume that jobs would be shed in equal proportions across the entire wage distribution, and report the loss in "average jobs." (The precise number of jobs would be lower if ACESA would disproportionately affect the relatively higher-paid positions, and it would be higher if ACESA would cause a disproportionate loss of lower-paid types of jobs.) Figure 3.4 shows that in 2015, the number of people on the unemployment rolls is estimated to be approximately 1.5 million higher than in the baseline. It also shows that there would be about 2.2 million fewer average jobs in the economy in 2030 and 3.6 million in 2050 relative to what would otherwise have been possible but for the requirements of ACESA.

Because these estimated employment impacts are based on the general equilibrium requirement that total payments to labor must fall to the new, lower level that can be supported by the reduced overall productivity of the entire economy, *they are necessarily inclusive of all increases in so-called "green jobs" that will be created as a result of the proposed legislation.*[9]

Also, because these average losses in employment assume that workers do absorb some of the reductions in equilibrium payments to labor, there is still some depression in the average salaries to those who would retain their jobs. The decline in average annual wages that is consistent with the employment reductions in Figure 3.4 is shown in Figure 3.5.

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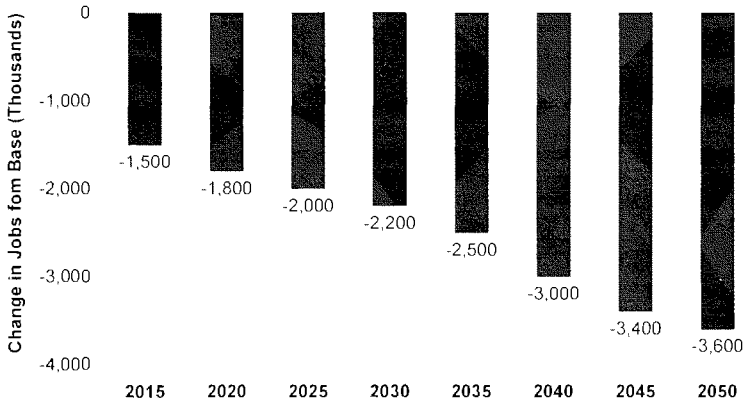
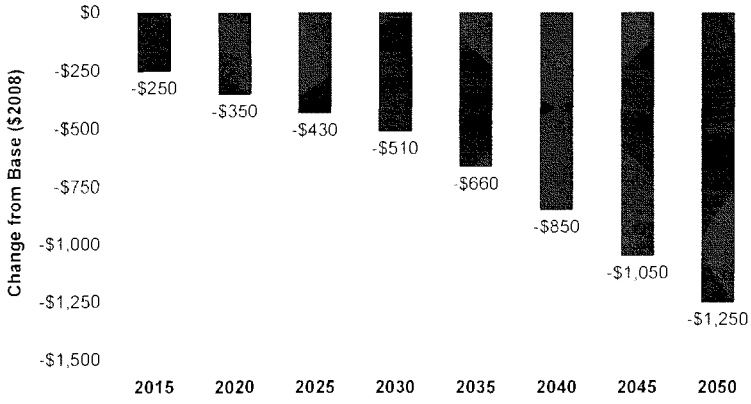
[9] CRA has made preliminary estimates of the number of average jobs directly associated with the increased payments to labor for increased renewable electricity, more efficient automobiles, biofuels, and energy efficiency improvements in its model scenario of ACESA. The preliminary estimate ranges from 1 million in 2015 to almost 2 million by 2030. The creation of a green job does not always mean the creation of a "new" job. For example, moving an autoworker from producing a vehicle powered by conventional fuels to a vehicle powered by a hybrid engine would not constitute a "new" job. Instead, it is a job transfer to what one might call a green job. Our estimate of green job creation includes green jobs that are both "new," which are incremental to a business as usual scenario, and "transfers," which are jobs shifted from part of an industry negatively impacted by a policy to another part of the industry that is positively impacted by the policy. Our net job loss estimates above are derived from the same model run that simultaneously contains this large number of implicit employment in "green jobs."

Figure 3.4: Projected changes to employment due to ACESA, assuming partial wage rate adjustments



Source: CRA Model Results, 2009

Figure 3.5: Projected impact on average annual wages due to ACESA for workers who remain employed, assuming partial wage rate adjustments

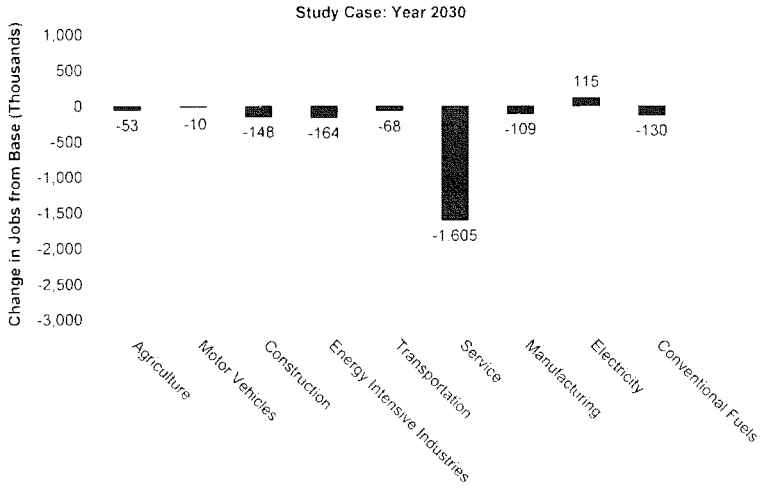


Source: CRA Model Results, 2009

It is noteworthy that the impact of a policy such as ACESA is not a short-term phenomenon that consists of a few years of belt-tightening, after which the economy will be on a different (lower-carbon) track. Rather, getting to the lower-carbon future will require a long-term,

sustained effort to continue growing the investment in more costly forms of energy, and this will mean that payments to workers will remain lower for many decades than would be the case if we were to continue to rely on the cheaper but higher-carbon conventional sources of energy. The growing decline in real wages is due to a slowdown in productivity growth that is a direct consequence of the success of the cap-and-trade program in transforming the U.S. economy into one with nearly zero carbon emissions.

Figure 3.6: Projected impact by sector to employment in 2030 due to ACESA



Source: CRA Model Results, 2009

Employment impacts will also vary by industrial sector. Figure 3.6 shows the job loss in 2030 by sector. About 70% of the job losses that would accompany ACESA are projected to be in employment opportunities in the services and commercial sectors. Service sector employment reductions reflect the cumulative impact of businesses having to pay more for their energy services, and facing higher costs for goods and services generally, almost all of which are made using more expensive energy. These will tend to be "silent" losses of opportunity in the relatively low-wage portions of the economy that are least often associated with either the emitting sectors who will face the direct cost of the policy or the activities where the most overt examples of new "green jobs" will be found. Energy-intensive industries will also be affected as their competitiveness relative to other producers' declines due to the increases in energy costs. Conventional fuels decline because of reduced demand for fuels in general and the substitution to various forms of biofuels. The electricity sector gains as a result of the need to replace existing generation plants with zero and low carbon emitting technologies, and also due to general equilibrium effects.

Discussion of green jobs prospects

To be sure, by mandating the use of the newer, more expensive energy sources and systems ACESA would create some new jobs. The difficulty is that the number of these new "green jobs" will be lower than the number of the other jobs that the bill would destroy elsewhere in the economy. The apparent discrepancy between our finding and estimates of large numbers of green jobs arises because the latter estimates are answering the wrong question. Those who claim there will be a job-creating attribute to a policy such as ACESA have asked whether it will require workers to carry out energy efficiency projects and produce biofuels and build and operate power plants using renewable energy. It will, but it will also require that those workers come from employment in other industries, some of which are directly targeted by a cap-and-trade program – such as fossil fuels production – and some of which will shrink because consumers can no longer afford their full production. The question that we have addressed is whether the balance of the many economic effects of a GHG cap is to increase or decrease total labor income in the United States, and the answer is that total labor income will decrease.

Whether green jobs will be lower-paying than the jobs they replace and require more labor per unit of output does not change the generally depressing effect of the cap-and-trade program on total labor income. It might lead to two low-paid workers moving out of unemployment while one worker who was earning more than twice their wages becomes unemployed. Only if this were to be the predominant pattern of the impact of the policy could one argue that there would be a net increase in total jobs under the policy concomitant with the inevitable decrease in total payments to workers. Whether that would be a desirable goal of social policy cannot be answered by economic analysis.

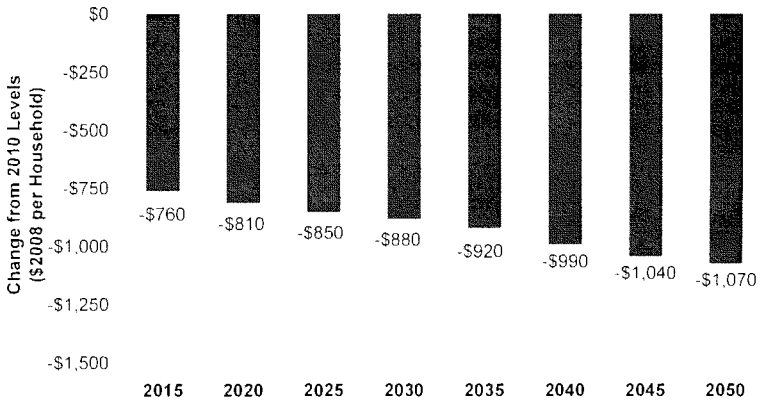
The debate is further confused by the lack of a clear definition of a "green job." For example, how would one classify a job supporting coal-fired power with carbon capture, or nuclear generation? How does one even tell if a given construction job is in "green" construction or not? Regardless of these definitional concerns, however, the fact remains that workers in aggregate will face lowered earnings potential under a policy that drives carbon emissions to much reduced levels. The net effect of lower productivity also ultimately translates into overall losses in average household spending power, and into reductions in GDP relative to what they would be if no such policy were in place. We turn to those cumulative macroeconomic effects in the next two sections.

3.1.3. Impacts on household consumption

Higher energy costs generally mean that consumers must spend a larger percentage of their income to maintain their current level of household energy services. At the same time, significant quantities of energy are needed to produce and transport the many non-energy goods and services. The projected higher costs of these goods and services would be expected to magnify the loss in household purchasing power associated with the direct purchase of energy services. At the same time, higher energy costs across the economy as

a whole would lower income. We have already discussed how average labor income would be reduced. Similarly, lower returns on investment would reduce household income from savings and retirement funds. Figure 3.7 shows the increasing erosion of household purchasing power that is projected as a result of ACESA, due to the combination of all these factors. These estimates of changes in household purchasing power are based on the assumption that all auction revenues are returned to households on a per capita basis and that the value of allocated allowances are also returned to households in the form of utility rebates and increased investment income from companies receiving allocations.

Figure 3.7: Projected impact on household purchasing power due to ACESA, stated in terms of 2010 income levels



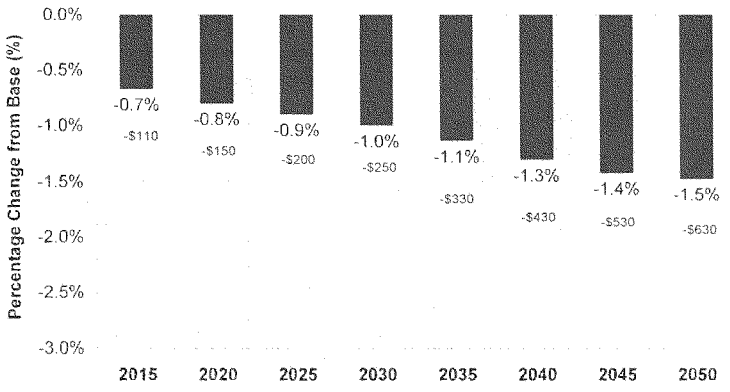
Source: CRA Model Results, 2009

Stated in terms of 2010 income levels, in 2015 the average household in the U.S. is estimated to experience a loss in purchasing power of roughly $760. This loss grows over time to $810 per household in 2020. In 2030, the estimated impact is projected to decline by roughly $880, and in 2050, the estimated impact reaches $1,070. A very large portion of the losses per household can be traced to the fact that a large fraction of total compliance is met by purchasing offsets from international sources. While these offsets lower the price of allowances, they also cause U.S. wealth to be given to other countries. More expensive compliance from domestic suppliers would at least keep that wealth from being transferred out of the pocketbooks of the average U.S. household.

3.1.4. Gross domestic product

The estimated impacts on GDP would follow the pattern already evident in the estimated results for consumption and employment. Higher production costs and lower household purchasing power interact; employment and consumption would fall; total economic activity, measured as GDP, would also decline. In 2015, the GDP is projected to decline by 0.7% ($110 billion) below the baseline level. In 2030, it is projected to decline further to 1.0% ($250 billion) below the baseline, reflecting the investment needed to build the infrastructure necessary to comply with future more stringent emission caps, and in 2050 the decline is 1.5% ($630 billion). Figure 3.8 illustrates the pattern of estimated GDP losses through time.

Figure 3.8: Projected impact on GDP due to ACESA, relative to the baseline

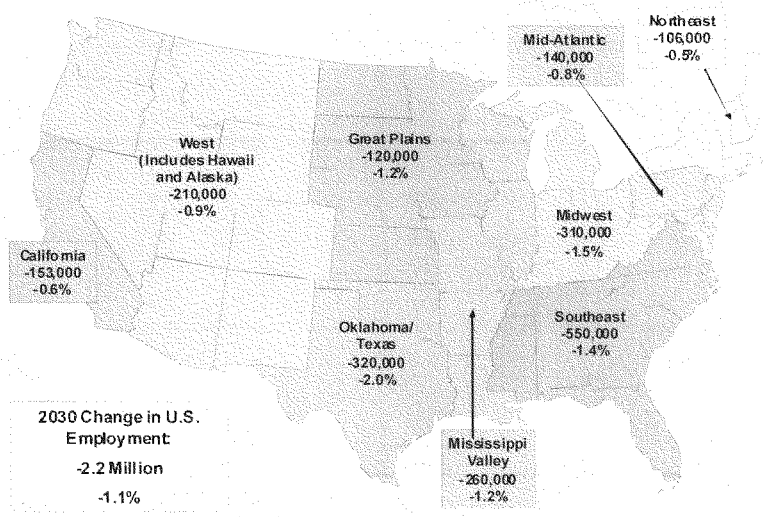


Source: CRA Model Results, 2009 *Values in Billions of $2008*

3.1.5. Impacts by Region

Figure 3.9 indicates that the projected job losses would be distributed throughout the country. Regions that experience a larger decline in employment relative to the U.S. average are Oklahoma/Texas, the Midwest and the Southeast; regions that suffer a smaller decline than the U.S. average are the Northeast, California, and Mid-Atlantic. Losses in the Great Plains, West and Mississippi Valley are near the national average for the U.S. as a whole.

Figure 3.9: Projected regional distribution of changes to employment in 2030 due to ACESA

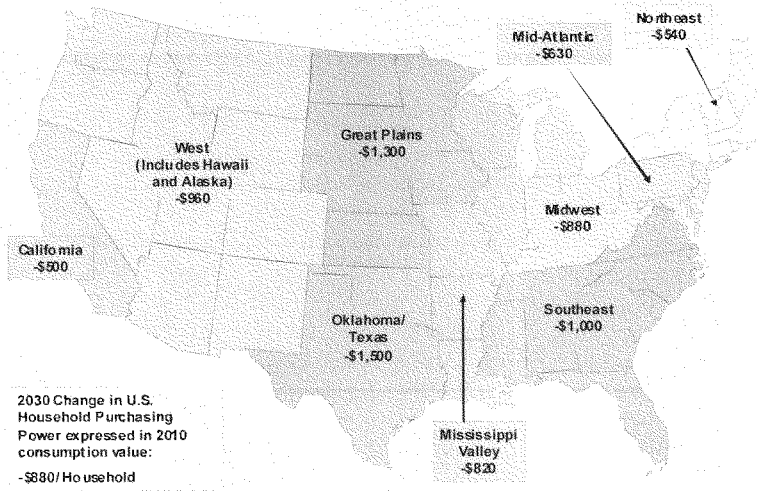


Source: CRA Model Results, 2009

A region's industrial impacts, and hence employment effects, strongly correlate with the region's composition of industries and the energy-intensity of these industries. The Northeast and California fare better than other regions because of their initial economic circumstances. Namely, these regions' industries are less energy-intensive, as is the overall composition of industry. At the other end of the spectrum are Oklahoma/Texas, the Southeast and the Midwest regions, which are more concentrated in conventional energy production activities and energy-intensive industries.

Figure 3.10 shows the loss in purchasing power by the regional household in 2030. Regions that experience a larger decline in purchasing power relative to the U.S. average are Oklahoma/Texas, Great Plains, the Southeast, and the West; regions that suffer a smaller decline than the U.S. average are California, the Northeast and the Mid-Atlantic. Losses in the Midwest and Mississippi Valley are near the national average for the U.S. as a whole. In general, households in regions that have to import higher-cost energy and those that face loss of domestic production incur the largest loss of purchasing power. (Changes in the regional distribution of permits could mitigate some of these disproportionate impacts, if designed effectively.)

Figure 3.10: Projected regional distribution of changes to 2030 household purchasing power due to ACESA, stated in terms of 2010 income levels



Source: CRA Model Results, 2009

The distribution of regional impacts is strongly influenced by the proposed permit allocation scheme. With consumption losses in Oklahoma and Texas more than three times as large as losses in California, the proposed allocation clearly does not even out regional impacts. California's allocation is sufficiently large that it ends up as a net seller of allowances, while many of the most heavily-impacted regions are net buyers. These results highlight the great care that must be taken in deciding on the initial allocation of permits so that the policy treats all concerned equitably.

3.2 Uncertainties of Carbon Prices and Economic Impacts

Rigid caps on greenhouse gas emissions achieve certainty in emission levels over a period of time at the cost of large uncertainties about long-run carbon prices and costs to the economy, as well as short-term volatility in carbon prices.

3.2.1. Uncertainty about carbon prices and cost

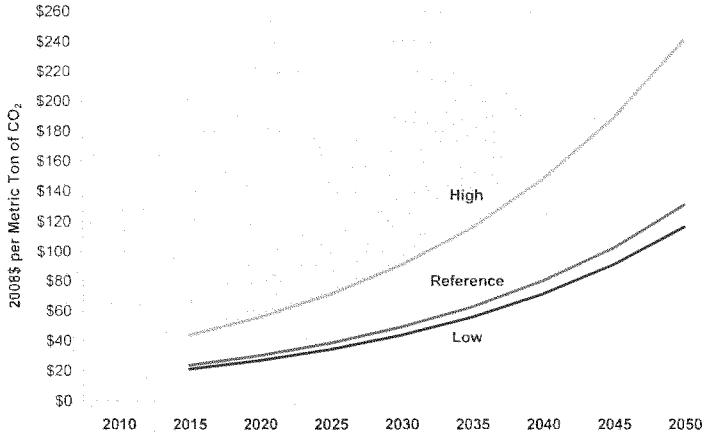
The uncertainty of outcomes from a rigid cap is illustrated by a pair of cases. These High and Low Cost cases were constructed by developing a range of assumptions about specific future economic and technology factors that will influence the level of carbon emissions and costs but cannot be predicted accurately in advance. Table 3-1 below describes the range of assumptions used to define the High and Low Cost cases, compared to Reference case assumptions.

Table 3-1: Range of assumptions in Low and High Cost cases compared to Reference case

	Low Cost	Reference	High Cost
Electricity Demand	AEO 2009 April Release (0.90% 2010-2030 CAGR)	AEO 2009 Early Release (1.00% 2010-2030 CAGR)	AEO 2009 Early Release + Difference b/w Early & April Release
Natural Gas Prices	Same as Reference	AEO 2009 Early Release through 2030, with a 2050 wellhead target of $9/MMBtu (in 2003$)	Same as reference
Demand Elasticity	Higher demand elasticity	CRA Standard	Lower demand elasticity
Low-Carbon Fuel Transportation Technology	Reduce zero- and low-carbon alternative fuels down to cost parity with motor gasoline	CRA Standard	Assume no zero-carbon fuel
Capital Costs for New Generating Technologies	Same as reference	AEO 2009 Early Release, save for nuclear (public filings) and geothermal (EPA NEEDS 2006)	Flat-line costs at first-year AEO 2009 Early Release
CCS Capacity Limits	270 GW by 2050	180 GW by 2050	Same as reference
Nuclear Capacity Limits	EPA W-M (266 GW by 2050)	206 GW by 2050	Allow existing nuclear fleet (103 GW) to be replaced, but no more
Offsets	Same as reference	Wealth transfers out of U.S. from international offset purchases priced at marginal cost of international offsets	Wealth transfers out of U.S. from international offset purchases priced at CO_2 allowance price, no international avoided deforestation offsets

Each of these factors represents a true uncertainty, about future growth in the economy and energy demand, about how energy use will respond to higher prices derived from the cap-and-trade system, about future developments in the performance and cost of electricity generation and transportation technologies, and about limits that may be imposed on key technologies due to regulatory action or litigation. These factors cannot be known in advance, and the assumptions chosen for the sensitivity analysis represent quite reasonable outcomes that many observers would see as likely. Figure 3.11 shows the range of carbon prices that this range of underlying uncertainty makes likely.

Figure 3.11: Carbon allowance prices by model scenario



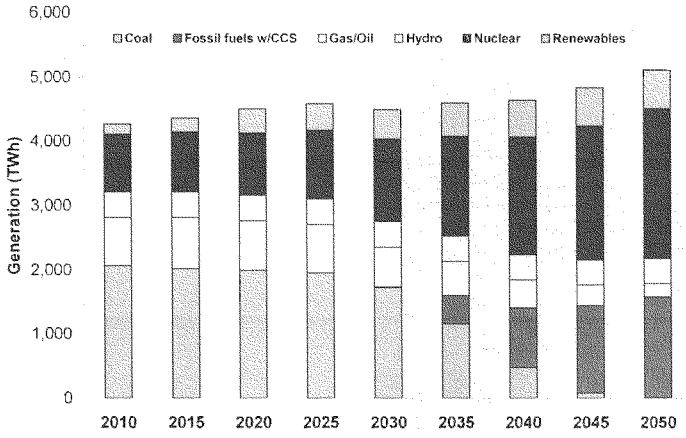
Source: CRA Model Results, 2009

The analysis reveals that the chance of higher prices and costs appears much larger than the chance of lower costs. In 2015 the High Cost assumptions lead to a carbon price about 80% higher than the Reference case, a percentage difference that is maintained out to 2050 because of the assumption that banking is utilized to minimize the overall cost of the cap. The Low Cost case only leads to carbon prices a few dollars lower, suggesting that the Reference case assumptions are about as favorable a set of relevant assumptions as it is possible to make about the factors considered, given current knowledge. (Some unanticipated, major breakthrough in technology might result in a lower cost than this range, but this would require very specific technology assumptions that are simply not justifiable with any current information. Such breakthroughs are unlikely without more emphasis on game-changing R&D than is found in ACESA and the stimulus package, which both concentrate on deployment of more mature technologies.)

Figure 3.12 and Figure 3.13 show differences in generation mix through 2050 and Figure 3.14 and Figure 3.15 show differences in technologies chosen for new capacity. The higher carbon allowance prices in the High Cost case (approximately double the carbon prices in the Low Cost case) call for considerably more renewables generation over the entire modeling horizon, and particularly for increased renewables investment from 2015 through 2020. The disparity in carbon allowance price projections makes investment planning for generators much more difficult in a cap-and-trade system that leaves future carbon allowance prices uncertain than it would be under an alternative, such as a carbon tax, that fixed the price in advance.[10] Investors who believed that carbon prices would follow the high track could find themselves with stranded renewable assets in the event lower carbon prices come about, and investors in other assets in the lower price cases could find themselves regretting the decision not to invest in renewables.

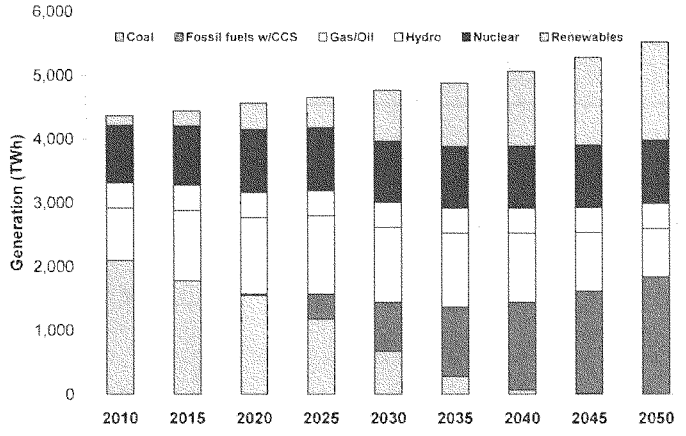
[10] Under a tax approach, there would also be uncertainties about long-run carbon price levels, because regulators would need to periodically reset the tax rate based on observed progress towards reducing emissions under initial tax rates. The tax policy approach offers short-term pricing stability, however, which helps with investment decisions, even though the long-term costs are unknown.

Figure 3.12: Generation by technology for the Low Cost case



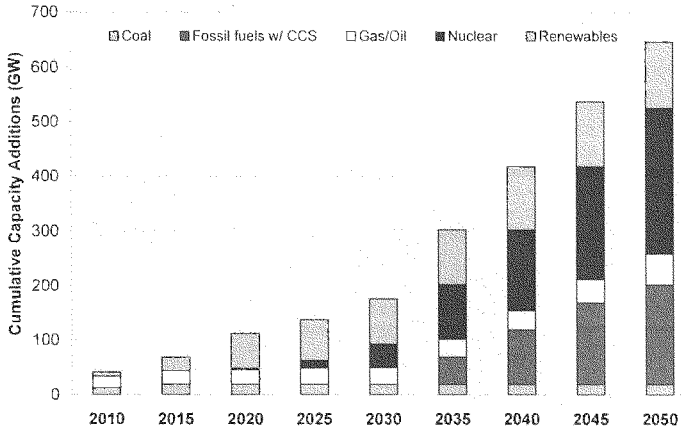
Source: CRA Model Results, 2009

Figure 3.13: Generation by technology for the High Cost case



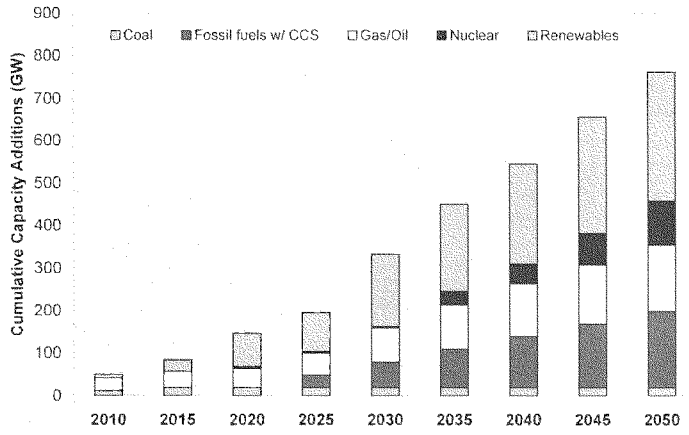
Source: CRA Model Results, 2009

Figure 3.14: Cumulative capacity additions by technology for the Low Cost case



Source: CRA Model Results, 2009

Figure 3.15: Cumulative capacity additions by technology for the High Cost case



Source: CRA Model Results, 2009

Moreover, investors' mistakes can contribute to carbon price volatility. If, for example, investors were convinced that carbon prices would remain at levels estimated in the Reference case for a decade, then they would build limited renewables. Later if it became clear that carbon prices were more similar to those in the High Cost case, then carbon prices could spike well above the estimated High Cost case levels until sufficient renewable generation is built to catch up with the High Cost case projection.

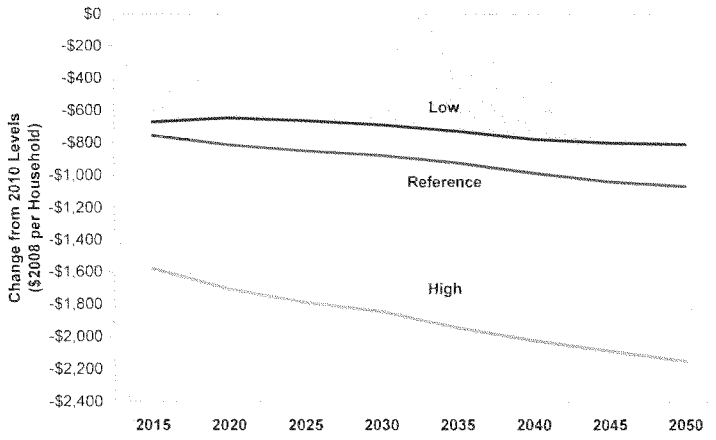
If, in contrast, the carbon price is known in advance – including how it can be expected to change many years into the future – covered emitters can plan compliance more easily and efficiently. They will be far more willing to undertake major capital investments in advanced, low-carbon technologies if they have some confidence that the carbon price level will either rise to or continue to remain at levels that make such investments cost-effective. They may also find it easier to obtain funding for such investments, if they are subject to less market risk.

The EU-ETS experience has also demonstrated that even very high carbon prices do not necessarily translate into a willingness of the private sector to make investments in new, lower-carbon technologies. Despite the fairly high average prices in the EU-ETS, there has been no serious degree of private sector investments in cleaner technologies.[11] The usual explanation for the failure of the EU-ETS to motivate investments in clean energy technologies is the uncertainty in its carbon price levels and the potential impermanence of the scheme. Even if investments in some clean technologies might be justifiable under the average carbon prices of about €20 per ton that have been experienced over the past four years, they have not been forthcoming. Uncertainty on what the carbon price level will be – not just for the next few years but for 10 to 20 years into the future – appears to be inhibiting private sector investments in low-carbon technologies.

[11] The fairly high rate of investment in renewables such as wind and solar in Germany is traceable to the very high guaranteed returns known as "feed-in tariffs" for such generation, and is not attributed to carbon prices.

Figure 3.16 shows the differences in household purchasing power under the three cases. These reveal that costs per household to meet the targets could be from $650 in the Low Cost case to $1,700 in the High Cost case in 2020, depending on uncertain future developments. This is the kind of unavoidable uncertainty about impacts on their constituents that policymakers face in deciding on whether to adopt a cap-and-trade system and where to set the caps. Again, alternatives such as a carbon tax can greatly narrow the range of costs and economic impacts that a policymaker must deal with.

Figure 3.16: Impact on household purchasing power by model scenario based on 2010 consumption levels



Source: CRA Model Results, 2009

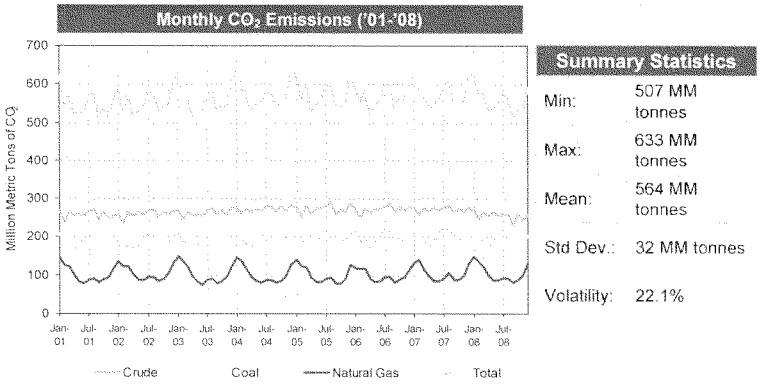
More complete results for the Low Cost and High Cost cases (similar to Table 1-1) are included in Appendix F.

3.2.2. Carbon price volatility

It is also quite likely that prices will move up and down within the range of possible futures, rather than settling down to one clear track after a few years. A major reason is that the banking provisions, relied on in many minds to reduce costs and uncertainty, themselves introduce significant additional uncertainty into near-term prices. Banking connects expected market conditions in the future to current willingness to pay for allowances, so that different or changing expectations about future technology costs, availability of offsets, or policy changes will be communicated immediately into current prices.

Carbon price volatility can also come from the normal factors that lead to swings in oil, natural gas and electricity demand and to volatility in refined product, natural gas and coal prices. Figure 3.17 shows monthly changes in emissions from oil, natural gas and coal consumption over the past decade, and the resulting monthly movements in total carbon emissions. This volatility in use is driven by changes in weather, overall economic activity, and fuel prices. These factors will continue to drive carbon emissions up and down unpredictably even with a cap on emissions, and carbon prices can be expected to rise when events that led to high CO_2 emissions in the past recur and to fall when events that led to low emissions occur. This volatility will be smoothed by the ability to bank allowances and by compliance periods of a year or more, but experience in other energy markets in which storage is possible, such as natural gas, and in Title IV sulfur dioxide markets demonstrates that even with such smoothing mechanisms volatility will appear.

Figure 3.17: Monthly CO_2 emissions from oil and gas and coal combustion



Source: Energy Information Administration, CRA Analysis

In all, a cap-and-trade program is effectively another market on which financial institutions can bet. Though the cap-and-trade program does not allow borrowing from the government, an over-the-counter market could conceivably arise where one could trade swaps and hence borrow. In addition, squeezes could occur near dates where entities need to true up their emissions and permits. All of this increases volatility and the costs of a cap-and-trade program.

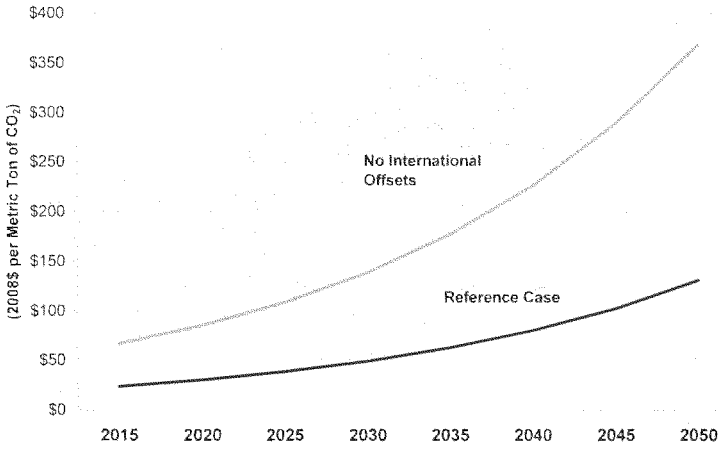
Businesses and consumers already have to live with substantial volatility in commodities markets, such as for fuels. Companies are generally able to cope with unavoidable volatility in natural commodities; but that is no reason to intentionally create volatility in a new, major input (i.e., allowances) given that policymakers can establish the same carbon price incentive without any volatility at all. No matter how manageable carbon price volatility is, it has a cost,

and no benefits are derived from that cost. Therefore, it is desirable to minimize carbon price volatility wherever possible. Carbon policy is one of the rare situations where price volatility can be eliminated altogether while still having a clear price signal.

3.2.3. Sensitivity: no international offsets

The cost and availability of international offsets is perhaps the most uncertain of all the factors influencing the cost of the policy. To understand how large a role international offsets play, we analyzed an alternative scenario to the Reference case in which no international offsets were allowed. Results from this scenario reveal that without use of the full amount of international offsets allowed by the bill, carbon prices would nearly triple. The reasons why international offsets might not be available at as low a cost and in as large quantities as assumed in the Reference case are discussed in Section 3.3.4.

Figure 3.18: Comparison of carbon allowance prices with and without international offsets



Source: CRA Model Results, 2009

More complete results for the No International Offsets case (similar to Table 1-1) are included in Appendix F.

3.2.4. Alternatives to reduce costs of uncertainty

The uncertainty of carbon prices under a cap-and-trade program imposes real economic costs. The uncertainty exemplified by the High and Low cases leads to an absence of clear signals for investors in low-carbon fuels and energy efficiency, as well as related R&D. This

will slow progress toward developing efficient new technologies and raise overall economic costs.

Uncertainties that are expected to be resolved, such as rules implementing certain standards or offset calculations, could create a significant option value to an entity if it were to delay investments until uncertainties are reduced.[12]

There is also a potentially significant cost of bearing or mitigating the risks that carbon price volatility creates for companies with a compliance obligation. When companies need to buy allowances to cover their emissions, as with a full auction, their new expenditure may be large compared to their current net revenue. For example, the cash needed by an electricity generating company that has a diversified mix of coal, gas and zero-carbon generation similar to the U.S. average would face new outlays for allowance purchases of $35 per ton that are approximately 20% of its gross revenues, and perhaps 200% of its net revenues. Any delays in the pass-though of such costs to customers could seriously disrupt their financial position. Volatility exacerbates this situation by causing continual variations in cash flow needs. For example, fluctuation in the allowance price between $15 per ton and $50 per ton would mean that the cash flow requirements might vary from 85% to 350% of pre-policy cash flows. Even after price pass-through has occurred, delays in adjustments of the retail rates could translate into see-sawing profitability.[13]

Oil refiners, who are responsible for emissions from the fuels they sell and not just facility emissions, would be in a similar but probably more risky situation. Refiners could face even larger cash flow requirements relative to their profit margins to purchase their required allowances (refiners are to receive 2% of the total allowances from 2014 through 2026). Similarly, if a company has any substantial bank of allowances, it could face large swings in its balance sheet situation. Conditions such as these could translate into companies facing reduced credit ratings and more difficulties in raising capital. This possibility has not been studied at all yet, but certainly requires some careful investigation, including gaining an understanding of the extent to which trading in futures contracts and other derivatives could reduce risks, and what the cash flow and balance sheet effects of such trading might be.

Proposals to limit this uncertainty include safety valves and carbon taxes. A carbon tax would allow emissions to fluctuate year by year rather than prices and economic costs, but if chosen to match the Reference case carbon price would be expected to lead to the same cumulative emissions as the Reference case caps by 2050 (given the realization of other key assumptions). If uncertainties about some of the factors were reduced over time, such that it became clear that emissions were coming in higher or lower than expected at the chosen

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[12] *Climate Policy Uncertainty and Investment Risk*. William Blyth, Ming Yang and Richard Bradley, International Energy Agency, 2007. Available at http://www.iea.org/textbase/nppdf/free/2007/Climate_Policy_Uncertainty.pdf.

[13] Smith, Anne E., "Auctioning under Cap and Trade: Design, Participation and Distribution of Revenues." Statement to the U.S. Senate Committee on Finance, May 7, 2009.

price, then the tax rate could be adjusted at intervals to aim for the desired cumulative emissions budget. Such tax rate adjustments would not be as disruptive to planning and operations as the volatility likely under a hard cap.

3.3 Discussion of Key Issues

3.3.1. Costs should be considered in relation to benefits

ACESA is estimated to raise domestic energy costs. The objective of the policy is to reduce greenhouse gas emissions by creating a mandated ceiling for these emissions. In so doing, it forces energy producers to either purchase allowances in order to continue to produce using their current practices or alter their production technologies through added costs in order to reduce their emissions. In either case, the cost of providing energy would increase and a portion of these costs would likely be borne by consumers.

The benefits of ACESA take the form of a reduced contribution of the United States to global concentrations of greenhouse gases, and the damages from climate change that these reduced concentrations would avoid. Because of the large share of GHG emissions over the next century that will come from other countries, particularly rapidly developing countries like China and India, any action by the U.S. will avoid only a small portion of the damages that have been attributed to global warming. The magnitude of the costs estimated in this study can only be judged to be large or small in comparison to these benefits, not by comparisons to other government programs.

3.3.2. Allowance allocations

This analysis includes the allowance allocation provisions in ACESA. Highlights include allocating 35% of allowances to the electricity sector, 15% of allowances to the energy-intensive industries, and smaller allocations to natural gas distributors, automotive companies and oil refiners. These allocations have a significant impact on the regional distribution of impacts, and could affect how regressive the overall impacts will be on different income groups.

Based on stated intentions in the bill, CRA's analysis has assumed that, except for allocations to industries, the value of all allowances would be rebated to households on a per capita basis. Allowances to oil refining, trade exposed industries, merchant coal generators, and the automobile industry serve to offset losses to businesses in those industries. Since any gains or losses ultimately affect share values, these amounts are assumed to be distributed among the population in proportion to ownership of financial assets, for which consumption is taken as a surrogate.

Changes in allowance allocations decisions will change the regional distribution of impacts, but will not materially change overall national economic impacts.

3.3.3. Costs of a duplicate regulatory system

ACESA establishes both a GHG cap-and-trade and a series of command-and-control mandates. The latter are, at best, redundant to the cap-and-trade. They regulate activities that are also subject to the proposed GHG cap. These include the RES and the coal-fired power plant performance standard, which are included in this analysis, as well as a series of more detailed and specific energy efficiency standards and programs that it was not possible to model due to their narrow application. The more detailed provisions are listed below:

TITLE II—ENERGY EFFICIENCY
Subtitle A—Building Energy Efficiency Programs
Sec. 201. Greater energy efficiency in building codes.
Sec. 202. Building retrofit program.
Sec. 203. Energy efficient manufactured homes.
Sec. 204. Building energy performance labeling program.

Subtitle B—Lighting and Appliance Energy Efficiency Programs
Sec. 211. Lighting efficiency standards.
Sec. 212. Other appliance efficiency standards.
Sec. 213. Appliance efficiency determinations and procedures.
Sec. 214. Best-in-Class Appliances Deployment Program.

Subtitle C—Transportation Efficiency
Sec. 221. Emissions standards.

PART B—MOBILE SOURCES
Sec. 821. Greenhouse gas emission standards for mobile sources.
Sec. 222. Greenhouse gas emissions reductions through transportation efficiency.

PART D—PLANNING REQUIREMENTS
Sec. 841. Greenhouse gas emissions reductions through transportation efficiency.
Sec. 223. SmartWay transportation efficiency program.
Sec. 822. SmartWay transportation efficiency program.
Sec. 224. State vehicle fleets.

Subtitle D—Industrial Energy Efficiency Programs
Sec. 241. Industrial plant energy efficiency standards.
Sec. 242. Electric and thermal waste energy recovery award program.
Sec. 243. Clarifying election of waste heat recovery financial incentives

The rationale of cap-and-trade is that it allows the market to select the lowest cost means, whatever they may be, for reaching a given GHG reduction target. By superimposing regulatory mandates on that system, Congress substitutes its own judgment for that of the market.

The provisions that were modeled, in particular the RES, appear to be binding only in a few years (*i.e.*, the cap might, by itself, motivate all of the actions needed to meet the standard). In these instances, the standards would have no effect on emissions. They would waste resources on needless monitoring, measuring, enforcement and compliance, but they would not affect the pattern of GHG reductions.

When efficiency or other standards are binding, they would affect the allocation of abatement resources. They would compel industry to buy more renewable energy, say, or to invest more in CCS than it would otherwise do to comply with the total GHG cap. However, while the pattern of emission reductions would change, the total amount reduced would not. The cap sets the total GHG cutback. If the regulations mandate more change in one area, less will take place somewhere else. Standards, therefore, can add costs but they will not add to the program's environmental benefits. They can only substitute more costly GHG cuts for those that could have been made at lower cost.

For the detailed standards mandated in Title II, it is impossible to tell by examining aggregate levels of energy efficiency whether or not the standards are binding. Even if the cap-and-trade program would be sufficient on its own to lead to similar or larger reductions in energy use in the specified sectors, the standards are very likely to mandate a different set of changes in energy use than consumers and businesses would choose on their own. This can only increase costs of complying with the overall cap, unless businesses and consumers are consistently making wrong decisions and the government agencies put in charge of the regulations can consistently make better decisions by substituting their regulatory authority for the decisions of those who know their own situations and alternatives.

These added costs are beyond what can be addressed in CRA's models -- or EPA's models used to produce their analysis of the draft Waxman-Markey bill -- at this point. But that implies that any bill including a significant number of detailed efficiency standards will have a cost greater than these modeling systems estimate.

3.3.4. Wealth transfers abroad

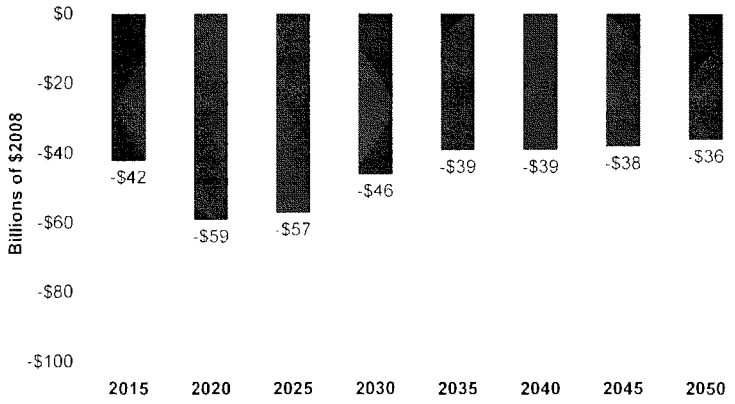
ACESA contains several provisions that entail wealth transfers from the U.S. to other nations. For example, it would sell "strategic reserve allowances" to covered entities, and use the revenues to purchase international offset credits issued for reduced deforestation. The strategic reserve will comprise 1% of each year's total allowance pool from 2012 through 2019, 2% of each year's total allowance pool from 2020 through 2029, and 3% of each year's total allowance pool from 2030 through 2050.

The bill mandates minimum auction prices for the strategic reserve allowances. In 2012 the minimum strategic reserve auction price will be double the EPA-modeled allowance price for that year. Minimum strategic reserve auction prices in 2013 and 2014 will rise by the rate of inflation plus 5%. For 2015 and thereafter, the minimum strategic reserve auction price will be 60% above the rolling 36-month average of the daily closing price for that year's allowances, calculated in constant dollars. EPA is to issue regulations governing both strategic reserve credits and private sector purchases of offsets.

The largest wealth transfers from the U.S. to other countries will be associated with purchases of international offsets. In effect, avoided deforestation becomes another U.S. import in an economy that has been struggling with a chronic structural trade deficit. As such, foreign offsets would be an added drag on U.S. terms of trade with the rest of the world. The

transfers that they entail lower the prices that U.S. exporters can obtain and raise the prices that Americans must pay for imports. The result is a further decline in U.S. standard of living that is reflected in the results reported in this study. The annual wealth transfer is shown in Figure 3.19.

Figure 3.19: Wealth transfer overseas from purchases of international offsets and internationally-allocated allowances under ACESA



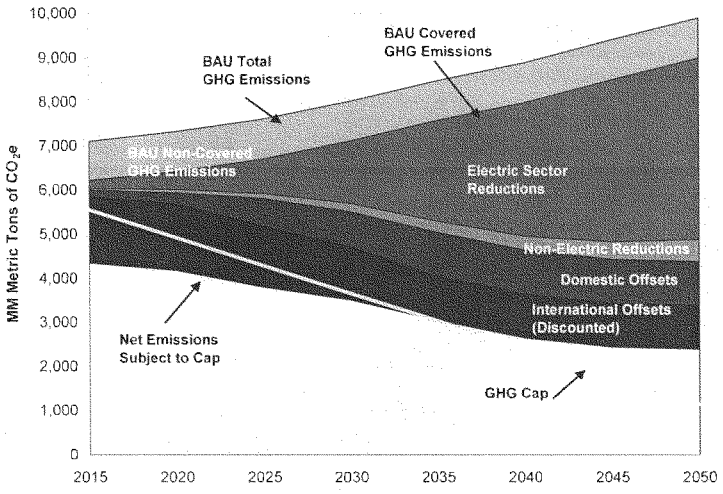
Source: CRA Model Results, 2009

While it is true that international offsets increase the potential supply of allowances and, hence, hold down allowance prices, the wealth transfer is a net loss to the U.S. Further, the bill's effective discounting of offsets, and the artificially high prices imposed on the strategic reserve allowance auction will rob offsets of much of their potential to control costs.

It is also possible that the U.S. will find it difficult to obtain the volume of offsets that this study estimates would be economic to purchase if their prices were reflective of only the cost of the associated emissions reduction projects in other countries. Based on experience in oil and mineral leasing, those countries that could sell permits are likely to want a substantial margin above cost to agree to supply offsets. That would increase the magnitude of wealth transfers, as well as the cost of meeting the domestic policy's requirements. One of the serious limits on production of oil resources worldwide is that in addition to insisting on a very large share of the economic rents from oil production, host countries are frequently politically unstable with unreliable legal systems, making long-term contracts difficult to rely on. Exactly the same conditions can be expected to prevail in many countries that could provide offset credits.

ACESA is so generous in its ceilings on international allowances that a significant amount of the required reduction will come from that source. Figure 3.20 shows the distribution of emission reductions between the electric sector, transportation, other energy use, domestic offsets and international offsets. International offsets provide 80% of the realized reduction in 2015, 33% in 2030 and 15% by 2050.

Figure 3.20: GHG emission reductions



Source: CRA Model Results, 2009

The large quantity of international offsets is at variance with the very strong sentiment in international negotiations – and reiterated in the most recent meetings of the ad hoc working group on long term cooperation – that developed countries should achieve most of their emission reductions through domestic measures. Combined with the observed wealth transfers and desire of host countries to maximize their take, the prospect of tightening the limits on international offsets seems plausible.

EPA regulation casts another cloud over offsets as a means of keeping policy costs down. Under ACESA, EPA would have a great deal of discretion to limit the effective supply of allowances. The effectiveness of measures to prevent deforestation and forest degradation are notoriously difficult to measure, and EPA may be very reluctant to (and face much external pressure not to) approve a very large share of the potential supply of these types of offsets that are assumed to be fully available in EPA's and our cost analyses.

Institutions greatly compound the scientific difficulties. In many developing countries, large disparities can exist between statute books and *de facto* practice. These disparities can cause gaps in the system of property rights. Thus, the ownership of forest land, let alone that of any value in the carbon content of standing trees, is often unclear.[14] There are often strong economic temptations to over-exploit resources that fall within lacunae in the system of property rights. Since governments can find it costly to define property rights and to enforce those that it has created, the task of curtailing this resource over-use is intractable.[15] In such cases laws intended to establish clear property rights and curb forest decline may have little real world effect. It would, then, not be surprising for EPA to adopt a highly skeptical attitude toward claims of avoided deforestation emissions. That stance, however, could well make forestry offsets very scarce despite the large potential for emission reduction that exists in principle. If this happens, estimated costs of ACESA would be greatly increased.

[14] Cotula, L. and Mayers, J. *Tenure in REDD – Start-point or afterthought?*. Natural Resource Issues No. 15 International Institute for Environment and Development. London, UK. 2009.

[15] Libecap, Gary D., "Contracting for Property Rights" in *Property Rights: Cooperation, Conflict and Law*, Terry L. Anderson and Fred S. McChesney editors, Princeton University Press. Princeton, 2003.

4. UNFINISHED BUSINESS

The results presented in this report represent our initial estimate of the economic impact resulting from ACESA. It represents our best efforts to model the provisions of the legislation with the information and time available to us. At the time that we performed this analysis, information on the particulars of the proposed legislation was still evolving. Provisions of the bill are still being negotiated. When the bill becomes more definitive, we will review its final provisions and may revise this analysis.

In addition, there are a number of issues related to ACESA that are not included in this report due to time limitations, but which we hope to address in a follow-on report:

- We will extend the regional results by providing estimates of key state-level impacts.
- In a future report, we intend to analyze in more detail the uncertainty about carbon prices and costs that is inherent in any policy that sets rigid caps on emissions that must be met over a relatively short measurement period, and discuss the likely volatility of GHG allowance prices given the normal fluctuations in economic activity and energy supply.
- We also intend to estimate impacts by income group of the cap-and-trade program under different allocation systems and approaches to recycling auction or carbon tax revenues. We will also look at how these impacts vary by regions and the reasons for the variation.

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APPENDIX A: REPRESENTATION OF ACESA IN MRN-NEEM

This analysis measures the effects of certain provisions in the ACESA bill released by Reps. Waxman and Markey.[16] ACESA contains several provisions aimed at reducing emissions of greenhouse gases. This appendix describes the provisions of ACESA that we have modeled in this study.

ACESA includes several provisions aimed at reducing emissions of greenhouse gases. Some of these provisions are relatively well defined, while others only specify future regulations to be determined at a later date. This initial report focuses on two of the most important provisions of the proposed bill, including:

- Economy-wide cap-and-trade for greenhouse gases (GHGs) and
- Federal renewable electricity standard (RES).

A.1 A Cap-And-Trade Policy for Greenhouse Gases

Title III of the proposed ACESA calls for imposition of an economy-wide cap-and-trade policy for GHGs. A cap-and-trade policy sets a total limit on emissions of GHGs. To legally emit GHGs that are subject to such a cap, a source must submit to the government a permit for each ton that it emits. In any given year, the government auctions or allocates only the number of greenhouse gas emission permits that equals the target set by the cap. Once the government has auctioned or allocated the emission permits, the permits can be freely traded among entities.

In the case of ACESA, the GHG cap would initially apply in 2012. At its onset, it would limit emissions to 3% below the level that had prevailed in 2005. By 2020, the cap on emissions would fall to 17% below the 2005 level, and by 2050, the cap on emissions would fall to 83% below the 2005 level. ACESA's cap-and-trade provisions include offsets and allow permits to be banked from one year to the next. The offsets provisions allow a quantity of offsets to be used to meet each emitter's compliance obligation. This annual offset limit is 2 billion tons, split evenly between domestic offsets and international offsets. There is a discounting of international offsets defined in the bill such that the purchase of 5 tons of offsets is allowed to meet 4 tons of compliance obligations (the discounting does not apply before 2018 and does not apply to domestic offsets). Therefore, nationally there would need to be purchases of 2.25 billion tons of offsets to achieve 2 billion tons of reductions from offsets.

[16] The version of the bill analyzed within this report is one that was released on May 15, 2009.

CRA has included these detailed offsets provisions in our analysis of ACESA. The analysis also includes unlimited banking of allowances.

Table A-1 includes the annual caps specified in the bill.

Table A-1: GHG cap (MM metric tons of CO_2)*

Year	Cap	Year	Cap	Year	Cap
2012	4,627	**2025**	4,294	**2038**	2,534
2013	4,544	**2026**	4,142	**2039**	2,409
2014	5,099	**2027**	3,990	**2040**	2,284
2015	5,003	**2028**	3,837	**2041**	2,159
2016	5,482	**2029**	3,685	**2042**	2,034
2017	5,375	**2030**	3,533	**2043**	1,910
2018	5,269	**2031**	3,408	**2044**	1,785
2019	5,162	**2032**	3,283	**2045**	1,660
2020	5,056	**2033**	3,158	**2046**	1,535
2021	5,903	**2034**	3,033	**2047**	1,410
2022	4,751	**2035**	2,908	**2048**	1,285
2023	4,599	**2036**	2,784	**2049**	1,160
2024	4,446	**2037**	2,659	**2050**	1,035

* CRA's MRN-NEEM models every five years and the first year in which the cap is in place in the model is 2015. In 2015, local distribution companies' emissions associated with natural gas are not covered, but coverage of these emissions begins in 2016. For simplicity, CRA has assumed that these emissions are covered in 2015. To account for this change in coverage we also increased the cap in 2015 to 5,589 MM metric tons, which was derived as the 2016 cap plus the change in the 2016 and 2017 caps.

A.2 Federal Renewable Electricity Standard

Title I of ACESA includes the establishment of a combined Federal RES and energy efficiency standard. The combined standard requires retail electricity suppliers to meet a certain percentage of their customer load with electricity generated from qualified renewables resources or from electricity savings gained through energy efficiency programs. This percentage increases from 6.0% in 2012 to 20.0% in 2020 through 2039, when the program ends.

The percentage requirement is applied to a base amount that is total sales less sales from non-qualified hydroelectric power and municipal solid waste. Also, smaller retail electricity suppliers (less than 4 million MWh) are not required to comply. The types of renewable resources that are eligible to meet the requirements include: wind energy, solar energy, geothermal energy, biomass/landfill gas, qualified hydropower, and marine/hydrokinetic

renewable energy. In addition, as new nuclear units and units with CCS are built their generation is also subtracted from the base amount.

In addition to the RES requirements, ACESA specifies an ACP whereby suppliers can purchase an ACP in lieu of holding a renewable energy credit. The price of the ACP is $25/MWh (in 2009$) growing with inflation. In addition, up to 25% of the requirement (*e.g.*, 5% of the 20% in 2020) can be met with energy efficiency savings. Table A-2 includes the annual percentage requirements that are applied to the base amount.

Table A-2: Federal renewable electricity standard

Year	% Requirement
2012-2013	6.0%
2014-2015[17]	9.5%
2016-2017	13.0%
2018-2019	16.5%
2020-2039	20.0%

A.3 Allowance Allocation Methodologies

ACESA specifies allowance allocations to certain sectors and groups to help in mitigating the cost increases they are likely to incur, while also assisting these industries in making a transition to a lower-carbon economy.

The electric sector is slated to receive 35% of the allowances through 2025, with the allowance allocation declining to 0% by 2030. This allocation is given to merchant coal-fired generators (5%) and local distribution companies (LDC). The allocation to local distribution companies is based on both sales and historical emissions. The LDC allocation cannot be used to reduce rates based on quantity of electricity consumed, but is intended to be used to rebate consumers based on some fixed portion of bills.

The other sectors that receive allocations are: energy-intensive industries, natural gas distributors, the automotive sector and oil refiners. All of these allocations decline to zero by 2030.

Allowances are also allocated to spur investments in CCS. In our analysis, these allowances help to bring about 3 GW of new CCS in 2020 and assist in the capital cost declines over time.

[17] In 2015, CRA modeled a 8.5% requirement, which was the requirement in the earlier March 31, 2009 draft of the bill, rather than a 9.5% requirement. The 8.5% requirement was not binding and it is unclear if increasing the requirement to 9.5% would result in a binding limit.

ACESA also specifies that some allowances are to be used to prevent tropical deforestation and assist in international adaptation. We have assumed that the value of these allowances would accrue to countries other than the United States, and therefore these dollars are wealth transfers from the United States.

Remaining allowances are allocated to a number of other areas including renewable energy and efficiency, research and development, low- and moderate income households, users of home heating oil, domestic adaptation, and worker assistance and job training. Also, any remaining allowances are used to ensure that ACESA is budget neutral. All of these allowances are grouped in Table A-3 as "Auction."

Table A-3: ACESA allowance allocations

	2015	2020	2025	2030	2035	2040	2045	2050
Total Electricity	35%	35%	35%	0%	0%	0%	0%	0%
Natural Gas	9%	9%	9%	0%	0%	0%	0%	0%
EIS Sector	15%	15%	15%	0%	0%	0%	0%	0%
Automotive Sector	3%	1%	1%	0%	0%	0%	0%	0%
Oil Refiners	2%	2%	2%	0%	0%	0%	0%	0%
CCS Investment	2%	5%	5%	5%	5%	5%	5%	5%
Preventing Tropical Deforestation	5%	5%	5%	3%	2%	2%	2%	2%
International Adaptation	1%	1%	2%	4%	4%	4%	4%	4%
Clean Technology Transfer	1%	1%	2%	4%	4%	4%	4%	4%
Auction	27%	26%	24%	84%	85%	85%	85%	85%
Total	100%	100%	100%	100%	100%	100%	100%	100%

APPENDIX B: BASELINE ASSUMPTIONS

The effects of the provisions that we have modeled are presented relative to a base case without any of these provisions. The base case is built upon many of the projections of the 2009 *Annual Energy Outlook* (AEO) Early Release produced by the Energy Information Administration (EIA) of the U.S. Department of Energy.[18] Several of the key baseline assumptions are described in this Appendix.

B.1 Cost and Performance Characteristics

The first-year technology capital cost assumptions (*i.e.*, the year in which a technology is first available) were based mainly on costs provided in EIA's AEO 2009 Electricity Market Module. In general, we found that EIA's capital costs assumptions for AEO 2009 fairly represented the capital costs being quoted in the trade press and in public filings. The exceptions were nuclear and geothermal. For nuclear, we relied upon capital cost data extracted from public filings that showed costs to be approximately 16% higher than EIA's estimates. For geothermal, we extracted data from Table 4.17 of EPA's NEEDS 2006 data source documentation, which provides capital cost by region and by potential capacity as opposed to the point estimate provided in EIA's Electricity Market Module. All capital costs include adders for fuel delivery infrastructure, transmission interconnection, and owners costs.[19]

For future capital costs, we trended costs downward to the AEO 2009 capital cost twenty years after the first-year. We then kept the technology's capital costs flat in subsequent years. For example, the first-year that Combined Cycle with CCS is available in MRN-NEEM is 2020. In 2040 and thereafter, the Combined Cycle with CCS capital costs are based upon the 2030 capital costs in AEO 2009 plus the adders described above (see Table B-1).

[18] Energy Information Administration, *Annual Energy Outlook 2009, Early Release with Projections to 2030*, prepared by U.S. Department of Energy, Energy Information Administration, December 2008.

[19] Owner's costs includes, but is not limited to land acquisition and right-of-way, permits and licensing, royalty allowances, economic development, project development costs, legal fees, and owner's engineering.

Table B-1: Total overnight capital costs excluding interest during construction (2008$/kW)

Technology	2010	2015	2020	2025	2030	2035	2040	2045	2050
Super Critical Pulverized Coal	2,404	2,296	2,187	2,079	1,970	1,970	1,970	1,970	1,970
IGCC	2,742	2,593	2,443	2,293	2,144	2,144	2,144	2,144	2,144
IGCC w/ CCS	N/A	N/A	3,952	3,711	3,470	3,229	2,988	2,988	2,988
Nuclear	N/A	N/A	4,800	4,625	4,450	4,275	4,100	4,100	4,100
Combustion Turbine	845	814	784	754	693	693	693	693	693
Combined Cycle	1,151	1,094	1,037	980	867	867	867	867	867
Combined Cycle w/ CCS	N/A	N/A	2,167	2,022	1,878	1,733	1,588	1,588	1,588
Biomass	4,265	3,988	3,711	3,435	2,881	2,881	2,881	2,881	2,881
Landfill Gas	3,082	2,948	2,813	2,678	2,408	2,408	2,408	2,408	2,408
Wind Cost Class 1-3	2,457	2,399	2,341	2,283	2,167	2,167	2,167	2,167	2,167
Wind Cost Class 4	3,932	3,839	3,746	3,653	3,467	3,467	3,467	3,467	3,467
Wind Offshore		4,590	4,339	4,087	3,836	3,585	3,585	3,585	3,585
Geothermal	Ranges from $3,155/kW to $8,783/kW depending on location								
Photovoltaic	6,228	5,706	5,184	4,663	4,141	4,141	4,141	4,141	4,141
Solar Thermal	6,034	5,732	5,430	5,129	4,827	4,827	4,827	4,827	4,827

Variable operating and maintenance (VOM) costs, fixed operating and maintenance (FOM) costs, and plant net heat rates on a higher heating value (HHV) basis are based mainly upon the AEO 2009 Early Release. FOM includes 'going-forward' costs that are required to maintain plant performance. For nuclear, we include levelized cost adders in the FOM for in-core carrying charges and for the spent nuclear fuel removal fee. The geothermal FOM is based on data from EPA NEEDS 2006. See Table B-2 which shows VOM, FOM, and heat rate assumptions by technology.

Table B-2: Operating and maintenance costs and plant efficiency

Technology	VOM (2008$/MWh)	FOM (2008$/kW-y)	Heat Rate – HHV (Btu/kWh)
Super Critical Pulverized Coal	4.4	41.8	9,200
IGCC	2.8	52.5	8,765
IGCC w/ CCS	4.3	62.0	10,781
Nuclear	0.5	111.8	10,434
Combustion Turbine	3.0	16.3	10,810
Combined Cycle	2.0	18.1	7,000
Combined Cycle w/ CCS	3.1	27.1	8,613
Biomass	7.1	83.3	13,000 (2010) 9,646 (2030)
Landfill Gas	0.0	109.6	13,648
Wind Cost Class 1-3	0.0	29.1	0
Wind Cost Class 4	0.0	29.1	0
Wind Offshore	0.0	94.3	0
Geothermal	0.0	134.3 – 292.1	0
Photovoltaic	0.0	11.2	0
Solar Thermal	0.0	54.5	0

B.2 Limits on Cumulative Capacity Additions

The cumulative capacity constraints in MRN-NEEM are based on a variety of public resources and CRA's own estimates and are shown in the table below. These limits serve as a ceiling on how much can be built over time as a matter of reasonableness. However, MRN-NEEM decides whether to build up to these limits, and may project much lower builds than these maxima.

Table B-3: Limits on U.S. cumulative capacity additions (GW)

Technology[20]	2010	2015	2020	2025	2030	2035	2040	2045	2050
SCPC and IGCC	12	30	90	150	210	270	330	390	450
Coal/gas with CCS	0	3	10	30	60	90	120	150	180
Nuclear	0	0	2	17	46	86	126	166	206
Offshore Wind	0	6	34	62	90	90	90	90	90
Total Wind	17	70	124	177	231	231	231	231	231
Biomass	6	33	60	87	113	113	113	113	113
Landfill Gas	0.3	2	3	4	5	5	5	5	5
Geothermal	1	3	6	10	15	15	15	15	15
Solar Thermal	No cumulative limits, but there are total capacity limits by region								
Photovoltaic	No cumulative limits, but there are total capacity limits by region								

[20] Sources of these capacity penetration rates are as follows: SCPC/IGCC (CRA), Coal/Gas with CCS (CRA and EPA analysis of Waxman-Markey), Nuclear (EPA analysis of Waxman-Markey), Offshore Wind (National Renewable Energy Lab), Total Wind (NREL, EIA, NYISO), Biomass (NREL, EIA), Landfill Gas (EPA NEEDS 2006), Geothermal (CRA), Solar Thermal (EPA NEEDS 2006), and Photovoltaic (CRA).

B.3 Other Major Input Assumptions

We calibrated our model baseline to closely match the outputs of EIA's *AEO 2009 Early Release*. The following table provides the major baseline indicators to which we calibrate:

Table B-4: Other major input assumptions

Indicator	Units	2010	2015	2020	2025	2030	2035	2040	2045	2050
Growth Rates										
GDP	%	2.0%	3.1%	2.5%	2.5%	2.7%	2.6%	2.6%	2.6%	2.6%
Electricity Demand	%	1.70%	0.88%	1.00%	1.00%	1.05%	1.02%	1.02%	1.02%	1.02%
Consumption										
Crude	Quads	34.6	33.8	32.1	31.9	33.0	33.9	34.8	36.4	36.9
Gas (Non-Electric Sector)	Quads	16.6	17.3	17.8	18.3	18.7	19.0	19.3	19.7	20.0
Oil	Quads	37.2	37.7	37.0	36.9	38.2	39.5	40.8	41.7	42.8
Transport Fuels	Quads	29.8	30.5	31.2	31.9	33.6	34.8	36.0	36.9	38.1
Driving Statistics										
VMT from Light Duty Vehicles (LDVs)	billions of miles	2,752	2,887	3,165	3,489	3,807	4,049	4,263	4,467	4,693
MPG of LDV Stock	MPG	20.3	21.9	25.0	29.0	32.2	33.4	34.1	35.1	36.5
Fuel Prices										
Natural Gas (Henry Hub)	2008$/MMBtu	$6.68	$7.06	$7.62	$8.25	$9.48	$9.98	$10.52	$11.08	$11.67
Natural Gas (Wellhead)	2008$/MMBtu	$5.90	$6.24	$6.73	$7.29	$8.37	$8.82	$9.29	$9.78	$10.30
Low Sulfur Crude	2008$/MMBtu	$13.41	$18.91	$19.89	$20.89	$22.44	$25.52	$29.03	$33.02	$37.56
Nuclear Fuel	2008$/MMBtu	$0.74	$0.74	$0.78	$0.81	$0.79	$0.79	$0.79	$0.79	$0.79
Biomass	2008$/MMBtu	$6.29	$6.29	$6.29	$6.29	$6.29	$6.29	$6.29	$6.29	$6.29
Coal	2008$/MMBtu	Computed endogenously in the model								

APPENDIX C: COMPARISON OF CRA RESULTS TO OTHER ANALYSES

At the time of this analysis there has been one other publicly-released, relevant analysis to which we can compare our results. EPA released an analysis of the cap-and-trade provisions of the draft Waxman-Markey bill.[21] EPA's study is based on the March 31, 2009 draft of the bill, which contains some slightly different provisions.

EPA's core analysis of the draft Waxman-Markey bill resulted in CO_2 allowance prices in 2015 of between $13 and $17 per metric ton of CO_2 (in 2005$). The high end of EPA's range of CO_2 allowance prices is only slightly below the CO_2 allowance prices in this study, based on the reference case assumptions.

This similarity in prices, however, is somewhat misleading. The provisions that EPA modeled within the cap-and-trade portion of the bill contain some important differences from the provisions modeled in this analysis. In particular, there are three key differences:

1. EPA's analysis did not include the RES provisions, which could lower their modeled allowance prices slightly.

2. The cap modeled by EPA is slightly tighter than that modeled in this study. H.R.2454 increased the cap in 2020 such that the cap is a 17% reduction from 2005 levels. This also changed the cap from 2012 through 2029. The cumulative cap from 2012 through 2050 in H.R.2454 is almost 2% higher than that in the draft Waxman-Markey bill that EPA modeled.

3. H.R.2454 includes a provision that allows for up to 1.5 billion metric tons of offsets from international sources, if domestic offsets are not fully utilized (up to 1 billion tons). In this analysis, this provision led to an increase in international offsets of 500 million metric tons in 2015 and 2020, 440 million metric tons in 2025 and 220 million metric tons in 2030. The availability of these international offsets effectively loosened the cap by almost 10% over the period from 2015 through 2030. This likely put significant downward pressure on the CO_2 prices in this analysis.

If EPA were to have modeled these three provisions as they are in H.R.2454, each would likely result in lower CO_2 allowance prices, and we would see a greater divergence between their CO_2 allowance prices and those included in this study. Therefore, it is important to understand the sources of the differences.

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[21] EPA's study is available at: http://www.epa.gov/climatechange/economics/economicanalyses.html#wax.

On May 17, 2009, EPA released a qualitative assessment of the revisions to ACESA, relative to what they modeled. Their conclusion is, "On balance, compared to the draft bill, H.R. 2454 would likely result in lower allowance prices, a smaller impact on energy bills, and a smaller impact on household consumption, based on EPA's preliminary reading of the bill."[22] EPA focused on four areas that had changed to support their conclusion. The four areas of change are: 1) Cap level, 2) Offsets provisions, 3) Allowance allocations for protection from electricity price increases, and 4) Incentives for CCS. EPA did not list the RES provisions, which it did not model from the draft bill.

With respect to item 3, we believe that EPA has mischaracterized the provisions on the allowance allocations to electric local distribution companies. The specific provisions on the use of the allowances do not allow the use of the allowances for rebates based "solely on the quantity of electricity delivered to such ratepayer."[23] Since the rebate is not to be based on electricity use it should not distort the incentive for consumers to conserve electricity.

Both EPA's analysis and this analysis show significant reductions in the electric sector, limited reductions in the non-electric sectors and significant uptake of offsets (including the full utilization of international offsets in all years). CRA's analysis utilizes more domestic offsets than EPA.

A detailed review of EPA's results reveals the primary source of the difference leading to EPA's low CO_2 allowance prices. EPA's analysis was performed with two different economy-wide models – ADAGE and IGEM. EPA did sensitivity analysis using results from the ADAGE model so we will focus on that model. The ADAGE model is a similar model to CRA's older MRN model in that both are computable general equilibrium (CGE) models. ADAGE lacks a detailed technology representation of the electric sector. MRN suffered from the same problem and this weakness led CRA to develop the MRN-NEEM model which pairs the CGE framework for the non-electric sectors (MRN) with a detailed electric sector model (NEEM).

Without a detailed technology representation for the electric sector CGE models forecast too great of an ease of making reductions from the sector. This is demonstrated by EPA's own modeling. To validate its modeling of the electric sector, EPA took the CO_2 allowance prices and percentage changes in electricity demand and ran its detailed electric sector model, IPM.[24] EPA's analysis using the detailed technology representation (IPM) yields significantly

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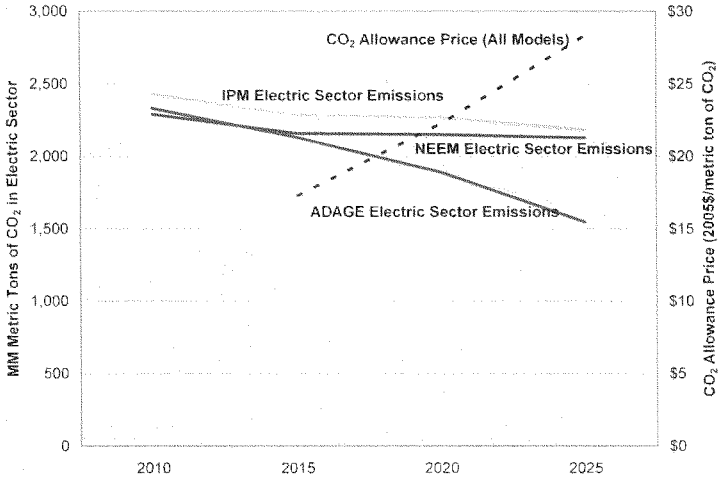
[22] "Ways in Which Revisions to the American Clean Energy and Security Act Change the Projected Economic Impacts of the Bill." U.S. EPA. May 17, 2009. available at: http://www.epa.gov/climatechange/economics/pdfs/EPAMemoonHR2454.pdf.

[23] H.R.2454, p. 559.

[24] See slides 19-25 in *EPA Preliminary Analysis of the Waxman-Markey Discussion Draft* for a detailed discussion of EPA's approach.

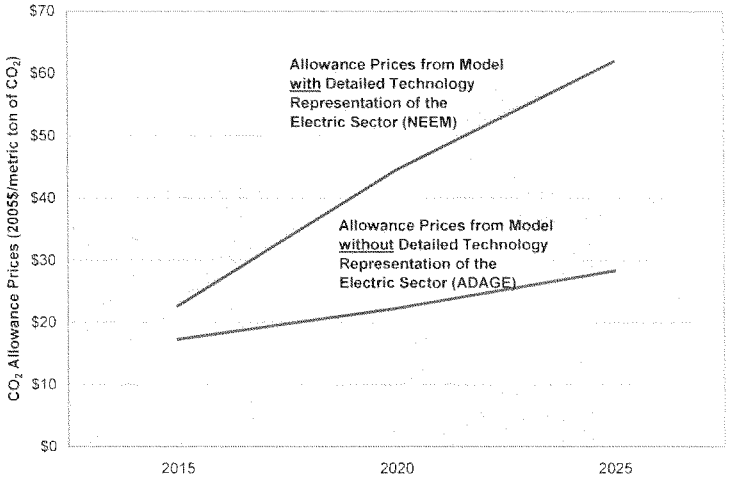
fewer CO_2 reductions from the electric sector as compared with a model without a detailed technology representation (ADAGE), at given CO_2 price levels. CRA used its NEEM model to do the same test that EPA did using IPM. We took the same CO_2 allowance prices and the percentage changes in electricity demand that EPA used in IPM. Our results were similar to those from EPA's analysis using IPM, as seen in Figure C.1. (Note that EPA's analysis using IPM only continued through 2025.)

Figure C.1: Comparison of electric sector emissions – ADAGE, IPM and NEEM



To evaluate just how much the ADAGE model might be overstating the ease with which electric sector reductions could be achieved, we used the resulting electric sector emissions from EPA's ADAGE analysis of the draft Waxman-Markey bill and implemented them as an electric sector cap in the NEEM model. Given the electric sector caps, NEEM then produced the marginal costs of abatement in the electric sector to achieve the level of electric sector emissions from ADAGE.

Figure C.2: Comparison of CO_2 allowance prices – ADAGE and NEEM



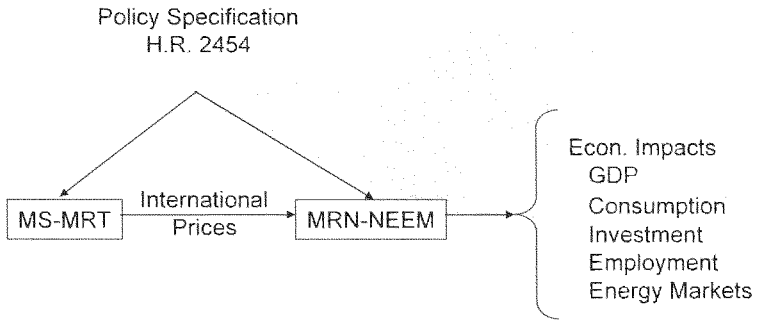
As seen in Figure C.2, the cost of achieving the electric sector emissions projected using ADAGE is significantly higher when evaluated with a model that contains a detailed technology representation of the electric sector. Thus, if EPA had coordinated its IPM and ADAGE models to produce consistent electric sector results, we would expect that EPA would have found significantly higher CO_2 prices for ACESA than they are currently reporting. Given that EPA says the IPM model is more "realistic" for the near-term, one can conclude that its ADAGE-based impact estimates are "not realistic" until they are made consistent with their IPM model projections.

APPENDIX D: MODEL DESCRIPTION

D.1 Model Framework

In conducting this analysis for the National Black Chamber of Commerce, CRA combined three of its widely accepted state-of-the-art economic models: the Multi-Sector, Multi-Region Trade (MS-MRT) model, the Multi-Region National (MRN) model, and the North American Electricity and Environment Model (NEEM). The linked model approach accounts for the international feedback effects of the U.S. adopting ACESA. As Figure D.1 illustrates, MS-MRT is used to compute the effect on international prices from the U.S.'s adoption of ACESA. These prices are fed into the MRN-NEEM modeling system, which has a much more detailed representation of the U.S. economy and hence allows for more detailed analysis of the effects of ACESA.

Figure D.1: Linkage between MS-MRT and the MRN-NEEM modeling framework



This section briefly describes the three models: MS-MRT, MRN, and NEEM. It also provides more information on how the models are linked.

Overview of the MS-MRT sub-model

MS-MRT represents the entire world at an extremely aggregated level. It is built upon the GTAP6-IEA database,[25] which includes 83 countries/regions and 23 industries. For this project, we aggregated the dataset into the following regions: USA, Europe, Other OECD, Eastern Europe and Former Soviet Union, Middle East, China and India, high income East Asia, and the rest of the world. To be consistent with the MRN model, the dataset included the following sectors: coal, crude oil, electricity, natural gas, refined petroleum products, agriculture, energy-intensive sectors, manufacturing, services, and commercial transportation.

The model is fully dynamic, which means the agents in the model have perfect foresight and therefore perfectly anticipate all future policies. In other words, there are no surprises in the model, and saving and investment decisions are based on full inter-temporal optimization. MS-MRT belongs to the class of models referred to as general equilibrium.

Conceptually, as a fully dynamic general equilibrium model, the MS-MRT model computes a global equilibrium in which supply and demand are equated simultaneously in all markets for all time periods. There is a representative agent in each region, and goods are indexed by region and time. The incorporated budget constraint implies that there can be no change in any region's net foreign indebtedness over the time horizon of the model. Changes in the prices of internationally traded goods produce changes in the real terms of trade between regions. All markets clear simultaneously, so that agents correctly anticipate all future changes in terms of trade and take them into account in making saving and investment decisions. The model computes, among other variables, investment, industry output, changes in household welfare, gross domestic product, terms of trade, wage impacts, and commodity price changes.

In order to capture some of the short-run costs of adjustment, elasticities of substitution between different fuels and between energy and other goods vary with time. The model is benchmarked to assume baseline rates of economic growth based on official government statistics and a common rate of return on capital in all countries. The rate of growth in the effective labor force (population growth plus factor-augmenting technical progress) and the consumption discount rate are calibrated to be consistent both with the assumed rates of growth and return on capital, and with zero capital flows between regions on the balanced growth path.

ACESA was analyzed under the assumption that the U.S. economy would evolve in accordance with the Energy Information Agency's *Annual Energy Outlook 2009*'s reference case. These forecasts provide the baseline growth rate, energy consumption, energy

[25] Dimaranan, Betina V., "The GTAP 6 Data Base: (Global Trade, Assistance, and Production)." Center for Global Trade Analysis, Department of Agricultural Economics, Purdue University, December 2006.

production, and energy prices to which the model is benchmarked. The macro economic sub-model MS-MRT is benchmarked to the same economic forecast used in the MRN sub-model to maintain consistency between the models.

MS-MRT includes the markets for three fossil fuels and their products. Electricity and all other non-energy sectors (*e.g.*, agriculture) are produced using these fuels, capital, labor, electricity, and materials as inputs. The model allows for complete bilateral trade in all goods produced by all industries.[26] The MS-MRT model uses an Armington structure in its representation of international trade in all goods except crude oil, which is treated as a homogeneous good perfectly substitutable across regions. The Armington structure assumes that domestically produced goods and imports from every other region are differentiated products. Domestic goods and imports are combined into Armington aggregates, which then function as inputs into production or consumption.

Because crude oil is treated as a homogeneous good, it trades internationally under a single world price. Conversely, representing natural gas and coal as Armington goods allows the model to approximate the effects of infrastructure requirements and high transportation costs between some regions. World supply and demand determine the world price of fossil fuels in the model. Current taxes and subsidies are included in each country's prices.

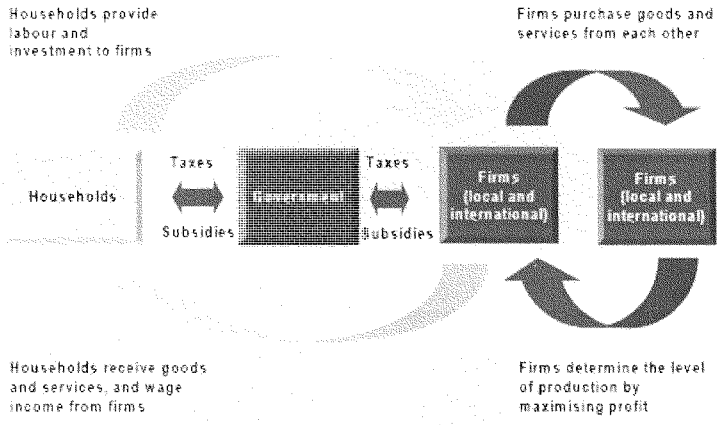
MRN-NEEM accounts for the added costs to U.S. refiners of the requirement that U.S. refineries hold allowances to cover their direct GHG emissions. This creates a competitive disadvantage relative to foreign refineries in countries not subject to emission limits. Since refined product imports are treated as Armington goods in the CRA model, that cost disadvantage does not lead to wholesale shutdown of U.S. refineries. If it were possible to obtain refined product imports meeting U.S. standards at a constant price lower than the cost of continued operation of U.S. refineries, there could be a larger switch from crude oil imports to refined product imports and further loss of jobs in the refining industry.

Overview of the MRN sub-model

The top-down component of the integrated MRN-NEEM model is tailored from CRA International's Multi-Region National (MRN) model, which is similar to MS-MRT in structure. MRN is a forward-looking, dynamic computable general equilibrium (CGE) model of the United States. It is based on the theoretical concept of an equilibrium in which macro-level outcomes (*e.g.*, consumption and investment) are driven by the decisions of self-interested consumers and producers. The basic structure of CGE models, such as MRN, is built around a circular flow of goods and payments between households, firms, and the government, as illustrated in Figure D.2.

[26] Where the data show no trade in a particular good occurs between two regions, such as electricity between Europe and the U.S., the model ensures that no trade can occur in the future.

Figure D.2: Circular flow of goods and services and payment figure



Overview of the NEEM sub-model

The North American Electricity and Environment Model (NEEM) fills the need for a flexible, bottom-up partial equilibrium model of the North American electricity market that can simultaneously model both system expansion and environmental compliance over a 50-year time frame.

The model employs detailed unit-level information on all of the generating units in the United States and large portions of Canada. In general, coal units over 200 MW are represented individually in the model, and other unit types are aggregated. NEEM models the evolution of the North American power system, taking account of demand growth, available generation, environmental technologies, and environmental regulations both present and future. The North American interconnected power system is modeled as a set of regions that are connected by a network of transmission paths.

D.2 Integration Methodology

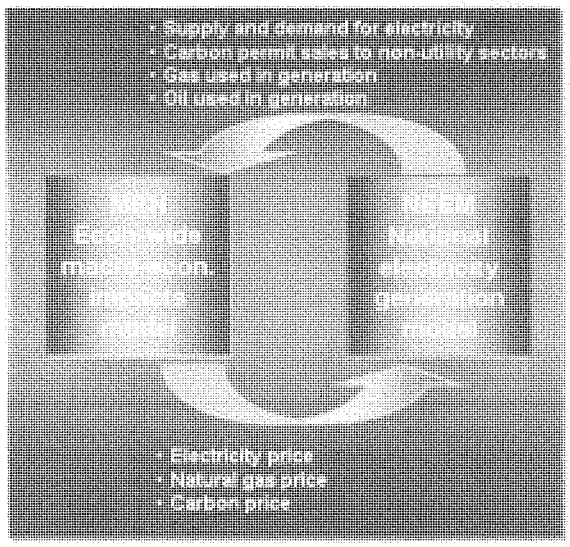
Linking MS-MRT and MRN-NEEM

There is a one-way link between the MS-MRT and MRN-NEEM models. The change in international prices from the U.S. adopting ACESA becomes an input to MRN-NEEM. This model represents the U.S. and assumes perfectly elastic supply and demand curves for imports and exports. The prices for these curves are determined by MS-MRT.

Linking MRN and NEEM

The MRN-NEEM integration methodology links the top-down and bottom-up models. The linking method utilizes an iterative process where the MRN and NEEM models are solved in succession, reconciling the equilibrium prices and quantities between the two. The solution procedure, in general, involves an iterative solution of the top-down general equilibrium model given the net supplies from the bottom-up energy sector sub-model followed by the solution of the energy sector model based on a locally calibrated set of linear demand functions for the energy sector outputs. The two models are solved independently using different solution techniques but linked through iterative solution points (see Figure D.3).

Figure D.3: MRN-NEEM iterative process



A more complete documentation of the MRN-NEEM model is available on CRA's website.[27]

[27] http://www.crai.com/uploadedFiles/RELATING_MATERIALS/Publications/BC/Energy_and_Environment/files/MRN-NEEM%20Integrated%20Model%20for%20Analysis%20of%20US%20Greenhouse%20Gas%20Policies.pdf.

APPENDIX E: ESTIMATION OF GREEN JOBS IN MRN-NEEM RESULTS

This appendix summarizes the methods CRA has developed to estimate the number of "green jobs" implicit in the MRN-NEEM results. These estimates of green jobs are preliminary and subject to further review and refinement, as they were very recently developed as an analytical component of CRA's modeling capability. All of our estimates of green jobs created are still consistent with the estimated net job losses that we have reported for the economy as a whole.

Estimating Employment Impacts of ACESA 2009 on the Renewable Electricity Industry

The imposition of a binding cap on GHG emissions incentivizes the deployment of renewable electricity sources such as wind and solar power, leading to an increase in employment in the sectors associated with the construction and operation of those technologies. Our analysis relies upon publicly-available data to estimate the number of direct jobs that would be created from the expanded use of renewable sources for generating electricity. Our methodology estimates new jobs associated with the manufacturing, construction, installation, and operation of five different technologies: wind, photovoltaic, solar thermal, biomass, and geothermal. Using CRA's MRN-NEEM modeling system to forecast new capacity additions along with public estimates of the relationship between new capacity and employment, we are able to estimate the number of full-time employment (FTE) years created as a result of ACESA 2009 in the renewable energy industry.[28,29] We also compared our results to those produced by the Department of Energy's Job and Economic Development Impact (JEDI) models for wind and solar and obtained similar results.[30]

It should be noted that there are limitations to estimating such employment impacts. The number of jobs associated with building and operating any industrial facility will vary by project, so applying a uniform assumption to all new projects represents a "best-guess" of the impacts.

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[28] "The Work That Goes Into Renewable Energy," Renewable Energy Policy Project (2001), Virinder Singh and Jeffrey Fehrs, Washington, D.C.

[29] Daniel M. Kammen, Kamal Kapadia, and Matthias Fripp (2004) *Putting Renewables to Work: How Many Jobs Can the Clean Energy Industry Generate?* RAEL Report, University of California, Berkeley.

[30] See http://www.nrel.gov/analysis/jedi/.

Estimating Employment Impacts of ACESA 2009 on the Biofuels Industry

Using MRN-NEEM results, we are able to estimate the number of jobs created as a result of ACESA 2009 in the biofuels industry. The model is capable of estimating the amount of biofuels – including corn ethanol and cellulosic ethanol – demanded annually in the U.S. in the future. We then use publicly-available sources to estimate the number of employees needed to operate a 40-million-gallon per year ethanol plant operating at 95% capacity and extrapolate to estimate overall employment impacts on a national level.[31]

The ACESA scenario predicts the same amount of biofuels being consumed in a business-as-usual scenario as in a policy scenario with a binding carbon cap. This is not surprising given the ambitious biofuels production mandate set forth Energy Independence and Security Act of 2007 (EISA 2007) and the duplicative nature of adding a carbon policy on top of pre-existing standards. EISA 2007 mandates the production of 36 billion gallons of corn and cellulosic ethanol by 2022.[32] The model results show that these mandates – even though the EIA estimates that they will not be met[33] – drive the amount of biofuels consumed and, therefore, employment levels in the industry. As a result, we have projected no change in biofuels employment as a direct result of ACESA.

Estimating Employment Impacts of ACESA 2009 on the Automobile Industry

We used an approach similar to the biofuels methodology to estimate the employment impacts of ACESA 2009 on the "green" automobile industry. We considered vehicles that run on biofuels to be included in this "green" classification. However, because very few vehicles currently run solely on biofuels, we estimated the number of "biofuel car equivalents" that would be needed to consume the biofuels produced in MRN-NEEM. To do this, we used public data to determine the average annual vehicle miles traveled (VMT) per vehicle in the U.S. and assumed that this would remain constant over time.[34] Then, by using MRN-NEEM to estimate total U.S. VMT in each year, along with modeled biofuels production estimates, we are able to estimate the number of "biofuel car equivalents" sold in a given year. This information, combined with an estimate of the average productivity of a U.S. automotive worker,[35] leads to an estimate of the number of jobs created in the "green" automobile sector.

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[31] "Economic Impacts of Ethanol Production," Ethanol Across America (2006), Washington, D.C.

[32] The biofuels in the baseline are calibrated to the levels in AEO 2009 Early Release.

[33] *Annual Energy Outlook 2009, Early Release with Projections to 2030*, prepared by the U.S. Department of Energy, Energy Information Administration, January 2009.

[34] *Annual Energy Outlook 2009, Early Release with Projections to 2030*, prepared by the U.S. Department of Energy, Energy Information Administration, January 2009.

[35] "Wages and Employment of Workers in Automobile Manufacturing," U.S. Bureau of Labor Statistics, Jeffrey Holt, 2005, Washington, D.C.

Since the use of biofuels, and therefore the production of biofuel and hybrid vehicles, is driven by the production mandates in EISA 2007, we again find that the impact of ACESA on employment in the "green" automobile industry will be small relative to a business-as-usual, no-policy scenario.

Estimating Employment Impacts of ACESA 2009 from Energy Efficiency

The vast majority of the green jobs that we have estimated in our ACESA scenario are associated with increased energy efficiency-related spending. As the carbon costs force energy cuts in production, firms will react by including more non-energy inputs, which are relatively cheaper. The general equilibrium effects show that output decreases as the cost of production rises and income drops, suggesting lower employment as the end result of the policy. If we assume that output remains at the same (baseline) level, we can determine how many more jobs would be needed to work with less energy in producing the same level of output given the relative changes in prices of energy and non-energy inputs.

It should be noted that the jobs created in relation to the energy efficiency in this study refer to the increase in employment when less energy is used to produce the same level of output. We do not distinguish between the increases in employment due to the energy-efficient technical/behavior changes from the increases due to the substitution of energy with more employment of labor from a pure cost perspective.

Results

CRA has made preliminary estimates of the number of average jobs directly associated with the increased payments to labor for increased renewable electricity, more efficient automobiles, biofuels, and energy efficiency improvements in its model scenario of ACESA. The preliminary estimate ranges from 1 million in 2015 to almost 2 million by 2030. The creation of a green job does not always mean the creation of a "new" job. For example, moving an autoworker from producing a vehicle powered by conventional fuels to a vehicle powered by a hybrid engine would not constitute a "new" job. Instead, it is a job transfer to what one might call a green job. Our estimate of green job creation includes green jobs that are both "new," which are incremental to a business as usual scenario, and "transfers," which are jobs shifted from part of an industry negatively impacted by a policy to another part of the industry that is positively impacted by the policy. Our net job loss estimates above are derived from the same model run that simultaneously contains this large number of implicit employment in "green jobs."

APPENDIX F: DETAILED RESULTS FOR LOW COST, HIGH COST AND NO INTERNATIONAL OFFSETS CASES

Table F-1: Summary of projected economic impacts (change from projected baseline) for Low Cost case

	2015	2020	2030	2040	2050
CO_2 Allowance Price (2008$/Metric Ton)	$21	$27	$44	$71	$117
Change in U.S. jobs (Millions)	-0.9	-1.0	-1.4	-2.0	-2.4
Change to Average Worker's Annual Wages: *Assumes Partial Wage Adjustment* ($2008)	-$290	-$320	-$430	-$690	-$960
Change in U.S. Purchasing Power ($2008 per Household)	-$670	-$650	-$690	-$780	-$810
Percentage Change in U.S. GDP	-0.5%	-0.5%	-0.7%	-0.9%	-1.0%
Percentage Change in Natural Gas Retail Rates*	9% ($1.0/MMBtu)	11% ($1.30/MMBtu)	14% ($1.90/MMBtu)	19% ($2.90/MMBtu)	28% ($4.40/MMBtu)
Percentage Change in Motor Fuel Cost	4% (17¢/Gallon)	5% (21¢/Gallon)	7% (34¢/Gallon)	9% (52¢/Gallon)	14% (84¢/Gallon)
Percentage Change in Electricity Retail Rates*	9% (1.0¢/ kWh)	14% (1.7¢/ kWh)	23% (2.6¢/ kWh)	33% (3.9¢/ kWh)	32% (3.8¢/ kWh)

* Percentage increases in utility bills will be smaller to the extent that there are free allowance allocations to load-serving entities and natural gas local distribution companies and/or reduced energy consumption.

Table F-2: Summary of projected economic impacts (change from projected baseline) for High Cost case

	2015	2020	2030	2040	2050
CO_2 Allowance Price (2008$/Metric Ton)	$44	$56	$91	$148	$241
Change in U.S. jobs (Millions)	-3.7	-4.3	-5.1	-6.6	-7.8
Change to Average Worker's Annual Wages: *Assumes Partial Wage Adjustment* ($2008)	-$430	-$650	-$1,070	-$1,650	-$2,400
Change in U.S. Purchasing Power ($2008 per Household)	-$1,580	-$1,710	-$1,850	-$2,030	-$2,150
Percentage Change in U.S. GDP	-1.6%	-1.8%	-2.3%	-2.8%	-3.1%
Percentage Change in Natural Gas Retail Rates*	23% ($2.60/MMBtu)	29% ($3.50/MMBtu)	41% ($5.70/MMBtu)	58% ($8.60/MMBtu)	73% ($11.60/MMBtu)
Percentage Change in Motor Fuel Cost	8% (36¢/Gallon)	10% (44¢/Gallon)	14% (71¢/Gallon)	19% (112¢/Gallon)	31% (182¢/Gallon)
Percentage Change in Electricity Retail Rates*	20% (2.2¢/ kWh)	32% (3.6¢/ kWh)	48% (5.5¢/ kWh)	74% (8.5¢/ kWh)	91% (10.7¢/ kWh)

* Percentage increases in utility bills will be smaller to the extent that there are free allowance allocations to load-serving entities and natural gas local distribution companies and/or reduced energy consumption.

Table F-3: Summary of projected economic impacts (change from projected baseline) for No International Offsets case

	2015	2020	2030	2040	2050
CO_2 Allowance Price (2008$/Metric Ton)	$67	$85	$139	$226	$368
Change in U.S. jobs (Millions)	-5.1	-5.5	-5.9	-6.7	-7.6
Change to Average Worker's Annual Wages: *Assumes Partial Wage Adjustment* ($2008)	-$690	-$910	-$1,300	-$1,780	-$2,530
Change in U.S. Purchasing Power ($2008 per Household)	-$1,610	-$1,750	-$1,890	-$2,050	-$2,320
Percentage Change in U.S. GDP	-2.1%	-2.3%	-2.6%	-2.8%	-2.9%
Percentage Change in Natural Gas Retail Rates*	37% ($4.20/MMBtu)	44% ($5.30/MMBtu)	49% ($6.90/MMBtu)	67% ($10.00/MMBtu)	104% ($16.70/MMBtu)
Percentage Change in Motor Fuel Cost	12% (52¢/Gallon)	14% (66¢/Gallon)	21% (108¢/Gallon)	30% (173¢/Gallon)	48% (279¢/Gallon)
Percentage Change in Electricity Retail Rates*	35% (3.8¢/kWh)	43% (5.0¢/kWh)	58% (6.5¢/kWh)	62% (7.1¢/kWh)	60% (7.3¢/kWh)

* Percentage increases in utility bills will be smaller to the extent that there are free allowance allocations to load-serving entities and natural gas local distribution companies and/or reduced energy consumption.

Chairman TOWNS. Let me thank all of you for your testimony.

Let me begin, I guess, with you, Mr. Morial and, of course, Ms. Murguía.

Many of the top banks issued a high portion of these subprime loans to Hispanics or African American borrowers. Is this an indication that minorities were targeted recipients of these exotic loans? I mean, was the program developed to go out and get them?

Mr. MORIAL. It is an excellent question. I think there is ample evidence that African Americans in many cases were steered into subprime or high interest loans. The numbers we have looked at indicate that for the period, I believe, 2005, 2006 and 2007, about 55 percent of all African Americans that took on home loans ended up with subprime loans.

Now, you have to add to that the data shows that a large number of those that ended up with subprime loans could have qualified for prime loans. And that is the issue. That people who could have qualified were directed or steered by brokers, servicers and banks into higher-interest subprime loans.

Certainly, there may have been those, in all fairness, who may have taken on more house than they could afford because the lack of requirements of income verification allowed that to occur. But, fundamentally, and this is what is important, the majority of all subprime loans went to White Americans.

But a disproportionate share of all Blacks who got loans period ended up with subprime loans. And it is important to paint the picture with accuracy. And I think that information, Mr. Chairman and Members, should instruct the kind of regulatory reform we need in this Nation to prevent this from continuing to occur and to prevent this kind of crisis from occurring in the future.

Ms. MURGUÍA. I would just add, Mr. Chairman, that, you know, Latinos are 30 percent more likely to get high cost loans. So the steering problem is one that we see dramatically effecting the Latino community in particular.

I think we believe that the foreclosure crisis was driven 2by harmful loans, mostly made by mortgage finance companies due to the lax oversight there. And at the end of the day, I think a lack of common sense regulations is what caused the foreclosure crisis and where we did have regulations, it was the lack of enforcement. So, steering is a big problem for us in our community and we need to address that.

Chairman TOWNS. Yes, yes, right. Let me just add, do you think the inability to speak the language had anything to do with it?

Ms. MURGUÍA. Yes, I think having home ownership counselors who are certified in the communities is one of the most important ways that we can assure that these individuals are getting accurate information. It is an important area that I think where we need to see more investment in addition to regulation and oversight, the funding could be directed.

We need to make sure that we are doing more to create that pool of credible, certified, trusted housing counselors who are in the community who can break down all of those barriers and be trusted voices for those individuals seeking to get those loans.

Chairman TOWNS. Ms. Hasegawa.

Ms. HASEGAWA. Ditto. Also, for Asian Americans, subprime loans almost tripled between 2004 and 2005. We heard from many companies that sort of started up in California that I think their entire business model was to target Asian Americans who were perceived as affluent, having a lot of cash, etc. So there was certainly targeting going on.

They were very culturally and linguistically competent, I have to say, in terms of the mortgage brokers getting young people to get out there to get their, what do you call it, their commissions to basically do the loans, particularly in communities that spoke specific Asian languages, targeting the Vietnamese, the Koreans, the Chinese language speaking communities.

And so, they were isolated from a lot of the mainstream products and outreach efforts that were conducted only in English. So, absolutely, I think that language was a barrier and we, as a non-profit organization, and the housing counseling groups, did not have the resources to be able to combat that on the streets with all of their media ads and with the unregulated brokers. So, absolutely.

Chairman TOWNS. Yes. Mr. Alford, do you want to comment on that?

Mr. ALFORD. Yes. Mr. Chairman, they are absolutely correct. But HUD issued billions of dollars in housing stabilization money last December and January. It is on the streets by now. So, where are these counselors that receive these billions of dollars? It was to fund counseling. It was to address the foreclosure problem. I think we need a quick audit as to who has that money and what they are doing with it because in the communities I visit, I cannot find any counselors.

Mr. MORIAL. Let me just say this, because we do counseling and we do counseling in 35 communities and we are going to probably do about 100,000 cases this year. A counselor can only get a result if a lender is willing to play ball on a modification. A counselor is an advocate for a homeowner and has to knock on the door of the lender and say, will you work with this buyer, this purchaser, this homeowner, to modify a loan.

I think the previous panel indicated that many servicers are reluctant, obstinate and not particularly favorable. And it goes back to, perhaps, the TARP. That the TARP could have required that those that received an injection of cash, an injection of cash out of the TARP, would be required, that it not be voluntary, to work with homeowners when it comes to the modification of these loans.

Many of these modifications are helping people take a high interest rate and reduce it down, to reduce the payments so that they are affordable. Certainly, if you do not have a job, you cannot pay a modified loan. But that was the idea to give so the counselors, and those of us who do counseling, are working feverishly, aggressively in many communities, but in some cases we cannot achieve the result because the servicer or the lender is not willing to engage in a modification that the homeowner can afford.

So, what we see now is double mods taking place, an original modification, and a further modification being needed by the homeowner so that they can stay in the home.

Chairman TOWNS. I think my time has expired so let me just, well, I think it definitely expired. [Laughter.]

The gentleman from Arizona, Mr. Flake.

Mr. FLAKE. I thank the chairman and I thank the witnesses.

I was interested in, I seem to detect a theme from all of you that the programs that we have, that we have implemented over the past year, are not working very well. What I hear is let us do more programs. Do some of them differently, perhaps. And I was interested in, Mr. Alford you mentioned that job training programs traditionally have not worked. It is a job that you can train on. Do you want to elaborate on that a little bit?

Mr. ALFORD. Mr. Congressman, let me give you an example. I was doing a monitoring for a high school in York, PA and they wanted to implement or replicate that Section 3 program. So, down the street there was a grant recipient for a home bill, I believe it was, which is a HUD program for job training. So, naturally, I went to them saying we want to place your graduates to do work. These contractors will hire your graduates from the high school and get them into the work force. They were livid that I would approach them to try to place some of their students in jobs.

In the end, they did not get their grant renewed. But what we did was on-the-job training. And a beautiful piece of on-the-job training is Gulf rebuilding, where Bechtel and Fluor and Turner Construction and a lot of associations such as ours got together.

We have trained 18,000 people in Louisiana, Texas, Mississippi and East Alabama. Eighth grade reading level, eighth grade math level, and drug free. You go through this course with the graduation into one of these companies that are sponsoring it. So, of the 18,000 people we have trained to date, 80 percent are working full-time now. And I am also proud to say that 70 percent are minorities.

Mr. MORIAL. I want to respond to that because I think it is very——

Chairman TOWNS. The gentleman from Arizona has the time.

Mr. MORIAL. Yes, but I cannot leave it at a blanket indictment of job training programs, because we do it and we do place people. Mr. Alford is right that a good job training program has to have a placement component to it. But a blanket indictment of job training programs is not fair.

What is fair to say is that some do not work. It is fair to say that some providers may not do a good job. But there are many job training programs that work, which are designed to help people access jobs in a variety of sectors. The placement component is very important.

Mr. FLAKE. Do you have a placement rate that you could inform us?

Mr. MORIAL. Different programs have different placement rates. We have some programs with a 50 percent placement rate. It depends on the population. If you are working with people who have no high school diploma, typically what you are trying to do is help them get a GED so that they get a sustainable job, not just a job for a month. We have done those types of work. If you are working with people who have a high school diploma and they are looking for some sort of more specified skill in the construction trades, for example, you may have a higher placement rate.

Mr. FLAKE. Since I have very limited time here, I wanted to get to loan modification. It is something that has come up here and it is coming up again and again and many of us are opposed to it, and I want to get your perspective on it, the so-called "cramdown provisions" which are allowing bankruptcy judges to basically modify mortgages.

Could you just say yes or no across the board if you agree with cramdown? And my concern is that we may address those currently having problems with modification, and I am not suggesting that there are no problems out there with modification, but that we will make it far, far, far more difficult in the future for anybody with less than stellar credit to be able to get a loan if there is a prospect, prospectively, of a Bankruptcy Judge simply coming in and modifying a mortgage downward.

Is that in the calculation that anybody is considering there? I would just like your perspective. We will go to Ms. Murguía, I guess, on "cramdown provisions."

Ms. MURGUÍA. Well, we think it is important to have some ability to modify those loans in the different venues and I think if there can be a fair assessment in that venue, then we would support it. I wanted to just——

Mr. FLAKE. Is there a concern, though, moving forward, that if you have provisions that allow bankruptcy judges to basically rewrite mortgages, that you make it very difficult for anybody with less than stellar credit to get a loan in the future?

Ms. MURGUÍA. I think we have to be thoughtful about how we approach it, but I think that the needs are so great right now to have opportunities for folks to have these issues addressed that we want to make sure that we can move forward. But we should do so thoughtfully to ensure that there are no ramifications that we would not intend to occur.

Could I just briefly, just because you mentioned, Congressman, that you said we supported, you know, we talked about some of the problems in the programs and we supported more programs, I just want to make it clear that what I said today is I want more accountable programs and I want more accountability in the programs that we have.

I am not talking about creating more programs necessarily. But the Federal Government has a responsibility to ensure that accountability. And what I will tell you that we ought to target benchmarks and we ought to try to require and report more useful data for us so that we can have that accountability.

Yes, there was a big rush to respond to this economic downturn. A lot of things happened very quickly. We are just merely pointing out that these programs can be improved and I wanted to clarify that.

Mr. FLAKE. Well, I just, the concern that a lot of us have is we rarely, if ever, hear any witness say this is a bad program, it should be eliminated. It is always it should be better funded, it should be changed, and as an oversight body, at some point it would be nice to hear, hey, we ought to follow the GAO recommendations and close this program and just not do it anymore. And we just rarely hear that.

I am sorry, my time is up. Thank you, Mr. Chairman.

Chairman TOWNS. Time has expired. I recognize the gentleman from Maryland.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. I just want to just refer to what Mr. Flake just said. I wish Mr. Flake could have been in my district last Saturday when we had 1,000 people lined up there who were losing their homes.

And so we talk about cramdowns, and I hate that term, but to have a bankruptcy judge sit, look through everything, determine what happened, Mr. Morial talked about it a moment ago, with people who basically were pushed into subprime loans when they were prime candidates, and then to bring some balance, particularly balance when the banks have been bailed out, they are now paying back some of the money that they got from us, from the United States of America, but yet and still homeowners in your district and mine, maybe your district is a lot better off, but in my district there are a lot of people who are suffering and about to be thrown out.

And these are not people who are looking for a handout. These are hard working Americans who paid their taxes when then were working, gave their blood, their sweat, their tears to this country, and because of no fault of their own, now they are out of a house.

So, it is easy to sit here in this place with our suits and the nice air conditioner, whatever, feeling good, but I am talking about Americans, Americans who have given everything they have. But now they just need a bridge to be able to stay in a house. I am not talking about living in some luxury condominium. I am talking about some of them have been in these houses for 20 years. They have kids. And they want to stay in those houses.

So, I just get a little bit upset when I hear things like that, as if it does not matter that these folks have an opportunity, for example, to go before a judge. Judges are sworn, they have the things that they need, the assistance they need, to analyze all of this and figure it out.

I just want to go to you, Mr. Morial. You were talking about these counseling programs with regard to jobs. I think one of the problem that we find, and I just want you to comment on this, some of the people that we are trying to train, and I live in the inner city, you have some hard, some folk did not get a decent education, they, in some instances they went to some of the worst schools.

I have parts of my district, Mr. Morial and panel, where I go in one county you go to a public school it looks like a private school. But in Baltimore City, we have our problems. Then when they get to the 12th grade, or if they get to the 12th grade, people expect those kids who came under those conditions to be able to compete with kids who have had computers ever since they were in Pre-K. I have high school students who do not have computers today.

So, I am just trying to figure out, how do you all see, and Mr. Morial I will start with you, this education thing is serious. And how do we, because I see this as a key to, even after you do the counseling, first of all, you have to have a candidate to counsel, you counsel them, then they have to have certain qualifications even after you counsel them. So, I am just wondering——

Mr. MORIAL. Let me give you an illustration, Congressman Cummings. You are absolutely right. We have a job training programs called the Urban Youth Empowerment Program. It was designed with the idea that people who would come to us would be high school dropouts but they would have seventh or eighth grade reading levels. And all we have to do is take them to a 12th grade level.

What we found, when we tested the people on intake, that a majority of them had a fourth grade reading level. And so, they were 19, 20 and 21 years old reading on a fourth grade level and, therefore, you were required to be successful to take them from a fourth grade reading level to 12th grade for them to get their GED before they could even qualify for most basic jobs. So——

Mr. CUMMINGS. In how much time? In how much time?

Mr. MORIAL. Well, you know, in probably 6 to 8 months. In many cases, it is not possible. You might be able to move them from fourth to eighth grade. So, many of these job training programs are functioning as education remediation programs for people in urban communities. They are trying to fix the failures of 30 years of benign neglect in public education.

And we have to recognize that, yes, that is why we seem to be fighting a losing battle, because the large numbers, if you just look at 1 million kids dropping out of high school each year and you add to that population 1 million each year, 1, 2, 3, 4, 5, the large number of people. So, in the economy of today, where jobs require more skills and more education and more technical ability, many of these folks are not going to be able to qualify.

That is a structural challenge with the economy of this Nation that we have to figure out a way to employ. It is the thing that is sucking jobs overseas. It is the thing that is promoting outsourcing to India and China and other places. And it is what we are fighting in urban communities like Baltimore, like Philadelphia, like New York, like Birmingham, like New Orleans, like Dallas, where young people who are high school dropouts come into these programs but it is difficult to get them to the skill level where they can qualify for the jobs that the economy was producing before this depression took place.

Chairman TOWNS. Gentleman, your time has expired, but I am willing to, if you want to get answers from someone else.

Mr. CUMMINGS. If they will, Mr. Chairman.

Ms. JOHNSON-PATA. I would like to respond to that because one of the programs that we have in Indian country is called the 477 Program. It is a model that I think that might be replicated someplace else because we are able to get the money from job training programs in the Department of the Interior and HHS and, rather than having this agency silos where you have very strategic, narrow focused programs and so then the counselors and job trainers have to work for them, we are actually able to pool the money together so that at the tribal level they can be more flexible in designing programs that have longer-term sustainable.

So, given where the tribes' interest in economic growth is, they can challenge the educational training as well as the technical training to be able to have a more comprehensive support system

for the job training, including, you know, any kind of family needs that need to be taken care of, etc., so our success rate is higher.

It is a very small program that we have been trying to spur more growth in. But it is probably one of the most successful models that we have had.

Mr. ALFORD. It is pretty overrated. You know, GED and high school, you have to complete high school. We have kids working in Louisiana right now building public housing facilities, making $20 to $30 per hour, and they could not fill out their application. We had people fill out their applications. But they know how to pick up some bricks, they know how to pour cement, they know how to grade a road, they know how to drive nails through wood. That is a start. They can get educated on the side, because that is what they should do.

But that is not a job preventer. It is not a job preventer. One hundred thousand jobs in Section 3, and we should do that in Baltimore, and Federal Highway Program, I would like to sit with you Congressman and show you how your District is getting exploited out of jobs through the Federal Highway Program and how we can go after it and get them employed.

I hung drywall in the seventh grade. It is no big thing.

Chairman TOWNS. The gentleman's time is expired. I know, we are getting into it, and I am guilty of that quite often, but we want to just sort of stick to the rules here——

Mr. CUMMINGS. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you.

I now yield to Mr. Jordan of Ohio.

Mr. JORDAN. Thank you, Mr. Chairman. I yield 30 seconds to my colleague from Arizona.

Mr. FLAKE. Thank you. I just want to address the issue that Mr. Cummings brought up and I appreciate his concern here.

I am not saying that we should not renegotiate loans and that the bank should not. It is in everyone's interest to renegotiate the interest downward on some of these loans. But what I am having concerns about is the "cramdown provisions" that have been proposed which would allow them to reduce the principal amount as well. And that will very negatively affect those who want to get loans in the future because, unless you have stellar credit, banks will be loath to enter into an agreement with you.

So, thank you.

Mr. MORIAL. I did not get an opportunity to——

Chairman TOWNS. No, no. He has the time, so we have to recognize him.

Mr. JORDAN. I thank you, Mr. Chairman. Let me just pick up where my colleague from Maryland left off with this education. Let me just ask, I want to do one question for everyone and then I want to direct a question to Mr. Alford if I could.

Where do you all stand on the issue of school choice? Let me give you a quick background. I come from Ohio. We did one of the first scholarship programs in the country in Cleveland, OH in my days in the General Assembly. Back in 1997 we passed this program. I can remember the first day, the very first day, mostly minority families showing up for 2,000 spots, K through second grade. The scholarship was worth $2,200 at the time and Cleveland public

schools were spending $7,000 per pupil. We only had 2,000 spots and thousands of families showed up.

Think about what they were saying. They were saying keep the extra money, we want that scholarship and the ability to get our kid in a school we think he or she is going to get the kind of education they deserve, frankly the kind of education they need to achieve things, as all of you said earlier, and to achieve the American Dream.

So, let me just ask you down the list. Do you support school choice programs that empower parents, particularly in urban areas, to give their kids the education that they think is better?

Mr. MORIAL. I do not support publicly financed vouchers, but do support privately financed scholarships that allow kids to go to private or parochial schools.

Mr. JORDAN. Let me ask you this. Do you support the District of Columbia option that we have had in Federal law in the past?

Mr. MORIAL. I do not support publicly financed vouchers at all.

Mr. JORDAN. OK. Next one.

Ms. MURGUÍA. You know, we have strongly supported charter schools and giving and empowering our parents' choices in seeking alternatives in their districts. But, for us, we have not taken a position on——

Mr. JORDAN. And can I ask, just real quick, for those of you who are against it, and so far it is two for two, why is it wrong to say the money that was going to spent on this child not be strapped on the back of that kid and follow that kid to the school his or her parents think they are going to get the better education? Why is that wrong?

Mr. MORIAL. Well——

Mr. JORDAN. We are going down the line. I already got your answer.

Ms. HASEGAWA. We actually do not have a position on it either, but we do work with charter schools.

Ms. JOHNSON-PATA. We do not have a position either because most of our schools are rural and very remote. There are not choices.

Mr. ALFORD. We believe a parent has a right to a choice for their child's education and there is nothing wrong with that at all, sir.

Mr. JORDAN. All right.

Let me just go to you, Mr. Alford. Let me ask, and somewhat related I guess, is it not true that most minority-owned construction firms are non-union?

Mr. ALFORD. Ninety-eight percent of Black-owned firms are non-union, because, one big thing, if they got into the unions, their employees could not get into the union halls because of the color of their skin.

Mr. JORDAN. Let me just ask you then about your position on project labor agreements, or what are typically called pre-hire contracts, where they require the owner or the general contractor of a construction project to sign an agreement with unions representing crafts that will work on the project before the actual work force for the project is hired.

February 6th of this year, President Obama signed Executive Order No. 13502, encouraging the use of project labor agreements.

Tell me your thoughts on this. Do you think this is positive for minority-owned construction firms?

Mr. ALFORD. It will double the rate of unemployment in the African American communities where there are significant Federal jobs or Federal projects. It will double it. And we spent a lot of time, my Board and I, spend a lot of time talking to OMB when they were threatening to do this and made it very clear that go over to the Department of Labor, look at the Office of Federal Contract Compliance Programs data on union projects, and you will see that Blacks, Hispanics and women do not work in them.

They have the data over there. But the Secretary of Labor will not release the data. But the unions should not even be certified by the Federal Government because they discriminate.

Mr. JORDAN. Well, let me just ask you what I think is an obvious question. Why do you think the President signed that order?

Mr. ALFORD. $200 million of campaign contributions, sir.

Mr. JORDAN. All right. Mr. Chairman, I yield back.

Chairman TOWNS. Thank you very much.

I now recognize the gentleman from California, Mr. Bilbray.

Mr. JORDAN. Mr. Chairman, if I could real quick. I have a few seconds.

I would like to ask for unanimous consent for the comments, this is the comments by Ranking Member Issa, to be entered into the record concerning PLAs.

Chairman TOWNS. Without objection, so ordered.

[The information referred to follows:]

EDOLPHUS TOWNS, NEW YORK
CHAIRMAN

DARRELL E. ISSA, CALIFORNIA
RANKING MINORITY MEMBER

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

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September 23, 2009

Ms. Hada Flowers
Supervisor
General Services Administration
Regulatory Secretariat
1800 F Street, N.W.
Room 4041
Washington, D.C. 20405

RE: FAR Case 2009-005: Use of Project Labor Agreements for Federal Construction Projects

Dear Ms. Flowers:

I write in strong opposition to the Obama Administration's continued preferential treatment of organized labor, specifically the amendment of the Federal Acquisition Regulation (FAR) published in the Federal Register on July 14, 2009, (74 FR 33953), which would allow and encourage the use of project labor agreements (PLA) on federal projects. Over the last 9 months the Administration has acted quickly to repay union allies: pressing for the passage of the Employee Free Choice Act and health care reform; giving the UAW preferential treatment over senior creditors in both the Chrysler and General Motors bankruptcies; proposing rules that will shield union officers from accountability by rescinding the Form T-1 and changes to the Form LM-2; and implementing tariffs on foreign products that compete with U.S. unionized industry. Now it seeks to force non-unionized employers and employees into collective bargaining agreements through the use of PLAs which are wasteful, unnecessary, discriminatory, anticompetitive, and illegal. The negative consequences of this rule, as laid out below, combined with the Administration's failure to provide any support for its adoption, dictates that this rule making must be abandoned.

The proposed rule would amend the FAR to allow and encourage federal departments and agencies to consider requiring the use of project labor agreements for federal construction projects that total more than $25 million. Project labor agreements vary, but in general PLA's require contractors and subcontractors on covered projects to: 1) agree to recognize unions as the representatives of their employees without a vote; 2)

use the union hiring hall to obtain workers; 3) obtain apprentices exclusively from union apprenticeship programs; 4) pay into union benefit and pension plans; and 5) obey costly, restrictive and inefficient union work rules, including dispute resolution. Employees, whether union members or not, must pay union dues while working on the project.

The Administration justifies effectively forced unionization of thousands of employers and over 6 million employees, representing over 84 percent of construction workers, by arguing that PLAs will promote economy and efficiency, but presents no evidence in support of its claims.[1] The lack of supporting evidence in the proposed rule is not surprising as many who have studied PLAs agree that not only do they not promote economy, efficiency and labor peace, but they are discriminatory, wasteful, and anticompetitive.

Project Labor Agreements Do NOT Promote Efficiency

Forcing all contractors and subcontractors to hire exclusively from the union hiring hall, and adhere to costly, restrictive and inefficient work rules, eliminates any possibility of efficiency. The hiring clause will require non-union employers to hire an entire new workforce from the union hiring hall, destroying any efficiency developed by employer and employee familiarity and unity. In addition to the difficulty of hiring new employees, employers will have to work under a new, unfamiliar uniform collective bargaining contract.

PLAs use uniform collective bargaining agreements that cover all crafts of the construction project- setting work schedules, hours, payment arrangements, grievance procedures, and other terms and conditions of employment. All of these conditions are set before the construction project is opened to bidding, the union and the federal government are the only entities involved in crafting the PLA. These uniform contracts limit both employee and employer choice and innovation. The employees, union and non-union alike, are forced to accept employment terms dictated by a union of which many are not members. Contractors and subcontractors are forced to accept the PLA conditions, eliminating any chance of efficiency through innovation and forcing many employers to overhaul their structures to accommodate the new requirements.

Efficiency and innovation can only be achieved by removing barriers to competition, including PLAs.

Project Labor Agreements Do NOT Promote Industrial Peace

There is no evidence that PLAs are more successful than traditional contracts at securing industrial peace. To the contrary, new grievance provisions are more likely to create unrest. A recent study by the Beacon Hill institute found that the Bush Administration initiated 57,287 construction projects worth $25 million or more without

[1] http://www.bls.gov/cps/cpsaat42.pdf

a single PLA.[2] None of these projects suffered from labor strife, slowdowns, or significant cost overruns.[3] Clearly, PLAs and their grievance provisions are not necessary to ensure industrial peace on federal projects.

The union/PLA grievance adjustment system places large administrative costs on merit shop contractors and non-union employees who have no experience with the union/PLA grievance system. It is more likely that subjecting merit shop contractors and non-union employees to such a system will slow down the grievance adjustment system as contractors and employees must expend time and resources familiarizing themselves with the process. Merit shop contractors have grievance adjustment systems in place to effectively deal with grievances on over 75 percent of all construction projects nationwide. Inexperience with the system inevitably leads to conflict and strikes.

Although most PLA's include a no-strike clause, it was not uncommon for unions to ignore no-strike clauses. Despite the inclusion of a no-strike provision in the San Francisco airport construction PLA, dissident union members protested the ratification of a local labor agreement.

The Administration must not unnecessarily complicate the federal contracting situation by requiring the use of PLAs.

Project Labor Agreements are Wasteful

Project labor agreements waste tax payer dollars by forcing contractors and subcontractors to comply with collective bargaining agreements dictated by a union and the federal government. It is estimated that PLAs increase the costs of projects by between 20 and 26 percent.

The Beacon Hill Institute conducted an extensive statistical analysis on the effects of PLAs on school projects in Massachusetts, Connecticut and New York. In each instance the analysis found bid costs to be significantly higher when a school construction project was executed under a PLA. The New York study found that the presence of a PLA increased a project's base construction bids by $27 per square foot relative to non-PLA projects, a 20 percent increase. The potential savings from not entering into a PLA on a school construction project range from $2.7 million for a 100,000-square-foot structure to $8.1 million for a 300,000-square-foot structure.[4]

A 1995 study of the Buffalo Roswell Park project done by Associated Building and Contractors, Inc., estimated that the PLA increased the cost of the project by more

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[2] Tuerch, David G., Sarah Glassman, and Paul Bachman, *Project Labor Agreements on Federal Construction Projects: A Costly Solution in Search of a Problem,* The Beacon Hill Institute, August 2009, pg. 5.
[3] Id.
[4] Bachman, Paul and David G. Tuerck. "Project Labor Agreements and Public Construction Costs in New York State." Beacon Hill Institute at Suffolk University, 2006.

than 26 percent. Additionally, the packages bid with PLA's averaged 10 percent over budget while the packages bid without PLA's averaged 13 percent below budget.[5]

Studies of the Erie County New York Roswell Cancer Center bid packages showed that cost of construction projects under the union-only PLA were 48 percent higher than those without PLAs, and the projects not subject to the union-only PLA were 13 percent under budget.[6]

Assuming PLA agreements increase project costs by 20 percent, the federal government will spend all $131 billion allocated to federal construction projects by the American Recovery and Reinvestment Act, on work that could have been done for $109 billion without the PLA.[7] This labor windfall will cost the American taxpayer $22 billion.

The Administration should drop this rule making and use the $22 billion saved to build more roads, schools, and essential infrastructure.

Project Labor Agreements are Anticompetitive

To avoid the difficulties inherent in PLAs, many employers who are capable of managing and completing large projects choose not to bid on construction projects covered by a PLA. This response reduces competitive bidding and quality of workers. The 1995 study of the Buffalo Roswell Park project (referenced above) estimated that a PLA reduced total bidders by 30 percent.[8]

Similarly, a review and analysis of the Erie County New York Courthouse Construction Project found that the PLA, diminished the likelihood of qualified and appropriate craft and tradesmen participating on the project by discouraging non-union bidders. There were approximately six union contractors, and between six and twelve merit contractors, of sufficient size and resources to bid on the project. However, only the six union contractors bid on the project- not one merit contractor bid on the job. The lack of merit shop contractors significantly reduced the pool of workers. In 2001, approximately 80 percent of all construction workers were not affiliates with a union organization, 75 percent of all construction projects nationwide were completed with

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[5] Association of Builders and Contractors to Harry Robinson, April 6, 1995 available at http://opencontracting.com/studies/pdfs/Letters.pdf

[6] Ernest and Younge, Erie County Courthouse Construction Projects, September 10, 2001, available at http://opencontracting.com/studies/pdfs/Erie.pdf

[7] Carlin, Elise M., The American Recovery and Reinvestment Act of 2009 and Its Impact on Federal Construction Contracting, February 18, 2009, available at http://federalconstruction.phslegal.com/tags/american-recovery-and-reinvest/

[8] Ernest and Younge, Erie County Courthouse Construction Projects, September 10, 2001, available at http://opencontracting.com/studies/pdfs/Erie.pdf

non-union labor. Additionally, Erie County neither reported nor discovered any differences in quality where union and merit shop contracts were employed jointly.[9]

All federal contracts should be open to competitive bidding without project labor agreements to ensure best value and quality of work.

Project Labor Agreements are Discriminatory

The underrepresentation of minorities in unions, combined with PLA union hiring clauses and the lack of non-union contractor bidding on construction projects covered by PLAs, as outlined above, acts as a barrier for minority workers and contractors. In 2008, approximately 73 percent of union members where white, 13 percent were African-American, 4 percent were Asian, and 11 percent were Hispanic.[10] Further, 98 percent of black construction workers and construction companies are not in unions.[11] These disparities ensure that small and minority businesses will not be able to compete on PLAs.

I join with the National Black Chamber of Commerce, Women Construction Owners & Executives, USA, Bay Area Black Contractors Association, Latin Builders Association, Inc., United States Pan-Asian-American Chamber of Commerce, American Asian Contractors Association, and National Association of Women Business Owners in opposition to this discriminatory rule making.[12]

Conclusion

The Administration has failed to present any rational basis for the use of project labor agreements on any federal project. In the absence of such rational basis and the negative consequences of such agreements, as laid out above, I urge the Administration to drop this rule making and open all federal contracts to open competitive bidding without the inclusion of project labor agreements.

Respectfully submitted,

Darrell Issa
Ranking Minority Member
Committee on Oversight and Government Reform

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[9] Ernst & Young LLP. "Erie County Courthouse Construction Projects Project Labor Agreement Evaluation." 2001.
[10] Household Data Annual Averages, available at http://www.bls.gov/cps/cpsaat40.pdf
[11] http://www.nationalbcc.org/index.php?option=com_content&view=article&id=752:the-games-they-play-on-blacks&catid=63:beyond-the-rhetoric&Itemid=8
[12] http://opencontracting.com/info/index.cfm?page=5

Panel 3 Questions for DEI

Questions for Mr. Alford on Union-Only Project Labor Agreements

Background:

Project Labor Agreements, or "pre-hire" contracts, require the owner or general contractor of a construction project to sign an agreement with unions representing crafts that will work on the project before the actual work force for the project is hired. This agreement governs the terms and conditions of employment for the project, providing for union wage rates and benefits, grievance and arbitration procedures, and the right of the unions to be the exclusive bargaining representatives of the covered employees.[1]

On February 6, 2009, President Obama signed Executive Order 13502, encouraging the use of project labor agreements, a type of collective bargaining agreement unique to the construction industry, on federal construction projects valued at $25 million or more. This order rescinds President Bush's 2001 Executive Order 13202 prohibiting federal agencies from requiring bidders to use project labor agreements. Executive Order 13502 broadly defines "construction" to include construction, rehabilitation, alteration, conversion, extension, repair, or improvement of buildings, highways, or other real property.[2] Unsurprisingly, unions are the biggest supporters of project labor agreements, while non-unionized construction contractors are uniformly against such agreements. Only approximately 15% of the U.S. construction workforce is unionized, down from 20.6% in 1990.[3] According to Mr. Alford, 98% of Black-owned contracting firms are non-union.

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[1] Kilpatrick Stockton LLP, "President Obama Signs Executive Order Encouraging Project Labor Agreements on Federal Construction Projects," February 20, 2009. *Available at* http://www.kilpatrickstockton.com/publications/legal-alert.aspx?ID=304

[2] *Id.*

[3] Aleksandra Kulczuga, "Obama's Gift for Labor," *Forbes*, September 8, 2009.

Questions: (PLA Continued)

1. Mr. Alford, it is estimated that $131 billion of the stimulus package is going toward federal construction projects[4]. How will President Obama's Executive Order encouraging the use of project labor agreements on federal construction projects affect who can bid on and win these stimulus contracts?
2. In your testimony, you state that 98% of Black-owned contracting firms are not union. Are the figures similar for other minority groups and how will President Obama's project labor agreement Executive Order affect minority-owned firms?
3. In announcing his Executive Order on project labor agreements, President Obama stated that it was necessary "in order to promote the efficient administration and completion of Federal construction projects." In your experience, do project labor agreements promote efficient administration and completion of projects? Or do they hinder competition by disallowing non-union bidders and requiring the "union way" of doing business?
4. Mr. Chairman, I would like to submit for the record comments I will be submitting today to the General Services Administration expressing my strong opposition to their proposal to allow and encourage federal agencies to use project labor agreements for federal construction projects that total more than $25 million.

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[4] *See* American Recovery and Reinvestment Act: Federal Construction Contracting Blog, February 18, 2009. *Available at* http://federalconstruction.phslegal.com/tags/american-recovery-and-reinvest/

Chairman TOWNS. Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman. I would love to go around, and we talk about the horse before the cart and the back and forth this issue of why the concern, or the disproportionate impact of downturns on certain segments of our community.

I will tell you, Mr. Chairman, I was a county supervisor of a county of 3 million, bigger than 20 States in the Union, and it became real obvious as we were trying to do work there that we had people that would not even bother to fill out the practice application and it was because they could not read the application coming out of the public school systems.

And all I have to say to the gentleman who says public school, public school, you look at my family. The two older boys went to parochial school; myself and my little brother went to public school. And let me tell you something. When you look at the difference between our two careers, there is no bet in the world that our public school education in a working class neighborhood matched up against the parochial school.

Where disadvantage comes from, it comes in many different forms, and it is not just the color of people's skins. That background, that educational thing, is a hot one. And this whole disproportionate burden of having to bear bad education gets thrown on the working class which happens to be a high percentage of people of color. It is just the facts of life.

I founded the Literacy Council in San Diego because I wanted to get to the root cause of the fact that people were not getting jobs. So, we have to go back and talk about this. But I just think that too often we say, let us defend the establishment as we know it and not be willing to hold them accountable. The fact is that outcome does matter.

It is just really frustrating for those of us who try to work in the system to see that these sacred cows refuse to get over and the monopoly of public education has to be held accountable. I think it is absolutely essential that we have public education. But the outcome matters more than the facilities.

Schools are not teaching institutions. They should be learning institutions. They are not employment opportunities. They are supposed to be education and learning opportunities. And we get all of that.

Let us just talk about green jobs though. I want to get over this. We talk a lot about green jobs. The fact is that the working class community has some real opportunities here. But one of the things that I have run into is that we talk about the green jobs. Let us just say solar panels. You want to do solar panels, you want to assemble them. How much of our government regulation stands in the way?

Now I will give you an example, a high-tech thing, algae fuel, new green fuel. My scientists at Scripps have developed an alternative that is a true gasoline, not this garbage called ethanol, a true environmental fuel. But they will not produce it, and cannot produce it, in California because the government regulation will not allow them to build the facility to provide the environmental opportunity. And I think on the tribal systems, we have some opportunity maybe to avoid that.

But would you like to comment on the government obstructionism to those economic opportunities, especially with the green application?

Mr. ALFORD. To me, sir?

Mr. BILBRAY. Yes.

Mr. ALFORD. Yes. I have two very capable businesses trying to get into the solar industry and they are finding that most of the supplies are made in China to begin with. And then, at the Federal level, Norfolk Naval Station has an RFP out and one of my businesses doing $250 million a year went to try to compete for that and they told them that the minimum bid capacity would have to be $1 billion. So, they make it difficult.

And then, all of these projects, the U.S. Chamber's Web site, part of their Web site, is Project/No Project where they list all of the potential solar projects and what have you that have been blocked by local regulation. It is thousands.

So, do we want a green economy or do we not? But it seems like the very people who say we want one are blocking those businesses who try.

So, in terms of green jobs, I have yet, I asked Ben Jones what is a green job and he could not tell me. There are no green jobs. As of yet.

Mr. BILBRAY. Well, but there is that advantage though. I mean, the Department of the Interior has 155 plus applications for solar panels in California.

Mr. ALFORD. Yes, sir.

Mr. BILBRAY. Not permitted one. One of the great advantages that we have had with the tribal system is that wind generators have been able to go up because they have been able to avoid the Federal bureaucracy and the obstructionism and California is a real culprit on that.

Ms. Johnson-Pata.

Ms. JOHNSON-PATA. Exactly. Mirango is a good example of wind energy in California. But a couple of things that have been preventing that energy development happening in the other parts of the country is, one, tribes do not get access to say, kind of, the same kinds of funds that the States do for development and for expanding development. I have the data in my testimony. You can look at that.

We need some other things that, economic tools that put us at par, like depreciation, accelerated depreciation, tax credits that are available to other investors, to be able to have transferable tax credits to our investors and our partners. You know, I have a number of things that I could share with you, a list that prevent us from being at par with the other folks in the arena for alternative energy development.

Mr. BILBRAY. Mr. Chairman, one of the things that I would like to investigate is that you have, I guess Rosebud was a good example of an aggressive nation that was trying to work with other nations at developing a resource to be able, one of the big problems we have this country, we have not built a new refinery in 30 years.

Rosebud's looking at trying to be aggressive at that cooperative. We end of having the Federal Government walk in and step on them in an area that is grossly deficient when it comes to economic

opportunity. Instead of encouraging, well, we do not trust you with your own environment.

I really find it absolutely absurd that anybody in the Federal Government could go to a Native American and tell the Native American they do not know what the environment is all about. And I think this is one of those things that we have to talk about.

What are we doing right? But most importantly, what are we doing wrong that are keeping people from being able to have those opportunities and be able to read, be able to read a blue print so that you just do not have to just pour concrete or be able to improve your neighborhood and create the economic opportunity in your own sovereign territory is something that we ought to be talking about.

Thank you very much, Mr. Chairman.

Chairman TOWNS. Thank you very much.

And I now yield to the gentleman from Utah, Mr. Chaffetz.

Mr. CHAFFETZ. Thank you, Mr. Chairman. And thank you all for being here. I do appreciate it.

Mr. Alford, my first question is for you. Let us talk a little bit about cap-and-trade and the burden that is going to be put on Americans. How do you see that playing out in the United States?

Mr. ALFORD. Well, as I said earlier, sir, we cannot find any identifiable benefit of cap-and-trade, other than Wall Street having a new toy to abuse. Cap-and-trade was invented by Enron and then it was pushed down the throats of Europe. And Europe is still complaining about it. They did not lower emissions. They lost a lot of money.

Cap-and-trade is a scheme, derivatives and defaults and what have you and Wall Street doing money. We are spending all the money, losing all the jobs, and they are still doing the same game they are doing with the TARP.

Mr. CHAFFETZ. And how do you see that, what effect is that going to have on lower income families across the country?

Mr. ALFORD. It is going to knock us out. I believe the figure is about $2,000, close to $2,000, per African American family, 60 percent of which only make $50,000 a year. So, another $2,000 and if they have a job.

And people, proponents on this bill, are saying people in Detroit and Cleveland, when you lose your jobs, you just move out to Montana and start over. You know, Grapes of Wrath. It is scary. It is very scary, very ill thought out.

Mr. CHAFFETZ. Mr. Alford, one of my deep concerns is that we have lost our ability to manufacture in this country, that we are actually, as a Nation, going to actually have to create things and build things if we are going to be successful in this global economy.

Specifically to cap-and-trade, and the other factors that are happening, what do you see this doing to the manufacturing base of this country?

Mr. ALFORD. It is going to export a lot of our manufacturing to other nations. And let me go back to World War II. We survived World War II. We survived World War II because we had the manufacturing clout. That is what saved us, to turn our manufacturing into tank machines and planes and ammunition. We were 19th in ammunition production on Pearl Harbor Day—19th. And in 2

years, we were the dominant force because we had the technology, the industry and the work force.

Mr. CHAFFETZ. Well, what are the impediments today? Why are we not leading the world in manufacturing today?

Mr. ALFORD. Regulation, basically.

Mr. CHAFFETZ. What is the No. 1 thing, Mr. Alford, that you would like to see us do to help us stimulate and grow the economy? To my mind, it is the American entrepreneur, it is the men and women who are going to create jobs, not government.

Mr. ALFORD. I would like to see us bring the Small Business Administration back. I would like to see us put emphasis on entrepreneurship and small business. That is the creator and that is the job maker and that ingenuity is what makes America great.

Mr. CHAFFETZ. So how do we put the emphasis upon the entrepreneur? Is it going to be government that is going to do that?

Mr. ALFORD. No. Entrepreneur and government, they do not really go too well together. I think it is pure capitalism, and the need of being able to be entrepreneurs.

I have my twin sons back here. They are University of Maryland graduates and they went to all the finest schools and all that, but they are entrepreneurs. They came out of college and started their own businesses. Their friends, many of them are laid off now because of downturn. A lot of their friends are tending bar. They are out thriving and living.

Mr. CHAFFETZ. Well, congratulations to you and to your two sons. We appreciate it.

I know our time is short. I yield back the balance of my time.

Mr. ISSA. Did the gentleman yield?

Mr. CHAFFETZ. Yes, I would be happy to yield to Mr. Issa.

Mr. ISSA. I thank the gentleman.

I want to followup a little bit on this. When you talk about the Small Business Administration not doing its job, when I came to Congress in 2001, the Small Business Administration was not doing their jobs, Government contracts were bundled, Section 3 of the HUD act and other set asides and programs were not being enforced.

One, can you give us any goods things that happened in the last 8 years? I am asking, as a Republican, was there any shining light in the last 8 years? And, since we inherited it from the previous one and it was broken, and it is clearly broken today minus whatever shining lights you put on it, tell us what we need to do to change that because I do not want this to be partisan. I want this to be about what we should do in the future.

Mr. ALFORD. Yes, I think, go back to 1993 and I think the late Ron Brown really had a handle on it and was steering the Clinton administration in the right way. Right after his death, it all fell apart and it kind of went in reverse. They put people over there who were getting bonuses by putting a cap on their work force. If they could decrease their work force, they got a big bonus at Christmas time.

So, it left the field units high and dry for manpower to where our members and other up and coming entrepreneurs in Seattle and Denver and places, had no technical assistance any more. There was no reach out there.

I think with the Bush administration, as I reflect back, I believe his Cabinet had sensitivity. Not necessarily the SBA. I do not think President Bush, it still kept going down, the revenues for the SBA.

But you look at HUD under Alphonso Jackson, who made records in procurement for women, Hispanics, African American procurements. He was up to 50 percent of HUD's procurement going to 8(a) firms and disadvantaged business firms, unheard of at the Federal level. And the only reason why he did it, he went to his procurement people and he said I want our procurement to look like America and I will be checking every 6 months. And if it does not look like America, you may not have a future. That is all he had to say. And the outreach was there.

So we started steering everybody to HUD. But he is gone now and I think HUD has gone back to its old ways.

Chairman TOWNS. The gentleman's time has expired. Would you like to request your own time?

Mr. ISSA. I think it is a good time for me to take my time, Mr. Chairman.

Chairman TOWNS. OK. All right.

Mr. ISSA. Continuing on along that line, I have looked for years at the laziness in the Federal procurement system. At DOD it is endemic. It is the same, though, in every large bureaucracy in the Federal Government. They just cannot help themselves. If they have a project to build houses on the East Coast and the West Coast, they will bundle them together and they will throw in Guam, and the Philippines and 10 other places and they will say, well, we are just looking for a vendor that can do it. And, of course, just like that Navy contract, you end up with two companies or three companies that can bond $1 billion.

This committee does not directly control the Small Business. We have a committee for that. I hate to say it does not have enough authority. I wish it was in Energy and Commerce where it really probably needs to be with an A committee. But we do have specific authority over how we go to bid. And this committee can do a lot of reform.

Let me ask you a question. If we are not getting enforcement of existing laws, what should this committee do? Who should we bring in? Who should we have before us to find out where the problem is in the bureaucracy? Because this committee owns the bureaucracy; we own all the oversight over it.

Mr. ALFORD. Yes, I received a call from an intern from Senator Burton's office and he was frustrated that he could not get data on African American procurement and Hispanic procurement at the Department of Defense. They told him it did not exist, that it was just one lump minority. I told him that was just a lie.

Cal Jenkins, Deputy Administrator now at the SBA, has been very astute and proficient in getting that data if he is allowed to get it. I have locked horns with the former SBA Administrator and asked for the data for the Gulf Region and he allowed Cal to get me that data and in 2 days I have every contract by Black contractors, Hispanic contractors, and women contractors for the Gulf rebuilding by NAIC code, all the distinctions.

It is there. The data is there. But if this committee could say, Defense, we want to see the data on small businesses, African

American, Hispanic, Native American, Asian, women and so forth, and we want it there and we want you to sign to it, that would expose a lot of opportunities.

And we could go so forth on down the line: Interior, Energy, all of the other places. If you get the data, you can see the opportunities. And if they know they have to produce the data, then they go to work.

Mr. ISSA. I am going to go to Ms. Johnson-Pata but I want to ask just one followup question or make a small comment.

Chairman Towns and I have worked together on a very bipartisan effort to try to take it one step further. We are trying to take it to where you, the consumer, you the bidder, and all the groups that oversee the Government, can see it online in real time. We are trying to get where there is a common flow to where, to be honest, where we are not looking, every group concerned is looking and sending it to it.

Ms. JOHNSON-PATA. I agree with Harry Alford about the data. But the problem is making sure the data is consistent amongst agencies. That is also a challenge.

Mr. ISSA. Common format. Common format is what you are saying.

Ms. JOHNSON-PATA. Common format and some kind of electronic portal. I know they are working on one, but it is only for the future.

Mr. ISSA. We call it XBRL here usually, or equivalent.

Ms. JOHNSON-PATA. Right. So, those are some of the issues that we have. We put together a number of recommendations about what we think that could help some of the training that is necessary for the SBA and the contract officers, etc. That would be able to be helpful.

But we have a whole list of recommendations on how to improve the entire process of government contracting and it is signed on by a number of other minority groups for those recommendations. But one of them is really the consistency of data.

Mr. ALFORD. Do I have time?

Mr. ISSA. Please, yes.

Mr. ALFORD. Do we have a law that would prevent contracting officers from going to work for some of these major prime contractors?

Mr. ISSA. No, unfortunately, the revolving door is one of our challenges on this side of the dais.

Mr. ALFORD. Yes, so the ones you have frustrations with end up being vice presidents for some of these prime contractors later.

Mr. ISSA. Not at all unusual in DOD and throughout the Government.

Let me ask one final question for all of you. What I am hearing today, and, Mr. Alford, I am hearing it most loudly from you, but I very much hear it from everyone, is that we have a problem getting what is already codified in the law, which is opportunity and investment in our inner cities and in areas of high unemployment and, in some cases, even rural areas, tribal areas, and so on.

Is it, perhaps, that we have a set of rules in a bureaucracy to enforce? And then the very people who we need to have these opportunities tend to be small entrepreneurial companies that do not

have the leverage, that cannot offer a senior vice presidency to somebody when they retire?

Is it, perhaps, for this committee to look at something in between, the ability of companies to be formed for the specific purpose of aggregating small business collectives? If that billion dollar entity, if the government-facilitated companies that were nothing more than, in fact, destined against the big boys for purposes of having some percentage, maybe not 100, but 50 or 60 percent, be to minority, disadvantaged, new companies, women owned companies, is that something that we should look at facilitating in the law so that we actually have some larger entity when the bureaucracy says we cannot break it down and your people cannot get access to it and your tribes cannot get access to it and, in fact, emerging Hispanic businesses cannot get access to it, am I hearing that we have an endemic problem over and above what we can solve from this side of the dais?

Mr. ALFORD. Yes. And that scenario certainly works at the municipal level. But Mayor Stephen Goldsmith of Indianapolis, when he was mayor, they were doing their $600 million infrastructure project, he gave the program management fees to S.R. Smoot Construction, a Black-owned firm, with the proviso that he would go out and get two partners, major partners, and that the subcontracting level would reflect the population of Indianapolis. It was done on time, he saved the city $100 million, and it had 35 percent minority participation.

Mr. ISSA. And the payroll stayed in the city.

Mr. ALFORD. Yes, sir. Banks, lawyers, everything.

Ms. MURGUÍA. I would just comment that I think that we need to be creative in terms of how we are going to respond to these growing needs. You know, for us in the Latino community, Latinas, Latina-owned businesses, are the fastest growing segment of the business community. We have a great need to respond to them in terms of how we can best address their ability to establish these businesses and to make sure that they are sustainable.

I would encourage you to look at proven, community-based organizations that can offer that direct support, can offer than guidance, can offer the ability to help navigate through the system and get them the support that they need and can help be a convener.

For many of those small businesses that are struggling and are facing the various challenges, but many of those challenges are common challenges and, if we can use and leverage community-based organizations to bring those folks together and to engage them more effectively into how they can have access to this assistance and grow their ability to succeed.

Mr. ISSA. My time has expired. Just quickly, answers, if you have them.

Ms. HASEGAWA. Just quickly I would say that, you know, the SBA's success also depends on the partnership with financial institutions to offer those loans and those products. So, I think that it also a challenge that we have been facing. So, I think that also needs to be looked at.

Ms. JOHNSON-PATA. I think there is one thing that prevents what you are talking about right now is not the incentives up front, because sometimes the contracts go out so quickly, you do not have

time to put the partnerships together that take a little bit of time to steer that. So, it needs to be incentive up front to make that happen.

I think if you look at something that, you know, the tribal governments, their ability to play that role right now, have been doing some of that.

Mr. ISSA. Alaskan Native American tribe, for example.

Ms. JOHNSON-PATA. And that is the model that I am aware of, that, you know, you ask the question of should we allow or encourage those sort of preferential organizations? Ultimately, people have to bid and win but at least they would exist.

Ms. HASEGAWA. I think that technical assistance from the SBA, also, would be very helpful because I think a lot of the small business assistance centers are not specifically targeted to particular communities of colors and for Asian Americans and Pacific Islands. There are certainly language needs there.

Ms. ISSA. Thank you, Mr. Chairman. You have been very generous with the time and this has been a very productive hearing. I appreciate your indulgence.

Chairman TOWNS. Thank you very much.

Let me just say that I really appreciate your testimony. It points out that yes, we are sending out $787 billion to the community, but we have to make certain that money is targeted in a way that is going to truly make a difference and we have to make certain that people who have been left out are now in and to be able to do whatever we can do to keep people in their homes. I think that is just so important.

And, of course, I want to thank you for your work and thank you for testimony. I look forward to working very closely with you in the days and months ahead to make certain that we are getting these resources out to the communities and that it is truly going to make a difference.

I want to thank you all.

This is the end of the hearing, Mr. Alford.

Mr. ALFORD. I have a thank you for you, sir. I owe you a thank you. You sent a letter to President Bush after Katrina, suggesting that the White House work with the National Black Chamber of Commerce on rebuilding. As a result of that letter, we got $3 billion in contracts, and I thank you.

Chairman TOWNS. Thank you very much. I appreciate your kind words. And I thank all of you for your testimony.

The committee is adjourned.

[Whereupon, at 1:05 p.m., the committee was adjourned.]

[Additional information submitted for the hearing record follows:]

EXHIBIT BOOK

HOUSE COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

CHAIRMAN EDOLPHUS TOWNS

HEARING

"The Silent Depression: How are Minorities Faring in the Economic Downturn?"

SEPTEMBER 23, 2009

"The Silent Depression: How are Minorities Faring in the Economic Downturn?"

Record Book

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Testimony of John E. Morton
Managing Director, Economic Policy
The Pew Charitable Trusts

House Committee on Oversight and Government Reform
September 23, 2009

Chairman Towns, Ranking Member Issa, and other members of the Committee: thank you for the opportunity to offer this testimony about the critically important topic of how minority populations are faring in the current economic climate.

My name is John Morton, and I am managing director of The Pew Charitable Trusts' Economic Policy Group, and project director of Pew's Economic Mobility Project.

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical, and nonpartisan approach to improve public policy, inform the public and stimulate civic life. We partner with a diverse range of donors, public and private organizations and concerned citizens who share our commitment to fact-based solutions. Pew is an independent, nonprofit public charity based in Philadelphia and Washington.

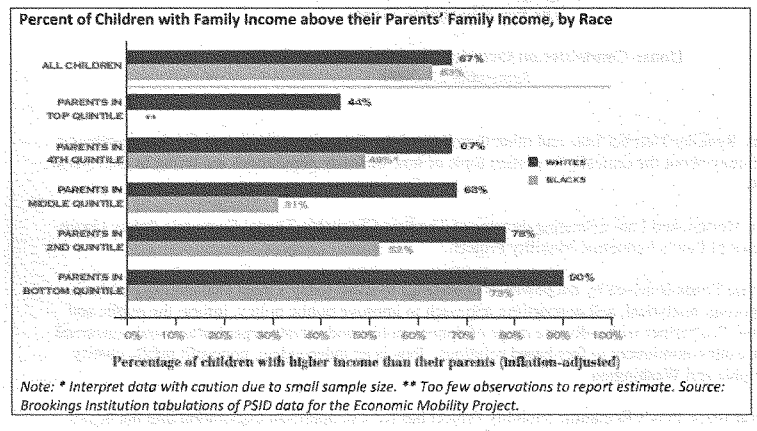
For the last several years, Pew's Economic Mobility Project has led a nonpartisan exploration into the health and status of the American Dream. Working in collaboration with leading scholars from institutions across the political spectrum---including principals from the Heritage Foundation, the Brookings Institution, the American Enterprise Institute, the Urban Institute, and the New America Foundation---the project's goal is to focus attention on the trends and factors that influence Americans' economic mobility: their ability to move up and down the income ladder within their lifetimes and across generations. With these principals, the project is compiling the best available facts, figures and trends on economic mobility, seeking to answer the question, "Is the American Dream alive and well?"

As the Committee on Oversight and Government Reform explores the condition of minorities in the current economic downturn, my testimony will provide a longer-term view about the more entrenched challenges minority populations face in moving up the economic ladder in both good and bad economic times. Pew and our partners believe that a generational perspective is essential to consider as you develop policy options to assist all Americans during this economic downturn and beyond. My comments are limited to the mobility of African Americans in contrast to whites, because the dataset our work relies on for long-term longitudinal analysis–the Panel Study of Income Dynamics (PSID)-cannot produce statistically significant results for any other minority group.

Economic mobility can be measured in both absolute and relative terms. Absolute mobility refers to whether an individual increases her earnings in absolute, inflation-adjusted dollars over the course of her lifetime, and in comparison to the previous generation. To use an analogy, this is the idea of a rising tide lifting all boats. Relative mobility refers to whether an individual's income rank, relative to her peers or relative to the previous generation, changes over time. This is the concept of boats changing position within the harbor. Pew's project

believes understanding and measuring both is critical for forming a complete picture of economic mobility trends.

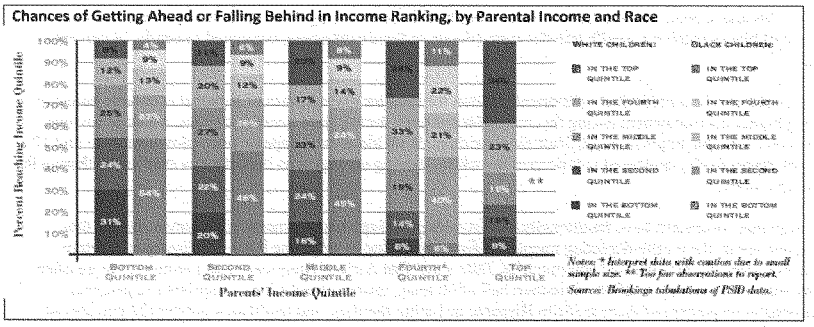
Considering both of these mobility concepts, the story of African Americans' economic mobility is mixed. In absolute, inflation-adjusted dollar terms, 63 percent of blacks have higher incomes than their parents.[1] This is comparable to the 67 percent of whites who do. Still, when data are controlled for parental income quintile (dividing parents' incomes into equal fifths across the income distribution), at each income level black adult children are less likely than their white counterparts to have higher income than their parents.



*Note: * Interpret data with caution due to small sample size. ** Too few observations to report estimate. Source: Brookings Institution tabulations of PSID data for the Economic Mobility Project.*

Moreover, while two-thirds of blacks are exceeding their parents' income, the extent of their gains is not large, and many black families' increased earnings do not translate into movement up the income ladder in relative terms. A startling 54 percent of blacks born into the bottom fifth of the income distribution remain there as adults, compared to just 31 percent of whites.[2] Perhaps more unsettling, blacks also are more likely to fall down the income ladder--- almost *half* of middle-income black children fall all the way to the bottom income quintile as adults, compared to just 16 percent of whites.

[1] Isaacs, Sawhill and Haskins, 2008.
[2] Ibid.



The project has identified a series of factors---including education, savings, family structure and neighborhoods---that influence economic mobility, and can begin to explain why blacks and whites experience such different mobility trajectories.

EDUCATION

Educational attainment is a powerful driver of upward economic mobility. Regardless of the income quintile they are born into, all individuals are more likely to both exceed their parent's incomes in absolute terms and reach the top income quintile if they have a college degree.[3]

Notably, education is particularly mobility-enhancing for low-income Americans. Adult children born into the bottom income quintile are *four times* more likely to reach the top income quintile as adults if they have a college degree.[4] Without a college degree, nearly half (45 percent) of this cohort remain stuck at the bottom.

College graduation rates among black students remain behind those of their white counterparts. While minorities as a group have increased from 16 to more than 33 percent of total enrolled college students over the last thirty years, enrollment of black students has lagged; increasing just three percentage points over this period.[5] And once enrolled, blacks drop out with much higher frequency. In 2005 the national college graduation rate for whites was 62 percent, an alarming twenty percentage points higher than the 42 percent rate for blacks.[6] As a result, in 2007 just 16 percent of black men and 21 percent of black women between the ages of 25 and 29 had a four-year degree, compared to more than 25 percent of white men and 33 percent of white women.[7]

SAVINGS AND WEALTH

Savings is also crucial to upward economic mobility and preventing downward mobility. On average, black households have just one-tenth the net worth that white households do.[8] This lack of savings and wealth not only impedes the upward mobility of black parents, but also hinders their ability to promote their children's upward mobility by, for example, making college tuition payments or providing down payment help on a house. Wealth transfers of this kind are quite common, and quite impactful; they are received by one in five

[3] Ibid.
[4] Ibid.
Haskins, Holzer, and Lerman, 2009.
[6] The Journal of Blacks in Higher Education, 2005.
[7] Butler, Beach, and Winfree, 2008.
[8] National Urban League, 2009.

households and account for one-fifth of the net worth of those receiving them at the time of transfer.[9] Only 11 percent of blacks receive a wealth transfer from friends or family members, compared to nearly 24 percent of whites.[10]

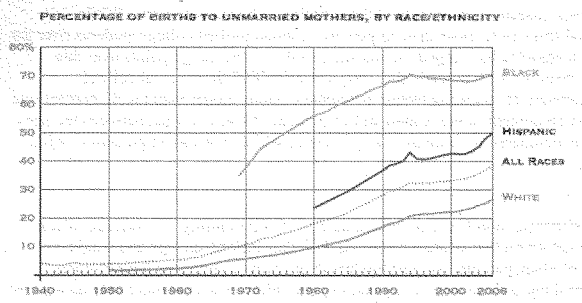
Savings can also be a particularly important cushion for families during times of personal economic hardship. Facing higher unemployment during this recession and even during good economic times, a lack of savings makes recovery that much more difficult for minorities. With black and Hispanic unemployment at 15 and 12 percent, respectively, compared to 9 percent for whites, having savings is as important as ever in weathering the economic storm.

One way that Americans have traditionally built wealth is through homeownership. However, during this economic crisis, the wealth depleting impacts of foreclosure due to subprime loans are disproportionately impacting minority families and communities. Data show that African Americans and Latinos are more often hit by subprime lending. In 2006, more than half of all loans made to blacks were subprime (52 percent), compared to 41 percent of those made to Hispanic or Latino families, and less than a quarter (22 percent) of those made to non-Hispanic white families.[11] Higher foreclosure rates across counties are also associated with higher unemployment levels, and higher proportions of high-priced mortgage loans to Hispanic and black homeowners, having significant impacts on whole communities.[12]

FAMILY STRUCTURE

The project's data also reveal that upward economic mobility is increasingly a family enterprise, and that two-income households have an easier time moving up the income ladder.[13] Yet, the percentage of single-parent families has risen dramatically for all groups, and especially among blacks. In 2006, nearly 71 percent of black children were born to single mothers, a significantly higher number than among both whites and Hispanics.[14] Single-income families are more likely to live in poverty, and have significantly less protection in the event of a negative event such as unemployment or a health incident. Black single-parent families are extremely vulnerable during the current recession.

Births to Unmarried Mothers Continue to Rise



Source: 1940-1960 data: Ventura and Bachrach, 2000; 1960-2004 data: Child Trends Databank, 2005; 2005 final birth data: Martin, and others, 2007; 2006 preliminary birth data: Brady, Martin and others, 2007.

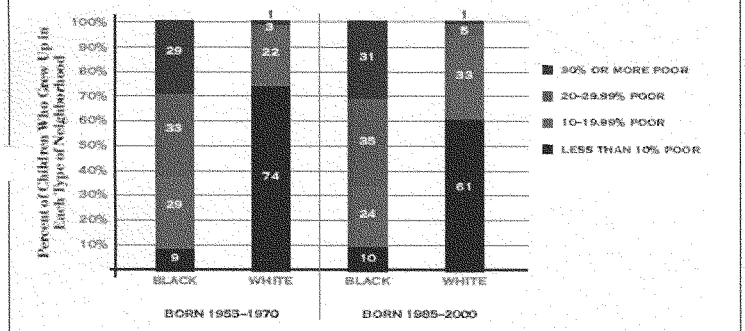
[9] Butler, Beach, and Winfree, 2008.
[10] Ibid.
[11] Schloemer et al, 2006.
[12] Kochhar et al, 2009.
[13] Sawhill and Morton, 2006.
[14] Butler, Beach, and Winfree, 2008.

NEIGHBORHOOD POVERTY

Project analysis also reveals that experiencing high neighborhood poverty throughout childhood strongly increases the risk of falling down the income ladder.[15] For children whose family income is in the top three income quintiles, spending childhood in a high-poverty neighborhood versus a low-poverty neighborhood (for example, experiencing a rate of 20 percent compared to a rate of 5 percent) raises the chances of downward mobility by 52 percent.

Notably, living in a high-poverty neighborhood is a common experience for black children. Over the course of childhood, two out of three black children (66 percent) born from 1985 through 2000 were raised in neighborhoods with at least a 20 percent poverty rate, compared to just 6 percent of white children. This disparity in neighborhood poverty rates has changed little over the previous generation. Among children born from 1955 through 1970, 62 percent of black children were raised in neighborhoods with at least a 20 percent poverty rate, compared to only 4 percent of white children. Growing up in a high-poverty neighborhood during childhood accounts for one-quarter to one-third of the racial gap in downward mobility.

Average Neighborhood Poverty During Childhood Among Black and White Children Born 1955-1970 and 1985-2000



POLICY ROAD MAP

Having generated a solid and at times provocative fact base, Pew is now leading an effort with our principals group to develop a nonpartisan policy road map to identify ways our society can improve the opportunities that all Americans have to move up the income ladder. While it is important to ensure that the rising tide lifts all boats, it is also essential to identify policy levers that allow all Americans to develop the social, human and financial capital that will enable them to climb the economic ladder. The project's policy road map will be released in November and will likely include the following ideas.

- Education, from birth to adulthood, is a critical component of economic mobility. Public policy should be focused on increasing the availability of high-quality educational opportunities for all Americans, at all ages and career stages.
- Savings help families weather economic and personal income shocks, and promote upward mobility into the next generation. Public policy should encourage all Americans, especially those at the bottom of the income ladder, to save and acquire assets.

[15] Sharkey, 2009.

- Family structure is an important element of intergenerational mobility. Policymakers should investigate removing disincentives to marriage in current public assistance programs and the tax code, and consider other ways to promote safe and healthy family formation.
- Comprehensive investments in improving education and opportunities particularly within high poverty neighborhoods could also significantly improve the economic outcomes of minority children.

Last January, in the midst of the economic downturn, the Economic Mobility Project conducted a public opinion poll on Americans' perceptions of the American Dream. African Americans were by far the most optimistic group: more than 8 in 10 said it was still possible to get ahead, even in the current economy. Pew and our partners believe that focusing attention on economic mobility and the factors that influence it will serve to remind policymakers that, no matter the economic climate, they must ensure the American Dream is within reach of all of our citizens.

Mr. Chairman, thank you again for allowing us the opportunity to present this testimony. The Committee should be congratulated for holding a hearing to explore policies to address this important issue and Pew and our colleagues stand ready to assist the Committee in any way possible.

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Understanding the Depth of Joblessness in Communities of Color

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Statement for the Record

on

The Silent Depression
How Are Minorities Faring In the Economic Downturn?

U.S. House of Representatives
Committee on Oversight and Government Reform

September 23, 2009
Rayburn 2154

The United States is in the 21st month of the most severe economic downturn since the Great Depression. All groups are experiencing a great deal of economic distress. Unfortunately, America's racial and ethnic minorities are hurting more than average.

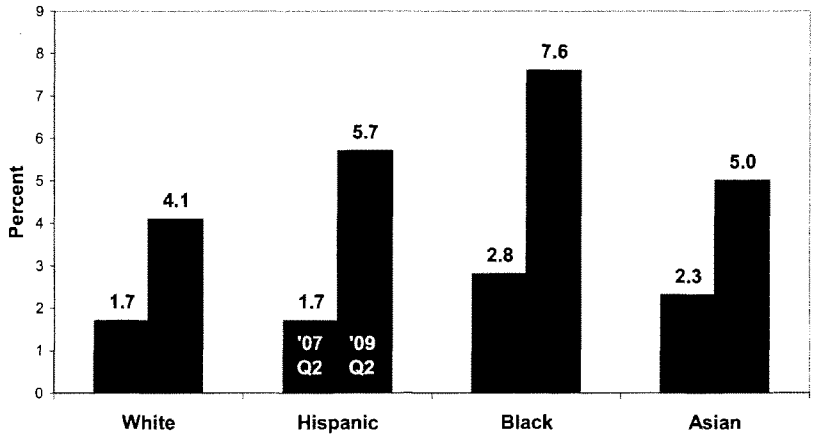
In August of this year, the white unemployment rate reached a high of 8.9 percent. However, in December of 2007, the very first month of the current recession, the African American unemployment rate was already at 8.9 percent. For the 11 months prior to the start of the recession in December 2007, the black unemployment rate averaged 8.2 percent. It was not until April of this year that the white unemployment rate reached 8 percent.

The 8.9 percent unemployment rate for whites is a very high unemployment rate. By acknowledging this fact, we are also acknowledging that even in "good" economic times, minority communities—and African-Americans in particular—suffer from a very high rate of unemployment.

While African Americans had the highest unemployment rate of 15.1 percent in August of this year, Hispanic Americans have experienced the greatest percentage-point increase in their unemployment rate. The Hispanic unemployment rate was 6.2 percent in December of 2007. It increased 6.8 percentage points to reach 13 percent in August of this year.

Typically, individuals with a bachelor's degree or higher education are fairly well insulated from the effects of a recession. In this recession, however, even the college-educated population has experienced a significant increase in their unemployment rate. In the second quarter of 2007, the unemployment rate for college-educated whites was 1.7 percent. In the second quarter of this year, it had risen to 4.1 percent. While 4.1 percent is a high rate for the college-educated in general, college-educated Hispanics, blacks and Asians all had higher second quarter unemployment rates this year. See Figure 1.

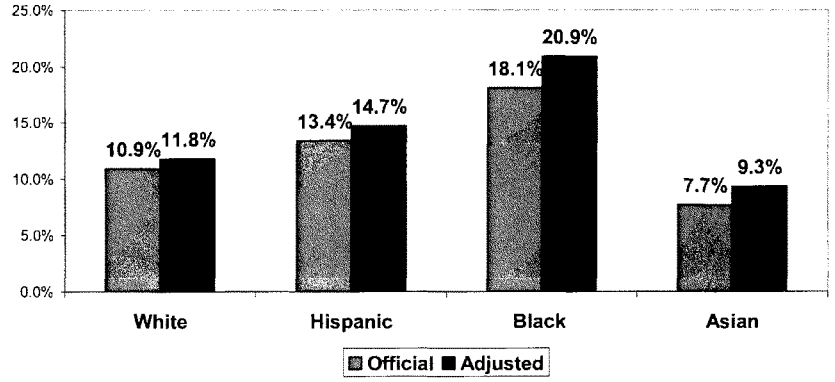
Figure 1. Quarter 2 College-Educated Unemployment Rates, 2007 and 2009



The official unemployment rates are useful for getting a general sense of how groups are faring, but in a variety of ways the official unemployment rates sometimes paint too rosy a picture. Only individuals who are actively looking for work in the four weeks prior to being surveyed are counted as unemployed. Individuals who are jobless but have temporarily given up hope of finding work are not counted as unemployed. These individuals are defined as not being in the labor force because they are not actively looking for work, even if they eventually seek work once the job market improves.

For men, who have been hit hard by this recession, and for minority men in particular, the official unemployment numbers underestimate the severity of their unemployment situation. Figure 2 presents August unemployment rate estimates that have been adjusted for the recent decline in labor force participation. Specifically, I apply the labor force participation rate from August 2007—before the recession began—to the August 2009 data. This adjustment attempts to correct for the decline in the labor participation rate that is a result of discouragement due to bad job prospects caused by the recession.

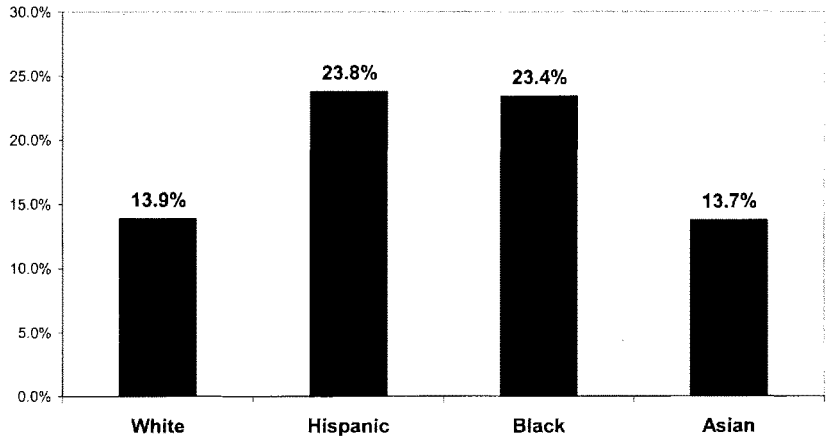
Figure 2. August 2009
Male Unemployment Rates
Adjusted for the Decline in Labor Force
Participation from 2007 to 2009



The adjusted unemployment rates are about 1 percentage point higher for white men, about 1.5 percentage points higher for Hispanic and Asian men, and about 3 percentage points higher for black men. The adjusted unemployment rates suggest that one-in-five black men who would like to work are not able to find work.

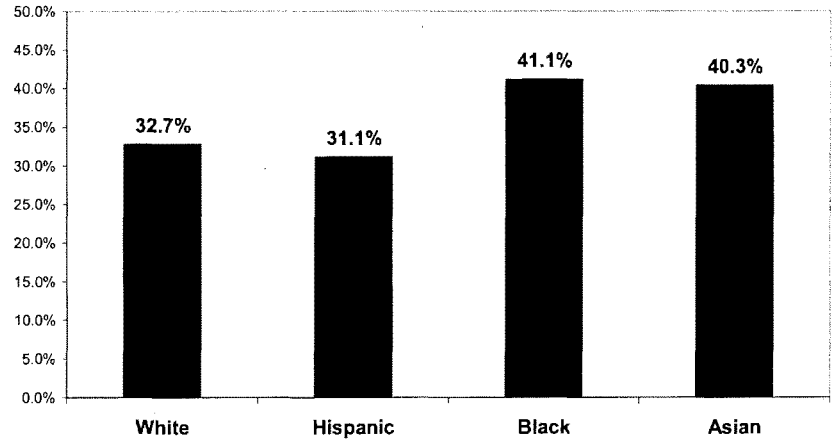
An alternative measure to the unemployment rate is the *under*employment rate. The underemployment rate adds to the unemployed those who want a job but have recently given up looking for work and those who would like to work full-time but only have part-time work. Figure 3 shows the August underemployment rates by race. Understandably, these rates are all much higher than the unemployment rates. In underemployment, Hispanics and African Americans both exceed a rate of 20 percent. See Figure 3.

Figure 3. August 2009 Underemployment Rates



Another useful measure of the current economic hardship is the long-term unemployment rate. This rate is the percent of the unemployed who have been unemployed for more than six months. About 30 percent of white and Hispanic unemployed have been unemployed for more than six months. More that 40 percent of black and Asian unemployed are in this situation. See Figure 4.

Figure 4. August 2009 Long-Term Unemployment Rates



On nearly all of the measures reviewed, America's communities of color are significantly worse off than the white population. While everyone is suffering during this Great Recession, even in the Great Recession some communities face more acute hardships.

The truly sad part is that some communities face high unemployment and high rates of general economic distress even in "good" economic times. In the second part of this statement, I will offer an outline of policy ideas to address the short-term and long-term economic needs of communities of color.

Addressing the Short-Term Economic Needs of Communities of Color

All Americans are experiencing severe economic hardship that requires government intervention. As Figure 4 shows, a large portion of those unemployed have been unemployed for a long period of time. Many of the unemployed will lose their unemployment insurance soon without an additional extension of unemployment benefits. Unemployment insurance needs to be extended again, and the unemployment provisions in the American Recovery and Reinvestment Act should also be renewed.

From 2007 to 2008, the median household income fell for all racial groups. Again, the hardship was not equally felt. In percentage terms, Hispanic and Asian households showed the largest income losses, 5.6 percent and 4.4 percent respectively (see Table 1). Household incomes will likely fall an even greater amount from 2008 to 2009, since the recession has been much worse in 2009.

To address the immediate distress of declining household incomes, there should be continued increases in the minimum wage. Hispanic and African-American workers are disproportionately low-wage workers as is suggested by their low median household incomes (see Table 1). These workers also disproportionately benefit from increases in the minimum wage.

Table 1. Median Household Income 2007 and 2008 (2008 dollars)

	White	Hispanic	Black	Asian
2007	$57,030	$40,165	$35,219	$68,643
2008	$55,530	$37,913	$34,218	$65,637
Percent Change	-2.6%	-5.6%	-2.8%	-4.4%

Some argue that increases to the minimum wage hurt low-wage workers by making it too expensive for employers to keep them employed. A number of recent studies, however, have failed to find any significant negative effect. This non-effect is likely due to the fact that low-income households spend any additional income they receive. This increased spending also increases the demand for labor thereby counteracting any decreases in demand for labor caused by increased wages (Filion 2009).

The Temporary Assistance for Needy Families (TANF) policies and procedures need to be revised. A recent *New York Times* analysis (DeParle 2009) showed that states were reducing the number of families receiving TANF while their unemployment rates and their enrollment numbers for the Supplemental Nutrition Assistance Program both increased. TANF enrollment should expand during recessions, not contract.

Addressing the Long-Term Economic Needs of Communities of Color

Even in "good" economic times, minority communities suffer from high unemployment rates. There should be a national goal to have the African-American and Hispanic-American unemployment rates equal the white rate. To accomplish this goal, job creation efforts need to be more effectively targeted to communities experiencing high unemployment.

Just as the national unemployment rate varies by racial and ethnic group, so does the state and local unemployment rates. For example, in 2006 before the recession, the unemployment rate for blacks (16-64 years old) in Chicago was 18.5 percent, but it was only 5 percent for whites. Job creation efforts should target residents of communities with persistently high unemployment rates. On job creation projects, a percent of the total work hours should be provided by individuals in high-unemployment communities. If there are skill deficiencies among individuals in these high-unemployment communities,

projects should provide pre-apprenticeship and Registered Apprenticeship programs for these individuals.

"Green jobs" are a potentially promising strategy to address the long-term job needs in communities of color. The Green Construction Careers Demonstration Project and the Green Jobs Act should be supported to assess the potential benefits of the "green economy" to communities of color.

Greater investment in maintaining, expanding and modernizing urban public transportation systems will provide broad social benefits. Public transportation is an old "green" investment because it reduces the consumption of fossil fuels. Well-designed, modern public transportation systems also improve air quality and reduce traffic congestion. Good public transportation systems have two important additional benefits. They increase poor, urban minorities' access to jobs, and they provide jobs as transportation service providers to urban minority residents. This type of infrastructure investment is especially beneficial to communities of color.

Research shows that racial and ethnic minorities continue to face discrimination in the labor market. Audit or paired-tester studies where white and nonwhite "testers" present similar job qualifications in similar ways to employers consistently show an employer preference for white job applicants (Austin 2009). This year Steve Vogel of the *Washington Post* reported that the "U.S. Equal Employment Opportunity Commission...is facing its largest caseload in at least a quarter-century with sharply diminished staffing and resources" and "morale problems and an overwhelmed workforce."

To address the racial and ethnic discrimination in the labor market the EEOC and the Office of Federal Contract Compliance Programs should be adequately staffed to address their caseloads. The agencies should also be encouraged to seek new and creative ways to address discrimination in the post-Civil-Rights era which tends to be subtle and hidden.

Data Sources

National unemployment, underemployment and long-term unemployment rates are derived from the author's analysis of Bureau of Labor Statistics' Current Population Survey data. Median household income figures are from the Census Bureau. Chicago unemployment rates are derived from the author's analysis of the Census Bureau's American Community Survey data. For additional details, contact Dr. Algernon Austin at aaustin@epi.org.

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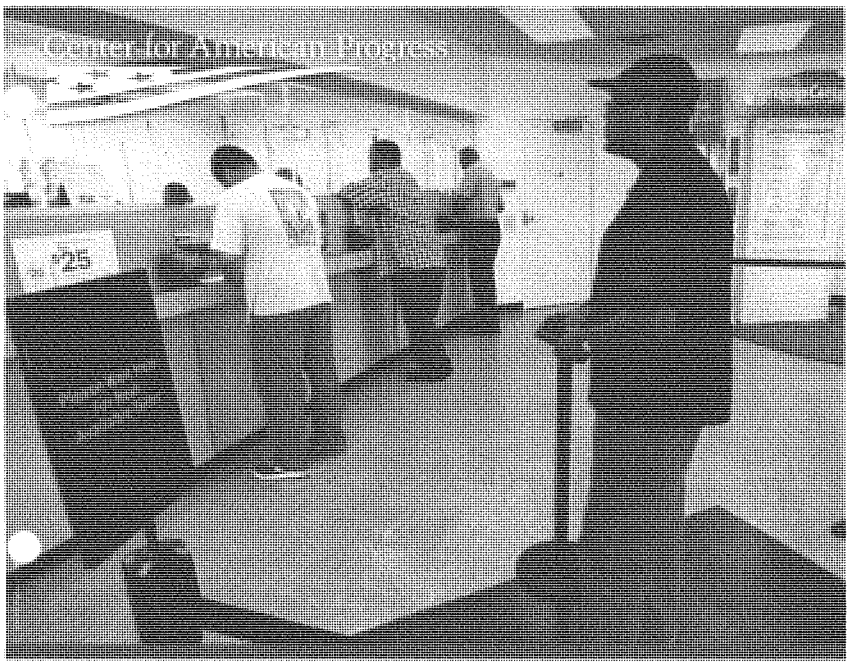

Unequal Opportunity Lenders?

Analyzing Racial Disparities in Big Banks' Higher-Priced Lending

Andrew Jakabovics and Jeff Chapman September 2009

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Analyzing Racial Disparities in Big Banks' Higher-Priced Lending

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Introduction and summary

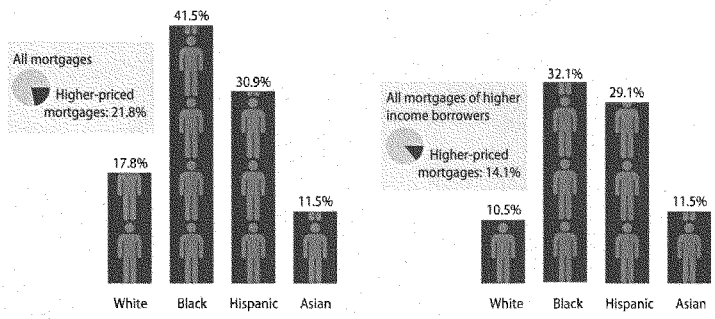
There's a common perception that subprime loans originated solely from now-shuttered mortgage firms, but many of the nation's largest banks and their current subsidiaries were quite active in doling out these higher-priced mortgages. The 14 systemically significant banks and current subsidiaries we analyze in this paper—using data from the Home Mortgage Disclosure Act, which requires extensive loan level disclosures from most mortgage originators—were responsible for originating more than one of every three higher-priced mortgages in the nation at the height of the housing bubble in 2006.[1] These banks and current subsidiaries together originated more than 876,000 higher-priced first mortgages—defined by the Federal Reserve as having an annual percentage rate at least three percentage points higher than a Treasury security of the same maturity—in 2006 alone.

Overall, 17.8 percent of white borrowers were given higher-priced mortgages when borrowing from large banks in 2006, yet 30.9 percent of Hispanics and a staggering 41.5 percent of African Americans got higher-priced mortgages. Only 11.5 percent of Asians got higher-priced mortgages.

Valid underwriting criteria would lead institutions to offer higher interest rates to riskier borrowers. But that leads to the question of whether low-risk borrowers were also driven toward higher-priced mortgages. We found that, in 2006, 14.1 percent of households earning more than twice their area's median income, nearly all of whom reported six-figure incomes, were given higher-priced mortgages. Were there in fact legitimate underwriting reasons that would lead these banks to issue higher-priced loans to nearly one in seven high-income applicants?

This question is sharpened when asked in the context of disparate mortgage pricing across racial and ethnic lines. Among high-income borrowers in 2006, African Americans were three times as likely as whites to pay higher prices for mortgages—32.1 percent compared to 10.5 percent. Hispanics were nearly as likely as African Americans to pay higher prices for their mortgages at 29.1 percent. We would welcome explanations based solely on legitimate underwriting criteria to clarify why the incidence of higher-priced mortgages among high-income minority borrowers was three times that for white borrowers with similar incomes.

Share of mortgages lent in 2006 by 14 major banks and current subsidiaries that were higher-priced, by race/ethnicity



	All borrowers					High-income borrowers only				
	All	White	Black	Hispanic	Asian	All	White	Black	Hispanic	Asian
All	21.8%	17.8%	41.5%	30.9%	11.5%	14.1%	10.5%	32.1%	29.1%	11.5%
Bank of America	15.1%	11.4%	28.1%	21.6%	8.5%	11.1%	8.2%	21.8%	21.2%	9.4%
Wells Fargo	15.5%	13.8%	33.2%	16.4%	5.4%	6.6%	5.6%	17.2%	10.5%	3.8%
JPMorgan Chase	22.0%	16.4%	47.5%	36.6%	12.0%	15.8%	11.0%	44.1%	37.6%	12.1%
Citigroup	55.6%	51.2%	76.6%	71.3%	23.9%	35.7%	27.6%	70.3%	73.5%	22.2%
PNC Financial Services	50.2%	42.6%	67.8%	69.8%	44.7%	45.5%	35.3%	71.9%	74.5%	48.4%
GMAC/Ally Bank	16.1%	13.8%	31.0%	20.5%	9.1%	10.3%	8.2%	18.5%	18.4%	7.8%
SunTrust	6.5%	5.8%	11.4%	9.0%	5.4%	3.8%	3.0%	8.9%	8.3%	4.0%
MetLife (First Tennessee)	9.1%	7.8%	19.0%	13.2%	7.1%	5.9%	5.0%		8.7%	12.4%
Capital One Financial Corp.	20.5%	19.0%	27.0%	21.9%	16.3%	18.0%	15.9%	25.3%	21.3%	16.3%
U.S. Bancorp	15.2%	15.5%	22.4%	13.9%	8.0%	10.3%	10.1%	17.8%	12.6%	8.2%
Regions Financial Corp.	67.7%	59.1%	81.9%	86.3%	77.5%	56.1%	47.0%	73.5%	84.1%	
BB&T	10.8%	10.0%	18.0%	12.3%	3.4%	7.8%	7.5%			
Fifth Third Bancorp	4.6%	4.1%	8.7%	13.7%	2.3%	2.5%	2.4%			
KeyCorp	47.8%	26.2%	45.6%			21.7%	10.3%			

Solid underwriting takes into account more than just a household's income. Credit scores, assets, loan-to-value ratios, and other indebtedness all influence a borrower's ability to repay the mortgage, and riskier borrowers are reasonably offered more costly loans to offset the risk. Some portion of the racial gap is likely the result of differing household incomes, credit scores, loan-to-value ratios, and other underwriting criteria. Nevertheless, we are skeptical that these factors fully explain gaps of these magnitudes, particularly because the gap persists across the income scale.

These data raise important questions about these banks' lending practices. We cannot say based on the HMDA data at what level the seemingly discriminatory practices originated—whether brokers located in predominantly minority communities steered clients into higher-priced mortgages, if banks' subprime lending units actively targeted minorities, or if it is rooted in other practices. While fair lending laws and the Fair Housing Act have outlawed explicitly discriminatory lending practices, we have identified a clear pattern of disparate outcomes based on race for which large financial institutions should shoulder some responsibility.

These banks all have been recipients of massive government assistance over the past year, and the largest of them have all committed to participate in government-backed foreclosure prevention programs. They are all crucial to restoring the mortgage market to get the housing market back on its feet.

It is essential that the patterns described in this report be investigated by the special inspector general for TARP to ensure that these taxpayer-supported benefits are not subsidizing discriminatory practices. It is also necessary that as these critical institutions move out from government support, they and the rest of the mortgage finance industry do not behave in unfair ways. Systemic problems in the industry—namely unfair lending practices—should be addressed immediately.

Our key recommendations in this paper are:

- No further repayments should be allowed to TARP recipients until the special inspector general for TARP gives a passing grade on fair lending practices.

- Establish an independent regulator focused on consumer protections such as the independent Consumer Financial Protection Agency the Obama administration has recommended to prevent recurrence of banking regulators' failures to protect consumers from unfair lending practices.

Key issues for financial regulation

Through our analysis of major banks' mortgage practices we identified two issues that policymakers and regulators should focus on going forward. We will briefly explain these before proceeding to the analysis of past lending patterns.

Ensuring consumer protection

The racial disparities we identified call into question the adequacy of the current regulatory system to actively police civil rights laws, and they highlight the need for a strong, independent regulator specifically tasked with consumer protection. The Obama administration has proposed an independent Consumer Financial Protection Agency to fill this role.

Simply put, consumer protection has always taken a back seat to safety and soundness among financial regulators. Indeed, it took over 14 years for the Federal Reserve to follow a congressional mandate to issue guidance on unfair lending practices.[2] And if in the run-up to the greatest financial crisis in 75 years regulators were slow to use their authority for safety and soundness purposes, it should come as little surprise that racial disparities in higher-priced lending have persisted.

Congress will begin debating financial regulatory reform over the coming months, likely working off the framework developed by the Obama administration in its June white paper, "Financial Regulatory Reform: A New Framework." One of the central tenets of the framework is protecting consumers and investors from financial abuse. Indeed, the administration argues, "Consumer protection is a critical foundation for our financial system."[3]

To see how bank regulators view consumer protection issues, consider Federal Reserve Bank Chair Ben Bernanke's recent letter in support of keeping consumer protection under the Federal Reserve's umbrella: "Clearly, a bank that errs in its dealings with consumers, either legally or with respect to good judgment, carries the risk of reputational damage, a matter of concern to prudential supervisors."[4]

In our opinion, spillovers from reputational damage are too weak of a motivation for addressing the enforcement of basic rights.

Fair lending with taxpayer money

While stronger consumer protection can help prevent violations of fair lending laws in the future, we must also focus on banks' current lending practices, particularly given the fact that taxpayer funds have been used to shore up these institutions and are directly and indirectly the source of liquidity for new lending activities.

The collapse of nonbank mortgage lending has led to a greater concentration of lending activity among a smaller number of banks. Moving forward, it will be important for the public to know whether these banks will continue the trend of loaning at higher prices to minorities across the income scale—particularly now that they are responsible for a significantly larger market share of new mortgages.

The top four banks—Bank of America (including Countrywide), Wells Fargo (including Wachovia), JP Morgan Chase (including Washington Mutual), and Citibank—collectively held a 54-percent market share of the estimated $1.75 trillion in new home loans in 2008.[5] This marks a significant increase over 2006, when the same institutions—again including their current subsidiaries and acquisitions—held less than a 30-percent market share.

Collectively, the systemically significant institutions in this report were the recipients of 43 percent of the bailout funds disbursed through the Troubled Asset Relief Program, or TARP.[6] As these banks seek to repay the TARP money, we should look critically at their lending behaviors and investigate whether they have been good stewards of public funds.

Twenty-one banks have fully repaid their TARP funds to date.[7] The federal government should not give any additional banks the green light to repay their public debts without a passing grade from the special inspector general for TARP. Recent Federal Financial Institutions Examination Council guidance on fair lending examinations lists "disparities in the incidence or rate spreads of higher-priced lending by prohibited basis characteristics [such as race or ethnicity][8] as reported in the HMDA data"[9] as an indicator of potential discrimination and should be the basis for evaluation by TARP's inspector general.

Institutions have a strong incentive to receive a passing grade because the bulk of the existing public investment in these institutions is in the form of senior-preferred stock that pays a 5-percent dividend annually. That dividend rises to 9 percent after five years. Banks with failing grades would need to modify or redo their unfair higher-priced mortgages before being allowed to eliminate their dividend payments.

TARP as a whole has already been criticized for privatizing profits and socializing losses. If we allow public money to go toward steering people into high-cost mortgages and other violations of fair lending laws, we will allow the large banks to reap the profits of those activities while leaving taxpayers to suffer the costs as those loans fail and more homes flood the market.

Examining mortgage pricing by major banks

We analyzed mortgage pricing by race and ethnicity at the nation's 14-largest mortgage-lending banks.[10] Each of these banks is a significant part of the national economy and each was subject to the federal government's "stress test" earlier this year. These banks—including their current subsidiaries—originated 43.9 percent of all mortgages and 35 percent of higher-priced mortgages in 2006 (See Table 1). We further analyzed the five banks with the most mortgage originations. These five account for 34.8 percent of all mortgages and 29 percent of all higher-priced mortgages originating in 2006.

Some major banks, such as Wells Fargo, were active in the higher-priced mortgage market in 2006. Others, such as Bank of America and PNC, were less active in 2006, but have acquired major subprime lenders in the interim. Acquisitions have been included in the totals for lending activity in 2006, but they remain broken out separately in our bank-by-bank analysis below.

Number and percent of loans and higher-priced loans by 14 major banks

In 2006 these banks, including current subsidiaries, originated 43.9 percent of all mortgages and 35 percent of higher-priced mortgages.

	Number of loans	Number of higher cost loans	Percent of loans	Percent of higher cost loans
All	4,016,934	876,151	43.9%	35.0%
Bank of America	1,178,538	178,529	12.9%	7.1%
Wells Fargo	898,261	139,073	9.8%	5.6%
JPMorgan Chase	571,274	125,918	6.2%	5.0%
Citigroup	277,552	154,357	3.0%	6.2%
PNC Financial Services	253,995	127,563	2.8%	5.1%
GMAC/Ally Bank	211,771	34,193	2.3%	1.4%
SunTrust	153,658	10,050	1.7%	0.4%
MetLife (First Tennessee)	102,647	9,363	1.1%	0.4%
Capital One Financial Corp.	97,677	20,025	1.1%	0.8%
U.S. Bancorp	84,941	12,901	0.9%	0.5%
Regions Financial Corp.	74,625	50,556	0.8%	2.0%
BB&T	48,509	5,249	0.5%	0.2%
Fifth Third Bancorp	50,885	2,354	0.6%	0.1%
KeyCorp	12,601	6,020	0.1%	0.2%

To analyze the lending practices of the nation's largest mortgage-lending banks, we used data mandated by the federal Home Mortgage Disclosure Act, or HMDA, which requires extensive annual disclosures from most mortgage lending institutions. The resulting data is made available to the public and includes information about the loan, property, and borrower.[11]

The HMDA data also identifies higher-priced loans. The Federal Reserve classifies a mortgage as "higher priced" when the difference between the loan's annual percentage rate and a Treasury security of comparable maturity is above three percentage points for a first-lien mortgage. (The APR used in this calculation estimates the total cost of the loan over the contract term of the mortgage, as opposed to simply the initial contract interest rate. However, it likely understates the impact of upfront fees on the cost of subprime loans since the average life of such loans is far shorter than the contract term.)

Lenders are able to use variations in mortgage pricing to account for the different levels of risk associated with various borrower characteristics. However, the mortgage market in recent years has been marked by misleading, abusive lending practices that have included unfair pricing.

One of the most pervasive practices highly correlated with subprime lending was prepayment penalties that effectively locked borrowers into high-cost loans by making it prohibitively expensive to refinance into lower-cost mortgages. Incentive payments from lenders to get borrowers into higher-cost mortgages often meant that borrowers were never even offered lower-cost mortgages when they applied for loans.

As an example, *The New York Times* reported, "Countrywide's entire operation, from its computer system to its incentive pay structure and financing arrangements, is intended to wring maximum profits out of the mortgage lending boom no matter what it costs borrowers, according to interviews with former employees and brokers who worked in different units of the company and internal documents they provided."[12]

Overall, 21.8 percent of the mortgages originating with the 14 banks considered here (including their current subsidiaries) were higher priced. An analysis of mortgage pricing by the major banks and their subsidiaries shows a staggering gap in most cases between the prices paid by white and Asian borrowers and those paid by African-American and Hispanic borrowers. Only 17.8 percent of white borrowers and 11.5 percent of Asians paid higher prices, yet over 40 percent of African Americans and more than 30 percent of Hispanics paid higher prices.

The HMDA data is limited in that it doesn't include key variables that bear on loan pricing such as credit scores and loan-to-value ratios, or the percentage of the home's value borrowed from the bank. These variables certainly play a role, but the size of this gap may not be explainable by factors that should appropriately be considered in mortgage pricing. This is consistent with previous research that controlled for such objective determinants and found persistent disparities.[13]

White households in the aggregate have higher incomes than either African-American or Hispanic households, and we have attempted to account for these differences by analyzing higher-income borrowers separately. Again, we do not have detailed information on borrowers' credit histories, so we are using high income as a proxy for the ability to repay the mortgage. We identified high-income borrowers as those households earning at least twice the median income for the metropolitan area where they purchased property. For properties outside of a metropolitan area, the statewide median income for nonmetropolitan areas was used.[14] These high-income households' median incomes were in excess of $100,000 in each state.

Distressingly, the gap in higher-priced lending by race and ethnicity persists across the income scale. And the racial disparities were drastic even among high-income borrowers. Over 30 percent of high-income African Americans and 29.1 percent of high-income Hispanics paid higher prices, compared to 14.1 percent of whites and 11.5 percent of Asians with incomes at least twice the area median.

The fact that such gaps existed even among borrowers with six-figure incomes raises a red flag and should clearly put the onus on lenders to provide a detailed explanation of this pervasive phenomenon if they were not engaging in unfair lending practices.

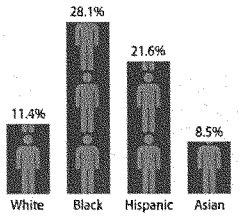
The following is a more detailed look at the five banks with the most mortgage originations in 2006. These five institutions and their subsidiaries made up 34.8 percent of all mortgages and 29 percent of all higher-priced mortgages originating in 2006. Closer scrutiny of these banks reveals African-American and Hispanic borrowers tended to receive higher-priced loans more often than whites or Asians.

Bank of America

Bank of America essentially stopped originating subprime loans in 2001. Less than 3 percent of loans originating through Bank of America—as it was structured at the time—were higher priced in 2006. Among high-income borrowers, fewer than 1 percent were issued higher-priced mortgages. Among high-income African Americans and Hispanics, 1.9 percent and 1.5 percent, respectively, had higher-priced mortgages in 2006.

In 2007, Bank of America acquired LaSalle Bank,[15] which also had a low share of higher-priced loans. Then, in 2008, it purchased Countrywide,[16] the largest mortgage originator in the country in 2006 and the largest originator of higher-priced loans. This consolidation of the third-largest originator and the largest originator (along with other acquisitions by both companies) resulted in a lender that accounted for nearly 12 percent of first mortgages originating in 2006.

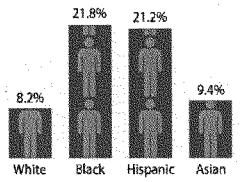
Share of mortgages lent by Bank of America and current subsidiaries in 2006 that were higher-priced, by race/ethnicity



	All	White	Black	Hispanic	Asian
All	15.1%	11.4%	28.1%	21.6%	8.5%
Bank of America	2.2%	2.2%	3.3%	2.6%	0.9%
LaSalle	1.3%	1.1%	6.9%	2.1%	0.2%
Countrywide	22.6%	17.5%	39.6%	30.5%	13.7%
Homebanc	7.3%	5.2%	14.0%	12.3%	

Authors' analysis of HMDA data.

Share of mortgages lent by Bank of America and current subsidiaries in 2006 that were higher-priced, by race/ethnicity, higher income borrowers only



	All	White	Black	Hispanic	Asian
All	11.1%	8.2%	21.8%	21.2%	9.4%
Bank of America	0.8%	0.7%	1.9%	1.5%	0.9%
LaSalle	0.3%				
Countrywide	17.4%	13.6%	29.6%	27.1%	14.5%
Homebanc	4.7%				

Authors' analysis of HMDA data.

Countrywide mortgages showed stark pricing distinctions by race and ethnicity. Even among high-income borrowers, African Americans were more than twice as likely as whites to pay higher prices (29.6 percent compared to 13.6 percent). The gap between Hispanics and whites was nearly as wide, with 27.1 percent of Hispanics paying higher prices.

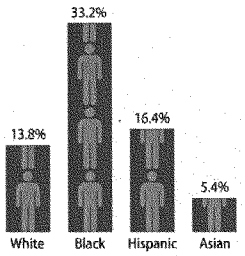
Countrywide now does business as Bank of America Home Loans. It's unclear whether the culture of Countrywide pervades the reconstituted business.

Wells Fargo

The gap in mortgage pricing between white and African-American borrowers originating loans through Wells Fargo (not including the since-acquired Wachovia) was among the largest in 2006.

Wells Fargo Financial is the subprime lending arm of Wells Fargo. Wells Fargo Financial only accounted for 8.4 percent of all Wells Fargo loans, but it issued one-third of Wells Fargo's higher-priced loans. African-American and Hispanic borrowers were more likely to receive loans through Wells Fargo Financial than whites and Asians. Across Wells Fargo, African-American borrowers were particularly likely to pay higher prices—47.3 percent compared to 16.7 percent of white borrowers.

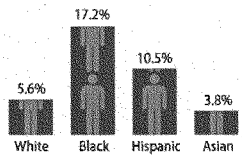
Share of mortgages lent by Wells Fargo and current subsidiaries in 2006 that were higher-priced, by race/ethnicity



	All	White	Black	Hispanic	Asian
All	15.5%	13.8%	33.2%	16.4%	5.4%
Wells Fargo	19.8%	16.7%	47.3%	26.0%	6.0%
Wachovia	6.4%	6.2%	10.1%	6.4%	3.9%

Authors' analysis of HMDA data.

Share of mortgages lent by Wells Fargo and current subsidiaries in 2006 that were higher-priced, by race/ethnicityhigher income borrowers only



	All	White	Black	Hispanic	Asian
All	6.6%	5.6%	17.2%	10.5%	3.8%
Wells Fargo	7.9%	6.4%	26.2%	16.3%	4.0%
Wachovia	3.8%	3.3%	6.3%	5.1%	3.3%

Authors' analysis of HMDA data.

The racial/ethnic disparity in higher-priced mortgages is even more pronounced among high-income borrowers. Twenty-six percent of high-income, African-American borrowers received higher-priced mortgages from Wells Fargo, a rate more than four times that of high-income whites. High-income Hispanics were nearly three times as likely to receive higher-priced mortgages.

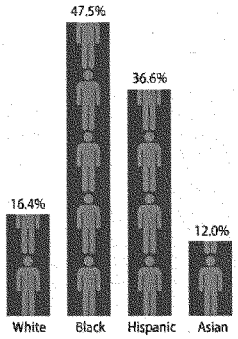
Wells Fargo—the second-largest originator in 2006—purchased Wachovia—the fourth-largest originator in 2006—in December 2008.[17] Wachovia was much less involved in the higher-priced market in 2006 than Wells Fargo. Racial/ethnic differences existed at Wachovia, but they were less pronounced.[18]

JP Morgan Chase

JP Morgan Chase, like other major banks in 2006, was much more likely to charge higher prices to African-American and Hispanic borrowers than whites and Asians, even among high-income borrowers. Over two-thirds of JP Morgan Chase's higher-priced lending was done through a subprime arm—Chase Manhattan Bank.

Washington Mutual was seized in September 2008 and placed into the receivership of the Federal Deposit Insurance Corporation, making it the largest bank failure in the nation's history.[19] It reopened the next day as a subsidiary of JPMorgan Chase and is currently in the process of being converted fully to the Chase brand.

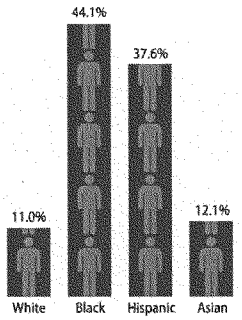
Share of mortgages lent by JP Morgan Chase and current subsidiaries in 2006 that were higher-priced, by race/ethnicity



	All	White	Black	Hispanic	Asian
All	22.0%	16.4%	47.5%	36.6%	12.0%
JPMorgan Chase	19.6%	15.7%	39.2%	28.5%	8.0%
Washington Mutual	24.1%	16.9%	56.9%	42.3%	13.7%
Bear Stearns	36.9%	32.0%	42.5%	41.5%	36.7%

Authors' analysis of HMDA data.

Share of mortgages lent by JP Morgan Chase and current subsidiaries in 2006 that were higher-priced, by race/ethnicity, higher income borrowers only



	All	White	Black	Hispanic	Asian
All	15.8%	11.0%	44.1%	37.6%	12.1%
JPMorgan Chase	9.8%	7.6%	26.5%	22.0%	4.3%
Washington Mutual	19.4%	13.2%	55.2%	46.1%	15.5%
Bear Stearns	31.9%				

Authors' analysis of HMDA data.

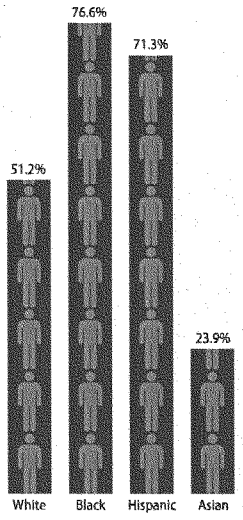
Washington Mutual was heavily involved in higher-priced lending, in particular through its subsidiary Long Beach Mortgage. Eighty-seven percent of WaMu's higher-priced loans were originated through Long Beach. Among the banks considered in this analysis, the racial/ethnic gap was largest at Washington Mutual, with fully 56.9 percent of African Americans and 42.3 percent of Hispanics paying higher prices, compared to 16.9 percent of whites. The gap was even wider among high-income borrowers, with African Americans paying high prices 55.2 percent of the time and Hispanics 46.1 percent of the time, compared to 13.2 percent for white borrowers.

JP Morgan Chase was the fifth-largest originator in 2006. WaMu was the sixth.

Citigroup

Sixty-seven percent of African Americans paid higher prices for loans originating through Citigroup in 2006, compared to 38.7 percent of whites, 43.8 percent of Hispanics, and only 8.2 percent of Asians. Higher-priced loans were concentrated within certain divisions

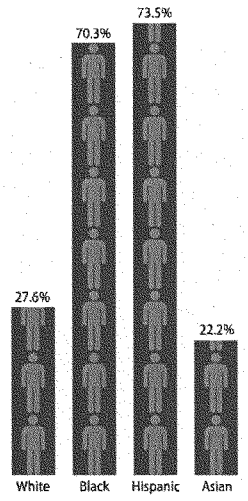
Share of mortgages lent by Citigroup and current subsidiaries in 2006 that were higher-priced, by race/ethnicity



	All	White	Black	Hispanic	Asian
All	55.6%	51.2%	76.6%	71.3%	23.9%
Citigroup	40.3%	38.7%	67.3%	43.8%	8.2%
Argent/AMC	89.5%	88.8%	91.5%	90.9%	86.7%

Authors' analysis of HMDA data.

Share of mortgages lent by Citigroup and current subsidiaries in 2006 that were higher-priced, by race/ethnicity, higher income borrowers only



	All	White	Black	Hispanic	Asian
All	35.7%	27.6%	70.3%	73.5%	22.2%
Citigroup	7.6%	7.1%	32.9%	16.2%	2.1%
Argent/AMC	89.4%	87.8%	92.4%	91.1%	89.3%

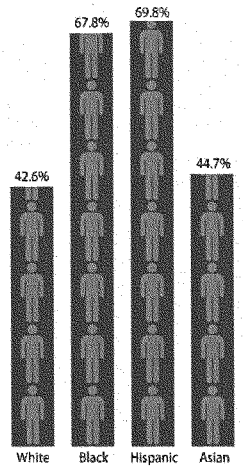
Authors' analysis of HMDA data.

of the bank, with 91.1 percent originating through CitiFinancial, CitiCorp Trust Bank, and CitiCorp Home Equity.

Among high-income Citigroup borrowers, 7.1 percent of whites paid higher prices for loans in 2006, compared to 32.9 percent of African Americans and 16.2 percent of Hispanics.

Citigroup purchased Argent and AMC in 2007, two subsidiaries of ACC Capital Holdings.[20] Ameriquest, another subsidiary of ACC, was closed down. Nearly 90 percent of Argent/AMC loans were higher priced, with little difference across races. Even high-income borrowers with Argent/AMC were issued higher-priced mortgages.

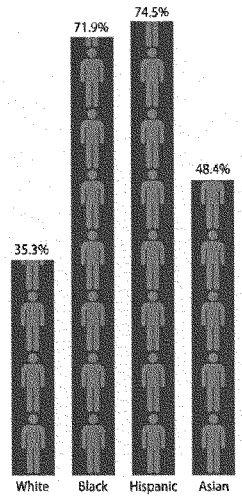
Share of mortgages lent by PNC and current subsidiaries in 2006 that were higher-priced, by race/ethnicity



	All	White	Black	Hispanic	Asian
All	50.2%	42.6%	67.8%	69.8%	44.7%
PNC Financial Services	6.8%				
National City	51.0%	43.4%	68.6%	70.1%	45.1%

Authors' analysis of HMDA data.

Share of mortgages lent by PNC and current subsidiaries in 2006 that were higher-priced, by race/ethnicity, higher income borrowers only



	All	White	Black	Hispanic	Asian
All	45.5%	35.3%	71.9%	74.5%	48.4%
PNC Financial Services	2.1%				
National City	46.0%	35.8%	72.1%	74.6%	48.7%

Authors' analysis of HMDA data.

PNC

PNC was a minor player in the national mortgage market in 2006. But PNC purchased Midwestern regional bank National City in 2008, which was the seventh-largest mortgage originator in 2006 and the third-largest originator of higher-priced loans. The purchase of National City makes PNC one of the largest banks in the nation.[21]

Mortgage pricing at National City was lopsided by race and ethnicity. Among all borrowers, 43.4 percent of whites paid higher prices compared to 68.6 percent of African Americans and 70.1 percent of Hispanics. The share of whites paying higher prices falls to 35.8 percent when looking specifically at high-income borrowers, while the share of African Americans and Hispanics was over 70 percent (72.1 percent and 74.6 percent respectively).

Conclusion

This analysis of lending patterns by bank and race indicates that significant disparities exist in the prevalence of high-cost lending between minorities and whites. These differences persist even when focusing solely on high-income borrowers. Our findings lead us to argue in favor of close federal scrutiny of current lending practices to ensure that no violations of fair lending laws are taking place.

Discriminatory practices are inherently illegal and immoral, and the affront is compounded when public funds are used for those purposes. Therefore, no further repayments should be allowed to TARP recipients, with dividend obligations accruing, until the special inspector general for TARP gives a passing grade on fair lending practices.

Opponents of an independent Consumer Financial Protection Agency argue that existing regulators have the authority needed to rein in abuses of consumers. But the disparities in lending that persist along racial lines, particularly among high-income borrowers, are an indication that the current system is failing consumers. Irrespective of whether this reflects regulators' unwillingness to use existing authorities or wrongly conceiving of consumer protection as simply a subset of a greater safety and soundness mission, the past failures of banking regulators to protect consumers from unfair lending make a solid case for an independent regulator focused on consumer protections.

Endnotes

1 Authors' calculations based on Home Mortgage Disclosure Act data for 2006. We include only first-lien mortgages on owner-occupied properties and exclude mortgages not subject to higher-rate reporting.

2 Center for Responsible Lending, "An Analysis of Federal Banking Regulators' Failure to Enforce Consumer Protections," available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/regulators-failure-to-enforce-consumer-protections.html.

3 *Financial Regulatory Reform: A New Framework*, (U.S. Treasury Department, 2009), p. 56.

4 Letter from the Federal Reserve Bank to House Financial Services Committee Banking Member Spencer Bachus responding to questions on the CFPA, July 28, 2009.

5 "Top Residential Originators," *American Banker*, July 2, 2009, available at http://www.americanbanker.com/rankings/-901377.html.

6 Some institutions have repaid their TARP money. This figure does not include any funds set aside as incentive payments for modifications under the Home Affordable Modification Program.

7 Another 13 have repaid all the capital invested but still have warrants outstanding. See Office of Financial Responsibility, *Troubled Asset Relief Program: Transaction Report* (U.S. Treasury Department, 2009), available at http://www.financialstability.gov/docs/transaction-reports/transactions-report_08252009.pdf.

8 See http://www.federalreserve.gov/boarddocs/supmanual/cch/200601/fair_lend_over.pdf.

9 Federal Reserve Board, "Interagency Fair Lending Examination Procedures," available at http://www.federalreserve.gov/boarddocs/caletters/2009/0906/09-06_attachment.pdf.

10 We exclude the Bank of New York Mellon, which was also subject to the stress tests, because they only originated a small number of loans in 2006.

11 See Federal Financial Institutions Examination Council, "Home Mortgage Disclosure Act," available at http://www.ffiec.gov/hmda/default.htm.

12 Gretchen Morgenson, "Inside the Countrywide Lending Spree," *The New York Times*, August 26, 2007, available at http://www.nytimes.com/2007/08/26/business/yourmoney/26country.html?ex=1345788800&en=a3245b14209bf8a3&ei=5124?nor=permalink&exprod=permalink.

13 See Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, "Race, Ethnicity, and Subprime Home Loan Pricing," *Journal of Economics and Business*, 60 (1-2) (2008): 110-124.

14 Area medians ranged from a low of $30,800 in McAllen, Texas, to as high as $98,400 in Bethesda, Maryland, which translates into requiring an income of at least $61,600 to be classified as high income in McAllen and nearly $200,000 for suburban Washington, D.C.

15 ABN AMRO Group, "ABN AMRO Completes Sale of LaSalle to Bank of America," Press Release, October 1, 2007, available at http://www.abnamro.com/press-room/pressreleasedetail.cfm?ReleaseID=278669.

16 Bank of America, "Bank of America Completes Countrywide Financial Purchase," Press Release, July 1, 2008, available at http://newsroom.bankofamerica.com/index.php?s=43&item=8202; in 2007, Countrywide acquired Homebanc, whose 2006 lending activity is broken out separately in the chart. See Elizabeth Hester, "Countrywide Buys Assets as Homebanc, Impac Halt Loans," Bloomberg News, August 7, 2007, available at http://www.bloomberg.com/apps/news?pid=20601087&sid=adXhLbc2sRyE&refer=home.

17 Wells Fargo, "Wells Fargo and Wachovia Merger Completed," Press Release, January 1, 2009, available at https://www.wellsfargo.com/press/2009/20090101_Wachovia_Merger.

18 World Savings was part of Wachovia in 2006 and made up over one-third of their loans. Less than 5 percent of World Savings loans were higher priced.

19 FDIC, "Bank Acquisition Information," available at http://www.fdic.gov/bank/individual/failed/wamu.html.

20 Paul Jackson, "Ameriquest to Close; Citigroup Exercises Purchase Option on ACC Capital," Housing Wire, August 31, 2007, available at http://www.housingwire.com/2007/08/31/ameriquest-to-exit-retail-citigroup-exercises-purchase-option/.

21 "PNC Acquires National City; Creates A Leading Deposit Banking Franchise," PR Newswire, October 24, 2008, available at http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/10-24-2008/0004910968&EDATE=.

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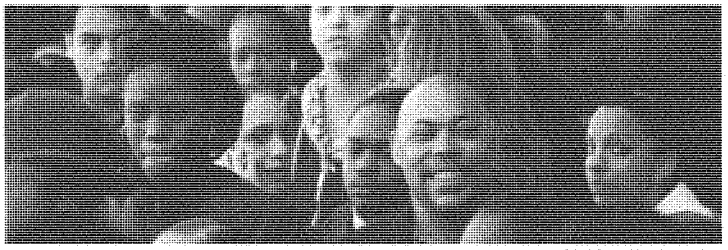
Back to this item

The State of Minorities

How Are Minorities Faring in the Economy?



SOURCE: AP/Mark Lennihan

A crowd of job seekers joins a line of hundreds of people seeking to apply for employment at the M&M's World store in New York.

By Amanda Logan, Tim Westrich | April 29, 2008

Léalo en español

Rapidly increasing amounts of debt, high job losses, skyrocketing gas and food prices, and a tidal wave of foreclosures are driving many American families to the edge of financial ruin. Although all U.S. households are hurt in the economic slowdown, Hispanic and African-American households are more vulnerable; they are likely to suffer first and to suffer more.

The 1990s were fruitful for both Hispanics and African Americans—as seen in the analysis below—because both groups made gains across several economic indicators and narrowed the gap between their economic standing and that of whites. Yet these gains have either slowed or been reversed since 2000.

Take a look at these key indicators of African Americans' and Hispanics' standing in the economy:

Family Income

Hispanics' median family income declined by an average of 0.5 percent per year from 2000 to 2006, after rising an average of 1.5 percent per year in the 1990s. From 1990 to 2000, Hispanics' median income rose from $33,394 to $38,834 (in 2006 dollars), an annualized average growth rate of 1.5 percent. Yet from 2000 to 2006, their median income *decreased* from $38,834 to $37,781, an annualized average decline of 0.5 percent. Whites' median income also decreased during this time, but only by an annualized average rate of 0.3 percent. In 2006, whites' median family income stood at $52,423, which was 1.4 times higher than Hispanics' median family income of $37,781.

African Americans' median income declined by an average of 1.3 percent per year from 2000 to 2006, after having risen by an average of 2.2 percent per year in the 1990s. From 1990 to 2000, African Americans' median income rose dramatically from $27,929 to $34,735 (in 2006 dollars). But this number actually *declined* from $34,735 in 2000 to $32,132 in 2006, an annualized average decline of 1.3 percent. Whites' median income decreased during this time as well, but only by an annualized average rate of 0.3 percent. In 2006, whites' median income was $52,423, which is 1.6 times greater than African Americans' median income in that year.

Unemployment

Hispanics' unemployment rate has increased faster than whites' since 2000, after declining more quickly tha whites' on average throughout the 1990s. Between 1990 and 2000, the unemployment rate for Hispanics declined by an average of 0.4 percent each year, but has since increased by an average of 0.2 percent each year. The unemployment rate for whites decreased at a moderately slower rate than Hispanics throughout the 1990s—an average of 0.1 percent each year—but h also risen more slowly since 2000, at an average annual rate of 0.1 percent each year. The disparity between the growth rates of the unemployment rates of the two races suggests that the current gap between the 5.6 percent unemployment rate for Hispani and 4.1 percent for whites may continue to increase.

Unemployment levels for African Americans have increased an average of 0.1 percent since 2000 after consistently decreasing during the 1990s. The unemployment rate for African Americans declined by an average of 0.4 percent each year between 1990 and 2000, while the rate for whites declined by an annual average of 0.1 percent. Yet since 20 the unemployment rate has averaged an annual increase of 0.1 percent for both African Americans and whites. African Americans' unemployment rate in 2007 was 8.3 percent—4.2 percentage points higher than whites' 4.1 percent unemployment rate.

Health Care

The percent of Hispanics not covered by health insurance increased by an average of 0.3 percent per year fro 2000 to 2006, after holding steady during the 1990s. During the more prosperous economic times of the 1990s, the percent of Hispanics not covered by health insurance effectively held steady, decreasing by an annual percent difference of less than 0.1 percent from 1990 to 2000. But after rising by an average rate of 0.3 percent since 2000, 34.1 percent of Hispanics we not covered by health insurance in 2006. Only 10.8 percent of whites were not covered in 2006.

The percent of African Americans not covered by health insurance increased by an average of 0.3 percent per year from 2000 to 2006, after having *decreased* significantly in the 1990s. The number of African Americans witho health insurance decreased from 19.7 percent in 1990 to 18.3 percent in 2000, an average annual decline of 0.2 percentage poi But from 2000 to 2006, the number of uninsured African-American individuals increased from 18.3 percent to 20.3 percent, a average annual rise of 0.3 percentage points. In 2006, 20.3 percent of African Americans were not covered by health insurance compared to only 10.8 percent of whites who were not covered.

Retirement Plan Participation

Less than one-third of Hispanics participated in an employer-sponsored retirement plan in 2006, compared t over half of whites. Between 2002 and 2006, the share of Hispanics who participated in an employer-sponsored retirement plan in the private sector declined by an average rate of 0.9 percentage points per year. Hispanics were already less likely than whites to participate in an employer-sponsored retirement plan, with only 31.1 percent of Hispanics participating in 2002 compared to 58.8 percent of whites, but this gap has only widened. By 2006, the percentage of Hispanics who participated in a employer-sponsored retirement plan had fallen to 27.6 percent, well below the 55.0 percent of whites who participated.

Only 43.8 percent of African Americans participated in an employer-sponsored retirement plan in 2006, compared to 55.0 percent of whites. The percent of African Americans who participated in an employer-sponsored retirement plan in the private sector declined from 47.5 percent in 2002 to 43.8 percent in 2006, which translates to an annual decline of 0.9 percentage points. This further widened the gap between the percentage of African Americans and the percentag of whites participating in an employer-sponsored retirement plan, with 55.0 percent of whites participating in 2006, or roughly 20 percent more than the percentage of African Americans participating.

High-Cost Mortgages

Nearly 46 percent of home-purchase loans made to Hispanics in 2006 were high-cost, as opposed to only 18 percent for whites. Many more Hispanics got high-cost mortgages than did whites. Data collected under the Home Mortgag Disclosure Act show that 241,919 loans made to Hispanics were high-cost, as opposed to only 284,208 that were market-rate.

More than 53 percent of home-purchase loans made to African Americans in 2006 were high-cost, as opposed to only 18 percent for whites. Many more African Americans received high-cost mortgages than whites. Data collected und the Home Mortgage Disclosure Act show that 172,055 loans made to African Americans were high-cost, as opposed to only

Earnings

A large earnings gap between Hispanics and whites persists even though Hispanics' usual median weekly earnings have grown at a faster average annualized rate than whites' since 2000. Between 2000 and 2007, the usu median weekly earnings of Hispanics in 2006 dollars grew at an average annualized rate of 0.7 percent, while whites' earnings grew at an average annualized rate of 0.2 percent. Despite the 0.5 percentage point difference between Hispanics' and whites' earnings growth rates, Hispanics' usual median weekly earnings were a troubling $207.05 less than those of whites by the end o 2007. Hispanics usual median weekly earnings stood at just $488.94 (in 2006 dollars), while whites' earnings were $695.95.

African Americans' usual median weekly earnings have stagnated since 2000, while whites' have continued to increase slightly. African Americans' usual median weekly earnings (in 2006 dollars) have essentially remained unchanged since 2000, declining at an average annualized rate of -0.001 percent, while whites' earnings grew at an average annualized rat of 0.2 percent. Although African Americans' earnings rose slightly in the early 2000s, they have since declined, standing at $553.10 at the end of 2007—$0.04 below where they were in 2000 (in 2006 dollars). The earnings gap between African Americans and whites also continued to widen, standing at a $142.89 difference at the end of 2007.

Poverty

The percent of Hispanics living in poverty increased slightly from 2000 to 2006, after having declined significantly in the 1990s. In 1990, 25.0 percent of Hispanics were living in poverty, but by 2000, this number dropped to 19.2 percent, an average decrease of 0.7 percent per year. Yet from 2000 to 2006, the percent of Hispanics living in poverty *increased*, rising from 19.2 percent to 20.6 percent, or an annual percentage point difference of 0.2 percent. In 2006, the most recent year for which data is available, only 8.2 percent of whites were in poverty, compared to the 20.6 percent of Hispanics.

The percent of African Americans living in poverty increased from 2000 to 2006 by an average of 0.82 percer per year, after having declined by an average of 1.25 percent per year in the 1990s. The percent of African Americ in poverty decreased from 29.3 percent in 1990 to 19.3 percent in 2000, an annual decline of 1.3 percent. But much of these gai were lost from 2000 to 2006. The percent of African Americans in poverty jumped from 19.3 percent in 2000 to 24.2 percent i 2006, an annual increase of 0.8 percent. In 2006, only 8.2 percent of whites were in poverty, compared to the 24.2 percent of African Americans.

Homeownership Rate

Hispanics' homeownership rose from 2000 to 2006, but at a much slower rate than from 1994 to 2000. The homeownership rate for Hispanics increased from 41.2 percent to 46.3 percent between 1994 and 2000—an annual increase of 0.85 percent. While it continued to rise from 2000 to 2006, it did so more slowly, rising from 46.3 percent to 49.7 percent, an annual increase of 0.6 percent. The homeownership rate for whites in 2006 was 75.8 percent, as compared to only 49.7 percent for Hispanics. Homeownership data by race are not available before 1994.

African-American homeownership rose at a slower rate between 2000 and 2006 than during the 1990s. From 2000 to 2006, the homeownership rate for African Americans increased by an average annual growth rate of just 0.1, from 47.2 percent in 2000 to 47.9 percent in 2006. Whites' homeownership rate, in comparison, increased by an average annual growth rate of 0.3 percent. This trend is in part because African Americans have actually seen their homeownership rate *decline* since 2004. This is compared to the 1990s, when African Americans' homeownership rate increased by an average annual growth rat of 0.8 percent from 1994 to 2000. Whites' rate was 0.6 percent during this time. Homeownership data by race are not available before 1994.

Employment Level

Hispanics' average annualized employment growth rate has markedly declined since the 1990s. The robust economy that dominated the later portion of the 1990s allowed the number of employed individuals to grow, a trend that was especially evident for Hispanics. Between 1990 and 2000, the number of employed Hispanics grew on average by an impressiv 4.7 percent each year, while the number of employed whites grew by an average rate of 1.1 percent each year. Yet since 2000, these growth rates have markedly declined. The average annual employment growth rate for Hispanics shrank by almost a quarter between 2000 and 2007 from 4.7 percent in 2000 to 3.7 percent in 2007; the rate for whites declined from 1.1 percent t 0.7 percent during the same period.

African Americans' employment rate has grown on average more than 60 percent more slowly since 2000 tha

it did throughout the 1990s. The robust economy that dominated the later portion of the 1990s allowed the number of employed individuals of all races to grow at steady rates. Between 1990 and 2000, the number of employed African Americans increased at an average rate of 2.2 percent each year, and the number of employed whites grew by an average rate of 1.1 percent each year. Yet between 2000 and 2007, the average annual employment growth rate for African Americans fell by more than 6(percent from 2.2 percent in 2000 to 0.8 percent in 2007; the rate for whites declined from 1.1 percent to 0.7 percent during the same period.

Employment to Population Ratio

The employment to population ratio for Hispanics has *declined* since 2000 after growing throughout the 199(The employment to population ratio for Hispanics—the percentage of the civilian population that is employed—increased by ar average of 0.4 percentage points each year throughout the 1990s. Since 2000, the ratio has declined by an average of 0.1 percentage points each year. Whites' employment to population ratio grew slower on average than Hispanics' throughout the 1990s, increasing on average by 0.1 percent each year, and has declined by an average of 0.2 percent every year since 2000.

The employment to population ratio for African Americas has shrunk at a faster rate than whites' since 2000 after growing at a faster rate during the 1990s. The employment to population ratio for African Americans increased by average of 0.4 percentage points each year between 1990 and 2000, compared to whites' average growth rate of just 0.1 percentage points each year. Yet since 2000, the employment to population ratio for African Americans has declined on averag by 0.4 percentage points each year—more quickly than whites' average decline of 0.2 percentage points per year. Importantly, t employment to population ratio of African Americans still lags behind that of whites, standing at 58.4 percent in 2007 compare to 64.9 percent for whites.

Sources

Family Income: U.S. Bureau of the Census, Historical Income Tables. White refers to white non-Hispanic. Beginning with 2002, data represent white non-Hispanic alone, which includes people who reported white alone or in combination. Beginning with 2005, data represent black alone or in combination. People of Hispanic origin may be of any race.

Unemployment: Bureau of Labor Statistics, Current Population Survey and Current Employment Statistics. African America refers to blacks and African Americans, and Hispanic refers to Hispanics and Latinos.

Health Care: U.S. Bureau of the Census, Historical Health Insurance Tables. White refers to white non-Hispanic. Beginning with 2002, data represent white non-Hispanic alone, which includes people who reported white alone or in combination. Beginning with 2005, data represent black alone or in combination. People of Hispanic origin may be of any race.

Retirement Savings: *Current Population Survey* data as analyzed in Purcell, Patrick. 2007. "Pension Sponsorship and Participation: Summary of Recent Trends." Washington: Congressional Research Service. White refers to white non-Hispanic a African American refers to black non-Hispanic. 2002 was the first year the *Current Population Survey* used expanded categori of race and ethnicity, making comparisons with earlier years problematic.

High-Cost Mortgages: Home Mortgage Disclosure Act data. White refers to white non-Hispanic. People of Hispanic origin may be of any race. High-cost mortgages are defined as those with a rate three points or greater than the treasury rate when the loan was enacted.

Earnings: Bureau of Labor Statistics, Current Population Survey and Current Employment Statistics. African American refers blacks and African Americans, and Hispanic refers to Hispanics and Latinos. Usual median weekly earnings refer to the median weekly earnings of a full-time non-self-employed wage and salary earner before taxes, including overtime pay, commissions, ar tips earned from a primary job.

Poverty: U.S. Bureau of the Census, 2008 Statistical Abstract, Income, Expenditures, Poverty, and Wealth section. White refe to white non-Hispanic. Beginning with 2002, data represent white non-Hispanic alone, which includes people who reported white alone or in combination. Beginning with 2005, data represent black alone or in combination. People of Hispanic origin m be of any race.

Homeownership Rate: U.S. Bureau of the Census, Housing Vacancies, and Homeownership. White refers to white non-Hispanic. Beginning with 2002, data represent white non-Hispanic alone, which includes people who reported white alone or i

combination. African American refers to African American only. People of Hispanic origin may be of any race.

Employment Level: Bureau of Labor Statistics, Current Population Survey and Current Employment Statistics. African American refers to blacks and African Americans, and Hispanic refers to Hispanics and Latinos.

Employment to Population Level: Bureau of Labor Statistics, Current Population Survey and Current Employment Statistics. African American refers to blacks and African Americans, and Hispanic refers to Hispanics and Latinos.

Léalo en español

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE,
City Hall
100 N. Holliday St.
Baltimore, MD 21202

Plaintiff,

v.

WELLS FARGO BANK, N.A.
464 California Street
San Francisco, CA 94104

and

WELLS FARGO FINANCIAL LEASING, INC.,
207 9th Street
Des Moines, IA 50307

Defendants.

L08CV 062

Case No. _____

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF AND DAMAGES

NATURE OF THE ACTION

1. The City of Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. From the first to the second quarter of 2007 foreclosure activity in the City increased five-fold. Since 2000, more than 33,000 homes have been subjected to foreclosure filings. The foreclosure crisis has caused severe economic damage to the City. The high rate of foreclosures has resulted in lost revenue in property taxes;

additional costs in social services and police and fire protection; and significant administrative and legal costs.

2. In Baltimore, the foreclosure crisis has hit African-American neighborhoods and homeowners the hardest. Foreclosure rates are significantly higher in Baltimore's minority neighborhoods, due in large part to the practice of "reverse redlining." In contrast to "redlining," which involves denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise unfair lending practices because of the race or ethnicity of the area's residents. Reverse redlining has repeatedly been held to violate the federal Fair Housing Act.

3. Defendant Wells Fargo Bank, N.A., is one of the largest mortgage lenders in Baltimore and the country at large. Together with Defendant Wells Fargo Financial Leasing, Inc. (collectively "Wells Fargo"), it is also one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. In 2005 and 2006, for example, two thirds of Wells Fargo's foreclosures were in Baltimore City census tracts that are more than 60% African-American, while only 15.6% were in tracts that are less than 20% African-American. Wells Fargo's foreclosure rate for loans in African-American neighborhoods is nearly double the overall City average, while the rate for its loans in white neighborhoods is less than half of the average.

4. Wells Fargo's disproportionately high foreclosure rate in Baltimore's African-American neighborhoods is the result of reverse redlining. Wells Fargo has been, and continues to be, engaged in a pattern or practice of unfair, deceptive and discriminatory lending activity in Baltimore's minority neighborhoods that have the

effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit to Wells Fargo without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods.

5. Wells Fargo's lending practices, targeted in this manner at Baltimore's underserved and vulnerable minority neighborhoods, have resulted in the disproportionately high rate of foreclosure in Baltimore's African-American communities, caused substantial and irreparable damage to these neighborhoods, and caused direct and continuing financial harm to the City of Baltimore.

6. This suit is brought pursuant to the Fair Housing Act of 1968, as amended, 42 U.S.C. §§ 3601 *et seq.*, by the Mayor and City Council of Baltimore ("Baltimore" or "City") to seek redress for the injuries caused by Wells Fargo's pattern or practice of illegal reverse redlining. Specifically, Baltimore seeks to recover damages for the injuries caused by the foreclosures in Baltimore's minority neighborhoods as a result of Wells Fargo's unlawful, irresponsible, unfair, deceptive, and discriminatory lending practices, and to obtain injunctive and declaratory relief. Absent judicial relief, the extent of the City's injury resulting from Wells Fargo's actions will continue – and potentially accelerate – as the housing market continues to decline.

PARTIES

7. Plaintiff Mayor and City Council of Baltimore is a municipal corporation, organized pursuant to Article XI-A of the Maryland Constitution. The City is authorized by the Baltimore City Charter to institute suit to recover damages suffered by the City.

8. Defendant Wells Fargo Bank, N.A. is organized as a national banking association under the laws of the United States. Upon information and belief, its

corporate headquarters are located in California. Wells Fargo Bank, N.A. maintains multiple offices in the State of Maryland and in Baltimore for the purposes of soliciting applications for and making residential mortgage loans and engaging in other business activities.

9. Wells Fargo Home Mortgage is a division of Wells Fargo Bank, N.A. that was formerly incorporated in California as a separate company and registered to do business in the State of Maryland under the name Wells Fargo Home Mortgage, Inc. Wells Fargo Home Mortgage, Inc. merged into Wells Fargo Bank, N.A. on May 5, 2004. Wells Fargo Bank, N.A. continues to do business under the name Wells Fargo Home Mortgage, including in the State of Maryland and in Baltimore.

10. Wells Fargo Bank, N.A. has been the largest or second largest provider of mortgage credit to homeowners in Baltimore since at least 2004. From 2004 to 2006, Wells Fargo Bank, N.A. made at least 1,285 mortgage loans a year to Baltimore homeowners with a collective value of over $600 million. Upon information and belief, Wells Fargo Bank, N.A. continues to make loans in Baltimore at a comparable pace. No other lender made more than 1,000 mortgage loans in Baltimore in each year from 2004 to 2006.

11. Defendant Wells Fargo Financial Leasing, Inc. is an Iowa corporation that is registered to do business in Maryland. Upon information and belief, Wells Fargo Financial Leasing, Inc. engages in the solicitation of applications for and origination of residential mortgage loans in Baltimore.

12. Each of the Defendants was and is the agent, employee, and representative of the other Defendant. Each Defendant, in acting or omitting to act as alleged in this Complaint, was acting in the course and scope of its actual or apparent authority pursuant

to such agencies, or the alleged acts or omissions of each Defendant as agent were subsequently ratified and adopted by each agent as principal.

JURISDICTION AND VENUE

13. This Court has jurisdiction over this matter pursuant to 42 U.S.C. § 3613 and 28 U.S.C. §§ 1331, 1343, because the claims alleged herein arise under the laws of the United States.

14. Venue is proper in this district under 28 U.S.C. § 1391(b) because Defendants conduct business in and are residents of the district and a substantial part of the events and omissions giving rise to the claims occurred in the district.

FACTUAL BACKGROUND

A. The Foreclosure Crisis and Baltimore

15. Like many cities across the country, Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. Of the 44 million active mortgages throughout the country currently tracked by the Mortgage Bankers Association ("MBA"), approximately 343,000 entered foreclosure during the third quarter of 2007. This is the highest rate of foreclosures in more than 35 years. Overall, nearly 450,000 properties tracked by the MBA were in some stage of foreclosure during the third quarter of 2007, up 30% from the second quarter.

16. Nationwide, the foreclosure crisis is worsening rapidly and is expected to deteriorate further. The number of foreclosure filings nearly doubled from the third quarter of 2006 to the third quarter of 2007. One out of every seventeen mortgage holders is no longer able to make payments on time, the highest rate in over twenty years. Delinquent payments are a strong indicator of near-term foreclosure filings. Equally important, approximately 150,000 adjustable rate loans are resetting to higher interest

rates every month. In 2008, $362 billion in subprime loans will reset to higher rates. As the housing market continues to decline, many of these adjustments will result in foreclosures. The Joint Economic Committee of Congress predicts that from 2007 to 2009 there could be nearly 2 million foreclosures nationwide on homes purchased with subprime loans.

17. The foreclosure crisis in Baltimore is especially severe. There have been more than 33,000 foreclosure filings since 2000, and the Maryland Department of Housing and Community Development reported in October 2007 that the number of foreclosure-related events in Baltimore – notices of default, foreclosure sales, and lender purchases of foreclosed properties – increased an extraordinary five-fold from the first to the second quarter of this year.

18. Foreclosures have multiple and far-reaching impacts on the cities in which they occur, especially when they are concentrated in distressed neighborhoods that are already struggling with issues of economic development and poverty. Foreclosures in these neighborhoods frequently lead to abandoned and vacant homes. Estimates of the number of vacant homes in Baltimore range from 16,000 to 30,000. Concentrated vacancies driven by foreclosures cause neighborhoods, especially ones already struggling, to decline rapidly.

19. One example of how foreclosures and consequent vacancies harm neighborhoods is by reducing the property values of nearby homes. In Baltimore, as in cities around the country, foreclosures are responsible for the loss of hundreds of millions of dollars in the value of homes. This, in turn, reduces the City's revenue from property taxes. It also makes it harder for the City to borrow funds because the value of the property tax base is used to qualify for loans.

20. Cities with high rates of foreclosure, like Baltimore, also lose revenue from real estate transfer taxes because foreclosures depress the market for home sales. And these cities must spend additional funds for services related to foreclosures, including the costs of securing vacant homes, holding administrative hearings, and conducting other administrative and legal procedures. The funds expended also include the costs of providing additional police and fire protection as vacant properties become centers of dangerous and illicit activities.

B. The Role of Subprime Lending

21. The growing crisis of foreclosures in Baltimore and across the nation is due in large part to the rapid expansion of subprime lending. Subprime lending developed in the mid-1990s as a result of innovations in risk-based pricing and in response to the demand for credit by borrowers who were denied prime credit by traditional lenders.

22. Prior to the emergence of subprime lending, most mortgage lenders made only "prime" loans. Prime lending offered uniformly priced loans to borrowers with good credit. Individuals with blemished credit were not eligible for prime loans. Although borrowers with blemished credit might still represent a good mortgage risk at the right price, prime lending did not provide the necessary flexibility in price or loan terms to serve these borrowers.

23. In the early 1990s, technological advances in automated underwriting allowed lenders to predict with improved accuracy the likelihood that a borrower with blemished credit will successfully repay a loan. This gave lenders the ability to adjust the price of loans to match the different risks presented by borrowers whose credit records did not meet prime standards. Lenders found that they could now accurately price loans

to reflect the risks presented by a particular borrower. When done responsibly, this made credit available much more broadly than had been the case with prime lending.

24. As the technology of risk-based pricing developed rapidly in the 1990s, so did the market in subprime mortgages. Subprime loans accounted for only 10% of mortgage loans in 1998, but within five years grew to 23% of the market. Currently, outstanding subprime mortgage debt stands at $1.3 trillion, up from $65 billion in 1995 and $332 billion in 2003. These subprime loans have allowed millions of borrowers to obtain mortgages, at marginally increased prices, even though their credit profiles do not qualify them for lower-cost prime loans. They have opened the door to homeownership to many people, especially low- to moderate-income and minority consumers, who otherwise would have been denied mortgages. At the same time, subprime lending has created opportunities for unscrupulous lenders to engage in irresponsible lending practices that result in loans that borrowers cannot afford. This, in turn, has led directly to defaults and foreclosures.

25. Enticed by the prospect of short-term profits resulting from exorbitant origination fees, points, and related pricing schemes, many irresponsible subprime lenders took advantage of a rapidly rising real estate market to convince borrowers to enter into loans that they could not afford. Often this was accomplished with the help of deceptive practices and promises to refinance at a later date. These abusive subprime lenders did not worry about the consequences of default or foreclosure to their business because once made, the loans were sold on the secondary market.

26. As the subprime market grew, the opportunities for abusive practices grew with it. These practices, which in recent years have become the target of prosecutors, legislators and regulators, include the following:

a. Failing to prudently underwrite hybrid adjustable rate mortgages (ARMs), such as 2/28s and 3/27s. After the borrower pays a low "teaser rate" for the first two or three years, the interest rate on these loans resets to a much higher rate that can continue to rise based on market conditions. Subprime lenders often underwrite these loans based only on consideration of whether the borrower can make payments during the initial teaser rate period, without regard to the sharply higher payments that will be required for the remainder of a loan's 30-year term. Irresponsible lenders aggressively market the low monthly payment that the borrower will pay during the teaser rate period, misleading borrowers into believing that they can afford that same low monthly payment for the entire 30-year term of the loan, or that they can refinance their loan before the teaser rate period expires.

b. Failing to prudently underwrite refinance loans, where borrowers substitute unaffordable mortgage loans for existing mortgages that they are well-suited for and that allow them to build equity. Such refinanced loans strip much or even all of that equity by charging substantial new fees, often hiding the fact that the high settlement costs of the new loan are also being financed. Lenders that aggressively market the ability of the borrower to pay off existing credit card and other debts by refinancing mislead borrowers into believing that there is a benefit to consolidating all of their debt into one mortgage loan, obscuring the predictable fact that that the borrower will not be able to repay the new loan. The refinanced loans are themselves often refinanced repeatedly with ever-increasing fees and higher interest rates, and with ever-decreasing equity, as borrowers seek to stave off foreclosure.

c. Allowing mortgage brokers to charge "yield spread premiums" for qualifying a borrower for an interest rate that is higher than the rate the borrower qualifies for and can actually afford.

d. Failing to underwrite loans based on traditional underwriting criteria such as debt-to-income ratio, loan-to-value ratio, FICO score, reserves, and work history. These criteria ensure that a borrower is obtaining a loan that he or she has the resources and assets to repay, and ignoring these criteria results in many loans that bear no relation to borrowers' ability to repay them. This allows the lender to make a quick profit from the origination, but sets the borrower up for default and foreclosure.

e. Requiring substantial prepayment penalties that prevent borrowers whose credit has improved from refinancing their subprime loan to a prime loan. Prepayment penalties not only preclude borrowers from refinancing to a more affordable loan, but reduce the borrowers' equity when a subprime lender convinces borrowers to needlessly refinance one subprime loan with another.

f. Charging excessive points and fees that are not associated with any increased benefits for the borrower.

27. As long as housing prices continued to rise, the deleterious effect of these practices was delayed and thus, hidden. When the real estate bubble burst earlier in 2007, the inevitable occurred, and foreclosure rates began their dramatic rise. Bent on maximizing short-term profits and protected by the ability to sell their loans on the secondary market, irresponsible subprime lenders have left countless homeowners saddled with mortgage debts they cannot afford and no way to save their homes in a declining housing market.

C. The Foreclosure Crisis in Baltimore Hits African-American Neighborhoods the Hardest

28. In Baltimore, the impact of the foreclosure crisis is felt most acutely in minority communities. This is because of the prevalence of the practice of "reverse redlining." As used by Congress and the courts, the term "reverse redlining" refers to the practice of targeting residents in certain geographic areas for credit on unfair terms due to the racial or ethnic composition of the area. In contrast to "redlining," which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents. This practice has repeatedly been held to violate the federal Fair Housing Act. *See, e.g., Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000).

29. Reverse redlining typically flourishes in cities where two conditions are met. First, the practice afflicts cities where minorities historically have been denied access to credit and other banking services. The legacy of historic discrimination, or redlining, often leaves the residents of minority communities desperate for credit, and without the knowledge or experience required to identify loan products and lenders offering products with the most advantageous terms for which they might qualify. Instead, residents of underserved minority communities often respond favorably to the first offer of credit made, without regard to the fairness of the product. This makes them especially vulnerable to irresponsible subprime lenders who, instead of underwriting carefully to ensure that the loans they offer are appropriate for their customers, engage in the unscrupulous lending practices described in paragraph 26 above.

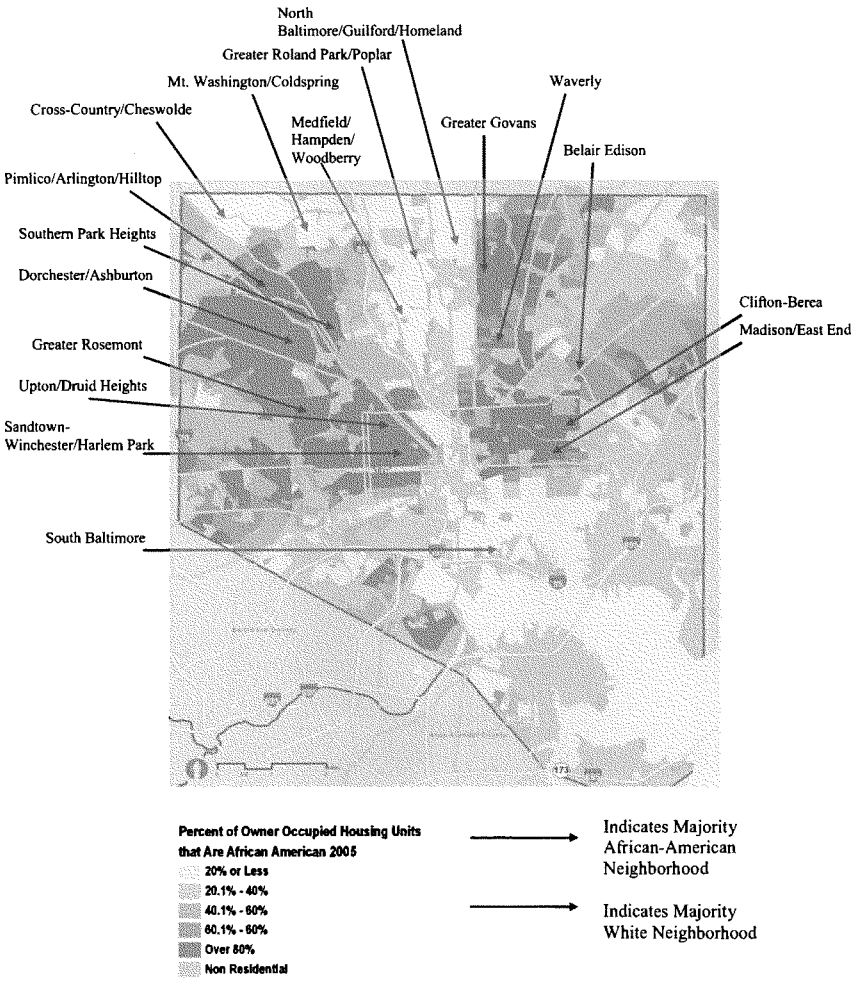
30. Second, reverse redlining arises in cities where there are racially segregated residential living patterns. This means that the people who are most vulnerable to abusive lending practices are geographically concentrated and therefore easily targeted by lenders.

31. Both of these conditions are present in Baltimore. First, Baltimore's minority communities historically have been victimized by traditional redlining practices. Through much of the twentieth century the federal government, mortgage lenders, and other private participants in the real estate industry acted to deny homeownership opportunities and choices to the City's African Americans. The Secretary of the United States Department of Housing and Urban Development admitted in 1970 that the federal government had "refus[ed] to provide insurance in integrated neighborhoods, promot[ed] the use of racially restrictive covenants," and engaged in other methods of redlining. *Thompson v. U.S. H.U.D.*, 348 F. Supp. 2d 398, 466 (D. Md. 2005). The federal government even published a map in 1937 titled "Residential Security Map for Baltimore" designed to facilitate private redlining by mortgage providers. *See id.* at 471. Mortgage lenders actively engaged in redlining for decades, treating "black and [the few] integrated neighborhoods as unstable and risky." Garrett Power, *Apartheid Baltimore Style: The Residential Segregation Ordinances of 1910-1913*, 42 Md. L. Rev. 289, 319, 322 (1983).

32. The practice and effects of widespread redlining in Baltimore persisted for decades. An analysis of data from the 1980s, long after much of the institutionalized governmental and corporate apparatus of discrimination had been dismantled, found that the more African-American residents in a Baltimore neighborhood, the fewer mortgage loans and dollars the neighborhood received. Anne B. Shlay, *Maintaining the Divided*

City: Residential Lending Patterns in the Baltimore SMSA (Maryland Alliance for Responsible Investment, March 1987). The study also found that while 73% of majority white census tracts received a medium or high volume of single family mortgage loans, the same was true of only 5% of majority African-American tracts.

33. Second, the City is highly segregated between African Americans and whites. As the following map shows, even though Baltimore is 64% African-American and 32% white, many neighborhoods have a much higher concentration of one racial group or the other. For example, the African-American population exceeds 90% in East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, and Greater Govans. It exceeds 75% in Waverly and Belair Edison. At the same time, the white population of Greater Roland Park/Poplar, Medfield/Hampden/Woodberry, and South Baltimore exceeds 80%, and the white population of Cross-Country/Cheswolde, Mt. Washington/Coldspring, and North Baltimore/Guilford/Homeland exceeds 70%.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Cross-Country/Cheswolde
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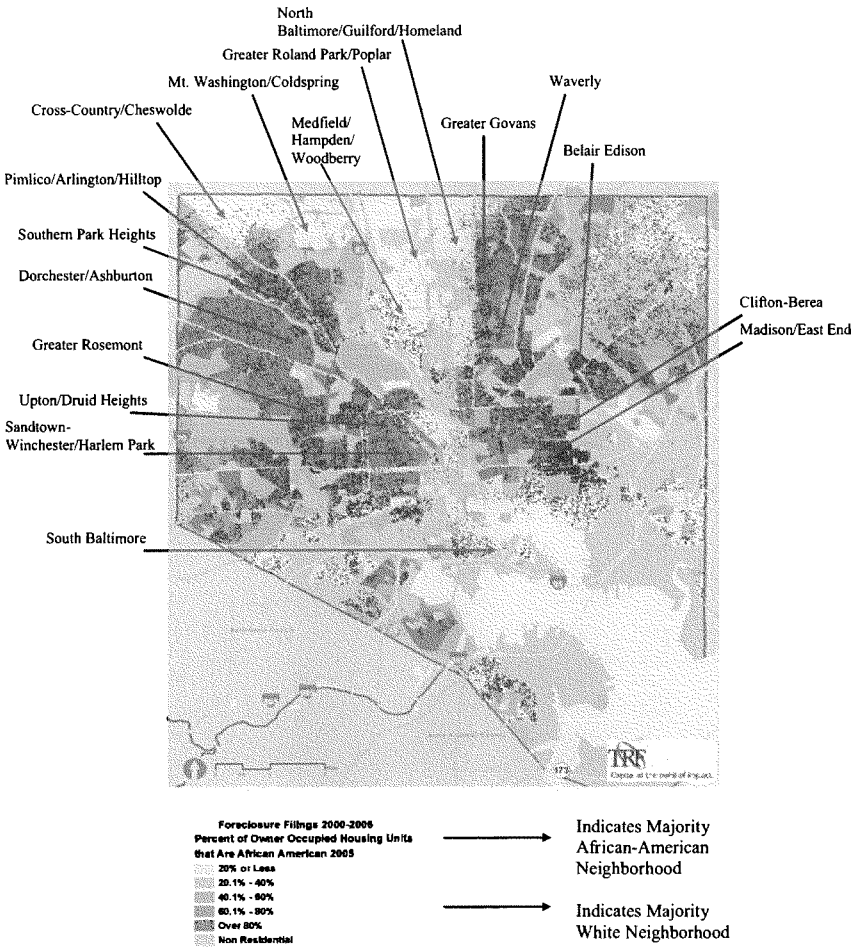
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Percent of Owner Occupied Housing Units that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

34. The location of foreclosures in the City of Baltimore is consistent with the existence of a pattern and practice of reverse redlining by lenders providing mortgages to residents of the City. As shown in the following map, although foreclosures have occurred in many parts of Baltimore, they are disproportionately concentrated in Baltimore's African-American neighborhoods. Neighborhoods like Greater Govans, Greater Rosemont, Madison/East End, and Southern Park Heights, all with African-American populations above 90%, are at the center of the foreclosure crisis. Citywide, census tracts that are above 80% African-American account for 49% of Baltimore's foreclosure filings, even though they account for only 37% of the City's owner-occupied households.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
Waverly
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Foreclosure Filings 2000-2005
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

D. Wells Fargo is a Major Contributor to the Foreclosure Crisis in Baltimore's African-American Neighborhoods

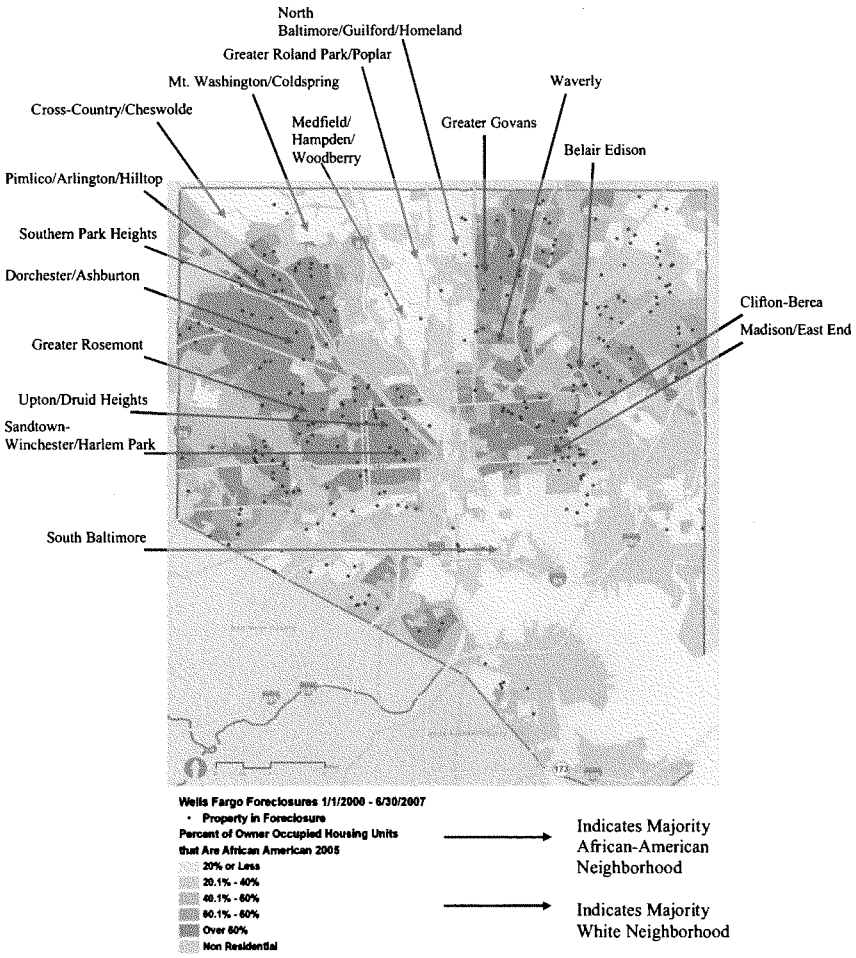
35. Wells Fargo is one of the largest mortgage lenders in Baltimore. It has made at least 1,285 mortgage loans in Baltimore in each of the last three years, with a collective value of over $600 million. In each of these years, it has been one of the top two mortgage lenders in the City. Wells Fargo makes loans in both the white and African-American neighborhoods of Baltimore.

36. Far from being a responsible provider of much-needed credit in minority communities, however, Wells Fargo is one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. Its foreclosures since at least 2000 have been concentrated in Belair Edison, East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, Greater Govans and Waverly, and other neighborhoods with African-American populations exceeding 75%.

37. Half of Wells Fargo's foreclosures from 2005 to 2006 were in census tracts that are more than 80% African-American and two-thirds were in tracts that are over 60% African-American, but only 15.6% were in tracts that are 20% or less African-American. The figures are virtually identical for Wells Fargo's foreclosures from 2000 to 2004 with more than half in tracts that are more than 80% African-American, 64% in tracts that are over 60% African-American, and only 14.8% in tracts that are 20% or less African-American. Wells Fargo's foreclosures during the first half of 2007 reflect a similar pattern. Almost half are in tracts that are more than 80% African-American, while only 11.4% are in tracts that are 20% or less African-American.

38. At the same time, Wells Fargo has the largest number of foreclosures in Baltimore of any lender – at least 135 from 2005 to 2006. Only two other lenders had

more than 100 foreclosures during this period. With at least seventy foreclosures during the first half of 2007, the pace of Wells Fargo's foreclosures is increasing. In addition, at least 108 Wells Fargo loans in Baltimore resulted in foreclosure from 2000 to 2004. The number of Wells Fargo foreclosures from 2000 through the first half of 2007 is probably much higher because in many cases the foreclosure records analyzed by Plaintiff do not indicate the original lender. The following map represents the concentration of Wells Fargo's foreclosures in African-American neighborhoods from 2000 through the first half of 2007.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Winchester/Harlem Park
South Baltimore
Wells Fargo Foreclosures 1/1/2000 - 6/30/2007
Property in Foreclosure
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

39. The likelihood that a Wells Fargo loan in a predominantly (60% or greater) African-American neighborhood will result in foreclosure is significantly greater than the likelihood of foreclosure for a loan in a predominantly white neighborhood. While 8.2% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, the same is true for only 2.1% of its loans in predominantly white neighborhoods. In other words, a Wells Fargo loan in a predominantly African-American neighborhood is nearly four times as likely to result in foreclosure as a Wells Fargo loan in a predominantly white neighborhood.

40. The overall foreclosure rate in Baltimore, based on loans from all lenders, is 4.5%. Thus, Wells Fargo's foreclosure rate for loans in African-American neighborhoods is nearly double the overall City average, while the ratio for its loans in white neighborhoods is less than half the average.

E. Wells Fargo Targets Baltimore's African-American Neighborhoods for Improper and Irresponsible Lending Practices

41. Wells Fargo's failure to underwrite loans in minority and underserved communities in a responsible manner has been the subject of public attention and concern for years. For example, its practices are the focus of a 2004 report from the Center for Responsible Lending. The report concluded that the company's customers "too often face the loss of their home or financial ruin as a result" of its "predatory practices." Center for Responsible Lending, *A Review of Wells Fargo's Subprime Lending* (Apr. 2004) at 10 (available at http://www.responsiblelending.org/pdfs/ip004-Wells_Fargo-0404.pdf).

42. Wells Fargo's pattern or practice of failing to follow responsible underwriting practices in Baltimore's African-American neighborhoods is evident from the type of loans that result in foreclosure filings in those neighborhoods. Approximately

70% of Wells Fargo's Baltimore loans that result in foreclosure are fixed rate loans. This ratio is the same in both African-American and white neighborhoods. This establishes that there is no legitimate reason for the stark difference in Wells Fargo's foreclosure rates by race.

43. Unlike adjustable rate loans, where the price may fluctuate with changing market conditions, the performance of fixed rate loans is relatively easy to predict using automated underwriting models and loan performance data because monthly payments do not vary during the life of the loan. Using these sophisticated risk assessment tools, and relying on traditional underwriting criteria such as FICO scores, debt-to-income ratios, loan-to-value ratios, and cash reserves, any lender engaged in responsible underwriting practices designed to identify qualified borrowers can predict with statistical certainty the likelihood of default and/or delinquency. Lenders engaged in marketing fixed rate loans in a fair and responsible manner should have no difficulty sifting out unqualified borrowers, or borrowers whose loans would likely result in delinquency, default or foreclosure.

44. Because the percentage of fixed rate loans is so high and the same in both African-American and white neighborhoods, Wells Fargo should, if it properly underwrites, have comparable foreclosure rates in both communities. The fact that Wells Fargo's underwriting decisions result in foreclosure nearly four times as often with respect to African-American than white neighborhoods means that it is not following fair or responsible underwriting practices with respect to African-American customers.

45. The disparate foreclosure rates are instead consistent with the type of unscrupulous subprime lending practices described in paragraph 26 above. Upon information and belief, and as explained below, Wells Fargo engages in these and

similarly inappropriate practices when making loans to African Americans and in African-American neighborhoods. This pattern or practice of targeted activities fully explains the disparate rates of foreclosure.

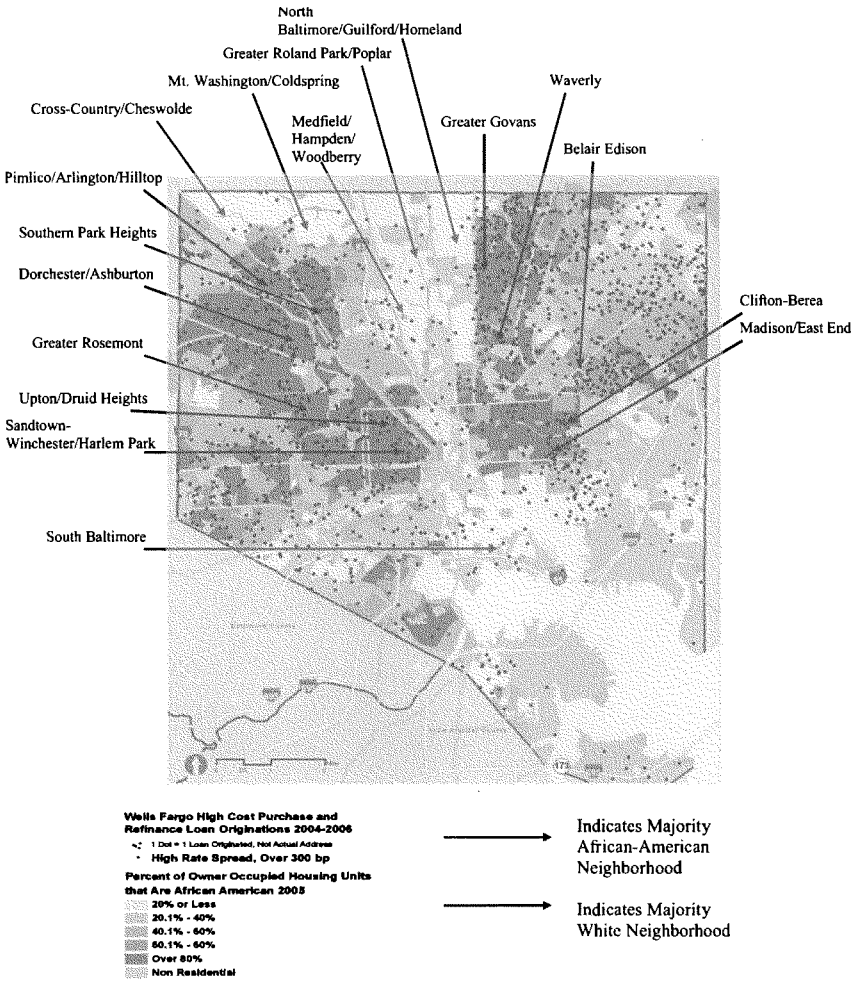
46. A closer look at the characteristics of the loans made by Wells Fargo in Baltimore demonstrates that it is engaged in a pattern or practice of reverse redlining with respect to the City's African-American neighborhoods. As described in sections E.1 through E.6 below, examination of Wells Fargo's loans indicates it is engaged in unfair and discriminatory practices in Baltimore's African-American neighborhoods that have the effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods. This targeted pattern or practice has resulted in the disproportionately high rate of foreclosures found in Baltimore's African-American neighborhoods.

1. Publicly Available Home Mortgage Disclosure Act Data Shows that Wells Fargo's High-Cost Loans are Disproportionately Located in African-American Neighborhoods in Baltimore

47. Publicly available data reported by Wells Fargo to federal regulators pursuant to the Home Mortgage Disclosure Act shows that in 2006, Wells Fargo made high-cost loans (*i.e.*, loans with an interest rate that was at least three percentage points above a federally-established benchmark) to 65% of its African-American mortgage customers in Baltimore, but only to 15% of its white customers in Baltimore. In 2005, the respective rates were 54% and 14%; in 2004, the respective rates were 31% and 10%. The proportion of refinance loans that are high cost is especially pronounced. In 2004,

2005, and 2006, a Wells Fargo refinance loan to an African-American borrower was 2.5 times more likely to be high cost than a refinance loan to a white borrower.

48. The maps that follow show the geographic distribution of high-cost loans in African-American and white neighborhoods in Baltimore. These maps demonstrate that Wells Fargo's high-cost loans are disproportionately located in Baltimore's African-American neighborhoods, including, among others, Sandtown-Winchester/Harlem Park, Upton/Druid Heights, Dorchester/Ashburton, and Madison/East End.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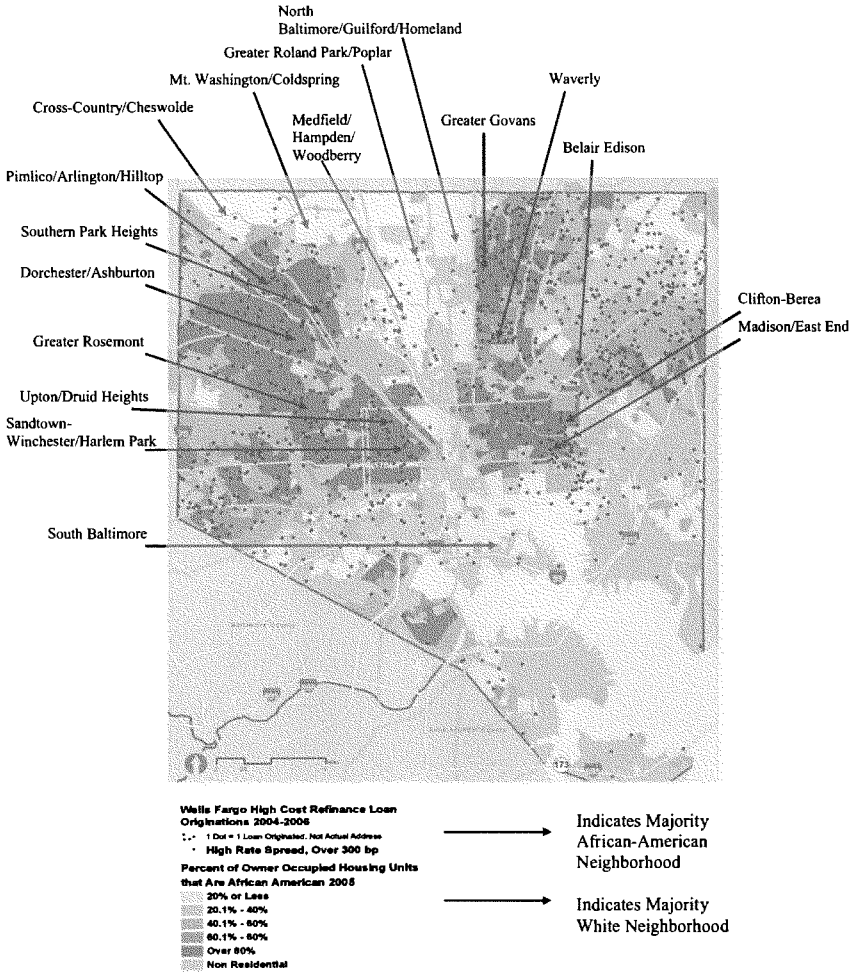
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Wells Fargo High Cost Purchase and
Refinance Loan Originations 2004-2006
1 Dot = 1 Loan Originated, Not Actual Address
High Rate Spread, Over 300 bp
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood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20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

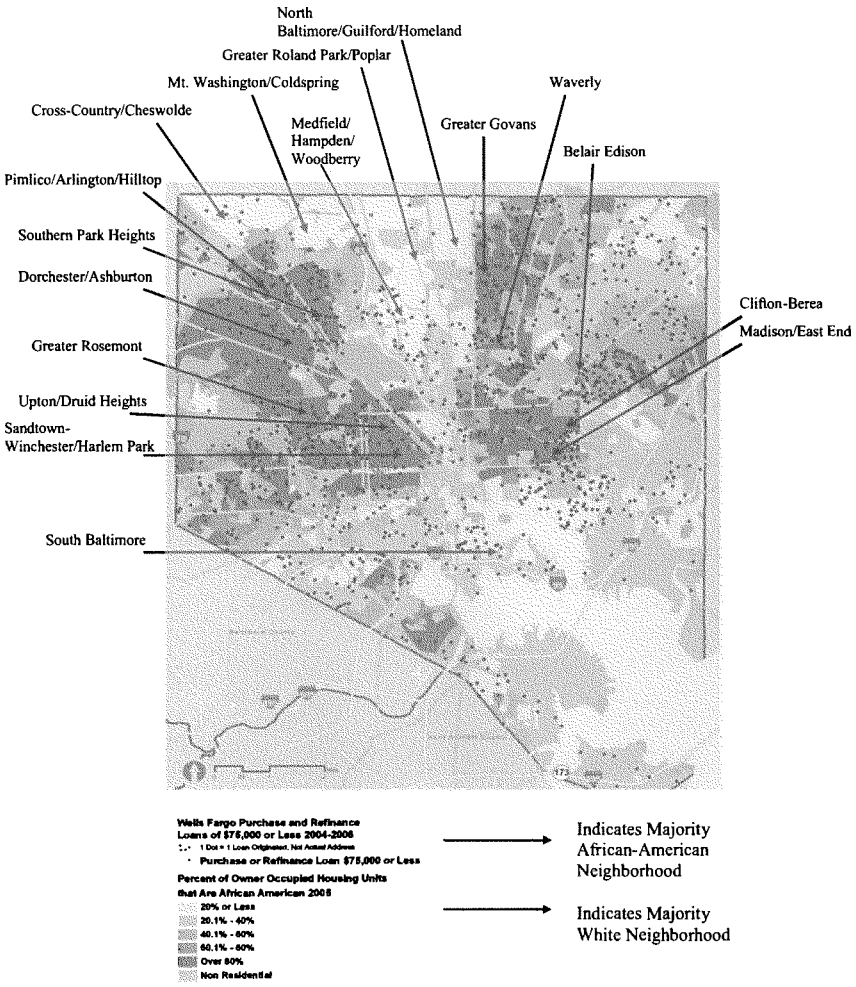
49. The fact that high-cost loans involving all of Wells Fargo's loan products are more heavily concentrated in Baltimore's African-American neighborhoods is consistent with the practice of reverse redlining and, upon information and belief, has contributed significantly to the disproportionately high rate of foreclosures in Baltimore's African-American communities. Within the subset of high-cost loans, however, the fact that a disproportionately large percentage of Wells Fargo's high-cost loans in African-American neighborhoods are refinance loans is particularly significant, for it is both consistent with and indicative of a deceptive and predatory subprime practice that involves encouraging minority borrowers who already have loans to refinance at excessive cost with little benefit. This increases the likelihood of foreclosure and, upon information and belief, has contributed to the disproportionately high rate of foreclosures in Baltimore's African-American communities.

2. Wells Fargo's Pricing Sheets Show that it Targets Homes that are More Likely to be Located in African-American Neighborhoods for Interest Rate Increases, and Lowers Rates for Homes that are Disproportionately Located in White Neighborhoods

50. One reason that residents of Baltimore's African-American neighborhoods are more likely to pay higher prices for Wells Fargo loans than residents of Baltimore's white neighborhoods is the discriminatory pricing found on its pricing sheets. As set forth explicitly on the Wells Fargo Home Mortgage 2005 pricing sheet, attached as Attachment A, Wells Fargo requires a 50 basis point increase in the loan rate for loans of $75,000 or less, a 12.5 basis point decrease for loans of $150,000 to $400,000, and a 25 basis point decrease for loans larger than $400,000. This means that a borrower with a $75,000 thirty-year fixed rate loan who qualifies for an 8% interest rate instead receives an 8.5% interest rate, which costs an extra $9,493 over the life of the loan. An equally creditworthy borrower with a $150,000 loan receives a 7.875% interest rate, which costs

$4,698 less than an 8% loan. A similarly qualified borrower with a $400,001 loan would receive a 7.75% interest rate, which costs $24,987 less than an 8% loan.

51. These pricing rules have a clear and foreseeable disproportionate adverse impact on African-American borrowers. As demonstrated by the maps that follow, loans originated by Wells Fargo in Baltimore from 2004 through 2006 in the amount of $75,000 and less were nearly twice as likely to be in census tracts where the population is predominantly African-American than in tracts where the population is predominantly white. By contrast, loans originated by Wells Fargo in Baltimore of more than $150,000 were nearly six times as likely to be in tracts that are predominantly white than in tracts that are predominantly African-American.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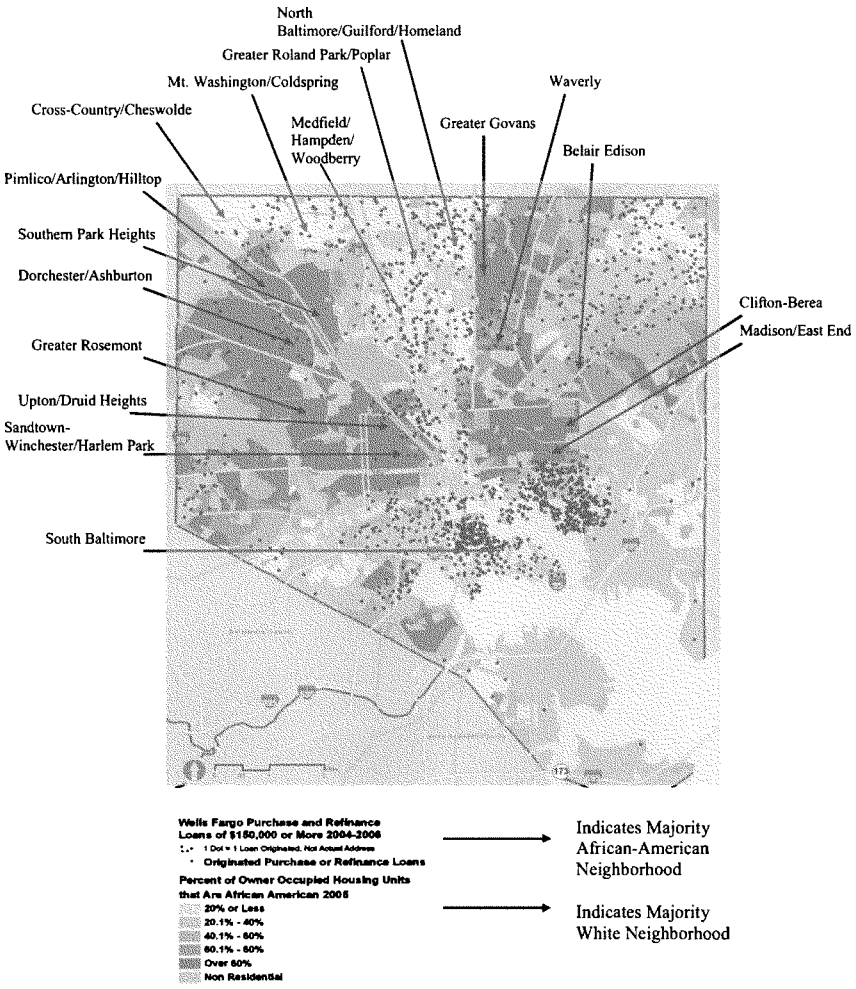
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52. Upon information and belief, the discriminatory pricing reflected in Wells Fargo's pricing sheets is consistent with unfair practices associated with reverse redlining and has contributed significantly to the disproportionately large number of foreclosures found in Baltimore's African-American communities.

3. Investigation of Wells Fargo's Pricing Practices in Philadelphia Further Demonstrates the Company is Targeting the African-American Community for Unfair and Improper Lending Practices

53. Discriminatory pricing observed in Wells Fargo's loan data in Baltimore is consistent with findings drawn from data obtained in litigation brought against Wells Fargo in Philadelphia. An expert report in a pending lawsuit based on Wells Fargo's Philadelphia loans concluded that "African American borrowers, and borrowers residing in African American neighborhoods (i.e., census tracts), pay more than comparable non-African Americans and residents of communities in which White people predominate." Aff. of I. Goldstein, *Walker v. Wells Fargo Bank, N.A.*, No. 05-cv-6666 (E.D. Pa. July 20, 2007) at ¶ 7 (Docket No. 24, Attach. 1).

54. Upon information and belief, Wells Fargo's pricing practices in Philadelphia are consistent with its practices in Baltimore, and provide further evidence that the company is engaged in a pattern or practice of unfair lending that contributes significantly to the disproportionately high rate of foreclosure found in Baltimore's African-American neighborhoods.

4. Wells Fargo Underwrites Adjustable Rate Loans in Baltimore's African-American Neighborhoods That Borrowers Cannot Afford

55. Wells Fargo frequently originates, or until earlier in 2007originated, "2/28" and "3/27" adjustable rate mortgages to borrowers from predominantly African-American neighborhoods in Baltimore. Thirty percent of Wells Fargo's foreclosures

from 2000 to 2006 involved such loans. Unless properly underwritten, such loans are destined to fail.

56. Upon information and belief, Wells Fargo does not properly underwrite these loans when made to African Americans and in African-American neighborhoods. Wells Fargo does not adequately consider the borrowers' ability to repay these loans, especially after the teaser rate expires and the interest rate increases. The fact that these loans would result in delinquency, default and foreclosure for many borrowers was, or should have been, clearly foreseeable to Wells Fargo at the time the loans were made.

57. The use of "2/28" and "3/27" adjustable rate mortgages in the manner described above is consistent with the practice of reverse redlining, has subjected African-American borrowers to unfair and deceptive loan terms, and has contributed significantly to the high rate of foreclosure found in Baltimore's African-American neighborhoods.

5. The Caps on Wells Fargo's Adjustable Rate Loans are Higher in African-American Neighborhoods

58. Upon information and belief, Wells Fargo has discretion to apply different caps on adjustable rate loans. The cap is the maximum rate that a borrower can be charged during the life of an adjustable rate loan.

59. The average cap on a Wells Fargo adjustable rate loan that was subject to foreclosure in 2005 or 2006 in predominantly African-American neighborhoods was 14.13%. The cap on such loans in predominantly white neighborhoods was only 13.61%.

60. The disparity observed in caps imposed on adjustable rate loans in predominantly African-American neighborhoods and predominantly white neighborhoods further demonstrates that Well Fargo is engaged in a pattern or practice of

unfair and improper lending in Baltimore's African-American communities that contributes significantly to the high rate of foreclosure in these neighborhoods.

6. Wells Fargo's Loans in African-American Neighborhoods Result in Especially Quick Foreclosures

61. A comparison of the time from origination to foreclosure of Wells Fargo's loans in Baltimore shows a marked disparity with respect to the speed with which loans in African-American and white neighborhoods move into foreclosure. In African-American neighborhoods, the average time to foreclosure is 2.06 years. In white neighborhoods it is 2.45 years, or 19% longer.

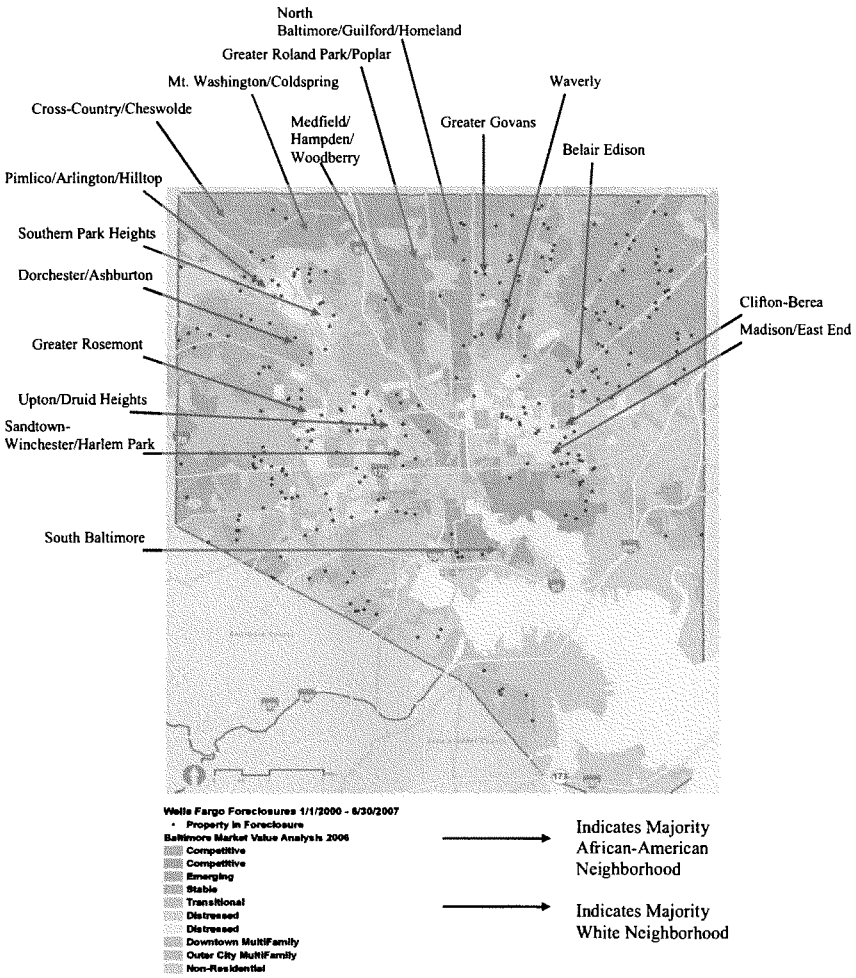
62. This disparity in time to foreclosure is further evidence that Wells Fargo is engaged in lending practices consistent with reverse redlining. As with all of the practices identified in paragraphs 47-60 above, and like the abusive practices identified in paragraph 26 above, the disparity in time to foreclosure demonstrates that Wells Fargo is engaged in irresponsible underwriting in African-American communities that does not serve the best interests of borrowers. If Wells Fargo were applying the same underwriting practices in Baltimore's African-American and white neighborhoods, there would not be a significant difference in time to foreclosure. Were Wells Fargo underwriting borrowers in both communities with equal care and attention to proper underwriting practices, borrowers in African-American communities would not find themselves in financial straits significantly sooner during the life of their loans than borrowers in white communities. The faster time to foreclosure in African-American neighborhoods is consistent with underwriting practices in the African-American community that are less concerned with determining a borrower's ability to pay and qualifications for the loan than they are in maximizing short-term profit.

63. This difference in time to foreclosure is especially important because foreclosures occur more quickly in Baltimore than in neighboring jurisdictions. For all lenders, the average time from loan origination to foreclosure in Baltimore is three years, while in Philadelphia it is four years and in New Castle County, Delaware (which includes Wilmington) it is 4.3 years. This means that the injuries that result from foreclosures in Baltimore are compounded, and therefore grow, at a faster pace.

INJURY TO BALTIMORE CAUSED BY
WELLS FARGO'S DISCRIMINATION IN MORTGAGE LENDING

64. Wells Fargo has engaged in a pattern or practice of reverse redlining that has resulted in a disproportionately high rate of foreclosure on loans to African Americans and in Baltimore's majority African-American neighborhoods. Wells Fargo continues to engage in this discriminatory pattern or practice with similar and continuing deleterious consequences for Baltimore's African-American neighborhoods.

65. The foreclosures caused by Defendants' discriminatory lending practices are particularly injurious because they are concentrated in distressed and transitional neighborhoods, as reflected on the following map. These neighborhoods include, among others, Greater Rosemont, Upton/Druid Heights, Clifton-Berea, and Madison/East End, all with African-American populations over 90%. These neighborhoods have high vacancy rates, low rates of owner occupancy, substantial housing code violations, and low property values. These characteristics make these neighborhoods most vulnerable to the deleterious effects of foreclosures.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Distressed
Downtown MultiFamily
Outer City MultiFamily
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Indicates Majority
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66. The foreclosures caused by Defendants' discriminatory reverse redlining practices have caused, and continue to cause, multiple types of injuries to Baltimore, including:

a. A significant decline in the value of nearby homes, resulting in a decrease in property tax revenue;

b. An increase in the number of abandoned and vacant homes;

c. An increase in criminal and gang activity as abandoned and vacant homes become centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities;

d. Increased expenditures for police and fire protection;

e. Increased expenditures to secure abandoned and vacant homes;

f. Additional expenditures to acquire and rehabilitate vacant properties; and

g. Additional expenditures for administrative, legal, and social services.

67. Damages suffered by the City of Baltimore as a result of Wells Fargo's foreclosures are fully capable of empirical quantification. Recent studies demonstrate that the precise financial impacts of the different types of injuries caused by foreclosures are quantifiable. A study published by the Fannie Mae Foundation, using Chicago as an example, determined that each foreclosure is responsible for an average decline of approximately 1% in the value of each single-family home within a quarter of a mile. *See* D. Immergluck & G. Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Policy Debate 57 (2006).

68. Other studies have focused on the impact of abandoned homes on surrounding property values. A recent study in Philadelphia, for example, found that each home within 150 feet of an abandoned home declined in value by an average of $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542. Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, at 20 (2004).

69. The costs of increased municipal services that are necessary because of foreclosures have also been analyzed empirically. A study commissioned by the Homeownership Preservation Foundation isolated twenty-six types of costs incurred by fifteen government agencies in response to foreclosures in Chicago. *See* W. Apgar, M. Duda & R. Gorey, *The Municipal Costs of Foreclosures: A Chicago Case Study* (Feb. 27, 2005) at 24-26 (available at http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/documents/2005Apgar-DudaStudy-FullVersion.pdf). It then analyzed the amount of each cost based on different foreclosure scenarios, such as whether the home is left vacant, whether and to what degree criminal activity ensues, and whether the home must be demolished. The study found that the total costs ran as high as $34,199 per foreclosure.

70. The damages and costs to Baltimore of the foreclosures caused by Defendants' discriminatory lending practices, including but not limited to those described above, are in the tens of millions of dollars.

71. Defendants' actions set forth herein constitute a pattern or practice of discriminatory lending and a continuing violation of federal law. Unless enjoined, Wells Fargo will continue to engage in the unlawful pattern or practice described above.

72. Baltimore has been, and continues to be, adversely affected by the acts, policies, and practices of Defendants, their employees, and/or their agents.

73. The extent of Baltimore's injuries will increase unless and until Wells Fargo ceases to discriminate against African Americans and borrowers in majority African-American neighborhoods.

74. Defendants' unlawful actions described above were, and are, intentional and willful, and/or have been, and are, implemented with callous and reckless disregard for Baltimore's federally protected rights.

CAUSE OF ACTION
(Federal Fair Housing Act)

75. Plaintiff repeats and incorporates by reference all allegations contained in Paragraphs 1 through 74 as if fully set forth herein.

76. Defendants' acts, policies, and practices constitute reverse redlining and violate the Fair Housing Act, as amended, 42 U.S.C. §§ 3604 and 3605:

(a) Defendants' acts, policies, and practices have made and continue to make housing unavailable on the basis of race and/or color, in violation of 42 U.S.C. § 3604(a);

(b) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions, and privileges of sale of housing, as well as different services and facilities in connection therewith, on the basis of race, and/or color, in violation of 42 U.S.C. § 3604(b);

(c) Defendants' published policies and statements have expressed and continue to express a preference on the basis of race and/or color, in violation of 42 U.S.C. § 3604(c); and

(d) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions and privileges on the basis of race and/or color in connection with the making of residential real estate-related transactions, in violation of 42 U.S.C. § 3605.

DEMAND FOR JURY TRIAL

77. Pursuant to Fed. R. Civ. P. 38(b), Plaintiff demands a trial by jury on all issues triable as of right.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully prays that the Court grant it the following relief:

(1) enter a declaratory judgment that the foregoing acts, policies, and practices of Defendants violate 42 U.S.C. §§ 3604 and 3605;

(2) enter a permanent injunction enjoining Defendants and their directors, officers, agents and employees from continuing to publish, implement, and enforce the illegal, discriminatory conduct described herein and directing Defendants and their directors, officers, agents and employees to take all affirmative steps necessary to remedy the effects of the illegal, discriminatory conduct described herein and to prevent additional instances of such conduct or similar conduct from occurring in the future;

(3) award compensatory damages to Plaintiff in an amount to be determined by the jury that would fully compensate Plaintiff for its injuries caused by the conduct of Defendants alleged herein;

(4) award punitive damages to Plaintiff in an amount to be determined by the jury that would punish Defendants for the willful, wanton and reckless conduct alleged herein and that would effectively deter similar conduct in the future;

(5) award Plaintiff its reasonable attorneys' fees and costs pursuant to 42 U.S.C. § 3613(c)(2); and

(6) order such other relief as this Court deems just and equitable.

January 8, 2008

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Attorneys for Plaintiff

ATTACHMENT A

WHOLESALE - ALTERNATIVE LENDING/ SUBPRIME RATE SHEET
15 Day Best Effort Pricing - 7/13/05
Loan Programs with Prepayment Penalties
Fax on Demand 888/209-7177 Doc #252

	Credit Grade	FICO	LTV	1 Year ARM PAR	1 Year ARM <1.00>	1 Year ARM <2.00>	1 Year ARM <3.00>	2/28 ARM PAR	2/28 ARM <1.00>	2/28 ARM <2.00>	2/28 ARM <3.00>	30 Year Fixed PAR	30 Year Fixed <1.00>	30 Year Fixed <2.00>	30 Year Fixed <3.00>
Y5	Credit Score	680+	70%	6.950	6.750	6.550	6.750	6.990	6.800	6.600	7.000	6.990	6.875	7.075	7.475
	Mtg. History	0x30	75%	6.975	6.875	6.875	6.875	7.025	6.925	6.925	7.125	6.990	7.000	7.200	7.600
	BKPO	3Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.125	7.325	7.725
	Debt Ratio	<=50%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.250	7.450	7.850
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.375	7.575	7.975
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.500	7.700	8.100
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	7.625	7.825	8.225
Y4	Credit Score	640-680	70%	6.990	6.990	6.990	6.990	7.050	7.050	7.050	7.250	7.000	7.250	7.450	7.850
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.375	7.575	7.975
	BKPO	3Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.500	7.700	8.100
	Debt Ratio	<=50%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.625	7.825	8.225
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.750	7.950	8.350
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.875	8.075	8.475
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
Y3	Credit Score	620-640	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.375	7.575	7.975
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.500	7.700	8.100
	BKPO	3Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.625	7.825	8.225
	Debt Ratio	<=45%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.750	7.950	8.350
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.875	8.075	8.475
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
Y2	Credit Score	600-620	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.500	7.700	8.100
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.625	7.825	8.225
	BKPO	3Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.750	7.950	8.350
	Debt Ratio	<=45%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.875	8.075	8.475
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.250	8.450	8.850
Y1	Credit Score	580-600	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.625	7.825	8.225
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.750	7.950	8.350
	BKPO	< 1 Year	80%	6.990	10.000	10.000	10.000	7.050	10.000	10.000	10.250	7.000	7.875	8.075	8.475
	Debt Ratio	<=40%	85%	6.990	10.000	10.000	10.000	7.050	10.000	10.000	10.250	7.000	8.000	8.200	8.600
			90%	6.990	10.000	10.000	10.000	7.050	10.000	10.000	10.250	7.000	8.125	8.325	8.725
			95%	6.990	10.000	10.000	10.000	7.050	10.000	10.000	10.250	7.000	8.250	8.450	8.850
			100%	7.000	10.000	10.000	10.000	7.050	10.000	10.000	10.250	7.000	8.375	8.575	8.975
Y0	Credit Score	540-580	70%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	7.750	7.950	8.350
	Mtg. History	1x60	75%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	7.875	8.075	8.475
	BKPO	1Y	80%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
	Debt Ratio	<=40%	85%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
			90%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.250	8.450	8.850
			95%	6.990	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.375	8.575	8.975
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.500	8.700	9.100
Y6	Credit Score	500-540	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	7.875	8.075	8.475
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
	BKPO	1Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
	Debt Ratio	<=40%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.250	8.450	8.850
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.375	8.575	8.975
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.500	8.700	9.100
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.625	8.825	9.225
Y7	Credit Score	480-500	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.000	8.200	8.600
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
	BKPO	1Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.250	8.450	8.850
	Debt Ratio	<=40%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.375	8.575	8.975
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.500	8.700	9.100
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.625	8.825	9.225
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.750	8.950	9.350
Y8	Credit Score	460-480	70%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.125	8.325	8.725
	Mtg. History	1x60	75%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.250	8.450	8.850
	BKPO	1Y	80%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.375	8.575	8.975
	Debt Ratio	<=40%	85%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.500	8.700	9.100
			90%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.625	8.825	9.225
			95%	6.990	6.990	6.990	7.000	7.050	7.050	7.050	7.250	7.000	8.750	8.950	9.350
			100%	7.000	7.000	7.000	7.000	7.050	7.050	7.050	7.250	7.000	8.875	9.075	9.475

ARM Floor Rate = 6.00% | **Fixed Floor Rate = 6.50%**

Rate discounts or credits apply for value, first lien, size of mtg amt, borrower's credit grade, and for all discounts see rate.

Underwriting Notes:
•Satisfy 3 day list (signed form) prior to all pre-to-buy conditions.
•Maximum margin is profile - No further margin discounts allowed.
•No Section 32 or state-specific high cost loans
Number Filter: (FHB) + Tax Service (State Specific)

Mortgage Broker Compensation:
•Broker Compensation is capped at 4 total of 5%
•2/28 Libor, 3/27 ARM & Fixed rate (w/out prepay penalty) = <1.00>
•1 Year ARM(w/out prepay penalty) = PAR

Prepayment Penalty Adjustments: Rate and Margin				
	1 Yr ARM	2/28 ARM	3/27 ARM	All Fixed
No Prepay	0.50	0.50	0.50	0.75
2 Years Prepay	n/a	0.00	0.25	0.50
3 Years Prepay	n/a	n/a	0.00	0.00

Adjustments:

	Rate/Margin
Interest Only Program	+.250
PMI Paid	-.125
Lite Doc	+.250
Second Home	+.250
Non-Owner Occupied	+.500
2-4 Units	+.500
High-Rise Condo	+.500
Loan Amounts on $75,000	+.500
Loan Amounts $75,001 - $149,999	As Profile
Loan Amounts $150,000 - $400,000	-.125
Loan Amounts to $600,001	-.250

Loan Programs:

	Rate/Margin
30/15 Balloon or 15 Year Fixed	Reduce 30 yr Fixed by .250
1 Year ARM	Reduce Start ARM by .125

SUBPRIME MORTGAGE PAYMENTS
Credit Grades "C", "B" & "A" only

0 x 30 last 24 mos.	Payment rate by $7.5 /box
0 x 60 last 12 mos.	Rate/Payment by .25 bps
1 x 30 last 24 mos.	Payment rate by .5 bps

See guidelines for additional information and exceptions

Title Fees: Based upon the transaction costs and charges for:
ARM Initial:
AL, AR, AZ (with loans $0-$99,999), AR, CA, CO, CT, DE, DC, FL
GA (with loans $0-$99,999, investments and 2nd home), IL, ID, IN, IA
KS, KY, LA, ME, MA (2nd home purchases & refinance)
MI, MN, MS, MO, MT, NE, NH, NJ (with loans $1-$0,001)
NJ (all purchases with loans $0-$99,999; investment, 2nd home)
NM (with loans $0-$99,999), ND, NV, NY, OH, OK, OR, PA, RI
SC (all with loans $0-$99,999; 2nd & investment with loans $0-$0,001)
SD, TN, TX, UT, VA, VT, WA, WI, WV, WY

Fixed Rate loans and ARM Balloon in:
AL, AZ (with loans $0-$0,000), AR, CA, CO, CT, DE, DC
FL, GA (all with loans $0-$0,000, investments, 2nd home), HI, ID, IN, KY
LA (with loans $0-$0,000), MA (2nd home, investment), MO, ME, NH, MD, MT
NE, NH, NV, NY (2yr max; Max YSP <2.00>), NC (2yr max; min loans $0-$0,001)
ND, OH, OK, OR, PA (min loans $0-$0,001), RI (refinance)
SC (all min loans $0-$0,000; 2nd & investment min loans $0-$0,001)
SD, TN, TX (& VPM), UT, VA, WA, WI (purchases), WI, WY
*30/15 balloon not available for loans in NC> 40yr (MA, 2nd homes)

Alternative Lending Marketing Group Contact: Baton Rouge (800) 209-7574 — 4041 Essen Lane, Suite 500, Baton Rouge, LA 70809
Fax-Attn: (888) 403-5449 — 3480 Stateview Blvd, Fort Mill, SC 29715
Cincinnati (888) 474-8544 — 1401 Willow Pass Road, Concord, CA 94520
Doc Mailing (888) 600-81 10 — One Home Campus, West Des Moines, IA 50328

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Oral Testimony of

Suzanne Sangree, Chief Solicitor

Baltimore City Law Department

Before the United States House Judiciary Committee

Subcommittee on Commercial and Administrative Law

Hearing on the Role of the Lending Industry in the Subprime Mortgage Crisis

Wednesday September 9, 2009

Baltimore City Department of Law

City Hall, 100 Holliday Street, Room 109

Baltimore, MD 21202

suzanne.sangree@baltimorecity.gov

Oral Testimony of

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Hearing on the Role of the Lending Industry in the Subprime Mortgage Crisis

Wednesday September 9, 2009

Members of the Committee, I am Suzanne Sangree, a Chief Solicitor in the Baltimore City Department of Law, testifying on behalf of the Mayor and City Council of Baltimore. Thank you for inviting me to speak with you today.

Baltimore is a case study of the damage that has befallen cities in the absence of aggressive federal enforcement of this nation's civil rights laws, especially the Fair Housing Act of 1968. In particular, lax enforcement of the Fair Housing Act, combined with federal relaxation of federal banking regulations and federal preemption of states' ability to regulate lenders, created an environment in which racially discriminatory predatory lending flourished. Baltimore, a majority African-American city, is currently contending with the devastating economic fall out of this petri dish for racially targeted predatory lending. The City has developed and continues to develop a six pronged approach to staunching the resulting economic damage and repairing it. Litigation against the wrong doers is one prong of our plan, beginning with our Fair Housing Act suit against Well Fargo for reverse redlining. In the absence of federal enforcement cities have been left to contend for themselves. Under the leadership of City Solicitor George Nilson and our co-counsel John Relman and Brad Blower of Relman & Dane, Baltimore

City turned to the Fair Housing Act as our best weapon for fending off reverse redlining and obtaining relief to repair the damage it has inflicted. The shapers of that Act smartly provided a broad capacity for standing to sue, thus the Supreme Court has long recognized that Cities have standing under the Act. However, it was always envisioned that the federal government would play a leading role in enforcement. It has not.

Like other American cities with large non-white populations and a history of racial segregation, Baltimore is particularly vulnerable to predatory lending. This vulnerability is caused by two complimentary factors: 1) a history of denying minorities access to credit; and 2) a history of racially segregated living patterns. As to the first factor, communities that for generations had been locked out of credit and housing opportunities, because of redlining are rendered desperate for credit and without the knowledge or experience required to identify loan products and lenders offering better terms. When one's only experience with loan applications has been no, it is common to jump on the first yes without much critical evaluation. The second factor is key because when these vulnerable communities are geographically concentrated they are easily targeted by abusive lenders. Unfortunately Baltimore fulfills both of these factors.

Our solid patterns of racial segregation were initially enforced by racially restrictive convenants. In 1954, within months of the Supreme Court's *Brown I* decision, forward looking Baltimore officials decided to desegregate the City's low-income housing units. However, well into the 1970's and later the siting and maintenance of racially segregated public housing continued to reinforce Baltimore's patterns of housing segregation. Importantly, redlining practices by federal and state government authorities-- and by private entities (mortgage lenders and insurers)—also created barriers to desegregation. The Secretary of the United States Department of Housing and Urban Development admitted in 1970 that the federal government had "refused to provide insurance in integrated neighborhoods, promoted the use of racially restricted covenants," and engaged in other methods of redlining. Data from the 1980's, long after the institutionalized government and corporate apparatus of discrimination had been formally dismantled, shows that the more African-American residents in a Baltimore neighborhood, the fewer the mortgage loans and dollars the neighborhood received. And while we are 64% African-American and 32% white, today's map of our neighborhoods shows that many still have very high concentrations of one race or the other.

As our history of redlining and racial segregation would predict, beginning in the late 1990's, Baltimore has been targeted for predatory loans. This fact is reflected in the wave of foreclosures currently wracking the City. Since 2000, more than 33,000 homes have been subjected to foreclosure filings. From the first to the second quarter of 2007, foreclosure activity in the City increased five-fold. Moreover, we expect this year to be even worse than last year as an additional 4,300 ARMs adjust to higher rates in the City, often to rates the borrowers cannot afford. Another 2,000 ARMs readjust in 2009. During the first quarter of 2008 alone, 1,447 foreclosure filings were made in Baltimore City.

On January 8, 2008, Baltimore City filed suit against Wells Fargo in the federal district court of Maryland alleging that Wells Fargo engaged in reverse redlining, i.e. that it has targeted Baltimore's African-American neighborhoods for bad loans. We chose Wells Fargo because it is one of the largest mortgage lenders in Baltimore and it has the greatest number of foreclosures in the City. Since 2004 to the present, Wells Fargo has made over a 1,200 mortgage loans per year in Baltimore City. No other lender made more than 1,000 mortgage loans in Baltimore during these years. In addition, the racial disparities in lending practices for Wells Fargo loans were among the greatest of all lenders. But there are certainly other bad actors in the City, and we hold them accountable as well.

Home Mortgage Disclosure Act (HMDA) data reveals the racial disparities in Wells Fargo lending practices in Baltimore. As documented in the attached complaint, in 2006 Wells Fargo made high-cost loans to 65% of its African-American mortgage customers in Baltimore, but to only 15% of its white customers in Baltimore. Wells Fargo's refinance loans were even worse: in 2004, 2005, and 2006, a Wells Fargo refinance loan to an African-American borrower was 2.5 times more likely to be high cost than a refinance loan to a white borrower. In addition, Wells Fargo's pricing sheets require that equally credit worthy borrowers in predominantly African-American neighborhoods pay higher interest rates than their counterparts in white neighborhoods, imposing thousands of dollars in extra interest payments on African-American borrowers.

High level ex-employees of Wells Fargo have submitted affidavits with our amended complaint (attached hereto) detailing the economic incentive structure at Wells Fargo which encouraged employees to engage in racial targeting—to steer African-Americans into subprime loans even when they qualified for prime loans, and to engage in numerous other deceptive practices to induce unsuspecting borrowers into unfavorable loans.

Interestingly, research recently conducted by Chris Herbert of Abt Associates Inc. for the Annie E. Casey Foundation confirms that race accounts for lenders' disparate lending practices in Baltimore neighborhoods and not credit scores or other risk factors. He has analyzed HMDA, Census Bureau and credit scores from the credit bureau Experian for selected neighborhoods in 13 cities, including the Sandtown/Winchester/East Side Revitalization Area in Baltimore. He concludes that **when one corrects for credit scores,** there is a "Very High" (over 15%) racial disparity in these Baltimore neighborhoods for refinances for 2006, and a "High/Med" (5-15%) racial disparity for purchase loans in 2006. Wells Fargo was the most active lender in both categories in Baltimore. In other words, even after taking the credit characteristics of borrowers into consideration, Wells Fargo was ranked first among lenders in Baltimore for having the largest disparity in the prices it charged African Americans versus whites. So while we are just commencing discovery now in our suit, we have every reason to believe that the loan files will bear out the allegations of our amended complaint.

As our amended complaint documents, Wells Fargo also has one of the highest foreclosure rates of any lender in Baltimore, and its foreclosure rate in majority African American neighborhoods is 4 times the rate in majority white neighborhoods. Two thirds

of Wells Fargo foreclosures in Baltimore in 2005 and 2006 were in census tracts more than 60% African-American, while only 16% were in tracts that are less than 20% African American. Wells Fargo's foreclosure rate for loans in African-American neighborhoods is nearly double the overall City average, while its rate for loans in white neighborhoods is less than half of the average.

An interesting fact about Wells Fargo loans in Baltimore is that fixed rate loans constitute the majority of Wells Fargo's foreclosures. With contemporary underwriting methods lenders can reliably predict whether a borrower will be able to repay a fixed rate loan (debt to income ratio/loan to value/FICO/work history etc.), and the loan payments do not change over the life of the loan. However, even though 70% of Wells Fargo's foreclosures in both African-American and white neighborhoods are on fixed rate mortgages, African Americans are nearly 4 times more likely to be foreclosed upon by Wells Fargo than whites. This is compelling evidence that Wells Fargo followed a policy of putting African-Americans into loans they could not afford.

When people are locked into mortgages that they cannot afford, they will soon fall behind on payments and foreclosure will often result. This pattern of predatory lending and foreclosure is ravaging our City. The TRF/Goldseker Study, "Foreclosures in Baltimore, Maryland" found that Baltimore lost $41.9 million in tax revenue in 2006 alone because of foreclosures. Lost property values across Baltimore in 2004 and 2005 total $17.8 billion.

Baltimore incurs increased code enforcement, police, and fire costs when buildings remain vacant. And the dollars and effort spent to nurture neighborhoods, and to spark and maintain the urban renaissance the City had been undergoing, are being washed down the drain, as up and coming neighborhoods are stalled and even reversed in their economic progress.

The City seeks compensatory and punitive damages from Wells Fargo in order to mend the damage the company's predatory lending has inflicted, and to deter such conduct in the future. Judge Legg denied Wells Fargo's Motion to Dismiss in July of this year and we are now engaging in discovery.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, City Hall 100 N. Holliday St. Baltimore, MD 21202 Plaintiff, v. **WELLS FARGO BANK, N.A.** 464 California Street San Francisco, CA 94104 and **WELLS FARGO FINANCIAL LEASING, INC.,** 207 9th Street Des Moines, IA 50307 Defendants.	Case No. 1:08-cv-00062-BEL

FIRST AMENDED COMPLAINT FOR DECLARATORYAND INJUNCTIVE RELIEF AND DAMAGES

NATURE OF THE ACTION

1. The City of Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. From the third to the fourth quarter of 2008, foreclosure activity increased 26%. Since 2000, more than 33,000 homes have been subjected to foreclosure filings. The foreclosure crisis has caused severe economic damage to the City. The high rate of foreclosures has resulted in lost revenue in property taxes; additional costs in

social services and police and fire protection; and significant administrative and legal costs.

2. In Baltimore, the foreclosure crisis has hit African-American neighborhoods and homeowners the hardest. Foreclosure rates are significantly higher in Baltimore's minority neighborhoods, due in large part to the practice of "reverse redlining." In contrast to "redlining," which involves denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise unfair lending practices because of the race or ethnicity of the area's residents. Reverse redlining has repeatedly been held to violate the federal Fair Housing Act.

3. Defendant Wells Fargo Bank, N.A., is one of the largest mortgage lenders in Baltimore and the country at large. Together with Defendant Wells Fargo Financial Leasing, Inc. (collectively "Wells Fargo"), it is also one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. From 2005 to 2008, for example, over 60% of Wells Fargo's foreclosures were in Baltimore City census tracts that are more than 60% African-American, while only 12% were in tracts that are less than 20% African-American. Wells Fargo's foreclosure rate for loans in neighborhoods that are more than 80% African-American is nearly triple the overall average of the other major mortgage lenders in Baltimore, while the rate for its loans in neighborhoods that are less than 20% African-American is less than half of their average.

4. Wells Fargo's disproportionately high foreclosure rate in Baltimore's African-American neighborhoods is the result of reverse redlining. Wells Fargo has been, and continues to be, engaged in a pattern or practice of unfair, deceptive and

discriminatory lending activity in Baltimore's minority neighborhoods that have the effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit to Wells Fargo without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods.

5. Wells Fargo's lending practices, targeted in this manner at Baltimore's underserved and vulnerable minority neighborhoods, have resulted in the disproportionately high rate of foreclosure in Baltimore's African-American communities, caused substantial and irreparable damage to these neighborhoods, and caused direct and continuing financial harm to the City of Baltimore.

6. This suit is brought pursuant to the Fair Housing Act of 1968, as amended, 42 U.S.C. §§ 3601 *et seq.*, by the Mayor and City Council of Baltimore ("Baltimore" or "City") to seek redress for the injuries caused by Wells Fargo's pattern or practice of illegal reverse redlining. Specifically, Baltimore seeks to recover damages for the injuries caused by the foreclosures in Baltimore's minority neighborhoods as a result of Wells Fargo's unlawful, irresponsible, unfair, deceptive, and discriminatory lending practices, and to obtain injunctive and declaratory relief. Absent judicial relief, the extent of the City's injury resulting from Wells Fargo's actions will continue – and potentially accelerate – as the housing market continues to decline.

PARTIES

7. Plaintiff Mayor and City Council of Baltimore is a municipal corporation, organized pursuant to Article XI-A of the Maryland Constitution. The City is authorized by the Baltimore City Charter to institute suit to recover damages suffered by the City.

8. Defendant Wells Fargo Bank, N.A. is organized as a national banking association under the laws of the United States. Upon information and belief, its corporate headquarters are located in California. Wells Fargo Bank, N.A. maintains multiple offices in the State of Maryland and in Baltimore for the purposes of soliciting applications for and making residential mortgage loans and engaging in other business activities.

9. Wells Fargo Home Mortgage is a division of Wells Fargo Bank, N.A. that was formerly incorporated in California as a separate company and registered to do business in the State of Maryland under the name Wells Fargo Home Mortgage, Inc. Wells Fargo Home Mortgage, Inc. merged into Wells Fargo Bank, N.A. on May 5, 2004. Wells Fargo Bank, N.A. continues to do business under the name Wells Fargo Home Mortgage, including in the State of Maryland and in Baltimore.

10. Wells Fargo Bank, N.A. has been one of the three largest providers of mortgage credit to homeowners in Baltimore every year since at least 2000. From 2002 to 2007 (the most recent year for which data is available), Wells Fargo Bank, N.A. made at least 1,341 mortgage loans a year to Baltimore homeowners with a collective value of more than $1 billion. Upon information and belief, Wells Fargo Bank, N.A. continues to make loans in Baltimore at a comparable pace. No other lender made more than 1,200 mortgage loans in Baltimore in each year from 2004 to 2007, and only two others made more than 1,000 in each year.

11. Defendant Wells Fargo Financial Leasing, Inc. is an Iowa corporation that is registered to do business in Maryland. Upon information and belief, Wells Fargo Financial Leasing, Inc. engages in the solicitation of applications for and origination of residential mortgage loans in Baltimore.

12. Each of the Defendants was and is the agent, employee, and representative of the other Defendant. Each Defendant, in acting or omitting to act as alleged in this First Amended Complaint, was acting in the course and scope of its actual or apparent authority pursuant to such agencies, or the alleged acts or omissions of each Defendant as agent were subsequently ratified and adopted by each agent as principal. Each Defendant, in acting or omitting to act as alleged in this First Amended Complaint, was acting through its employees, agents, and/or representatives, and is liable on the basis of the acts and omissions of its employees, agents, and/or representatives.

JURISDICTION AND VENUE

13. This Court has jurisdiction over this matter pursuant to 42 U.S.C. § 3613 and 28 U.S.C. §§ 1331, 1343, because the claims alleged herein arise under the laws of the United States.

14. Venue is proper in this district under 28 U.S.C. § 1391(b) because Defendants conduct business in and are residents of the district and a substantial part of the events and omissions giving rise to the claims occurred in the district.

FACTUAL BACKGROUND

A. The Foreclosure Crisis and Baltimore

15. Like many cities across the country, Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. Of the 45 million active mortgages throughout the country currently tracked by the Mortgage Bankers Association ("MBA"), approximately 343,000 entered foreclosure during the third quarter of 2007. This is the highest rate of foreclosures in more than 35 years. Overall, nearly 450,000 properties tracked by the MBA were in some stage of foreclosure during the third quarter of 2007, up 30% from the second quarter.

16. Nationwide, the foreclosure crisis is worsening rapidly and is expected to deteriorate further. Foreclosures continued to increase rapidly in 2008, with 2.2 million mortgages entering foreclosure during the year according to the MBA. Analysts predict that the number could rise to 4 million in 2009. One out of every thirteen mortgage holders is no longer able to make payments on time, the highest rate in over thirty-five years. Delinquent payments are a strong indicator of near-term foreclosure filings. On subprime loans alone, the Joint Economic Committee of Congress has predicted that from 2007 to 2009 there could be nearly 2 million foreclosures nationwide. Many of these foreclosures are linked to $362 billion in adjustable rate subprime loans resetting to higher interest rates last year. As the housing market continues to decline, many of these adjustments will result in foreclosures.

17. The foreclosure crisis in Baltimore is especially severe. There have been more than 33,000 foreclosure filings since 2000, and the Maryland Department of Housing and Community Development reported in October 2007 that the number of foreclosure-related events in Baltimore – notices of default, foreclosure sales, and lender purchases of foreclosed properties – increased an extraordinary five-fold from the first to the second quarter of the year. More recently, the Department reported that foreclosure-related events in the City increased to 1,111 in the fourth quarter of 2008, up 26% from the previous quarter.

18. Foreclosures have multiple and far-reaching impacts on the cities in which they occur, especially when they are concentrated in distressed neighborhoods that are already struggling with issues of economic development and poverty. Foreclosures in these neighborhoods frequently lead to abandoned and vacant homes. Estimates of the number of vacant homes in Baltimore range from 16,000 to 30,000. Concentrated

vacancies driven by foreclosures cause neighborhoods, especially ones already struggling, to decline rapidly. The United States Department of Housing and Urban Development ("HUD") and the United States Department of the Treasury ("Treasury") explained in a joint report on predatory subprime lending that "foreclosures can destabilize families and entire neighborhoods" and that "[f]oreclosed homes are often a primary source of neighborhood instability . . . ." HUD & Treasury, *Curbing Predatory Home Mortgage Lending* (2000) at 13, 51 (available at http://www.huduser.org/Publications/pdf/treasrpt.pdf) ("HUD/Treasury Report") (attached as Attachment B).

19. One example of how foreclosures and consequent vacancies harm neighborhoods is by reducing the property values of nearby homes. In Baltimore, as in cities around the country, foreclosures are responsible for the loss of hundreds of millions of dollars in the value of homes. This, in turn, reduces the City's revenue from property taxes. It also makes it harder for the City to borrow funds because the value of the property tax base is used to qualify for loans.

20. Cities with high rates of foreclosure, like Baltimore, also lose revenue from real estate transfer taxes because foreclosures depress the market for home sales. And these cities must spend additional funds for services related to foreclosures, including the costs of securing vacant homes, holding administrative hearings, and conducting other administrative and legal procedures. The funds expended also include the costs of providing additional police and fire protection as vacant properties become centers of dangerous and illicit activities.

B. The Role of Subprime Lending

21. The growing crisis of foreclosures in Baltimore and across the nation is due in large part to the rapid expansion of subprime lending. Subprime lending developed in the mid-1990s as a result of innovations in risk-based pricing and in response to the demand for credit by borrowers who were denied prime credit by traditional lenders.

22. Prior to the emergence of subprime lending, most mortgage lenders made only "prime" loans. Prime lending offered uniformly priced loans to borrowers with good credit. Individuals with blemished credit were not eligible for prime loans. Although borrowers with blemished credit might still represent a good mortgage risk at the right price, prime lending did not provide the necessary flexibility in price or loan terms to serve these borrowers.

23. In the early 1990s, technological advances in automated underwriting allowed lenders to predict with improved accuracy the likelihood that a borrower with blemished credit will successfully repay a loan. This gave lenders the ability to adjust the price of loans to match the different risks presented by borrowers whose credit records did not meet prime standards. Lenders found that they could now accurately price loans to reflect the risks presented by a particular borrower. When done responsibly, this made credit available much more broadly than had been the case with prime lending.

24. As the technology of risk-based pricing developed rapidly in the 1990s, so did the market in subprime mortgages. Subprime loans accounted for only 10% of mortgage loans in 1998, but within five years grew to 23% of the market. Currently, outstanding subprime mortgage debt stands at $1.5 trillion, up from $65 billion in 1995 and $332 billion in 2003. These subprime loans have allowed millions of borrowers to

obtain mortgages, at marginally increased prices, even though their credit profiles do not qualify them for lower-cost prime loans. They have opened the door to homeownership to many people, especially low- to moderate-income and minority consumers, who otherwise would have been denied mortgages. At the same time, subprime lending has created opportunities for unscrupulous lenders to engage in irresponsible lending practices that result in loans that borrowers cannot afford. This, in turn, has led directly to defaults and foreclosures.

25. Enticed by the prospect of short-term profits resulting from exorbitant origination fees, points, and related pricing schemes, many irresponsible subprime lenders took advantage of a rapidly rising real estate market to convince borrowers to enter into loans that they could not afford. Often this was accomplished with the help of deceptive practices and promises to refinance at a later date. These abusive subprime lenders did not worry about the consequences of default or foreclosure to their business because once made, the loans were sold on the secondary market.

26. As the subprime market grew, the opportunities for abusive practices grew with it. As a consequence, abusive and predatory practices "are concentrated in the subprime mortgage market," as the federal government has found. HUD/Treasury Report at 1. These practices, which in recent years have become the target of prosecutors, legislators and regulators, include the following:

a. Failing to prudently underwrite hybrid adjustable rate mortgages (ARMs), such as 2/28s and 3/27s. After the borrower pays a low "teaser rate" for the first two or three years, the interest rate on these loans resets to a much higher rate that can continue to rise based on market conditions. Subprime lenders often underwrite these loans based only on consideration of whether the borrower can

make payments during the initial teaser rate period, without regard to the sharply higher payments that will be required for the remainder of a loan's 30-year term. Irresponsible lenders aggressively market the low monthly payment that the borrower will pay during the teaser rate period, misleading borrowers into believing that they can afford that same low monthly payment for the entire 30-year term of the loan, or that they can refinance their loan before the teaser rate period expires.

b. Failing to prudently underwrite refinance loans, where borrowers substitute unaffordable mortgage loans for existing mortgages that they are well-suited for and that allow them to build equity. Such refinanced loans strip much or even all of that equity by charging substantial new fees, often hiding the fact that the high settlement costs of the new loan are also being financed. Lenders that aggressively market the ability of the borrower to pay off existing credit card and other debts by refinancing mislead borrowers into believing that there is a benefit to consolidating all of their debt into one mortgage loan, obscuring the predictable fact that that the borrower will not be able to repay the new loan. The refinanced loans are themselves often refinanced repeatedly with ever-increasing fees and higher interest rates, and with ever-decreasing equity, as borrowers seek to stave off foreclosure.

c. Allowing mortgage brokers to charge "yield spread premiums" for qualifying a borrower for an interest rate that is higher than the rate the borrower qualifies for and can actually afford.

d. Failing to underwrite loans based on traditional underwriting criteria such as debt-to-income ratio, loan-to-value ratio, FICO score, reserves,

and work history. These criteria ensure that a borrower is obtaining a loan that he or she has the resources and assets to repay, and ignoring these criteria results in many loans that bear no relation to borrowers' ability to repay them. This allows the lender to make a quick profit from the origination, but sets the borrower up for default and foreclosure.

e. Requiring substantial prepayment penalties that prevent borrowers whose credit has improved from refinancing their subprime loan to a prime loan. Prepayment penalties not only preclude borrowers from refinancing to a more affordable loan, but reduce the borrowers' equity when a subprime lender convinces borrowers to needlessly refinance one subprime loan with another.

f. Charging excessive points and fees that are not associated with any increased benefits for the borrower.

g. Placing borrowers in subprime loans even though they qualify for prime loans on better terms.

27. As long as housing prices continued to rise, the deleterious effect of these practices was delayed and thus, hidden. But the inevitable occurred when the real estate bubble burst in 2007 and home prices began to fall, and foreclosure rates began their dramatic rise. Bent on maximizing short-term profits and protected by the ability to sell their loans on the secondary market, irresponsible subprime lenders have left countless homeowners saddled with mortgage debts they cannot afford and no way to save their homes in a declining housing market. The median sales price of a home in Baltimore declined 19.35% from the first quarter of 2008 to the first quarter of 2009 and analysts predict that the housing market will continue to decline. This will continue to drive people with onerous mortgage terms into foreclosure.

C. The Foreclosure Crisis in Baltimore Hits African-American Neighborhoods the Hardest

28. In Baltimore, the impact of the foreclosure crisis is felt most acutely in minority communities. This is because of the prevalence of the practice of "reverse redlining." As used by Congress and the courts, the term "reverse redlining" refers to the practice of targeting residents in certain geographic areas for credit on unfair terms due to the racial or ethnic composition of the area. In contrast to "redlining," which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents. This practice has repeatedly been held to violate the federal Fair Housing Act. *See, e.g.*, *Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000).

29. The HUD/Treasury Report (discussed in ¶ 18 above) found that reverse redlining in subprime mortgage lending is a major problem: "Predatory lenders often engage in 'reverse redlining' – specifically targeting and aggressively soliciting homeowners in predominantly lower-income and minority communities . . . ." HUD/Treasury Report at 72. "Testimony at the forums [held by the HUD-Treasury National Predatory Lending Task Force in Baltimore and four other cities] strongly indicates that many predatory lenders may have engaged in reverse redlining, or targeting abusive practices to protected groups." *Id.*

30. There is a substantial body of empirical evidence that supports the HUD/Treasury finding and establishes that subprime mortgage lending and the predatory

practices often associated with subprime lending are targeted at African Americans and African-American neighborhoods. *See* Attachments C-L.

31. The Fannie Mae Foundation found that many borrowers who qualify for prime mortgage loans are instead given subprime loans, and that the problem is particularly acute for African-American borrowers. James H. Carr and Lopa Kolluri, Fannie Mae Foundation, *Predatory Lending: An Overview* (2001) (available at http://www.cra-nc.org/financial.pdf) (attached as Attachment C). Fannie Mae reported that "research by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans" and that "Fannie Mae estimates that number closer to 50 percent." *Id.* at 37. Focusing on race, Fannie Mae concluded that "the level of subprime lending to black households and communities far exceeds the measured level of credit problems experienced by those households." *Id.*

32. A study by the National Reinvestment Coalition ("NCRC") reached the same conclusion. NCRC, *The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age – Subprime Lending in Ten Large Metropolitan Areas* (2003) (available at http://www.ncrc.org/images/stories/pdf/research/ncrcdiscrimstudy.pdf) (attached as Attachment D). The NCRC studied subprime mortgage loans in Baltimore and nine other major metropolitan areas. *Id.* at 6, 24-25. It combined data that lenders are required to release to the public under the federal Home Mortgage Disclosure Act ("HMDA") with credit scoring data on a census tract level that the authors obtained from one of the three major credit bureaus. *Id.* at 19-20, 25. (Credit scores are not released under HMDA.) The NCRC controlled for differences in credit scores and found a statistically significant and positive correlation

between the percentage of African Americans in a census tract and the percentage of subprime loans in the tract. *Id.* at 31-34.

33. HUD, though it did not have access to credit scores or other data about creditworthiness, studied 1998 HMDA data on almost 1 million mortgages and likewise concluded that the growth of subprime lending was disproportionately concentrated in African-American neighborhoods. HUD also found that the disparity persisted across income lines and actually increased as neighborhood income increased and stated that the problem requires "closer scrutiny." HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (2000) at 4-5 (available at http://www.huduser.org/Publications/pdf/unequal_full.pdf) (attached as Attachment E). HUD observed with alarm that "only one in ten families in white neighborhoods [receive subprime loans and] pay higher fees and interest rates, but *five in ten families in African-American communities are saddled with higher rates and costs*." *Id.* at 4 (emphasis in original). Describing HUD's research in their subsequent joint report, HUD and Treasury stated that "the research consistently revealed that, controlling for income, predominantly non-white census tracts showed much higher subprime refinance penetration rates than predominantly white census tracts." HUD/Treasury Report at 105.

34. A study of 2000 HMDA data covering every metropolitan statistical area in the country found a parallel racial disparity in the frequency of subprime loans. Calvin Bradford, Center for Community Change, *Risk or Race? Racial Disparities and the Subprime Refinance Market* (2002) at vii-ix (available at http://www.knowledgeplex.org/redir.html?id=1032&url=http%3A%2F%2Fwww.knowledgeplex.org%2Fkp%2Freport%2Freport%2Frelfiles%2Fccc_0729_risk.pdf) (attached as Attachment F).

35. The studies discussed above show that African Americans and residents of African-American neighborhoods receive subprime loans at a much greater frequency than whites and residents of white neighborhoods, and that the disparity is much greater than legitimate underwriting factors can explain.

36. The following studies provide empirical evidence that, after controlling for creditworthiness and other legitimate underwriting factors, there are likewise substantial disparities based on race in the terms and conditions of the subprime loans given to African Americans and residents of African-American neighborhoods.

37. A study by the Center for Responsible Lending ("CRL") found racial disparities in the pricing of loans. The study included loans made by Wells Fargo. The study found that African Americans receive higher-priced subprime mortgages than whites who are similarly situated with respect to credit and other underwriting criteria. CRL, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (2006) (available at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf) (attached as Attachment G). This study combined HMDA data with a proprietary database to determine whether race had a statistically significant effect on the pricing of subprime loans in 2004. *Id.* at 3, 9. The proprietary database covered 87% of the U.S. subprime market. *Id.* at 9. It included credit criteria such as the credit score and loan-to-value ratio for each loan; such data is not released under HMDA and is not publically available. *Id.*

38. The CRL found that, after controlling for credit and other underwriting factors, the odds were 40% to 84% higher that an African-American borrower would receive a high-cost purchase loan than a similarly-situated white borrower. *Id.* at 16. The difference was statistically significant for most types of purchase loans. *Id.* Similarly,

the study found that the odds were 4% to 62% higher that an African-American borrower would receive a high-cost refinance loan than a similarly-situated white borrower, also after controlling for credit and other underwriting factors. *Id.* at 17. The difference was statistically significant for refinance loans with prepayment penalties, which constituted nearly two-thirds of the refinance loans analyzed. *Id.*

39. Another study by the Center for Responsible Lending found that subprime borrowers in predominantly African-American and other minority neighborhoods are much more likely to be given loans with prepayment penalties than subprime borrowers in predominantly white neighborhoods who are similarly situated with respect to credit and other characteristics. CRL, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans* (2005) (available at http://www.responsiblelending.org/pdfs/rr004-PPP_Minority_Neighborhoods-0105.pdf) (attached as Attachment H). The Center analyzed proprietary data from The First American Corporation on 1.8 million subprime loans originated from 2000 to mid-2004. First American's proprietary database allowed the Center to control for a variety of underwriting factors, such as credit score, loan-to-value ratio, debt-to-income ratio, and more. *Id.* at 5, App.-1. The study found that "[t]he odds of borrowers receiving prepayment penalties are consistently and positively associated with minority concentration, and the differences are statistically significant." *Id.* at 1-2. It concluded, "[i]n the simplest terms, the odds of avoiding a prepayment penalty on a subprime loan are significantly better for borrowers who live in predominantly white neighborhoods." *Id.* at 7.

40. Another study found racial disparities with respect to requiring borrowers to pay yield spread premiums. Howell E. Jackson & Jeremy Berry, "Kickbacks or

Compensation: The Case of Yield Spread Premiums" (2002), *available at* http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf (attached as Attachment I). The authors analyzed data on creditworthiness and other underwriting criteria, including credit scores and loan-to-value ratios, that was obtained in discovery in a mortgage lending lawsuit under the federal Real Estate Settlement Procedures Act, 12 U.S.C. § 2601, *et seq.* *Id.* at 7, 122-23 & n.147. They found that, after controlling for such criteria, African Americans (and Hispanics) paid substantially more in yield spread premiums than other borrowers, and that the disparity was statistically significant. *Id.* at 9, 125. Moreover, they found that for every dollar paid by borrowers in yield spread premiums, the borrowers gained only 20 to 25 cents of value. *Id.* at 127.

41. Reverse redlining typically flourishes in cities where two conditions are met. First, the practice afflicts cities where minorities historically have been denied access to credit and other banking services. The legacy of historic discrimination, or redlining, often leaves the residents of minority communities desperate for credit, and without the knowledge or experience required to identify loan products and lenders offering products with the most advantageous terms for which they might qualify. Instead, residents of underserved minority communities often respond favorably to the first offer of credit made, without regard to the fairness of the product. This makes them especially vulnerable to irresponsible subprime lenders who, instead of underwriting carefully to ensure that the loans they offer are appropriate for their customers, engage in the unscrupulous lending practices described in paragraph 26 above.

42. Second, reverse redlining arises in cities where there are racially segregated residential living patterns. This means that the people who are most

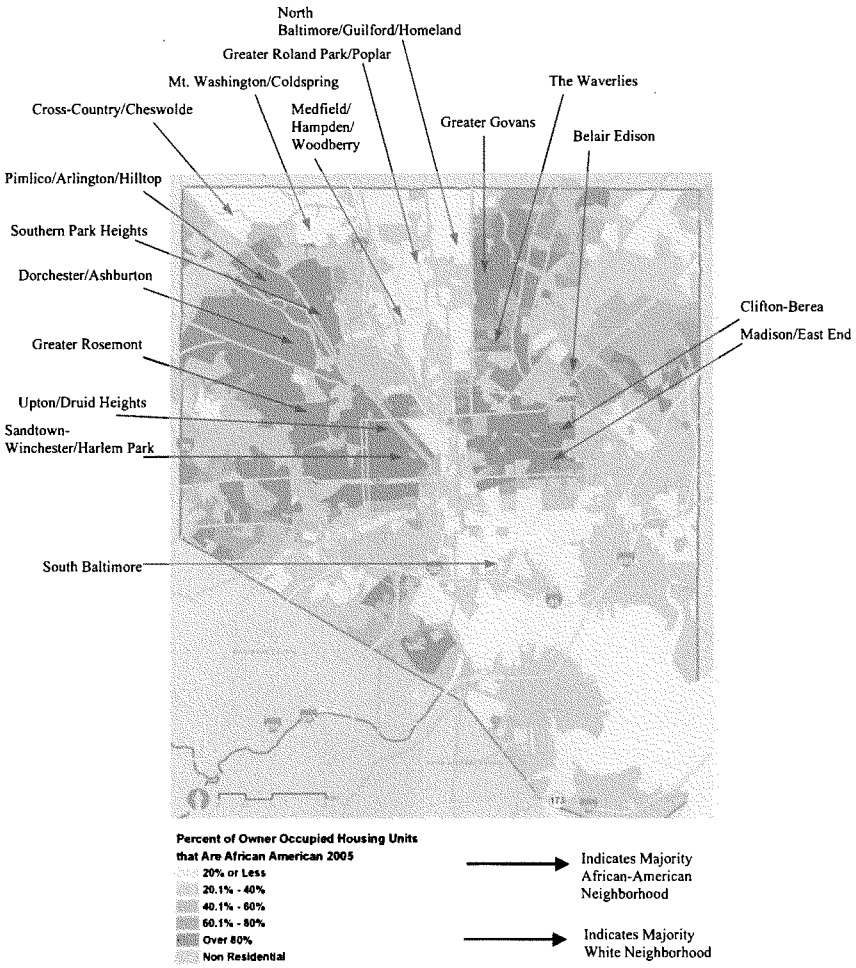
vulnerable to abusive lending practices are geographically concentrated and therefore easily targeted by lenders.

43. Both of these conditions are present in Baltimore. First, Baltimore's minority communities historically have been victimized by traditional redlining practices. Through much of the twentieth century the federal government, mortgage lenders, and other private participants in the real estate industry acted to deny homeownership opportunities and choices to the City's African Americans. The Secretary of the United States Department of Housing and Urban Development admitted in 1970 that the federal government had "refus[ed] to provide insurance in integrated neighborhoods, promot[ed] the use of racially restrictive covenants," and engaged in other methods of redlining. *Thompson v. U.S. H.U.D.*, 348 F. Supp. 2d 398, 466 (D. Md. 2005). The federal government even published a map in 1937 titled "Residential Security Map for Baltimore" designed to facilitate private redlining by mortgage providers. *See id.* at 471. Mortgage lenders actively engaged in redlining for decades, treating "black and [the few] integrated neighborhoods as unstable and risky." Garrett Power, *Apartheid Baltimore Style: The Residential Segregation Ordinances of 1910-1913*, 42 Md. L. Rev. 289, 319, 322 (1983).

44. The practice and effects of widespread redlining in Baltimore persisted for decades. An analysis of data from the 1980s, long after much of the institutionalized governmental and corporate apparatus of discrimination had been dismantled, found that the more African-American residents in a Baltimore neighborhood, the fewer mortgage loans and dollars the neighborhood received. Anne B. Shlay, *Maintaining the Divided City: Residential Lending Patterns in the Baltimore SMSA* (Maryland Alliance for Responsible Investment, March 1987). The study also found that while 73% of majority

white census tracts received a medium or high volume of single family mortgage loans, the same was true of only 5% of majority African-American tracts.

45. Second, the City is highly segregated between African Americans and whites. As the following map shows, even though Baltimore is 64% African-American and 32% white, many neighborhoods have a much higher concentration of one racial group or the other. For example, the African-American population exceeds 90% in East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, and Greater Govans. It exceeds 75% in Waverly and Belair Edison. At the same time, the white population of Greater Roland Park/Poplar, Medfield/Hampden/Woodberry, and South Baltimore exceeds 80%, and the white population of Cross-Country/Cheswolde, Mt. Washington/Coldspring, and North Baltimore/Guilford/Homeland exceeds 70%.

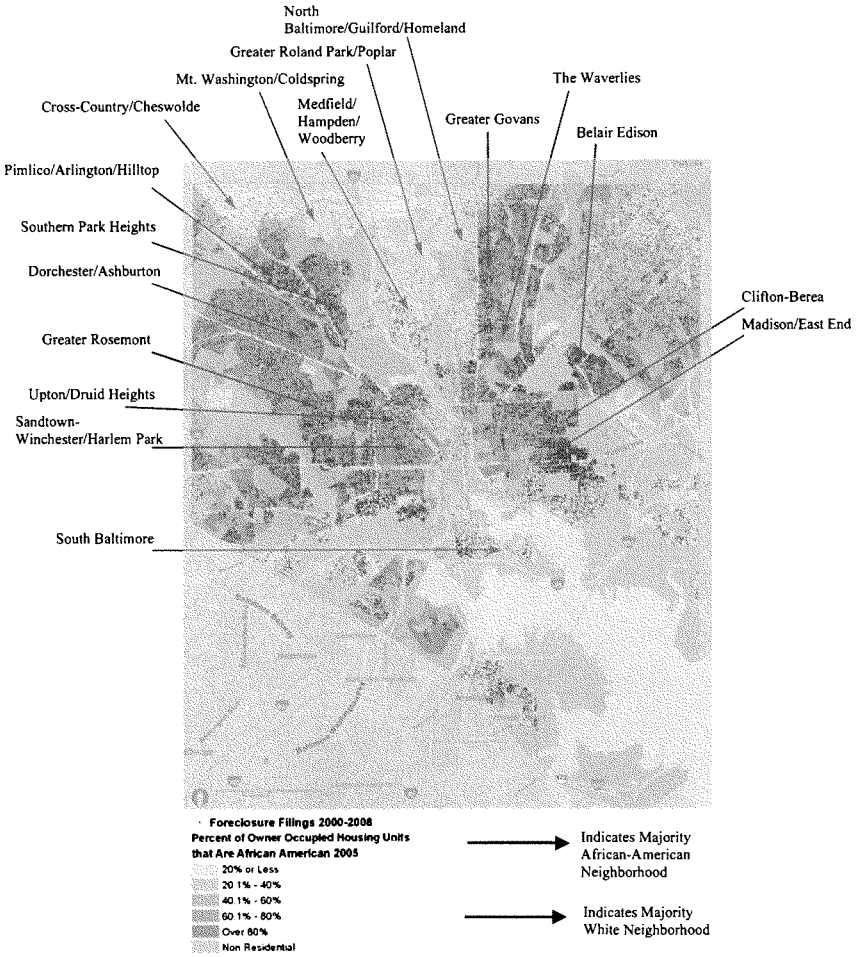

North Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield/ Hampden/ Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-Winchester/Harlem Park
South Baltimore
Percent of Owner Occupied Housing Units that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

46. A recent study of lending in Baltimore is consistent with the existence of a pattern and practice of reverse redlining by lenders providing mortgages to residents of the City. Abt Associates, *Using Credit Scores to Analyze High-Cost Lending in Central City Neighborhoods* (2008) (attached as Attachment J). The study combined 2004 HMDA and other publically available data with credit scores obtained from one of the three major credit bureaus. *Id.* at 1. The study found that, after controlling for credit scores and other legitimate underwriting factors, the prevalence of high-cost (*i.e.*, subprime) purchase and refinance mortgage loans increased with increases in the African American concentration of Baltimore neighborhoods. *Id.* at 2, 13-14. The racial disparity was statistically significant. *Id.* at 18.

47. The location of foreclosures in the City of Baltimore is also consistent with the existence of a pattern and practice of reverse redlining by lenders providing mortgages to residents of the City. As shown in the map following paragraph 48, although foreclosures have occurred in many parts of Baltimore, they are disproportionately concentrated in Baltimore's African-American neighborhoods. Neighborhoods like Greater Govans, Greater Rosemont, Madison/East End, and Southern Park Heights, all with African-American populations above 90%, are at the center of the foreclosure crisis. Citywide, census tracts that are above 80% African-American account for 48% of Baltimore's foreclosure filings, even though they account for only 40% of the City's owner-occupied households.

48. HUD analyzed foreclosures in Baltimore filed during the first quarter of 2000 and reached the same conclusion: "Subprime loans had a disproportionate share of foreclosures in Baltimore City's predominantly black neighborhoods." HUD, *Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending* (2000) at 8

(available at http://www.huduser.org/Publications/pdf/baltimore.pdf) (attached as Attachment K). Subprime loans accounted for 42% of the purchase and refinance loan originations in predominantly African-American neighborhoods in the City, but 57% of the foreclosures. *Id.* at 8, fig. 11.


North Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield/ Hampden/ Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-Winchester/Harlem Park
South Baltimore
Foreclosure Filings 2000-2008
Percent of Owner Occupied Housing Units that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

D. Wells Fargo is a Major Contributor to the Foreclosure Crisis in Baltimore's African-American Neighborhoods

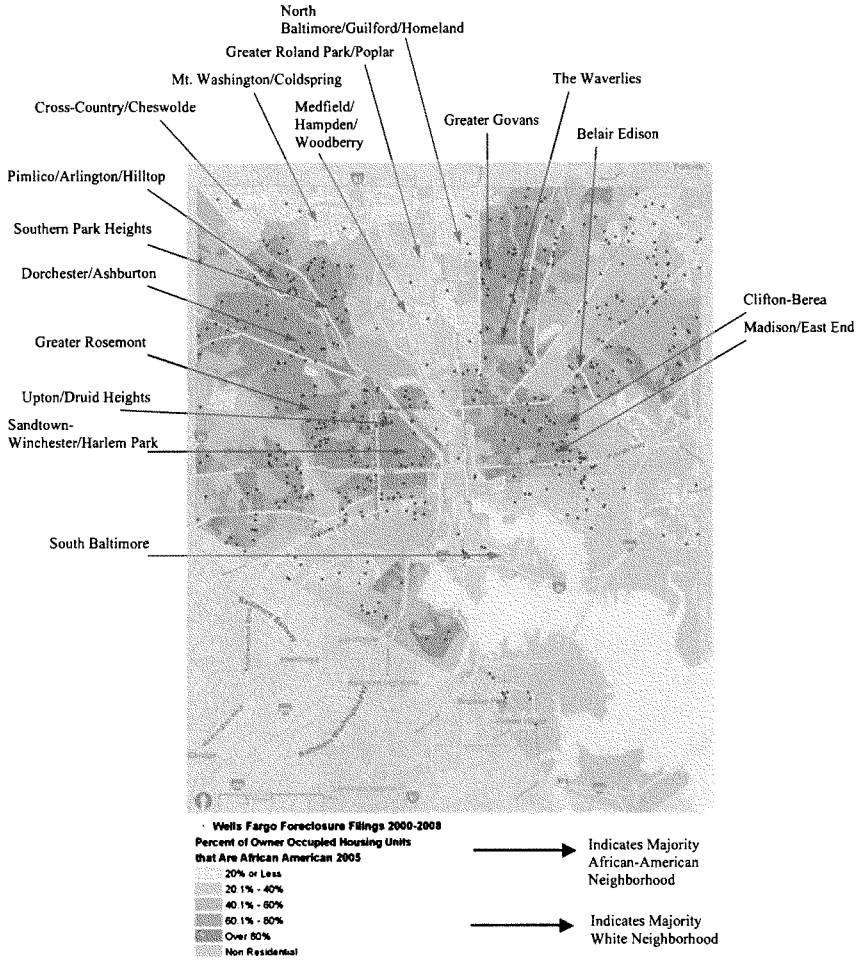
49. Wells Fargo is one of the largest mortgage lenders in Baltimore. It has made at least 1,341 mortgage loans in Baltimore in each of the last six years for which data is available (2002-2007), with a collective value of more than $1 billion. In each of these years, it has been one of the top three mortgage lenders in the City. Wells Fargo makes loans in both the white and African-American neighborhoods of Baltimore.

50. Far from being a responsible provider of much-needed credit in minority communities, however, Wells Fargo is one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. Its foreclosures since at least 2000 have been concentrated in Belair Edison, East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, Greater Govans and Waverly, and other neighborhoods with African-American populations exceeding 75%.

51. Fifty-four percent of Wells Fargo's foreclosures from 2005 to 2008 were in census tracts that are more than 80% African-American and 63% were in tracts that are over 60% African-American, but only 12% were in tracts that are 20% or less African-American. The figures are virtually identical for Wells Fargo's foreclosures from 2000 to 2004 with more than half in tracts that are more than 80% African-American, 64% in tracts that are over 60% African-American, and only 14.8% in tracts that are 20% or less African-American.

52. At the same time, Wells Fargo has the third largest number of foreclosures in Baltimore of any lender from 2005 to 2008. At least 108 additional Wells Fargo loans in Baltimore resulted in foreclosure from 2000 to 2004. The number of foreclosures from 2000 to 2004 is probably much higher because in many cases the foreclosure records

analyzed by Plaintiff do not indicate the original lender. The following map represents the concentration of Wells Fargo's foreclosures in African-American neighborhoods from 2000 through 2008.


North Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield/ Hampden/ Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-Winchester/Harlem Park
South Baltimore
Wells Fargo Foreclosure Filings 2000-2008
Percent of Owner Occupied Housing Units that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

53. The likelihood that a Wells Fargo loan in a predominantly (60% or greater) African-American neighborhood will result in foreclosure is significantly greater than the likelihood of foreclosure for a loan in a predominantly white neighborhood. While 4.82% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, the same is true for only 1.63% of its loans in predominantly white neighborhoods. In other words, a Wells Fargo loan in a predominantly African-American neighborhood is three times as likely to result in foreclosure as a Wells Fargo loan in a predominantly white neighborhood.

54. Wells Fargo's foreclosure rate for loans in neighborhoods that are 80% or more African-American is nearly three times as high as the overall average of the other major mortgage lenders in Baltimore, while the ratio for its loans in neighborhoods that are less than 20% African-American is less than half the average.

E. Wells Fargo Targets Baltimore's African-American Neighborhoods for Improper and Irresponsible Lending Practices

55. Wells Fargo's failure to underwrite loans in minority and underserved communities in a responsible manner has been the subject of public attention and concern for years. For example, its practices are the focus of a 2004 report from the Center for Responsible Lending. The report concluded that the company's customers "too often face the loss of their home or financial ruin as a result" of its "predatory practices." Center for Responsible Lending, *A Review of Wells Fargo's Subprime Lending* (Apr. 2004) at 10 (available at http://www.responsiblelending.org/pdfs/ip004-Wells_Fargo-0404.pdf) (attached as Attachment L). The predatory practices identified in the report include charging excessive fees; charging excessively high interest rates that are not justified by borrowers' creditworthiness; requiring large prepayment penalties while deliberately misleading borrowers about the penalties; using deceptive sales practices to

wrap insurance products into mortgages; convincing borrowers to refinance mortgages into new loans that only benefit Wells Fargo; and deceiving borrowers into believing that they are getting fixed rate loans when they are really getting adjustable rate loans, and more.

56. Wells Fargo's pattern or practice of failing to follow responsible underwriting practices in Baltimore's African-American neighborhoods is evident from the type of loans that result in foreclosure filings in those neighborhoods. Approximately 65% of Wells Fargo's Baltimore loans that result in foreclosure are fixed rate loans. This ratio is the same in both African-American and white neighborhoods. This establishes that there is no legitimate reason for the stark difference in Wells Fargo's foreclosure rates by race.

57. Unlike adjustable rate loans, where the price may fluctuate with changing market conditions, the performance of fixed rate loans is relatively easy to predict using automated underwriting models and loan performance data because monthly payments do not vary during the life of the loan. Using these sophisticated risk assessment tools, and relying on traditional underwriting criteria such as FICO scores, debt-to-income ratios, loan-to-value ratios, and cash reserves, any lender engaged in responsible underwriting practices designed to identify qualified borrowers can predict with statistical certainty the likelihood of default and/or delinquency. Lenders engaged in marketing fixed rate loans in a fair and responsible manner should have no difficulty sifting out unqualified borrowers, or borrowers whose loans would likely result in delinquency, default or foreclosure.

58. Because the percentage of fixed rate loans is so high and the same in both African-American and white neighborhoods, Wells Fargo should, if it properly

underwrites, have comparable foreclosure rates in both communities. The fact that Wells Fargo's underwriting decisions result in foreclosure three times as often with respect to African-American than white neighborhoods means that it is not following fair or responsible underwriting practices with respect to African-American customers.

59. The disparate foreclosure rates are instead consistent with the type of unscrupulous subprime lending practices described in paragraphs 26, 55, and 61-86. Wells Fargo engages in these and similarly inappropriate practices when making loans to African Americans and in African-American neighborhoods. This pattern or practice of targeted activities fully explains the disparate rates of foreclosure. The disparities are not the result of or otherwise explained by legitimate non-racial underwriting criteria.

60. A closer look at Wells Fargo's lending practices and the characteristics of its loans in Baltimore demonstrates that it is engaged in a pattern or practice of reverse redlining with respect to the City's African-American neighborhoods. As described in sections E.1 through E.7 below, sworn statements of former Wells Fargo employees and examination of Wells Fargo's loans indicates it is engaged in unfair and discriminatory practices in Baltimore's African-American neighborhoods that have the effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods. This targeted pattern or practice has resulted in the disproportionately high rate of foreclosures found in Baltimore's African-American neighborhoods.

1. Former Wells Fargo Employees Explain How the Company Targets African Americans in Baltimore for Subprime Loans and Abusive Subprime Lending Practices

61. Attached to this First Amended Complaint are sworn declarations from two former Wells Fargo employees, Elizabeth Jacobson and Tony Paschal. Until late in 2007, Ms. Jacobson and Mr. Paschal were responsible for making loans on behalf of Wells Fargo in the greater Baltimore region. *See* Attach. M ("Jacobson Decl."); Attach. N ("Paschal Decl."). Jacobson and Paschal describe in great detail how Wells Fargo has targeted African Americans and residents of African-American neighborhoods in and around Baltimore for abusive subprime lending practices.

62. Jacobson began working for Wells Fargo as a loan officer in August 1998. Jacobson Decl. ¶ 2. She was subsequently promoted to Sales Manager and remained in that position until leaving the company in December 2007. *Id.* ¶¶ 2, 34. Jacobson made subprime loans exclusively. *Id.* ¶ 3, 10. She made the loans in a geographic area called "Region 12" that included Baltimore, Prince George's County, Northern Virginia, and other places. *Id.* ¶ 3. Most of her customers were African Americans, including African Americans in Baltimore. *Id.* ¶ 26. She was one of Wells Fargo's top three subprime loan officers nationally year after year, and in some years was the company's top subprime loan officer in the country. *Id.* ¶ 4. Between 2003 and 2007, Jacobson completed approximately $50 million in subprime loans per year. *Id.* ¶ 5. This translates into about 180 loans per year. *Id.* Jacobson is white.

63. Paschal was a Wells Fargo loan officer from September 1997 to September 2007 (with a hiatus of approximately 2½ years beginning in June 1999). Paschal Decl. ¶¶ 2-3. His job was to solicit Wells Fargo borrowers to refinance their home mortgage with a prime or Federal Housing Administration ("FHA") loan. *Id.* ¶¶ 3,

7. FHA loans have interest rates that are closer to prime than subprime rates. *Id.* ¶ 23. Paschal referred the borrowers who did not qualify to the Mortgage Resources division, known as "MORE," which exclusively originates subprime loans. *Id.* ¶ 7. He worked on the same floor of the same building as the MORE employees and he communicated with them daily. *Id.*

64. Jacobson's and Paschal's declarations confirm that Wells Fargo targeted African Americans and African-American neighborhoods in Baltimore and elsewhere for deceptive, abusive and predatory subprime loans and that Wells Fargo's subprime loan officers engaged in a myriad of deceptive, abusive and predatory practices. This constitutes reverse redlining.

A. Targeting African Americans for Subprime Mortgage Loans

65. The declarations show that Wells Fargo targeted African Americans in Baltimore in a variety of ways. One was by marketing its subprime products to predominantly African-American zip codes in Baltimore, Prince George's County, and Washington, D.C. Paschal Decl. ¶¶ 8, 10. Wells Fargo did not target white areas for subprime loans. Paschal Decl. ¶ 8. Paschal "heard employees in the MORE division comment that Howard County was not good for subprime loans because it has a predominantly White population." *Id.*

66. Wells Fargo also targeted African-American churches in the City and their congregations for subprime loans. Jacobson Decl. ¶¶ 27-28, 30; Paschal Decl. ¶ 12. Wells Fargo did not target white churches – "[w]hen it came to marketing, any reference to 'church' or 'churches' was understood as code for African-American or black churches." Jacobson Decl. ¶ 30.

67. Wells Fargo even assigned employees to make presentations at the churches on the basis of race. During a conference call in 2005 with subprime loan officers and branch managers about making presentations to black churches in Baltimore, the loan officers were told that only employees "of color" could attend. Jacobson Decl. ¶ 28. Jacobson was later told that she could come, but only if she "carried someone's bag." *Id.*

68. Wells Fargo also targeted African Americans for subprime loans through a variety of special events. Jacobson Decl. ¶ 29. Wells Fargo selected employees to make presentations at these events on the basis of race, as it did with church presentations. One such event was a "'wealth building' seminar" designed to promote subprime products in 2005 in Greenbelt, Maryland, where the audience was expected to be predominantly African-American. *Id.* Jacobson was told by the manager of Emerging Markets, a subprime unit that targeted African Americans, that she was "too white" to appear before the audience at the seminar. *Id.* ¶¶ 27, 29. Jacobson complained to higher management, but received no response and no action was taken. *Id.* ¶¶ 29, 31.

69. Wells Fargo also created a unit called the "Affinity Marketing Group" in its Silver Spring, Maryland office to target African Americans, including members of African-American churches. Paschal Decl. ¶ 12. All the employees of the Affinity Marketing Group were African-American. *Id.* Subprime loan officers in the group who targeted African Americans were selected on the basis of their race and Wells Fargo's desire to use African-American employees to target African-American customers. *Id.*

70. Another way in which Wells Fargo targeted African Americans was by tailoring its subprime marketing materials on the basis of race. *Id.* ¶ 11. It devised software to print out subprime promotional materials in different languages, one of which

was called "African American" by Wells Fargo *Id.* A computer screen shot from 2006 showing this option is attached to Paschal's declaration as Exhibit A. Wells Fargo did not remove the African American "language" option until Paschal complained. *Id.*

71. Wells Fargo's subprime loan officers held derogatory stereotypes of African Americans, which contributed to their targeting of African Americans in and around Baltimore for subprime loans. Jacobson Decl. ¶ 28; Paschal Decl. ¶ 8, 16. Subprime loan officers described African American and other minority customers by saying "those people have bad credit" and "those people don't pay their bills," and by calling minority customers "mud people" and "niggers." Paschal Decl. ¶¶ 8, 16. They referred to loans in minority communities as "ghetto loans." *Id.* They described Prince George's County, which has a slightly higher percentage of African-American residents than Baltimore, as the "subprime capitol of Maryland." Jacobson Decl. ¶ 26. At the same time, they believed that areas such as Howard County that are predominantly white were bad locations for making subprime loans. Paschal Decl. ¶ 8.

B. Steering People Who Qualify for Prime Mortgages into Subprime Mortgages

72. Jacobson's and Paschal's declarations demonstrate that Wells Fargo regularly steered borrowers who qualified for prime loans into subprime loans. Wells Fargo gave loan officers substantial financial incentives and the discretion to steer borrowers in this manner. Jacobson Decl. ¶¶ 8, 10-12, 15-16, 32; Paschal Decl. ¶¶ 12-13. Paschal was instructed by management to refer borrowers who could have qualified for more advantageous prime or FHA loans to the subprime unit. Paschal Decl. ¶ 9. He was even reprimanded for giving too many people FHA loans instead of referring them for subprime loans. *Id.* ¶ 19.

73. Paschal saw many files of "minority customers who had good credit scores and credit characteristics in subprime loans who should have qualified for prime or FHA loans." Paschal Decl. ¶ 12. Jacobson likewise made subprime loans to many people with prime credit who were referred to her by loan officers responsible for making prime loans. Jacobson Decl. ¶ 9. She could identify people steered in this manner if she had the opportunity to review Wells Fargo's loan files. *Id.*

74. The financial incentives to steer people into subprime loans were very substantial. "A reps," who made prime loans, generally made more money in referral fees by referring a person with prime credit to a subprime loan officer than by originating a prime loan. Jacobson Decl. ¶ 8. Subprime loan officers, whose pay was based on commissions and fees, likewise made more money by originating loans with higher interest rates and fees. *Id.* ¶ 6. This allowed Jacobson to gross well over half a million dollars in 2004 and again in 2005. *Id.* The effect of Wells Fargo's compensation system for subprime loans was to put "bounties" on minority borrowers. Paschal Decl. ¶ 13.

75. Wells Fargo also gave lavish gifts and trips to successful subprime loan officers, even as foreclosures increased in recent years. Jacobson Decl. ¶ 32. This was part of a culture that focused only on making the most money possible and not on putting borrowers in loans that were appropriate for them. *Id.*

76. Loan officers were able to steer people with good credit into subprime loans because Wells Fargo gave them broad discretion. As Jacobson states, "underwriting guidelines and pricing rules for prime and subprime loans . . . . [provided] more than enough discretion to allow A reps to steer prime loan customers to subprime loan officers like me. Likewise, the guidelines gave me enough discretion to figure out how to qualify most of the referrals for a subprime loan once I received the referral."

Jacobson Decl. ¶ 11. This included "discretion to decide which subprime loan products to offer the applicant" "[o]nce I received a referral from an A rep." *Id.* ¶ 13.

77. Wells Fargo loan officers developed a multitude of unscrupulous ways to apply their discretion to get away with steering subprime loans to people who qualified for prime or FHA loans. One method was to intentionally mislead customers by, for example, giving "stated income" loans to customers who could document their income, or telling customers not to make a down payment or to take more cash from their home equity, which would automatically cause a prime loan to "flip" into a subprime loan. Jacobson Decl. ¶ 17, Paschal Decl. ¶ 14. Another was to intentionally mislead underwriters by "telling the underwriting department that the customer did not want to provide documentation for the loan, had no source[d] or seasoned assets, or needed to get the loan closed quickly." Jacobson Decl. ¶¶ 15. Some loan officers would simply falsify loan applications. *Id.* ¶ 18. Loan officers used such techniques to increase their commissions while discriminating against minority applicants. Paschal Decl. ¶ 13.

78. In 2004 Wells Fargo responded to public criticism by creating "filters" that were supposed to prevent the steering of prime customers into subprime loans. Jacobson Decl. ¶ 19; Paschal Decl. ¶ 18. It was widely understood that the filters were not effective. *Id.* Loan officers learned many ways to work around the filters by using the broad discretion they were afforded by Wells Fargo. *Id.* These techniques were widely used. *Id.* Senior managers were aware of their use and eventually made certain changes in response, but the loan officers continued to easily undermine the filters. Jacobson Decl. ¶ 19. The filters were also ineffective because Wells Fargo did not create disincentives to steering prime customers into subprime loans. Paschal Decl. ¶ 18. To the contrary, employees continued to have substantial financial incentives to engage in

such steering and continued to do so. *Id.* Management knew that these practices continued.

C. Other Abusive Subprime Lending Practices Engaged in by Wells Fargo

79. Jacobson's and Paschal's declarations further demonstrate that Wells Fargo loan officers had substantial discretion to increase the costliness of subprime loans and that they regularly used this discretion at the expense of subprime borrowers.

80. The loan officers had broad discretion to set the pricing, points, and fees for subprime loans. Jacobson Decl. ¶¶ 22, 24; Paschal Decl. ¶¶ 5, 13. Even when Wells Fargo created some limits in 2007, loan officers retained significant discretion. Jacobson Decl. ¶ 24. Loan officers had strong financial incentives to increase the pricing, points, and fees because it would increase their commissions. *Id.*; Paschal Decl. ¶ 13.

81. Loan officers also used this discretion to harm African-American and other minority customers by telling them that interest rates were "locked" when, in fact, the rates were not locked. Paschal Decl. ¶ 5. This prevented minority customers from getting lower interest rates, but loan officers lowered interest rates for whites in the same situation. *Id.*

82. Loan officers also used their discretion to select loan products and set rates and fees to "discriminate[] against minority loan applicants by not offering them [] better or newer products which had lower fixed interest rates and fees." Paschal Decl. ¶ 14.

83. Jacobson's and Paschal's declarations further demonstrate that Wells Fargo loan officers deceived subprime borrowers about the inclusion and significance of onerous prepayment penalties in the terms and conditions of their loans. Jacobson Decl. ¶ 13; Paschal Decl. ¶ 15. The prepayment penalties typically made it difficult for borrowers to refinance into new and better loans. Jacobson Decl. ¶ 13. Loan officers

were encouraged by Wells Fargo trainers not to tell applicants about the prepayment penalties. Paschal Decl. ¶ 15. When the subject was raised, loan officers told borrowers that prepayment penalties could be waived, even though they could not be, or otherwise downplayed their significance. Jacobson Decl. ¶ 13; Paschal Decl. ¶ 15.

84. Jacobson identifies another abusive subprime lending practice by showing that some Wells Fargo subprime loan officers intentionally falsified loan files so that they could make loans to borrowers who could not afford them. Loan officers falsified applications by cutting and pasting the credit report or income documentation of borrowers who had been approved in the past into the file of applicants who would otherwise not qualify for a loan. Jacobson Decl. ¶ 18. These tactics made the applicants appear to the underwriters to satisfy the qualifications for subprime loans even though the loan officers knew that they did not. *Id.* Jacobson reported this conduct to management but is not aware of any corrective action that was taken. *Id.* ¶¶ 18, 31. Foreclosures are a predictable result of this practice.

85. Wells Fargo also qualified adjustable rate subprime loans "with the assumption that the borrower would pay the teaser rate for the full life of the loan even though this lower rate only applied during the first two or three years of the loan." Jacobson Decl. ¶ 16. Foreclosures are a predictable result of this practice.

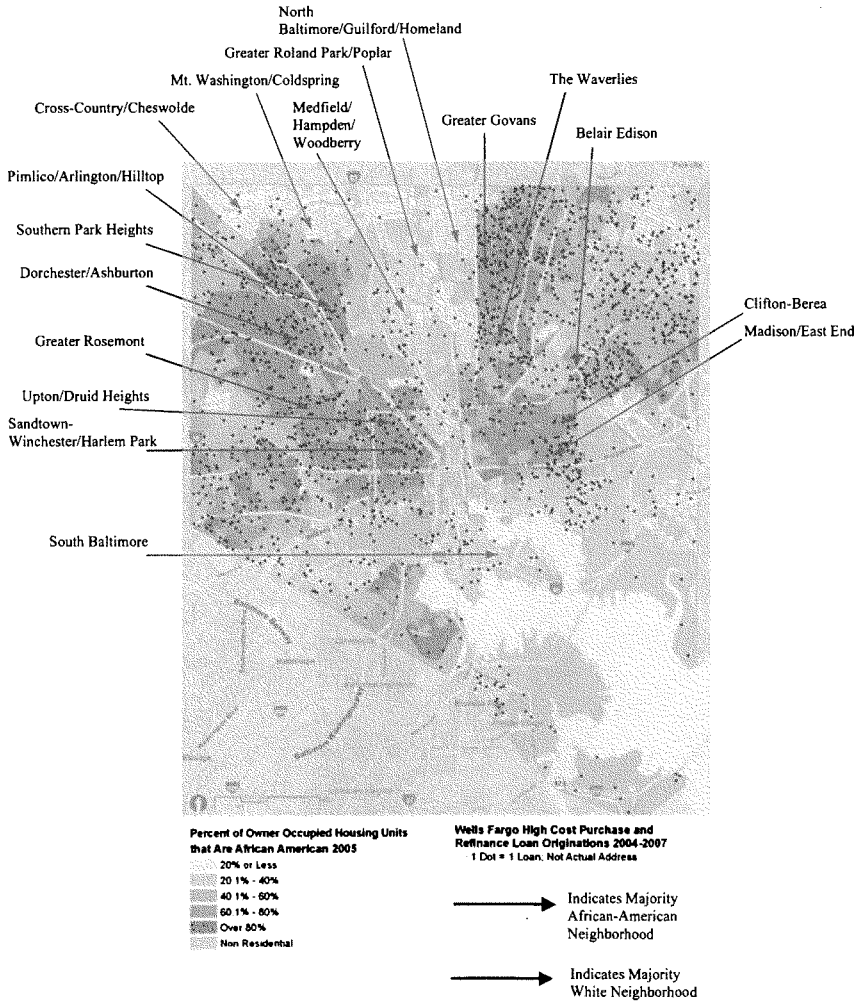
86. Wells Fargo also used mortgage brokers and listing agents to target African Americans and African-American neighborhoods in Baltimore and Prince George's County and to engage in the other abusive lending practices described by Jacobson and Paschal. These brokers and listing agents are Wells Fargo's agents and Wells Fargo is responsible for their acts and omissions.

2. Publicly Available Home Mortgage Disclosure Act Data Shows that Wells Fargo's High-Cost Loans are Disproportionately Located in African-American Neighborhoods in Baltimore

87. Publicly available data reported by Wells Fargo to federal regulators pursuant to the Home Mortgage Disclosure Act shows that in 2007, Wells Fargo made high-cost loans (*i.e.*, loans with an interest rate that was at least three percentage points above a federally-established benchmark) to 43% of its African-American mortgage customers in Baltimore, but only to 9% of its white customers in Baltimore. In 2006, the respective rates were 65% and 15%; in 2005, the respective rates were 54% and 14%; in 2004, the respective rates were 31% and 10%. The proportion of refinance loans that are high cost is especially pronounced. In 2004, 2005, 2006, and 2007, a Wells Fargo refinance loan to an African-American borrower was 3.2 times more likely to be high cost than a refinance loan to a white borrower.

88. Racial disparities in the pricing of Wells Fargo's mortgage loans are confirmed by a study released this year, which also found that the disparity actually increased at higher income levels. National People's Action, *The Truth About Wells Fargo: Irresponsible Lending and African Americans* (2009) at 2 (available at http://www.npa-us.org/downloads/truthaboutwellsfargo.pdf).

89. The maps that follow show the geographic distribution of high-cost loans in African-American and white neighborhoods in Baltimore. These maps demonstrate that Wells Fargo's high-cost loans are disproportionately located in Baltimore's African-American neighborhoods, including, among others, Sandtown-Winchester/Harlem Park, Upton/Druid Heights, Dorchester/Ashburton, and Madison/East End.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
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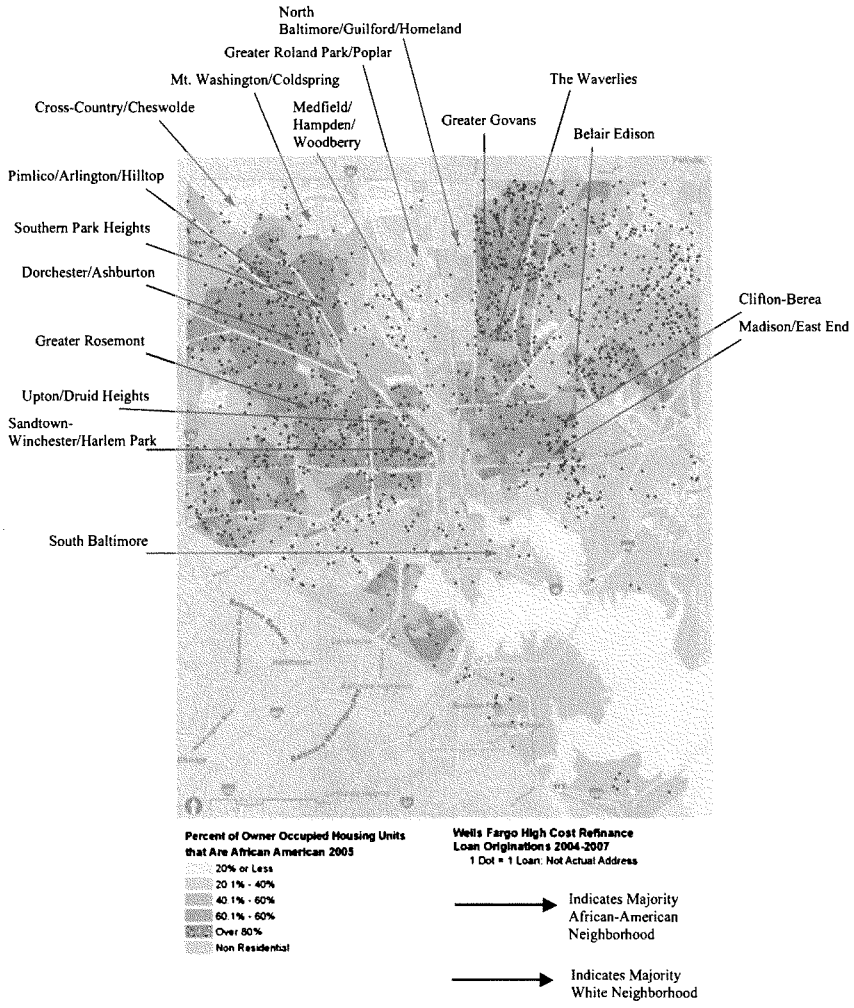
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90. The fact that high-cost loans involving all of Wells Fargo's loan products are more heavily concentrated in Baltimore's African-American neighborhoods is consistent with the practice of reverse redlining and, upon information and belief, has contributed significantly to the disproportionately high rate of foreclosures in Baltimore's African-American communities. Within the subset of high-cost loans, however, the fact that a disproportionately large percentage of Wells Fargo's high-cost loans in African-American neighborhoods are refinance loans is particularly significant, for it is both consistent with and indicative of a deceptive and predatory subprime practice that involves encouraging minority borrowers who already have loans to refinance at excessive cost with little benefit. This increases the likelihood of foreclosure and, upon information and belief, has contributed to the disproportionately high rate of foreclosures in Baltimore's African-American communities.

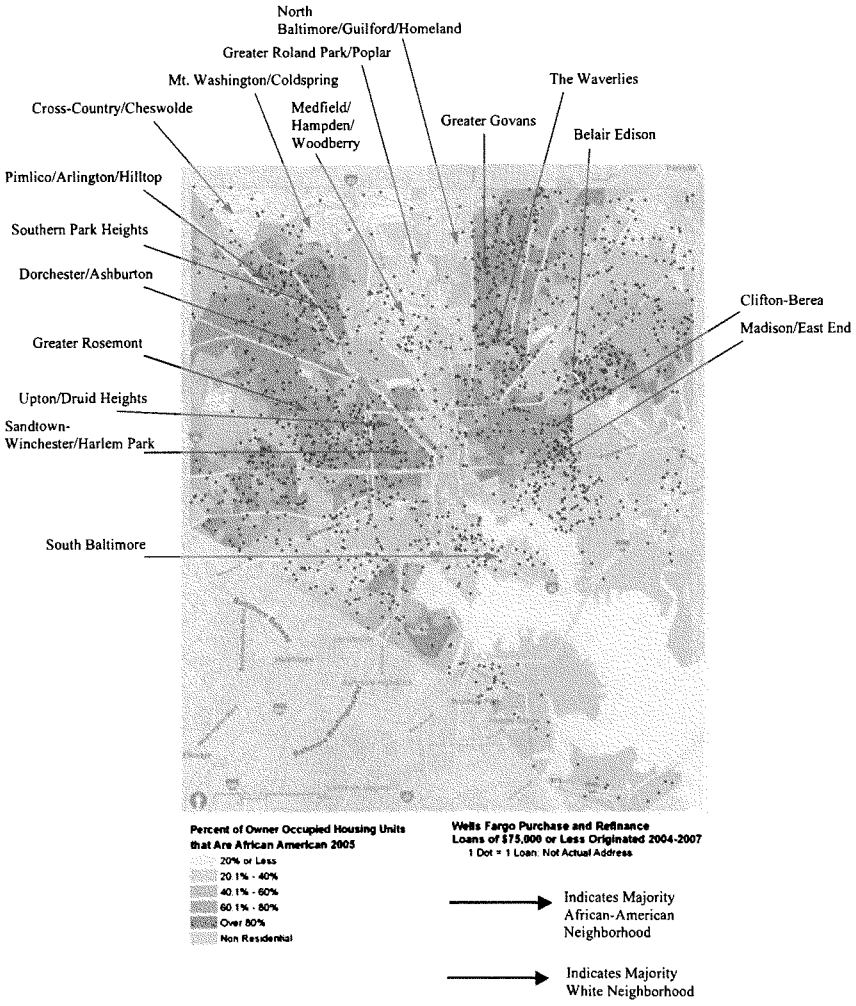
3. Wells Fargo's Pricing Sheets Show that it Targets Homes that are More Likely to be Located in African-American Neighborhoods for Interest Rate Increases, and Lowers Rates for Homes that are Disproportionately Located in White Neighborhoods

91. One reason that residents of Baltimore's African-American neighborhoods are more likely to pay higher prices for Wells Fargo loans than residents of Baltimore's white neighborhoods is the discriminatory pricing found on its pricing sheets. As set forth explicitly on the Wells Fargo Home Mortgage 2005 pricing sheet, attached as Attachment A, Wells Fargo requires a 50 basis point increase in the loan rate for loans of $75,000 or less, a 12.5 basis point decrease for loans of $150,000 to $400,000, and a 25 basis point decrease for loans larger than $400,000. This means that a borrower with a $75,000 thirty-year fixed rate loan who qualifies for an 8% interest rate instead receives an 8.5% interest rate, which costs an extra $9,493 over the life of the loan. An equally creditworthy borrower with a $150,000 loan receives a 7.875% interest rate, which costs

$4,698 less than an 8% loan. A similarly qualified borrower with a $400,001 loan would receive a 7.75% interest rate, which costs $24,987 less than an 8% loan.

92. The Fannie Mae Foundation has likewise documented how modest interest rate disparities can cause dramatic financial consequences for borrowers steered into higher-cost loans. James H. Carr and Jenny Schuetz, Fannie Mae Foundation, *Financial Services in Distressed Communities: Framing the Issue, Finding Solutions* (2001) at 12-13 (available at http://www.cra-nc.org/financial.pdf) (attached as Attachment C) (1% increase in interest rate on 30-year $81,000 mortgage translates into loss of over $78,000 in wealth due to increased payments and lost investment opportunity).

93. Wells Fargo's pricing rules have a clear and foreseeable disproportionate adverse impact on African-American borrowers. As demonstrated by the maps that follow, loans originated by Wells Fargo in Baltimore from 2004 through 2007 in the amount of $75,000 and less were almost three times as likely to be in census tracts where the population is predominantly African-American than in tracts where the population is predominantly white. By contrast, loans originated by Wells Fargo in Baltimore of more than $150,000 were 3.25 times as likely to be in tracts that are predominantly white than in tracts that are predominantly African-American.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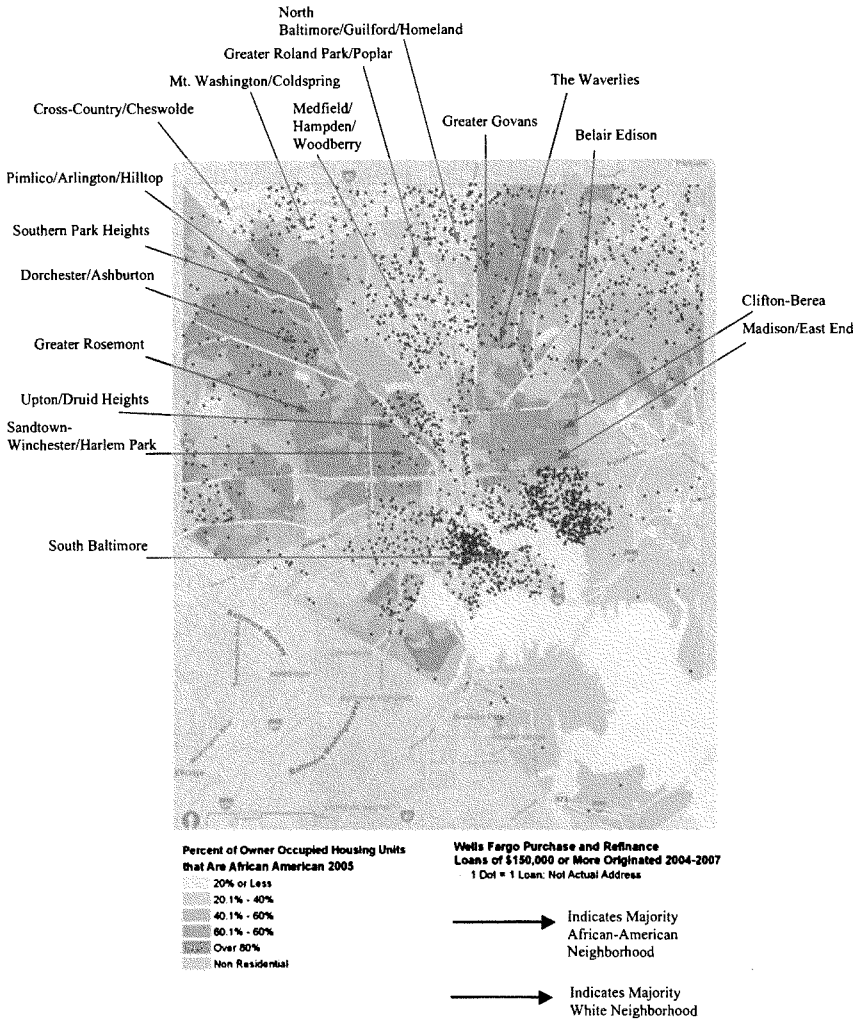
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94. Upon information and belief, the discriminatory pricing reflected in Wells Fargo's pricing sheets is consistent with unfair practices associated with reverse redlining and has contributed significantly to the disproportionately large number of foreclosures found in Baltimore's African-American communities.

4. Investigation of Wells Fargo's Pricing Practices in Philadelphia Further Demonstrates the Company is Targeting the African-American Community for Unfair and Improper Lending Practices

95. Discriminatory pricing observed in Wells Fargo's loan data in Baltimore is consistent with findings drawn from data obtained in litigation brought against Wells Fargo in Philadelphia. An expert report in a pending lawsuit based on Wells Fargo's Philadelphia loans concluded that "African American borrowers, and borrowers residing in African American neighborhoods (i.e., census tracts), pay more than comparable non-African Americans and residents of communities in which White people predominate." Aff. of I. Goldstein, *Walker v. Wells Fargo Bank, N.A.*, No. 05-cv-6666 (E.D. Pa. July 20, 2007) at ¶ 7 (Docket No. 24, Attach. 1).

96. Upon information and belief, Wells Fargo's pricing practices in Philadelphia are consistent with its practices in Baltimore, and provide further evidence that the company is engaged in a pattern or practice of unfair lending that contributes significantly to the disproportionately high rate of foreclosure found in Baltimore's African-American neighborhoods.

5. Wells Fargo Underwrites Adjustable Rate Loans in Baltimore's African-American Neighborhoods That Borrowers Cannot Afford

97. Wells Fargo frequently originates "3/27" adjustable rate mortgages, and frequently originated "2/28" adjustable rate mortgages until mid-2007, to borrowers from predominantly African-American neighborhoods in Baltimore. Thirty-four percent of

Wells Fargo's foreclosures from 2000 to 2008 involved such loans. Unless properly underwritten, such loans are destined to fail.

98. Wells Fargo does not properly underwrite these loans when made to African Americans and in African-American neighborhoods. Wells Fargo does not adequately consider the borrowers' ability to repay these loans, especially after the teaser rate expires and the interest rate increases. The fact that these loans would result in delinquency, default and foreclosure for many borrowers was, or should have been, clearly foreseeable to Wells Fargo at the time the loans were made.

99. Most of the loans that Elizabeth Jacobson made were adjustable rate mortgages. Jacobson Decl. ¶ 13. Jacobson confirms in her declaration that Wells Fargo underwrites these loans as if the teaser rate will apply for the full life of the loan instead of considering the borrowers' ability to repay the loan after the teaser rate expires in two or three years. *Id.* ¶ 16.

100. The use of "2/28" and "3/27" adjustable rate mortgages in the manner described above is consistent with the practice of reverse redlining, has subjected African-American borrowers to unfair and deceptive loan terms, and has contributed significantly to the high rate of foreclosure found in Baltimore's African-American neighborhoods.

6. The Caps on Wells Fargo's Adjustable Rate Loans are Higher in African-American Neighborhoods

101. Upon information and belief, Wells Fargo has discretion to apply different caps on adjustable rate loans. The cap is the maximum rate that a borrower can be charged during the life of an adjustable rate loan.

102. The average cap on a Wells Fargo adjustable rate loan that was subject to foreclosure in 2005 or 2006 in predominantly African-American neighborhoods was 14.13%. The cap on such loans in predominantly white neighborhoods was only 13.61%.

103. The disparity observed in caps imposed on adjustable rate loans in predominantly African-American neighborhoods and predominantly white neighborhoods further demonstrates that Well Fargo is engaged in a pattern or practice of unfair and improper lending in Baltimore's African-American communities that contributes significantly to the high rate of foreclosure in these neighborhoods.

7. Wells Fargo's Loans to African Americans Result in Especially Quick Foreclosures

104. A comparison of the time from origination to foreclosure of Wells Fargo's loans in Baltimore shows a marked disparity with respect to the speed with which loans to African Americans and whites move into foreclosure. The average time to foreclosure on African-American borrowers is 1.27 years. With white borrowers it is 1.45 years, or 14% longer.

105. This disparity in time to foreclosure is further evidence that Wells Fargo is engaged in lending practices consistent with reverse redlining. As with all of the practices identified in paragraphs 61-103 above, and like the abusive practices identified in paragraphs 26 and 55 above, the disparity in time to foreclosure demonstrates that Wells Fargo is engaged in irresponsible underwriting in African-American communities that does not serve the best interests of borrowers. If Wells Fargo were applying the same underwriting practices in Baltimore's African-American and white neighborhoods, there would not be a significant difference in time to foreclosure. Were Wells Fargo underwriting borrowers in both communities with equal care and attention to proper underwriting practices, borrowers in African-American communities would not find

themselves in financial straits significantly sooner during the life of their loans than borrowers in white communities. The faster time to foreclosure in African-American neighborhoods is consistent with underwriting practices in the African-American community that are less concerned with determining a borrower's ability to pay and qualifications for the loan than they are in maximizing short-term profit.

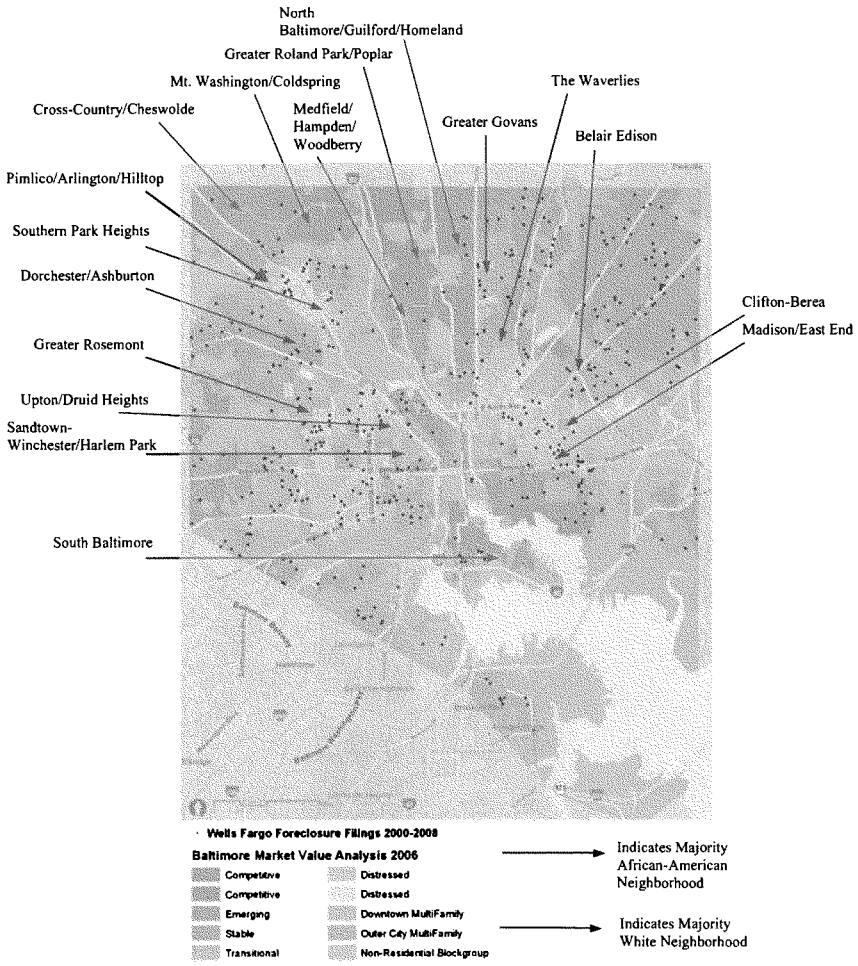
106. The HUD/Treasury Report confirms that time to foreclosure is an important indicator of predatory practices. Citing Baltimore specifically, HUD and Treasury stated that "[t]he speed with which the subprime loans in these communities have gone to foreclosure suggests that some lenders may be making mortgage loans to borrowers who did not have the ability to repay those loans at the time of origination," and that "lenders should not lend to borrowers that do not have the capacity to repay the loans that the lender offers." HUD/Treasury Report at 25 (attached as Attachment B).

107. The difference in time to foreclosure in Baltimore's African-American and white neighborhoods is especially important because foreclosures occur more quickly in Baltimore than in neighboring jurisdictions, including Philadelphia and New Castle County, Delaware (which includes Wilmington). This means that the injuries that result from foreclosures in Baltimore are compounded, and therefore grow, at a faster pace.

INJURY TO BALTIMORE CAUSED BY
WELLS FARGO'S DISCRIMINATION IN MORTGAGE LENDING

108. Wells Fargo has engaged in a pattern or practice of reverse redlining that has resulted in a disproportionately high rate of foreclosure on loans to African Americans and in Baltimore's majority African-American neighborhoods. Wells Fargo continues to engage in this discriminatory pattern or practice with similar and continuing deleterious consequences for Baltimore's African-American neighborhoods.

109. The foreclosures caused by Defendants' discriminatory lending practices are particularly injurious because they are concentrated in distressed and transitional neighborhoods, as reflected on the following map. These neighborhoods include, among others, Greater Rosemont, Upton/Druid Heights, Clifton-Berea, and Madison/East End, all with African-American populations over 90%. These neighborhoods have high vacancy rates, low rates of owner occupancy, substantial housing code violations, and low property values. These characteristics make these neighborhoods most vulnerable to the deleterious effects of foreclosures.


North Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield/ Hampden/ Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-Winchester/Harlem Park
South Baltimore
Wells Fargo Foreclosure Filings 2000-2008
Baltimore Market Value Analysis 2006
Competitive
Competitive
Emerging
Stable
Transitional
Distressed
Distressed
Downtown MultiFamily
Outer City MultiFamily
Non-Residential Blockgroup
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

110. The foreclosures caused by Defendants' discriminatory reverse redlining practices have caused, and continue to cause, multiple types of injuries to Baltimore, including:

a. A significant decline in the value of nearby homes, resulting in a decrease in property tax revenue;

b. An increase in the number of abandoned and vacant homes;

c. An increase in criminal and gang activity as abandoned and vacant homes become centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities;

d. Increased expenditures for police and fire protection;

e. Increased expenditures to secure abandoned and vacant homes;

f. Additional expenditures to acquire and rehabilitate vacant properties; and

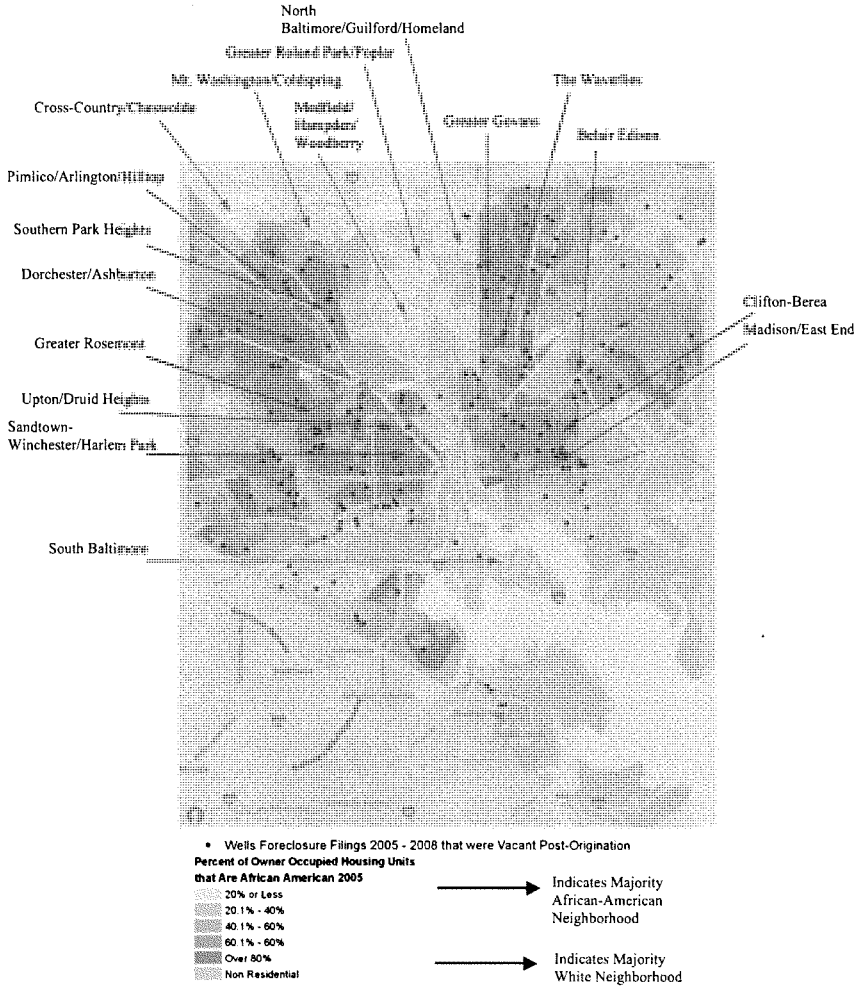
g. Additional expenditures for administrative, legal, and social services.

111. Vacancies caused by Wells Fargo foreclosures result in injuries to the City that are especially costly. Vacancies cause, among other harms, squatters, increased risk of crime and fire, and infrastructure damage such as burst water pipes and broken windows. Expensive responses by the City are required to address these harms. Vacancies likewise cause especially significant declines in property values and, therefore, in property tax revenues collected by the City.

112. Vacancies caused by Wells Fargo foreclosures are concentrated in distressed and transitional neighborhoods and in predominantly African-American neighborhoods. More than half of the 379 properties subject to a Wells Fargo foreclosure

between 2005 and 2008 were vacant after the loan was originated. Seventy-one percent of these properties are located in neighborhoods that are predominantly African-American, as shown on the map following paragraph 113. Moreover, 107 of the properties are currently vacant. Sixty-nine percent of these 107 properties are in neighborhoods that are predominantly African-American but only 16% are in neighborhoods that are predominantly white. *See* Attachment O ("Goldstein Decl.") ¶ 10.

113. These vacancies have a disproportionate and adverse impact on African-American neighborhoods. The harm from the vacancies is felt in African-American neighborhoods much more acutely than in white neighborhoods. The vacancies require Baltimore to devote substantial resources to combating their effects in African-American neighborhoods than would otherwise be required.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
The Waverlies
Cross-Country/Cheswolde
Medfield
Hampden
Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
• Wells Foreclosure Filings 2005 - 2008 that were Vacant Post-Origination
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

114. Declarations from Baltimore residents who live very close to some of the properties that Wells Fargo has foreclosed on confirm that the City suffers particularly significant direct injuries as a result of Wells Fargo foreclosures that cause vacancies. Richard and Stephen Faison, Lisa Porter, and Bridget Ross all live next door or a few doors down from Wells Fargo foreclosure properties that are now vacant and that are in neighborhoods that are over 80% African-American. *See* Attachment P ("R. Faison Decl."); Attachment Q ("S. Faison Decl."); Attachment R ("Porter Decl."); Attachment S ("Ross Decl."); Goldstein Decl. ¶ 15. These residents highlight, in graphic terms, some of the ways in which vacancies cause the kind of harm that the City must spend substantial resources to address. This includes costs resulting from crime, squatting, loitering, trash, burst pipes, and more. Their declarations likewise confirm that foreclosures and vacancies cause neighborhoods to deteriorate, which erodes Baltimore's property tax base.

115. Richard Faison has had to call the police several times because of loiterers who hang out and drink at the vacant Wells Fargo foreclosed property next door to him, which was recently boarded up. R. Faison Decl. ¶¶ 3, 5. He also had to call the City to turn off the water and cap a pipe at the vacant house when the pipe burst. *Id.* ¶ 7. Richard and Stephen Faison both confirm that the vacant house is in serious disrepair and that it has created a rat infestation because loiterers and squatters let trash accumulate. R. Faison Decl. ¶ 4, 6, 8, 9; S. Faison Decl. ¶¶ 5-8.

116. The vacant Wells Fargo foreclosed property a few houses from Lisa Porter's home is also in disrepair. Porter Decl. ¶ 4, 6. Trash is scattered in the yard, the grass is not cut, and rats have become an increasing problem since it became vacant. *Id.* ¶¶ 4-5.

117. Bridget Ross and her neighbors had to call the City to come and board up the vacant Wells Fargo foreclosure property two doors down from her home. Ross Decl. ¶ 5. Vagrants stayed at the house until it was boarded. *Id.* ¶ 3. It is in disrepair, with a broken door and broken windows and large amounts of trash in the yard, and has also become a source of many rats. *Id.* ¶¶ 3, 6, 7. People have stolen plumbing from the vacant property. *Id.* ¶ 4. Ross has been trying unsuccessfully to sell her house for two years but the nearby vacant Wells Fargo foreclosure property has made her home lose value and has made it less desirable to potential purchasers. *Id.* ¶ 9.

118. The problems described by the Faisons, Porter and Ross impose direct costs on City. The City must, for example, send police officers in response to calls for assistance and send other municipal workers to cap burst pipes and board up these vacant properties. The problems and the costs incurred by the City to address them are the direct results of the foreclosures on Wells Fargo loans in these predominantly African-American neighborhoods.

119. The problems also cause these African-American neighborhoods to become less desirable and the homes in the neighborhoods to decline in value. R. Faison Decl. ¶ 10; Porter Decl. ¶ 6; Ross Decl. ¶ 9. As Richard Faison states, "[p]eople do not want to live in my neighborhood because of the condition of the" vacant Wells Fargo foreclosure property. R. Faison Decl. ¶ 10.

120. Damages suffered by the City of Baltimore as a result of Wells Fargo's foreclosures are fully capable of empirical quantification. Recent studies demonstrate that the precise financial impacts of the different types of injuries caused by foreclosures are quantifiable. A study published by the Fannie Mae Foundation, using Chicago as an example, determined that each foreclosure is responsible for an average decline of

approximately 1% in the value of each single-family home within a quarter of a mile. *See* D. Immergluck & G. Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Policy Debate 57 (2006).

121. Other studies have focused on the impact of abandoned homes on surrounding property values. A recent study in Philadelphia, for example, found that each home within 150 feet of an abandoned home declined in value by an average of $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542. Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, at 161-162 (2004).

122. The costs of increased municipal services that are necessary because of foreclosures have also been analyzed empirically. A study commissioned by the Homeownership Preservation Foundation isolated twenty-six types of costs incurred by fifteen government agencies in response to foreclosures in Chicago. *See* W. Apgar, M. Duda & R. Gorey, *The Municipal Costs of Foreclosures: A Chicago Case Study* (Feb. 27, 2005) at 24-26 (available at http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/documents/2005Apgar-DudaStudy-FullVersion.pdf). It then analyzed the amount of each cost based on different foreclosure scenarios, such as whether the home is left vacant, whether and to what degree criminal activity ensues, and whether the home must be demolished. The study found that the total costs ran as high as $34,199 per foreclosure.

123. Application of methodologies like the ones employed by Immergluck, Shlay, Apgar and their colleagues can be used to quantify precisely the injury to the City

caused by Defendants' discriminatory lending practices, including but not limited to those described above, and the Wells Fargo foreclosures that are the direct result of those practices. This includes the costs to the City of addressing the types of problems described by Richard and Stephen Faison, Lisa Porter, and Bridget Ross. It also includes property tax revenue that the City has lost as result of the decline in property values in the Faisons's, Porter's, and Ross's neighborhoods and in other African-American neighborhoods where Wells Fargo's discriminatory practices have caused foreclosures.

124. The damages and costs to Baltimore of the foreclosures caused by Defendant' discriminatory lending practices are in the tens of millions of dollars. These are direct damages and costs incurred by the City because of Wells Fargo's foreclosures that are the result of the reverse redlining practices that are described in this First Amended Complaint and that violate the Fair Housing Act.

125. Defendants' actions set forth herein constitute a pattern or practice of discriminatory lending and a continuing violation of federal law. Unless enjoined, Wells Fargo will continue to engage in the unlawful pattern or practice described above.

126. Baltimore has been, and continues to be, adversely affected by the acts, policies, and practices of Defendants, their employees, and/or their agents.

127. The extent of Baltimore's injuries will increase unless and until Wells Fargo ceases to discriminate against African Americans and borrowers in majority African-American neighborhoods.

128. Defendants' unlawful actions described above were, and are, intentional and willful, and/or have been, and are, implemented with callous and reckless disregard for Baltimore's federally protected rights.

CAUSE OF ACTION
(Federal Fair Housing Act)

129. Plaintiff repeats and incorporates by reference all allegations contained in Paragraphs 1 through 128 as if fully set forth herein.

130. Defendants' acts, policies, and practices as documented above and discussed in particular by Jacobson and Paschal constitute intentional discrimination on the basis of race. Defendants have intentionally targeted residents of predominantly African-American neighborhoods in Baltimore for different treatment than residents of predominantly white neighborhoods in Baltimore with respect to mortgage lending. Defendants have intentionally targeted residents of these neighborhoods for subprime loans without regard to their credit qualifications and without regard to whether they qualify for more advantageous loans, including prime loans. Defendants have intentionally targeted residents of these neighborhoods for increased interest rates, points, and fees, and for other disadvantageous loan terms including but not limited to prepayment penalties. Defendants have intentionally targeted residents of these neighborhoods for unfair and deceptive lending practices in connection with marketing and underwriting subprime mortgage loans.

131. Defendants' acts, policies, and practices have had an adverse and disproportionate impact on African Americans and residents of predominantly African-American neighborhoods in Baltimore as compared to similarly situated whites and residents of predominantly white neighborhoods in Baltimore. This adverse and disproportionate impact is the direct result of Defendants' policies of giving substantial discretion to loan officers and others responsible for mortgage lending; giving loan officers and others responsible for mortgage lending large financial incentives to give borrowers loans that are costlier than loans for which they qualify; otherwise encouraging

and directing loan officers and others responsible for mortgage lending to steer people into subprime loans without regard for whether they qualify for better loans, including but not limited to prime loans; increasing the interest rate on loans of $75,000 or less and decreasing the interest rate on loans of $150,000 or more; and setting interest rate caps. *See, e.g., Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 251 (D. Mass. 2008). These policies have caused African Americans and residents of predominantly African-American neighborhoods in Baltimore to receive mortgage loans from Wells Fargo that have materially less favorable terms than mortgage loans given by Wells Fargo to similarly situated whites and residents of predominantly white neighborhoods in Baltimore, and that are materially more likely to result in foreclosure.

132. Defendants' acts, policies, and practices constitute reverse redlining and violate the Fair Housing Act, as amended, 42 U.S.C. §§ 3604 and 3605:

(a) Defendants' acts, policies, and practices have made and continue to make housing unavailable on the basis of race and/or color, in violation of 42 U.S.C. § 3604(a);

(b) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions, and privileges of sale of housing, as well as different services and facilities in connection therewith, on the basis of race, and/or color, in violation of 42 U.S.C. § 3604(b);

(c) Defendants' published policies and statements have expressed and continue to express a preference on the basis of race and/or color, in violation of 42 U.S.C. § 3604(c); and

(d) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions and privileges on the basis of race and/or color in connection with the making of residential real estate-related transactions, in violation of 42 U.S.C. § 3605.

DEMAND FOR JURY TRIAL

133. Pursuant to Fed. R. Civ. P. 38(b), Plaintiff demands a trial by jury on all issues triable as of right.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully prays that the Court grant it the following relief:

(1) enter a declaratory judgment that the foregoing acts, policies, and practices of Defendants violate 42 U.S.C. §§ 3604 and 3605;

(2) enter a permanent injunction enjoining Defendants and their directors, officers, agents and employees from continuing to publish, implement, and enforce the illegal, discriminatory conduct described herein and directing Defendants and their directors, officers, agents and employees to take all affirmative steps necessary to remedy the effects of the illegal, discriminatory conduct described herein and to prevent additional instances of such conduct or similar conduct from occurring in the future;

(3) award compensatory damages to Plaintiff in an amount to be determined by the jury that would fully compensate Plaintiff for its injuries caused by the conduct of Defendants alleged herein;

(4) award punitive damages to Plaintiff in an amount to be determined by the jury that would punish Defendants for the willful, wanton and reckless conduct alleged herein and that would effectively deter similar conduct in the future;

(5) award Plaintiff its reasonable attorneys' fees and costs pursuant to 42 U.S.C. § 3613(c)(2); and

(6) order such other relief as this Court deems just and equitable.

June 1, 2009

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Attorneys for Plaintiff

EXHIBIT BOOK

HOUSE COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

CHAIRMAN EDOLPHUS TOWNS

HEARING

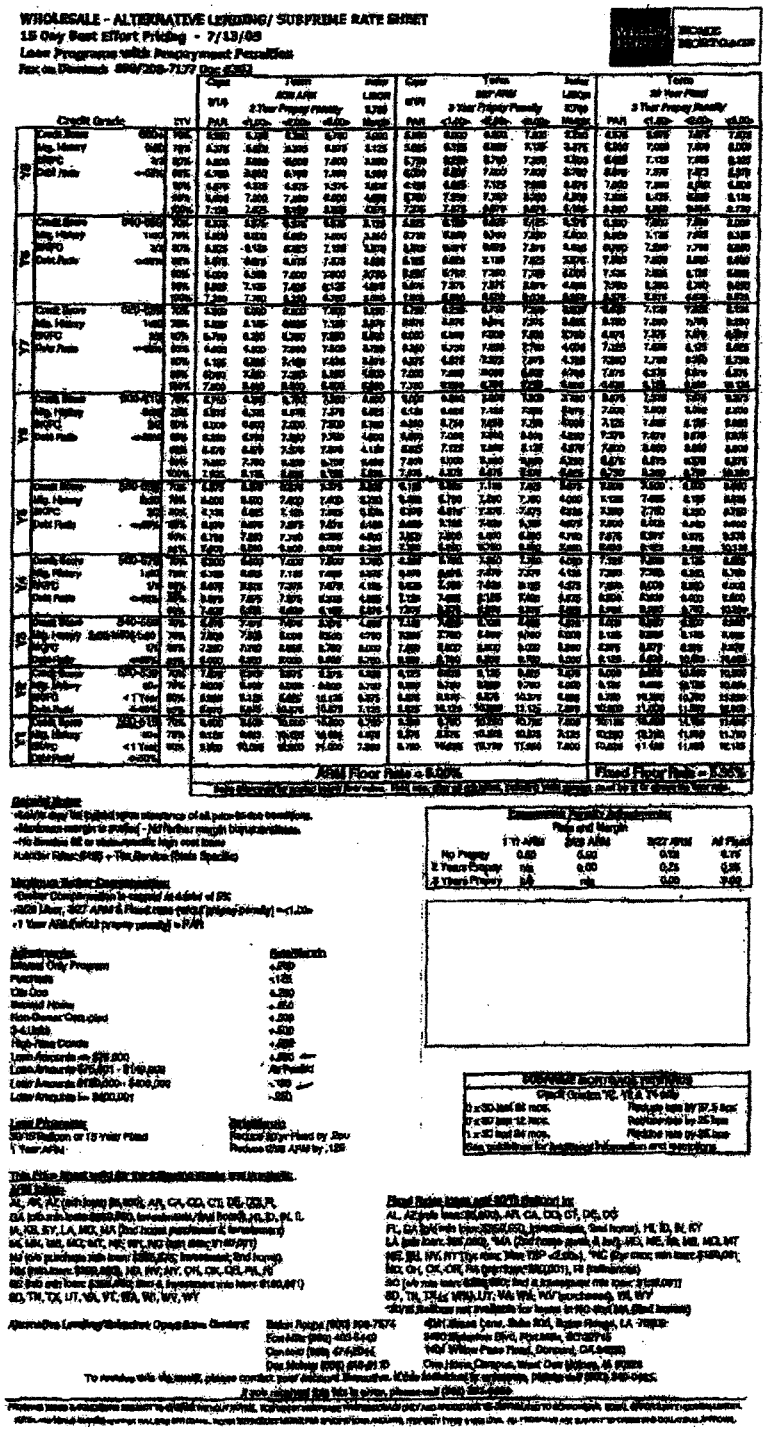
"The Silent Depression: How are Minorities Faring in the Economic Downturn?"

SEPTEMBER 23, 2009

City of Baltimore 74 Motion to file first amended complaint,
Document 74-2 through Document 74-22

Attachments
A-E

ATTACHMENT A



WHOLESALE - ALTERNATIVE LENDING/ SUBPRIME RATE SHEET
15 Day Best Effort Pricing - 7/13/09
Loan Programs with Prepayment Penalties
Fax on Demand 866/208-7177 Doc #3852

Credit Grade	LTV	Open 0/1/0	3 Year ARM 3 Year Prepay Penalty			Libor 5/1IO	Open 0/1/0	3/27 ARM 3 Year Prepay Penalty			Libor 2/28IO	30 Year Fixed 3 Year Prepay Penalty			
		PMT	<1.0%	<2.0%	<3.0%		PMT	<1.0%	<2.0%	<3.0%		PMT	<1.0%	<2.0%	<3.0%
A+	Credit Score 680+														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
A	Credit Score 640-680														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
A-	Credit Score 620-640														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
B+	Credit Score 600-619														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
B	Credit Score 580-599														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
B-	Credit Score 560-579														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
C+	Credit Score 540-559														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
C	Credit Score 520-539														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														
C-	Credit Score 500-519														
	Mtg. History 1x30														
	DTI<50														
	Debt Ratio <=50%														

ARM Floor Rate = 8.00%

Fixed Floor Rate = 7.50%

Submit Rules:
-Submit days' file (upload rates) inclusive of all price-to-day transitions.
-Maximum margin to profile[- No Perfect margin blips/anomalies.
-No Brokers QC or state-specific high cost loans
FLA/HOEPA Rates (FHA) = The Brokers (State Specific)

Mortgage Broker Compensation:
-Broker Compensation is capped At 4.00% of POC
-5/29 Libor, 3/27 ARM & Fixed rates (with 3 year prepay penalty) =<1.00%
-1 Year ARM (with prepay penalty) = FAR

Adjustments	Rate/Month
Interest Only Program	+.750
Purchase	+.125
Cite Zoo	+.250
Second Home	+.250
Non-Owner Occupied	+.500
2-4 Units	+.500
High-Rate Condo	+.500
Loan Amounts <= $50,000	+.500
Loan Amounts $75,001 - $149,999	No Penalty
Loan Amounts $150,000 - $400,000	-.100
Loan Amounts >= $400,001	-.250

Loan Programs:
30/15 Balloon or 15 Year Fixed
1 Year ARM

Underwriting:
Reduce Margin Fixed by .25%
Reduce Start ARM by .125

Prepayment Penalty Adjustments:
Prop and Margin

	1 Yr ARM	2/28 ARM	3/27 ARM	All Fixed
No Prepay	0.00	0.00	0.00	0.00
1 Years Prepay	n/a	0.00	0.25	0.50
2 Years Prepay	n/a	n/a	0.00	0.00

Max Yield Spread Premium (YSP) & Par Rate:
Open 0 (Under 1%) 101 & 1% rate
2 x 30 days in last 6 mos. — Par rate for 97.5 loan
2 x 60 days in last 12 mos. — Par rate for 95 loan
1 x 30 days in last 24 mos. — Par rate for 95 loan
See worksheet for additional information and exceptions

Max Price Spread for All Qualifying Mortgage Programs:
ARM Rates:
AL, AR, AZ (with loans $0-$200), AR, CA, CO, CT, DE, DC, FL
GA (with max loans $400,000), Investments, 2nd homes), HI, ID, IN, IL
IA, KS, KY, LA, ME, MA (2nd house purchases & investments)
MI, MN, MS, MO, MT, NE, NV, NJ (with loans $1,000,000)
NJ (w/o purchase rate loans $400,000; Investment; 2nd home)
NM (with loans $400,000), ND, NY, NY, OH, OK, OR, PA, RI
SC (with max loans $400,000; Inv & Investment rate loans $150,000)
SD, TN, TX, UT, VA, VT, WA, WI, WV, WY

Fixed Rates (open and 101% Balloon) in:
AL, AZ (with loans $0-$200), AR, CA, CO, CT, DE, DC, FL
FL, GA (with max loans $400,000), Investments, 2nd homes), HI, ID, IN, KY
LA (with loans $0-$400), MA (2nd home spots & 3rd), ME, MI, MS, MO, MT
NE, NV, NY, NY (3yr max; Max YSP +2.00%), NC (3yr max; min loan $149,001;
ND, OH, OK, OR, PA (with loans $0-$200), RI (refinance)
SC (w/o max loans $400,000; Inv & Investment rate loans $150,001)
SD, TN, TX, UT, VA, WA, WI, WV (w/o purchase), WI, WY
-2nd yr Balloon not available for loans in NO-Yield list, (2nd homes)

Alternative Lending Solutions Group Sales Contact:
Robin Ayres (800) 208-7674
Kim Hite (800) 488-5449
Clarence (888) 474-8944
Doc Money (800) 888-91 10

4041 Mount Lane, Suite 300, Baton Rouge, LA 70808
5400 Kingsview Blvd, Roseville, SC 95678
1607 White Plains Road, Bronxville, CA 94708
One Union Campus, West Chester, PA 19380

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

PLAINTIFF MAYOR AND CITY COUNCIL OF BALTIMORE'S
MOTION TO FILE ITS FIRST AMENDED COMPLAINT

Pursuant to Federal Rule of Civil Procedure ("Rule") 15(a)(1), Plaintiff Mayor and City Council of Baltimore ("Baltimore" or "City") respectfully moves to file its First Amended Complaint in the form attached hereto as Exhibit 1.

Baltimore is entitled to file the First Amended Complaint as of right. Rule 15(a)(1) states that "[a] party may amend its pleading once as a matter of course: (A) before being served with a responsive pleading . . . ." The complaint has not been amended before and Defendants Wells Fargo Bank, N.A. and Wells Fargo Financial Leasing, Inc. (collectively, "Wells Fargo") have not served an answer or any other responsive pleading. Wells Fargo instead responded to the complaint by filing a motion to dismiss under Rule 12(b). A motion to dismiss is not a responsive pleading under Rule 15(a)(1)(A). *See, e.g., Domino Sugar Corp. v. Sugar Workers*

Local Union 392, 10 F.3d 1064, 1068 n.1 (4th Cir. 1993); *Smith v. Blackledge*, 451 F.2d 1201, 1202-03 & n.2 (4th Cir. 1971); *Ramotnik v. Fisher*, 568 F. Supp. 2d 598, 602 (D. Md. 2008); *Coleman v. Talbot County Det. Ctr.*, No. Civ. L.-04-2295, 2005 WL 1271898, at *1 (D. Md. May 26, 2005) (Legg, C.J.); 6 Charles A. Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice & Procedure* § 1483 (2009).

Accordingly, pursuant to Rule 15(a)(1)(A), Baltimore is entitled to file the First Amended Complaint as a matter of right.[1]

[1] Exhibits three through twenty-one to this motion are the Attachments to the First Amended Complaint. Exhibit twenty-two is a redline of the original complaint as required by Local Civil Rule 103(6)(c). Technical limitations preclude including the maps, which have been updated, in redline format; instead, "(MAP HERE)" has been inserted where each map is found.

June 1, 2009

Respectfully submitted,

/s/ John P. Relman

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Suzanne.Sangree@baltimorecity.gov

Attorneys for Plaintiff

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

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Pursuant to Federal Rule of Civil Procedure ("Rule") 15(a)(1), Plaintiff Mayor and City Council of Baltimore ("Baltimore" or "City") respectfully moves to file its First Amended Complaint in the form attached hereto as Exhibit 1.

Baltimore is entitled to file the First Amended Complaint as of right. Rule 15(a)(1) states that "[a] party may amend its pleading once as a matter of course: (A) before being served with a responsive pleading . . . ." The complaint has not been amended before and Defendants Wells Fargo Bank, N.A. and Wells Fargo Financial Leasing, Inc. (collectively, "Wells Fargo") have not served an answer or any other responsive pleading. Wells Fargo instead responded to the complaint by filing a motion to dismiss under Rule 12(b). A motion to dismiss is not a responsive pleading under Rule 15(a)(1)(A). *See, e.g., Domino Sugar Corp. v. Sugar Workers*

Local Union 392, 10 F.3d 1064, 1068 n.1 (4th Cir. 1993); *Smith v. Blackledge*, 451 F.2d 1201, 1202-03 & n.2 (4th Cir. 1971); *Ramotnik v. Fisher*, 568 F. Supp. 2d 598, 602 (D. Md. 2008); *Coleman v. Talbot County Det. Ctr.*, No. Civ. L.-04-2295, 2005 WL 1271898, at *1 (D. Md. May 26, 2005) (Legg, C.J.); 6 Charles A. Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice & Procedure* § 1483 (2009).

Accordingly, pursuant to Rule 15(a)(1)(A), Baltimore is entitled to file the First Amended Complaint as a matter of right.[1]

[1] Exhibits three through twenty-one to this motion are the Attachments to the First Amended Complaint. Exhibit twenty-two is a redline of the original complaint as required by Local Civil Rule 103(6)(c). Technical limitations preclude including the maps, which have been updated, in redline format; instead, "(MAP HERE)" has been inserted where each map is found.

June 1, 2009

Respectfully submitted,

/s/ John P. Relman

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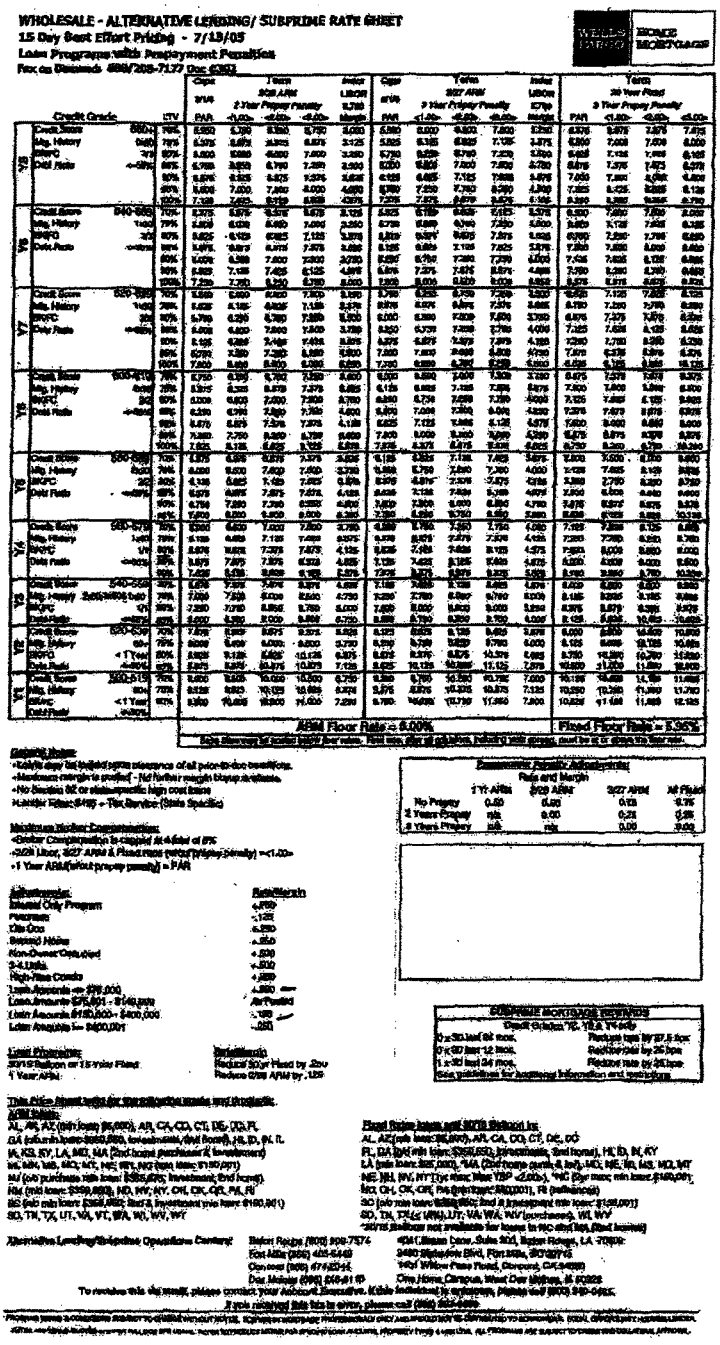
ATTACHMENT A



WHOLESALE - ALTERNATIVE LENDING/ SUBPRIME RATE SHEET
15 Day Best Effort Pricing - 7/13/05
Loan Programs with Prepayment Penalties
For ex Datenok 488/205-7177 Doc 6363

Credit Grade		LTV	2 Year Prepay Penalty PAR	2 Year Prepay Penalty <1.00>	2 Year Prepay Penalty <2.00>	2 Year Prepay Penalty <3.00>
A+	Credit Score	680+	6.000	6.125	6.250	6.375
	Mtg. History	0x30	6.375	6.500	6.625	6.750
	BK/FC	7Yr	6.500	6.625	6.750	6.875
	Debt Ratio	<=50%	6.750	6.875	7.000	7.125
		55%	6.875	6.925	7.125	7.250
		60%	6.875	7.000	7.000	7.000
		65%	7.000	7.000	7.125	7.250
		70%	7.125	7.250	7.375	7.500
A	Credit Score	640-680	7.000	7.125	7.250	7.375
	Mtg. History	1x30	7.125	7.250	7.375	7.500
	BK/FC	3Yr	7.250	7.375	7.500	7.625
	Debt Ratio	<=50%	7.375	7.500	7.625	7.750
		55%	7.500	7.625	7.750	7.875
		60%	7.625	7.750	7.875	8.000
		65%	7.750	7.875	8.000	8.125
A-	Credit Score	620-640	7.500	7.625	7.750	7.875
	Mtg. History	1x60	7.625	7.750	7.875	8.000
	BK/FC	3Yr	7.750	7.875	8.000	8.125
	Debt Ratio	<=50%	7.875	8.000	8.125	8.250
		55%	8.000	8.125	8.250	8.375
		60%	8.125	8.250	8.375	8.500
B+	Credit Score	580-620	8.000	8.125	8.250	8.375
	Mtg. History	2x60	8.125	8.250	8.375	8.500
	BK/FC	3Yr	8.250	8.375	8.500	8.625
	Debt Ratio	<=50%	8.375	8.500	8.625	8.750
		55%	8.500	8.625	8.750	8.875
		60%	8.625	8.750	8.875	9.000
B	Credit Score	540-580	8.250	8.375	8.500	8.625
	Mtg. History	3x60/90x1x90	8.375	8.500	8.625	8.750
	BK/FC	1Yr	8.500	8.625	8.750	8.875
	Debt Ratio	<=50%	8.625	8.750	8.875	9.000
		55%	8.750	8.875	9.000	9.125
		60%	8.875	9.000	9.125	9.250
C	Credit Score	520-539	9.000	9.125	9.250	9.375
	Mtg. History	1x90	9.125	9.250	9.375	9.500
	BK/FC	<1 Year	9.250	9.375	9.500	9.625
	Debt Ratio	<=50%	9.375	9.500	9.625	9.750
		55%	9.500	9.625	9.750	9.875
		60%	9.625	9.750	9.875	10.000
C-	Credit Score	500-519	9.500	9.625	9.750	9.875
	Mtg. History	90x1	9.625	9.750	9.875	10.000
	BK/FC	<1 Year	9.750	9.875	10.000	10.125
	Debt Ratio	<=50%	9.875	10.000	10.125	10.250

Credit Grade		LTV	3 Year Prepay Penalty PAR	3 Year Prepay Penalty <1.00>	3 Year Prepay Penalty <2.00>	3 Year Prepay Penalty <3.00>
A+	Credit Score	680+	6.000	6.125	6.250	6.375
	Mtg. History	0x30	6.375	6.500	6.625	6.750
	BK/FC	7Yr	6.500	6.625	6.750	6.875
	Debt Ratio	<=50%	6.750	6.875	7.000	7.125
		55%	6.875	6.925	7.125	7.250
		60%	6.875	7.000	7.000	7.000
		65%	7.000	7.000	7.125	7.250
		70%	7.125	7.250	7.375	7.500
A	Credit Score	640-680	7.000	7.125	7.250	7.375
	Mtg. History	1x30	7.125	7.250	7.375	7.500
	BK/FC	3Yr	7.250	7.375	7.500	7.625
	Debt Ratio	<=50%	7.375	7.500	7.625	7.750
		55%	7.500	7.625	7.750	7.875
		60%	7.625	7.750	7.875	8.000
		65%	7.750	7.875	8.000	8.125
A-	Credit Score	620-640	7.500	7.625	7.750	7.875
	Mtg. History	1x60	7.625	7.750	7.875	8.000
	BK/FC	3Yr	7.750	7.875	8.000	8.125
	Debt Ratio	<=50%	7.875	8.000	8.125	8.250
		55%	8.000	8.125	8.250	8.375
		60%	8.125	8.250	8.375	8.500
B+	Credit Score	580-620	8.000	8.125	8.250	8.375
	Mtg. History	2x60	8.125	8.250	8.375	8.500
	BK/FC	3Yr	8.250	8.375	8.500	8.625
	Debt Ratio	<=50%	8.375	8.500	8.625	8.750
		55%	8.500	8.625	8.750	8.875
		60%	8.625	8.750	8.875	9.000
B	Credit Score	540-580	8.250	8.375	8.500	8.625
	Mtg. History	3x60/90x1x90	8.375	8.500	8.625	8.750
	BK/FC	1Yr	8.500	8.625	8.750	8.875
	Debt Ratio	<=50%	8.625	8.750	8.875	9.000
		55%	8.750	8.875	9.000	9.125
		60%	8.875	9.000	9.125	9.250
C	Credit Score	520-539	9.000	9.125	9.250	9.375
	Mtg. History	1x90	9.125	9.250	9.375	9.500
	BK/FC	<1 Year	9.250	9.375	9.500	9.625
	Debt Ratio	<=50%	9.375	9.500	9.625	9.750
		55%	9.500	9.625	9.750	9.875
		60%	9.625	9.750	9.875	10.000
C-	Credit Score	500-519	9.500	9.625	9.750	9.875
	Mtg. History	90x1	9.625	9.750	9.875	10.000
	BK/FC	<1 Year	9.750	9.875	10.000	10.125
	Debt Ratio	<=50%	9.875	10.000	10.125	10.250

Credit Grade		LTV	30 Year Fixed 3 Year Prepay Penalty PAR	30 Year Fixed 3 Year Prepay Penalty <1.00>	30 Year Fixed 3 Year Prepay Penalty <2.00>	30 Year Fixed 3 Year Prepay Penalty <3.00>
A+	Credit Score	680+	6.875	6.875	7.000	7.125
	Mtg. History	0x30	7.000	7.000	7.000	8.000
	BK/FC	7Yr	7.000	7.125	7.000	8.125
	Debt Ratio	<=50%	7.000	7.125	7.250	8.250
		55%	7.125	7.250	7.375	8.375
		60%	7.250	7.250	7.500	8.500
		65%	7.375	7.375	7.625	8.625
		70%	7.500	7.500	7.750	8.750
A	Credit Score	640-680	7.250	7.250	7.375	8.375
	Mtg. History	1x30	7.375	7.375	7.500	8.500
	BK/FC	3Yr	7.500	7.500	7.625	8.625
	Debt Ratio	<=50%	7.625	7.625	7.750	8.750
		55%	7.750	7.750	7.875	8.875
		60%	7.875	7.875	8.000	9.000
		65%	8.000	8.000	8.125	9.125
A-	Credit Score	620-640	7.750	7.750	7.875	8.875
	Mtg. History	1x60	7.875	7.875	8.000	9.000
	BK/FC	3Yr	8.000	8.000	8.125	9.125
	Debt Ratio	<=50%	8.125	8.125	8.250	9.250
		55%	8.250	8.250	8.375	9.375
		60%	8.375	8.375	8.500	9.500
B+	Credit Score	580-620	8.250	8.250	8.375	9.375
	Mtg. History	2x60	8.375	8.375	8.500	9.500
	BK/FC	3Yr	8.500	8.500	8.625	9.625
	Debt Ratio	<=50%	8.625	8.625	8.750	9.750
		55%	8.750	8.750	8.875	9.875
		60%	8.875	8.875	9.000	10.000
B	Credit Score	540-580	8.750	8.750	8.875	9.875
	Mtg. History	3x60/90x1x90	8.875	8.875	9.000	10.000
	BK/FC	1Yr	9.000	9.000	9.125	10.125
	Debt Ratio	<=50%	9.125	9.125	9.250	10.250
		55%	9.250	9.250	9.375	10.375
		60%	9.375	9.375	9.500	10.500
C	Credit Score	520-539	9.500	9.500	9.625	10.625
	Mtg. History	1x90	9.625	9.625	9.750	10.750
	BK/FC	<1 Year	9.750	9.750	9.875	10.875
	Debt Ratio	<=50%	9.875	9.875	10.000	11.000
		55%	10.000	10.000	10.125	11.125
		60%	10.125	10.125	10.250	11.250
C-	Credit Score	500-519	10.250	10.250	10.375	11.375
	Mtg. History	90x1	10.375	10.375	10.500	11.500
	BK/FC	<1 Year	10.500	10.500	10.625	11.625
	Debt Ratio	<=50%	10.625	10.625	10.750	11.750

ARM Floor Rate = 6.00% — Fixed Floor Rate = 5.50%

Rate Sheet Notes:
- Lobby days for locked rates assume of all pull-through workflow.
- Maximum margin is profit! - No further margin blows available.
- No Section 32 or state-specific high cost loans
- Lender Fees: $495 + Tax Service (State Specific)

Maximum Broker Compensation:
- Broker Compensation is capped at 4.0pts at 6%
- 2/28 Libor, 3/27 ARM & Fixed rate terms (Hybrid/Penalty) =<1.00>
- 1 Year ARM (without prepay penalty) = PAR

Adjustments:

	Rate/Margin
Interest Only Program	+.250
Purchase	+.125
Cash Out	+.250
Second Home	+.250
Non-Owner Occupied	+.500
2-4 Units	+.250
High-Rise Condo	+.500
Loan Amounts <= $75,000	+.250
Loan Amounts $75,001 - $150,000	No Factor
Loan Amounts $150,000 - $400,000	-.125
Loan Amounts >= $400,001	-.250

Loan Programs:
30/15 Balloon or 15-Year Fixed
1 Year ARM

Underwriting:
Reduce 30yr Fixed by .25
Reduce ARM by .125

Documentation Penalty Adjustments:

	Rate and Margin 2 Yr ARM	3/27 ARM	All Fixed
No Prepay	0.00	0.00	0.125
1 Year Prepay	n/a	0.00	0.25
2 Years Prepay	n/a	n/a	0.00
3 Years Prepay	n/a	n/a	0.00

Subprime Mortgage Reserves
Credit Grades "C, C-" 24 mo only

0 x 30 last 24 mos.	Reduce ltps by 37.5 bps
0 x 60 last 12 mos.	Reduce fixed by 25 bps
1 x 30 last 24 mos.	Reduce ltps by 25 bps

See guidelines for additional information and restrictions

This Offer Sheet subject to the attached terms and conditions.

ARM States:
AL, MS, AZ (loan $<=600), AR, CA, CO, CT, DE, DC, FL
GA (all sub loans $<=650,000, investment, 2nd home), HI, ID, IN, IL
IA, KS, KY, LA, ME, MA (2nd home purchase & investment)
MI, MN, MS, MO, NC, NE, NH, NJ (loan $<=1,000,000)
NM (all purchases with loans $<=$650,000; investment, 2nd home)
NV (all loans $<=$650,000), ND, NY, OH, OK, OR, PA, RI
SC (all sub loans $<=$650,000; 2nd & investment sub loans $<=$400,000)
SD, TN, TX, UT, VA, VT, WA, WI, WV, WY

Fixed Rate loans and 30YR Balloon in:
AL, AZ (sub loans $<=$650,000), AR, CA, CO, CT, DE, DC
FL, GA (all sub loans $<=$650,000; investment, 2nd home), HI, ID, IN, KY
LA (sub loans $<=$600,000), MA (2nd home owner & Inv), MD, ME, MI, MS, MO, MT
NE, NH, NV, NY (sub loans $<=$650,000), NC (2yr max; Max YSP <2.00>), ND (2yr max; min loan $<=$400,000)
NM, OH, OK, OR, PA (2yr max; Max YSP <2.00>), RI, SC (all sub loans $<=$650,000), SD (2yr max; min loan $<=$400,000)
TN, TX (2yr max), UT, VA, WA, WI (purchase), WY
*30YR Balloon not available for loans in NC city list (list below)

Alternative Lending/Subprime Operations Centers:

Baton Rouge (800) 909-7574	4041 Essen Lane, Suite 300, Baton Rouge, LA 70809
Fort Mill (866) 405-6449	3480 Regent Blvd, Fort Mill, SC 29715
Concord (800) 474-2044	1401 Willow Pass Road, Concord, CA 94520
Des Moines (800) 848-8119	One Home Campus, West Des Moines, IA 50328

To receive this rate sheet, please contact your Account Executive. If this individual is unknown, please call (800) 848-0488.

If you received this fax in error, please call (866) 405-6449.

Program terms & conditions subject to change without notice. Rates are subject to change without notice. Not all products are available in all states. Not all loans qualify for all programs. Other restrictions may apply. Please see Wholesale Program Guidelines for complete details. Equal Housing Lender. NMLS #2611. All programs are subject to credit and collateral approval.

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Chapter I. Executive Summary

In April, the home ownership rate reached a record high with 67.1% of American families owning their own homes. A total of 70.7 million American families owned their homes in the first quarter of the year – more than at any time in American history.

Despite these gains, too many low- and moderate-income families have seen the dream of home ownership become a nightmare because of predatory or abusive lending practices. These practices are concentrated in the subprime mortgage market, where record numbers of Americans are refinancing their homes for consumer credit purposes. Subprime lending serves an important role, by providing loans to borrowers who do not meet the credit standards for the prime mortgage market. Some borrowers in the subprime market, however, may be particularly vulnerable to abusive lending practices.

This report details the recommendations of the Department of Housing and Urban Development (HUD) and the Department of Treasury for legislative and regulatory action to combat predatory lending, while maintaining access to credit for low- and moderate-income borrowers. In addition, the report describes regulatory and policy changes that HUD is implementing to combat predatory lending. The recommendations contained in this report are based, in significant part, on information gathered by the HUD-Treasury National Predatory Lending Task Force. Secretary Cuomo announced the Task Force in March 2000, in response to inquiries made by Senator Mikulski in the context of a VA/HUD Appropriations Subcommittee hearing. Secretary Cuomo and Secretary Summers jointly convened the Task Force in April 2000.

The Task Force drew its members from a wide range of parties interested in and affected by predatory lending, including consumer advocacy groups; industry trade associations representing mortgage lenders, brokers, and appraisers; local and state officials; and academics. Task Force members collected information about predatory lending and provided testimony on the effects of predatory practices through a process that included field forums held in Atlanta, Los Angeles, New York, Baltimore and Chicago.

What is Predatory Lending?

Although home mortgage lending is regulated by state and federal authorities, none of the statues and regulations governing mortgage transactions provides a definition of predatory lending. Predatory lending -- whether undertaken by creditors, brokers, or even home improvement contractors -- involves engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms. These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices.

Predatory lending generally occurs in the subprime mortgage market, where most borrowers use the collateral in their homes for debt consolidation or other consumer credit purposes. Most

borrowers in this market have limited access to the mainstream financial sector, yet some would likely qualify for prime loans. While predatory lending can occur in the prime market, it is ordinarily deterred in that market by competition among lenders, greater homogeneity in loan terms and greater financial information among borrowers. In addition, most prime lenders are banks, thrifts, or credit unions, which are subject to extensive federal and state oversight and supervision, unlike most subprime lenders.

Throughout the HUD-Treasury forums, there was substantial evidence of too-frequent abuses in the subprime lending market. These abuses tended to fall into four main categories:

Loan Flipping – Some mortgage originators refinanced borrowers' loans repeatedly in a short period of time. With each successive refinancing, these originators charged high fees, including sometimes prepayment penalties, that stripped borrowers' equity in their homes.

Excessive fees and "packing" – While subprime lending involves higher costs to the lender than prime lending, in many instances the Task Force saw evidence of fees that far exceeded what would be expected or justified based on economic grounds, and fees that were "packed" into the loan amount without the borrower's understanding.

Lending without regard to the borrower's ability to repay – One troubling practice involved lending based on borrowers' equity in their homes, where the borrowers clearly did not have the capacity to repay the loans. In particularly egregious cases, elderly people living on fixed incomes had monthly payments that equaled or exceeded their monthly incomes. Such loans quickly led borrowers into default and foreclosure.

Outright fraud and abuse – In many instances, abusive practices amount to nothing less than outright fraud. We heard many stories from borrowers who testified at the regional forums of fraud perpetrated by unscrupulous mortgage brokers, lenders, home improvement contractors, appraisers, and combinations thereof. Unscrupulous actors in these markets often prey on certain groups – the elderly, minorities, and individuals with lower incomes and less education – with deceptive or high-pressure sales tactics.

The Subprime Mortgage Market

Predatory lending occurs primarily in the subprime mortgage lending market, which has grown rapidly over the past several years. Subprime loan originations increased from $35 billion in 1994 to $160 billion in 1999. The subprime market share increased from less than 5 percent of all mortgage originations in 1994 to almost 13 percent in 1999. Securitization of subprime mortgages has developed in the past few years and has contributed significantly to rapid growth of the market. Issuance of securities backed by subprime mortgages increased from $11 billion in 1994 to $83 billion in 1998. In 1998, 55 percent of subprime mortgages were securitized, falling back to 37 percent in 1999.

By providing loans to borrowers who do not meet the credit standards for borrowers in the

prime market, subprime lending provides an important service, enabling such borrowers to buy new homes, improve their homes, or access the equity in their homes for other purposes. A majority of mortgages in the subprime market are used for consumer debt rather than housing purposes. As the HUD-Treasury Task Force forums demonstrates, however, the subprime market can be fertile ground for predatory lending activities. As documented by this report, predatory lending practices can occur at any stage of the loan process and be undertaken, or at least facilitated, by any of the many participants in a particular transaction.

Research conducted by HUD in connection with Task Force activities found that subprime lending tends to be concentrated in low-income and minority communities. Notably, HUD found that, even after controlling for neighborhood income (although without controllnig for credit history or risk), people living in predominantly African-American communities refinance in the subprime market much more often than people living in predominantly white communities.

Current Legal Context

Among the laws designed to protect consumers in mortgage lending are the Truth in Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), and the Real Estate Settlement Procedures Act (RESPA). In connection with transactions such as mortgages on a personal residence, TILA requires disclosure of essential terms, including the finance charge, the finance charge expressed as an annual percentage rate, and the total of all loan payments. For a subset of refinancings and closed-end home equity loans that are particularly high-cost, HOEPA requires additional disclosures and restricts some loan agreement provisions (e.g., prepayment penalties, balloon payments, and negative amortization) that can cause unique hardships to high cost loan borrowers. Private remedies for violations of TILA and HOEPA include, in appropriate circumstances, rescission and damages. RESPA requires disclosure of settlement costs, bars payments by settlement service providers for business referrals and unearned fees, limits amounts that can be held in borrowers' escrow accounts, and requires that borrowers be informed of mortgage servicing transfers and of lenders' business arrangements with affiliated settlement service providers.

Recommendations for New Legislation and Regulations

Treasury and HUD believe that new legislation and new regulation are both essential components of a coordinated strategy to combat predatory lending. The proposals set forth in this report address four specific areas: (1) Consumer Literacy and Disclosure; (2) Harmful Sales Practices; (3) Abusive Terms and Conditions; and (4) Market Structure.

(1) Consumer Literacy and Disclosure

Victims of predatory lending typically suffer from a lack of understanding of the mortgage loan process generally, and the specific terms of the loan they are entering into in particular. A consumer's lack of understanding makes him or her more vulnerable to abusive lending. HUD and Treasury recommend

that Congress enact legislation providing that:

> *Creditors be required to inform all HOEPA loan applicants of available home counseling programs prior to closing, and to recommend that such applicants seek counseling. The creditor would be required to provide the prospective borrower with a list of certified counselors in their area. HUD will study the most effective means of expanding access to counseling and its effectiveness.*

A 1998 report by HUD and the Federal Reserve Board concluded that the reform of the existing disclosure and enforcement scheme under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) could improve consumer understanding and facilitate meaningful loan shopping. Building on the recommendations in that report, HUD and Treasury recommend that Congress:

> *Amend RESPA and TILA to make information provided to consumers about the costs of credit and settlement services more reliable, more timely, and more helpful in comparison shopping.*
>
> *Amend Section 8 of RESPA to permit a creditor to provide consumers with a "guaranteed cost" package, guaranteeing both settlement costs, as well as loan rate and points, to enable consumers to effectively shop for the best price.*
>
> *Impose an accuracy standard, or tolerance, on permissible variations from the Good Faith Estimate required under RESPA.*
>
> *Require creditors to inform all borrowers of their credit scores and the indices for those scores on request.*
>
> *Enact essential reforms to the mortgage process, including combining and coordinating the timing of RESPA/TILA disclosures and establishing new or enhanced remedies, including civil penalties, for nondisclosure, misdisclosure, or other RESPA, TILA or HOEPA violations.*
>
> *Expand enforcement of HOEPA, RESPA, and TILA and create additional remedies under these laws.*

(2) Harmful Sales Practices

Targeting Predatory Loans to Specific Populations

The Task Force forums suggested that minorities, women, and the elderly bear the brunt of abusive mortgage lending practices, particularly in predominantly minority or low-income neighborhoods that do

not have access to mainstream sources of credit. To ensure that the potential civil rights implications of predatory lending receive the attention they deserve, HUD and Treasury recommend that:

> *Congress fund the President's request for fair lending enforcement and for funding of state, local, and private agencies with the capacity to effectively combat predatory lending practices that disadvantage minorities, women, and the elderly.*
>
> *The Federal Reserve Board take steps to increase the information lenders must report under the Home Mortgage Disclosure Act (described more fully below under part (4), Market Structure).*

Loan Flipping

Loan flipping is the practice of repeatedly refinancing a mortgage loan without benefit to the borrower, in order to profit from high origination fees, closing costs, points, prepayment penalties and other charges, steadily eroding the borrower's equity in his or her home. HUD and Treasury recommend that Congress amend HOEPA to:

> *Prohibit the refinancing of any existing mortgage with a new loan covered by HOEPA within 18 months of the preceding loan's origination unless the new loan provides the borrower with a tangible net benefit, as defined by the Federal Reserve Board.*
>
> *Permit a creditor that refinances an existing mortgage with a HOEPA loan within 18 months to charge points and fees only on the amount of the new advance.*
>
> *Restrict the imposition of modification or deferral fees in HOEPA loans unless the modified loan has a significantly lower Annual Percentage Rate (APR) or is not a HOEPA loan.*

HUD and Treasury also recommend that the Federal Reserve Board consider taking steps to prohibit loan flipping using its existing authorities.

Asset Based Lending

HOEPA prohibits lenders from engaging in a "pattern or practice" of making mortgage loans based solely on the value of the property securing the loan, without considering the borrower's capacity to repay. A borrower who has received an asset-based loan may have substantial difficulty proving that the lender engaged in a pattern or practice of making such loans. HUD and Treasury recommend that Congress amend HOEPA to:

> *Eliminate the pattern or practice requirement in HOEPA's provision restricting asset based lending.*

Authorize the Federal Reserve Board to establish by regulation to establish a "safe harbor" for lenders based on a maximum debt to income ratio and residual income guidelines, within which there is a conclusive presumption of lender compliance.

Require the Board to identify by regulation the criteria and processes that lenders must utilize in evaluating a "borrower's ability to repay under HOEPA.

Mandate retention of written documentation in the loan file of the borrower's income and other information that the lender considered in making the loan.

The Federal Reserve Board should consider using its existing authority under HOEPA to more precisely define the scope of the restriction on asset-based lending.

Broker, Appraiser, and Home Improvement Contractor Misconduct

In many cases of predatory lending, lenders work closely with unscrupulous mortgage brokers, home improvement contractors, and/or appraisers in originating abusive high cost loans. HUD and Treasury believe that extending the reach of HOEPA to encompass these actors will help to eliminate many of these practices. Specifically, we recommend that:

Congress require mortgage brokers originating HOEPA loans to provide borrowers with a disclosure documenting all information the broker relied on in making or arranging the loan and all fees paid to the broker in connection with the loan, and requiring the disclosure to be signed by the broker and the borrower at least 3 days prior to closing.

Congress expand the definition of a "creditor" under HOEPA to include all individuals or entities that control the activities of the loan originator.

Congress make a lender liable for the malfeasance of a mortgage broker or home improvement contractor when the latter acts as the lender's agent, or the lender knew or had reason to know of the malfeasance.

Congress require that all appraisals associated with HOEPA loans be performed by a licensed or certified appraiser.

The federal government assist in the development of model laws at the state level for registration and licensing of brokers, contractors, and appraisers and work with localities to support local predatory lending task forces.

Lenders' Failure to Report Full Payment History to Credit Bureaus

Some lenders may not be reporting borrowers' good credit histories to the national credit bureaus, in order to "capture" those borrowers from competitors. When subprime mortgage lenders do not report full payment histories, borrowers may not be able to establish or repair their credit history. HUD and Treasury recommend that Congress:

> *Amend the Fair Credit Reporting Act to require reporting lenders to provide borrowers' full payment histories for all mortgage products.*

(3) Abusive or Deceptive Loan Terms and Conditions

Expanding the Scope of HOEPA

Only a small number of loans in the subprime market currently are covered by HOEPA. Thus, few borrowers who are potential victims of predatory lending currently benefit from HOEPA's protections. HUD and Treasury recommend that Congress extend the reach of HOEPA by:

> *Lowering the Annual Percentage Rate (APR) trigger, and establishing separate triggers for first and second lien loans.*
>
> *Including* all *points and fees in the points and fees trigger, including prepayment penalties financed in a new loan, all amounts paid to brokers, financed insurance premiums, and other fees paid to third party settlement service providers.*
>
> *Lowering the points and fees trigger.*
>
> *Including purchase money mortgages, open-end home equity lines of credit, and reverse mortgages under the statute.*

HUD and Treasury also recommend that the Federal Reserve Board use its existing statutory authority under HOEPA to lower the APR trigger to 8 percentage points above comparable Treasury securities and include additional fees in the points and fees trigger.

Single Premium Insurance Products

Credit life insurance and similar products pay off a borrower's remaining mortgage debt if the borrower dies or is otherwise rendered incapable of meeting his or her loan obligation. When sold in a "single premium" or "lump sum," all premiums for the policy are collected in advance and typically added to the principal loan balance, increasing the overall cost of the insurance. HUD and Treasury believe that the charging and financing of single premiums is unfair, abusive, and deceptive, and recommend that Congress enact legislation:

> *Prohibiting the sale of single-premium insurance products in all mortgage transactions.*

Requiring written notification to borrowers of cancellation or rebate rights for all monthly premium insurance products sold in conjunction with a mortgage transaction.

HUD and Treasury also recommend that the Federal Reserve Board use its existing authority to restrict unfair, deceptive, and abusive practices to prohibit the sale of single premium insurance products in connection with mortgage transactions.

Prepayment Penalties

The existence of prepayment penalties in high cost loans can inhibit borrowers from refinancing at a interest lower rate when their credit status improves or rates turn downward. HOEPA currently prohibits a prepayment penalty for a borrower whose monthly debt obligations exceed 50% of his or her gross monthly income or where the same creditor provides the funds with which repayment is made. HOEPA also restricts the application of prepayment penalties to a five-year period after loan origination. HUD and Treasury recommend that Congress:

Shorten the period of time in which a prepayment penalty may be assessed on a HOEPA loan, and restrict the size of prepayment penalties, so that these restrictions would (1) curb predatory lending, and (2) not unduly inhibit the flow of credit to subprime borrowers.

Exempt specific prepayment circumstances from penalties, e.g., when the borrower moves, sells the property, defaults, or elects to accelerate loan payments by up to 20 percent annually.

Require creditors to offer HOEPA loan applicants the choice between a loan with a prepayment penalty and a loan without such a penalty.

Balloon Payments

Unscrupulous lenders may use balloon payments to induce borrowers into loans with attractive monthly payments without informing the borrower of the existence of the balloon or its long-term consequences. HOEPA restricts the existence of balloon payment mortgages to loans with terms of five years or more. HUD and Treasury recommend that Congress:

Restrict the timing of balloon payments under HOEPA to no fewer than 15 years.

Mandatory Arbitration

Mandatory arbitration clauses require, as a condition of receiving a loan, that a borrower agree to resolve any and all disputes arising out of the loan through arbitration, rather than litigation. Mandatory

arbitration may severely disadvantage HOEPA borrowers. Because of the potential for such clauses to restrict unfairly the legal rights of the victims of abusive lending practices, HUD and Treasury believe that Congress should:

Prohibit mandatory arbitration for HOEPA loans.

Financing of Points and Fees

Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans. Restricting the financing of points and fees for HOEPA loans would cause these costs to be reflected in the interest rate, enabling borrowers to better understand the cost of the loan, and to shop for better terms. Accordingly, Congress should:

Restrict the financing of points and fees on HOEPA loans to no more than the greater of 3 percent of the loan amount and a de minimus *dollar amount.*

(4) Market Structure

Data Collection

Most publicly available information about home mortgage lending is reported by lenders pursuant to the Home Mortgage Disclosure Act (HMDA) and the Federal Reserve Board's Regulation C, which implements that act. The data collected under HMDA, however, suffer from a number of inadequacies, which limit the data's utility in formulating policies to combat abusive lending practices. HUD and Treasury recommend that:

The Federal Reserve Board amend Regulation C to require collection of additional data items under HMDA, including (a) information on loan price (APR and cost of credit); (b) whether the loan was a manufactured home loan; (c) loan-to-value ratio; and (d) borrower debt-to-income ratio for HOEPA loans.

The Board revise Regulation C to repeal the "10 percent" rule to increase the number of lenders reporting under HMDA, and collect information on the "parent" of the reporting institution, and whether the loan was originated by a broker.

Congress amend HMDA to grant HUD the authority to impose sanctions and penalties against lenders not otherwise subject to federal supervision who fail to report, report incompletely, or misrepresent data pursuant to the Act.

The Prime Market

Prime lenders, and banks and thrifts generally, could play an important role in curbing predatory

practices. To this end, HUD and Treasury recommend that:

> *The regulators publish guidance to award banks and thrifts CRA credit for offering products that "promote" qualified borrowers from the subprime to the prime mortgage market, and to deny banks and thrifts CRA credit for their origination or purchase of loans that violate applicable lending laws.*
>
> *The regulators consider, in the context of CRA examinations, banks' and thrifts' other market activities that may support predatory lending.*
>
> *The Federal Reserve Board consider exercising its authority to conduct risk-based examinations of subprime lenders that are subsidiaries of bank holding companies.*

The Secondary Market

By providing a source of funding, those who purchase or securitize high cost subprime loans may, knowingly or unknowingly, support the activities of predatory loan originators. HUD and Treasury recommend that:

> *Secondary market participants recognize their legal obligations to comply with HOEPA, TILA and fair lending laws as assignees of these loans, and put in place processes to ensure their compliance with these laws.*
>
> *The incidence of HOEPA loans in mortgage-backed securities pools be disclosed by the lender to the rating agency, bond insurer, and/or issuer of security, and be disclosed by the securitizer in the offering documents.*

Congress enact legislation to clarify, as necessary, the authority of HUD and the Federal Housing finance Board as the mission regulators of the Government Sponsored Enterprises (Fannie Mae, Freddie Mac and the Federal Home Loan Banks) to prohibit the purchase by each of these entities of predatory loans. Regulations in this area should address the restrictions already voluntarily undertaken by Fannie Mae and Freddie Mac.

Foreclosure Prevention

Not all states may adequately protect consumers from abusive practices in connection with foreclosures. Consumers in the subprime mortgage market may benefit from better notices with regard to foreclosure, and from increased protections against foreclosure under state laws. Borrowers in the high-cost loan market may be most in need of procedures to help them avoid foreclosure. HUD and Treasury recommend that:

Congress enact new federal legislation establishing notice requirements that maximize opportunities for borrowers to cure a delinquency or arrange other financing.

The Task Force work with states to develop model legislation, patterned on "best practice" state laws, to provide consumers with substantive pre-foreclosure protections.

FHA Initiatives

HUD has developed a series of new Federal Housing Authority (FHA) initiatives based on both its work with the Baltimore Task Force and the evidence developed at National Predatory Lending Forums. The new initiatives address predatory practices targeted at FHA and its borrowers, including inflated appraisals, fraudulent underwriting, property flipping and other lending abuses.

FHA's reforms to protect homeowners from predatory lending focus on two main areas: (1) providing relief to FHA borrowers already in distress, especially those who have been victimized by abusive lending; and (2) strengthening FHA endorsement and fraud detection procedures to prevent predatory practices from occurring in the first place. These initiatives build on FHA efforts to streamline operations and eliminate abusive practices.

To assist victims of predatory lending, FHA is launching a new initiative to directly fund foreclosure avoidance counseling in selected "Hot Zones" for FHA homeowners in default. Those areas will also be assigned FHA loss mitigation specialists to work with lenders and borrowers. The FHA may also provide other assistance to borrowers, such as by directing mortgage lenders to write down a mortgage that has been inflated as a result of a fraudulent appraisal to a level consistent with a fair market appraisal or other actions.

FHA will take action to stop predatory practices from undermining the ability of FHA to promote housing opportunity. FHA will institute an automated system to review the sales price history of properties prior to approval of FHA insurance. This new system will identify and stop abusive appraisal

practices before the loan is endorsed. In addition, FHA will form "Swat Teams", modeled on the Baltimore team, to target abusive appraisal practices in areas with a high concentration of FHA foreclosures. Finally, FHA is launching a new Appraisal Watch System, similar to the Credit Watch system now targeted to lenders, to identify appraisers with a record of faulty appraisals and abusive practices, terminate them from FHA programs, and, if appropriate, pursue legal action.

In some instances, the new initiatives will be immediately available on a national basis. In other instances, FHA will operate pilots in Baltimore and other selected "Hot Zone" cities (defined as those with excessively high default and claim rates) to further test and refine the concept before moving to national implementation. In all cases, this new Fraud Protection Plan will better protect FHA, FHA borrowers and the communities FHA serves from the harmful effects of predatory practices in the home finance market.

Additionally, FHA will expand consumer education about predatory lending through improved housing counselor software, a predatory lending prevention best practices meeting with Fair Housing groups and a national public service ad campaign.

Recommendations for Appropriations

It was clear from the five public forums and the testimony of the experts on our National Task Force that funding would help in our fight against predatory lending. HUD and Treasury believe that funding in the following areas would be especially appropriate: (a) Foreclosure Counseling, (b) Local Fair Housing Initiatives, (c) Regulatory Enforcement and (d) Legal Services.

Foreclosure Counseling – HUD's home counseling program provides counseling services to over 250,000 consumers each year. Congress should fully fund the President's budget request for Housing Counseling Assistance in the FY 2001 appropriation to assist an additional 150,000 consumers.

Local Fair Housing Initiatives – HUD's Fair Housing Initiative Program (FHIP) funds private, nonprofit fair housing groups to help HUD monitor, enforce, and educate the public about the Fair Housing Act. Congress should fully fund the President's FY 2001 FHIP funding request and target funding for private enforcement and education.

Regulatory Enforcement – Congress should fully fund the President's requested increase in the budget for the Federal Trade Commission. Full funding will help the agency to meet the urgent need to increase its focus on combating abusive home mortgage lending practices.

Legal Services – By increasing the training and expertise of Legal Services Attorneys, we will help more consumers avoid predatory lenders. Congress should fully fund the President's request in this area.

Chapter II. Introduction and Background

Thanks to the robust economy of the past several years, more American families than ever before have been able to buy their own homes – an astounding 67.1 percent. To get the money to buy their homes, refinance their mortgages or meet other expenses using their home equity, nine out of 10 families turn to the prime mortgage market, which generally provides borrowers with many choices and the lowest mortgage rates.

Some families have problems in their credit history, however. Because they have overused consumer credit, or experienced a family illness or a spell of unemployment, they may have missed paying their bills in the past. If the credit applicant is young or lacks credit history, there may be insufficient basis for the prime lender to make a loan. These families can turn to the subprime lending market, where, for higher interest rates and generally higher up-front fees, they can still access home mortgage credit.

Subprime mortgages generally are made to individuals and households with impaired or limited credit histories, or high debt relative to their income. The subprime mortgage lending market has grown rapidly over the past several years. Between 1994 and 1999, subprime mortgage lending increased almost five fold -- growing from a $35 billion industry in 1994 to a $160 billion industry in 1999. Expanded access to credit for different levels of credit-worthy consumers has been a favorable development in the economy.

However, there is a growing body of anecdotal evidence that an unscrupulous subset of these subprime actors – lenders (often those not subject to federal banking supervision), as well as mortgage brokers, realtors, and home improvement contractors – engage in abusive lending practices that strip borrowers' home equity and place them at increased risk of foreclosure. The explosive growth of subprime mortgage lending has thus created a corresponding increased potential for abuse of consumers. The existence of these practices is especially troubling to the extent that, as findings from a recent HUD report indicate, subprime lending is most heavily concentrated in lower-income and predominantly minority neighborhoods.[1] Predatory lending has contributed to the rapid growth in foreclosures in many inner-city communities, and foreclosures can destabilize families and entire neighborhoods.

The purpose of this Report is to recommend proposals for legislative and regulatory action to combat predatory lending practices. In addition, the report describes some regulatory and policy changes that HUD has already implemented to address the growing problem of predatory lending.

A. The HUD-Treasury Task Force

The recommendations of the Department of Housing and Urban Development ("HUD") and the Department of Treasury ("Treasury") contained in this report are based, in significant part, on the information that HUD and Treasury gathered through the National Task Force on Predatory Lending ("HUD-Treasury Task Force"). The Task Force was initially convened by HUD Secretary Andrew

[1] *Unequal Burden: Income and Racial Disparities in Subprime Lending in America*, HUD, April 2000.

Cuomo in late March 2000, in response to a Baltimore field hearing held by Senator Mikulski's VA/HUD Appropriations Subcommittee on March 27 to discuss the issue of "real estate flipping" in that city. Secretary Cuomo announced the formation of the Task Force in his testimony before the Senate VA/HUD Appropriations Subcommittee on March 30. At the hearing, Secretary Cuomo committed to hold at least four regional forums around the country to discuss the problem of predatory lending and to develop detailed recommendations for legislative action for release in June.

Recognizing that predatory lending was a multifaceted issue with substantial consequences for the lending industry, Secretary Cuomo invited Treasury Secretary Lawrence Summers to co-chair the Task Force. The HUD-Treasury Task Force held its first meeting on April 12, 2000. The mission of the Task Force members has been to collect information about predatory lending, provide data on the impacts of predatory practices, and comment individually on existing proposals for reform in order to make recommendations for legislative action to Congress - the recommendations that are contained in this Report. The Task Force drew its members from a wide range of parties interested in and affected by the predatory lending issue, including representatives of consumer advocacy groups; industry trade associations representing mortgage lenders, brokers, and appraisers; local officials; and academics. A list of the HUD-Treasury Task Force members is attached as Appendix A.

Between late April and the end of May, HUD and Treasury convened five forums around the country for Task Force members. Forums were held in Atlanta, Los Angeles, New York, Baltimore, and Chicago. Each of the forums was structured to solicit information about both local and national aspects of the predatory lending problem, with input from both industry and consumer representatives. In order to focus the discussion, each forum had a specific theme:

- Atlanta, Georgia - The Impact of Predatory Lending on Minorities
- Los Angeles, California - The Elderly and Predatory Lending
- New York, New York - Funding Sources for Predatory Lending
- Baltimore, Maryland - The Role of Other Key, Non-lender Players
- Chicago, Illinois - State and Local Initiatives to Curb Predatory Lending

During the HUD-Treasury Task Force process, HUD adopted several proposals for reform particularly related to Federal Housing Administration ("FHA") loans, discussed in detail in Section IX of this report.

B. Other Federal, State and Local Efforts

In addition to the efforts of the HUD-Treasury Task Force, this report was informed by several past and current efforts undertaken by federal, state and local governments to address predatory lending issues.

The HUD/Fed Report – HUD and the Board of Governors of the Federal Reserve System ("the Board") carefully reviewed the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) to simplify and improve requirements under these laws for mortgage loans and to

determine, among other things, if these laws provided adequate protection against abusive lending practices. This process resulted in a July 1998 report to Congress (the "HUD/Fed Report") with proposals for legislative and other actions to combat predatory practices. The Report concluded that the most effective attack on predatory lending would be a multifaceted approach, including new legislation, strengthened federal and state enforcement, voluntary industry reforms, and consumer education and counseling. Specifically, HUD and the Board jointly recommended adoption of new substantive legislative protections, in particular, curbs on balloon payments and front-loaded credit insurance premiums. In the Report, HUD made several additional recommendations including increasing the Home Ownership Protection Act (HOEPA) coverage combined with prohibitions against loan flipping and other abusive practices. This Report builds upon and updates the HUD/Fed Report's analysis and recommendations.

The Clinton-Gore Plan for Financial Privacy and Consumer Protection – In May 1999, President Clinton, Vice President Gore and the Treasury Department set forth a series of proposals that the Administration believed should be part of a comprehensive consumer protection agenda. The Clinton-Gore agenda included a call for action against subprime lending abuses, including expanded protections in the home equity lending market, expanded enforcement tools, improved home mortgage lending reporting, and improved regulator guidance on subprime lending. Many of the recommendations that formed this part of the agenda were drawn from the 1998 HUD/Fed Report.

Federal/State Enforcement – The Department of Justice, the Federal Trade Commission and State Attorneys General have brought several enforcement actions in recent years against subprime lenders for violations of TILA, the Home Ownership and Equity Protection Act (HOEPA), federal fair lending laws and state laws/regulations. These cases revealed some of the more pervasive abuses in the high-cost mortgage market, including: lending to borrowers without regard to their ability to repay; failing to provide required disclosures; targeting low-income and minority neighborhoods for high-cost loans; and general fraud and misrepresentation.

Other State/Local Legislative Efforts – Growing evidence of abuses in the subprime mortgage market has led states and localities to mount their own legislative and regulatory efforts to curb predatory lending. Legislators in at least eight states introduced bills in recent sessions to restrict terms on certain classes of higher-cost mortgages and to prohibit certain abusive lending practices. In 1999, North Carolina adopted a law, effective July 2000, that: has thresholds for loans that are lower than HOEPA; limits prepayment penalties, balloon payments and financing of points and fees on high-cost loans; and prohibits abusive practices such as asset-based lending and loan "flipping." The New York State Department of Banking has issued a proposed regulation similar to the North Carolina statute. At the local level, the city of Chicago has proposed ordinances that would prohibit the city from contracting with lenders or affiliates of lenders who engage in certain abusive practices relating to the origination of high-cost loans.

The Interagency Task Force on Predatory Lending – In the fall of 1999, several federal agencies, including the Board, the Treasury Department's Office of the Comptroller of the Currency and Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union

Administration, the Federal Housing Finance Board, the Federal Trade Commission, the Department of Justice and HUD, established the Interagency Task Force on Predatory Lending. The purpose of that task force was to promote vigorous and coordinated enforcement of federal fair lending and consumer protection laws. The participants are now drafting an "Interagency Policy Statement on Predatory Lending Practices," which is intended as a statement of the agencies' general position on the federal fair lending and consumer protection laws for purposes of administrative enforcement of those statutes. In addition to this effort, the National Economic Council has been conducting an interagency working group on predatory lending. Moreover, Treasury has chaired an interagency group on fair lending issues since 1998.

Chapter III. Summary of the Problem

A. What is Predatory Lending?

Along with the benefits that have come from the expanded availability of credit in the subprime market, there is also evidence of growing abuses. In many neighborhoods, abusive practices threaten to erode the enormous progress that has been made over the past several years in revitalizing neighborhoods and expanding home ownership. In many instances, the consequences for borrowers, foreclosure in particular, have been disastrous.

Although diverse laws apply to home mortgage lending, none of the relevant statutes and regulations governing mortgage transactions provides a definition of predatory lending. Public debate around the issue of predatory lending has focused on practices and loan terms that alone, or in combination, are abusive or put borrowers at a high risk of abuse.

In a predatory lending situation, the party that initiates the loan often provides misinformation, manipulates the borrower through aggressive sales tactics, and/or takes unfair advantage of the borrower's lack of information about the loan terms and their consequences. The results are loans with onerous terms and conditions that the borrower often cannot repay, leading to foreclosure or bankruptcy.

Defining the practices that make a loan predatory, however, is a problematic task. Any list of predatory practices is destined to be incomplete because bad actors are constantly developing new abusive practices, sometimes to evade new government regulation. Furthermore, a list does not consider the context in which the alleged abuse has occurred. Some practices may be considered abusive in the context of high-cost subprime loans; other practices may be deemed unacceptable in all contexts; and others – while not necessarily abusive for all high cost borrowers – are abusive in the borrower's situation or because the borrower was misled or deceived . For these reasons, it is worth considering some overarching characteristics of predatory loans. These characteristics are discussed in detail in Chapter VI.

Evidence of predatory lending practices generally arises from the subprime mortgage market. While predatory lending can occur in the prime market, such practices are for the most part effectively deterred by competition among lenders, greater homogeneity in loan terms and the prime borrowers' greater familiarity with complex financial transactions. In combination, these factors make prime borrowers more likely to shop for the best loan terms and less likely to fall victim to predatory loans. In addition, many prime lenders are banks, thrifts, and credit unions that are subject to extensive oversight and regulation by federal and state governments.

The subprime market, in contrast, provides much more fertile ground for predatory lending practices. Several factors contribute to this result.

- The characteristics of many subprime borrowers make them more easily manipulated and misled by unscrupulous actors. Many subprime borrowers who have had difficulty obtaining credit in the past may underestimate their ability to obtain new sources of credit, which may make them more likely to accept the first offer of credit they receive, rather than shop for a loan with the best possible terms. In addition, subprime borrowers may be more in need of immediate funds due to the heightened challenge of meeting household and emergency expenses on their lower incomes.

- Many subprime borrowers live in low-income and minority communities that are comparatively underserved by traditional prime lenders. As a result, many of these communities suffer from insufficient competition among lenders, so that better loan terms may be harder to find, or persons may be unaware of them.

- The subprime mortgage and finance companies that dominate mortgage lending in many low-income and minority communities, while subject to the same consumer protection laws, are not subject to as much federal oversight as their prime market counterparts – who are largely federally-supervised banks, thrifts, and credit unions. The absence of such accountability may create an environment where predatory practices flourish because they are unlikely to be detected.

Another reason why creating a definitive list of predatory lending practices is problematic is that it fails to convey that predatory lending is as much a function of the manner in which the loans are made as the oppressive terms that they contain. Moreover, the predatory nature of many loans typically is not the result of a single loan term or feature, but a series of features that in combination, impose substantial hardships on the borrower.

A few examples from the testimony presented by victims of predatory lending at the HUD-Treasury Task Force's regional forums provide a flavor of the kinds of deceptive and manipulative sales techniques reportedly used, as well as some of the specific terms and oppressive features contained in predatory loans.[2]

Ms. J., who is 71 years old, testified at the Chicago forum. According to Ms. J., she received a phone call from a mortgage broker, who promised her that he would refinance her two existing mortgages, provide her with $5,000 in extra cash and lower her monthly payments. Ms. J. needed cash to repair her kitchen, so she agreed to meet. The broker visited Ms. J. at her home. Ms. J. maintains that he gained her trust by claiming that he liked her as a person and he wanted to help senior citizens because his own father had recently died of cancer. Later, the broker returned to Ms. J.'s house to have her sign the mortgage loan papers. Ms. J. said that she could not read the documents carefully because she suffers from vision problems and has a limited education. Ms. J. said she signed the mortgage loan documents based on the broker's promises and representations that the mortgage loan would provide her with cash to repair her kitchen and lower her monthly mortgage payments.

[2] HUD and Treasury take no position on the truth or accuracy of witness testimony. The agencies only report here testimony that was presented by borrowers at the regional forums and documentation some of those borrowers provided to the Task Force.

Ms. J. received a $90,100 mortgage with an APR of 14.819%. The mortgage loan contained a 15 year balloon note that required a final payment of $79,722.61 (due when she was 86 years old). Ms. J. paid 10% of the loan amount, or $9,100 as a broker's fee. The monthly payment increased to approximately 80% of her monthly income. Ms. J. did not receive any money from the proceeds of this transaction.

Ms. J.'s account highlights several practices common in predatory lending:

- Use of "bait and switch" tactics to defraud the borrower.
- Use of balloon payments that require refinancing.
- Structuring loans that the borrower cannot afford.
- The fact that the elderly and minorities are frequently victimized by predatory lenders.
- Aggressive solicitation of residents of low-income and minority neighborhoods, which may be underserved by conventional lenders.
- Excessive fees.

Ms. M, a 53 year old Haitian-American woman, testified at the New York City forum. According to Ms. M., a home improvement contractor came to her door soliciting home repairs. Ms. M. had a leaking roof and needed some other home repairs. Ms. M. stated that the contractor pressured her into contracting for additional home repairs that were unnecessary as a condition to getting a loan. According to Ms. M., the contractor informed her that he could get her a loan to complete the home repairs even though she had to pay off some other debts. The home improvement contract totaled $36,200. Ms. M. asserted that the contractor began gutting her house approximately a month prior to the loan closing and the 3 day rescission period ended. As a result, Ms. M. felt that she had no choice but to sign the mortgage loan documents in order to pay for the repairs. About a month after the loan closing, the contractor stopped coming to her house. Ms. M. felt that the contractor did not complete the work as promised, and the work that was completed was generally inadequate. Ms. M. contacted the lender to find out why the contractor stopped working on the repairs, and the company indicated that the contractor had been paid in full. Ms. M. has no recollection that she signed a check or any other document to verify that she approved payment to the contractor.

Through the home improvement contractor Ms. M. obtained the mortgage loan from the lender for $79,000 with monthly payments reaching approximately $970. She said she did not receive any closing documents until she contacted the lender more than a week after closing to ask for the amount of her monthly payment. The lender received 10 points, or $7,900, as well as a $695 application fee. The mortgage loan's interest rate is fixed at 14 ½% with an APR of 16.498%, along with a balloon payment of $71,812.64 due 15 years after the origination date. The mortgage loan also includes a prepayment penalty if paid off during the first 12 months. Ms. M.'s loan qualifies as a HOEPA loan, but she never received any HOEPA disclosures. The loan was sold to another lender.

Ms. M.'s account highlights several practices common in predatory lending:

- The role of unscrupulous home improvement contractors in originating predatory loans through aggressive solicitation of unnecessary services and collaboration with unscrupulous lenders.
- The prevalence of fraud by home improvement contractors who frequently perform substandard work or fail to complete tasks after being paid in full from loan proceeds.
- The high fees charged by some lenders who provide little or no actual service to the borrower.
- The failure of unscrupulous lenders to comply with existing laws, like HOEPA, designed to protect subprime borrowers entering into high cost loans.

Ms. H., a widowed 81 year old African-American homeowner who lives in Washington, D.C. testified at the Baltimore forum about her experience. In 1999 she was induced by a mortgage broker to refinance an existing $118,000 mortgage loan into a new loan for $129,000.

Ms. H. testified that the broker persuaded her to take the new loan by claiming it would retire existing unsecured debt, lower her monthly payments, cover her real estate taxes and insurance, and lower her interest rate. None of these assertions was true. In fact, Ms. H.'s new loan did not pay off any unsecured debt, raised her monthly payments, did not cover her tax and insurance obligations, and, after a two year period, will significantly increase her interest rate. Moreover, the new loan provided Ms. H. with absolutely no other tangible benefit of any kind. Not only were no unsecured debts paid off, but she received no cash out from the loan. The mortgage broker, however, made $3,850 as a result of the transaction.

The same mortgage broker had originated Ms. H.'s prior mortgage loan, taken out in 1997. That loan contained a substantial pre-payment penalty if paid off in less than three years; thus, Ms. H. paid significant sums in the form of a prepayment penalty, in addition to her closing costs, on the 1999 refinancing. The mortgage broker's combined compensation on the two loans exceeded $12,000.

Ms. H.'s account highlights several practices common in predatory lending:

- The tendency of predatory lenders to engage in "loan flipping" – successively refinancing loans with little or no resulting benefit to borrowers, but generating substantial fees for brokers.
- How repeatedly refinancing points and fees charged with the origination of each loan can reduce the borrower's equity in her home.
- The inclusion of prepayment penalties in predatory loans to discourage refinancing at more favorable rates or at least to generate additional fees should refinancing occur.

Mr. C. testified at the Baltimore forum about his experience. Mr. C. purchased a home from a property owner/seller. According to Mr. C., the property owner/seller suggested that he apply for an FHA mortgage to cover the $115,000 sales price and the closing costs. The property owner/seller referred Mr. C. to a lender in a close business relationship with the property owner/seller. The lender arranged FHA financing for the purchase price and all settlement charges, including the lender's origination costs.

The property was grossly over-appraised. Actual comparable properties in the area were appraised in the $75-85,000 range. Mr. C. stated he later learned that the property owner/seller had purchased the property less than a year earlier for $32,000. The property owner/seller then made cosmetic improvements to the house and put it on sale for $115,000. As a result of the transaction, Mr. C. now owes a mortgage of $115,000 for a property that is worth tens of thousands less. Should he be unable for any reason to make the payments, the lender will make a claim against the Federal Housing Administration for the amount of the inflated mortgage.

Mr. C.'s account highlights several practices common in predatory lending:

- "Asset flipping," the practice of purchasing a home and then reselling it at a dramatically increased cost to an unsuspecting borrower.
- The role that appraisers can play in originating predatory loans by generating fraudulent appraisals that prompt borrowers to take out loans that are larger than would be necessary to purchase the property at a fair value.
- The incentive for predatory lenders who collaborate with asset flippers to structure loans that the consumers cannot afford if the mortgage is insured by the FHA, so that the lender can collect on the FHA insurance after foreclosure.

While these lists is not exhaustive, it provides a flavor for the real life hardship that predatory lending inflicts on individual borrowers and their families.

Throughout the HUD-Treasury forums, there was consistent evidence of abuses in a segment of the subprime mortgage market that echoed the experiences of Ms. J., Ms. M., Ms. H. and Mr. C. These abuses tended to fall into four main categories:

- Loan Flipping - Some mortgage originators refinanced borrowers' loans repeatedly in a short period of time. With each successive refinancing, these originators charged high fees that reduced borrowers' equity in their homes. While fees in the subprime market can be expected to exceed those in the prime market, borrowers in some instances were charged upwards of $5,000 for each refinancing, sometimes as much as 10 percent of the loan amount (as in the case of Ms. J.), quickly draining the equity in their homes. Lenders also structured high-cost loans with terms that forced lower-income borrowers to refinance a loan multiple times. With mortgage loan flipping, the end results of default and foreclosure are often devastating.

- Excessive fees and "Packing" – While subprime lending carries higher costs to the lender than prime lending, in many instances the Task Force saw fees that far exceeded what would be expected or justified based on economic grounds. Many of these fees were charged by mortgage brokers, home improvement contractors and other third parties, in addition to the lender. Borrowers often did not realize how expensive their loans were, as the fees were added into the amount financed rather than paid up-front, and may not have been adequately disclosed to the borrower.

  Additionally, some lenders levied excessive fees that were not disclosed to the borrower – including fees for ancillary services whose cost is not included in the calculation of the cost of credit

– the annual percentage rate. For instance, borrowers were sold products such as single-premium credit life insurance without their knowledge. Ms. M., for example, was completely unaware that she was being sold such a product. The costs of these products were "packed" into the borrower's loan amount, raising their price and disguising their true cost to the borrower.

- Lending without regard to the borrower's ability to repay - One troubling practice the Task Force saw involved lending based on borrowers' equity in their homes, where the borrowers clearly did not have the capacity to repay the loans. Some lenders may have sought to recover the loan principal by foreclosing on the borrower's home. There were also cases where income figures or other data were apparently falsified by an unscrupulous broker and not adequately verified by the lender. In particularly egregious cases, loans were made to elderly people living on fixed incomes where the monthly payments equaled or exceeded their monthly income. Such loans quickly led borrowers into default and foreclosure actions.

- Outright Fraud - In many instances, abusive practices amount to nothing less than outright fraud. The Task Force heard many stories of fraud from borrowers who testified at the regional forums. For example, in the Baltimore forum the Task Force was introduced to the practice that is known as "asset flipping" described above. In these instances, an unscrupulous investor buys a dilapidated house, makes superficial repairs, and conspires with an appraiser and a mortgage broker or other originator to inflate the appraised value of the property. To facilitate sale at a fraudulently inflated price, the seller and broker will sometimes doctor the loan application and settlement documents. Many of the borrowers who are victims of this scheme cannot afford to repay or refinance the mortgage based on the inflated price, and these loans may go into default and foreclosure quickly. Appraisers and others engaging in this fraudulent practice are helping to send first-time home buyers and whole communities into economic ruin.

Through the regional forums and through other research, HUD and Treasury have seen certain patterns emerge in the use of these predatory practices:

First, unscrupulous actors in these markets are often preying on certain identifiable groups – the elderly, minorities, and individuals with lower incomes and less education. In many instances these individuals are not sufficiently experienced or knowledgeable about complex financial transactions to understand their potentially devastating implications, or are not offered the range of financial products available to other borrowers.

- Evidence from the government's case against subprime lender Delta Funding indicates that brokers for Delta loans nearly exclusively solicited low-income individuals in minority neighborhoods for high-cost mortgage loans. The Attorney General presented evidence that while the median income of all borrowers served by Delta was about $34,000, the company did little to no business in predominantly white neighborhoods where homeowners made $35,000 or less.

HUD's own research has shown that even after controlling for income, black borrowers and borrowers in predominantly black neighborhoods are more likely to refinance their mortgages in

the subprime market than white borrowers and borrowers in white neighborhoods. Because evidence suggests that abusive lending practices are concentrated in the subprime lending market, black borrowers may be at higher risk for encountering these practices. In its national report, titled Unequal Burden: Income and Racial Disparities in Subprime Lending in America, HUD found that subprime refinance loans accounted for one half (51 percent) of refinance loans in predominantly black neighborhoods (those census tracts where blacks comprise more than 75 percent of the population). By contrast, subprime loans accounted for only 9 percent of the refinance loans in predominantly white neighborhoods (those tracts where whites comprise more than 85 percent of the population). In other words, subprime loans for refinancing were five times more likely in black neighborhoods than in white neighborhoods.[3] Additional research focusing on each of the five cities in which HUD and Treasury held regional forums reached similar findings.[4]

The finding of higher subprime concentration for black neighborhoods remained when neighborhood income was taken into account. Almost two-fifths of refinance loans in upper-income black neighborhoods were subprime, compared with only five (5) percent in upper-income white neighborhoods and twenty (20) percent in low-income white areas. These data show that homeowners in upper-income black neighborhoods were twice as likely as homeowners in low-income white areas to rely upon subprime loans for refinancing.[5]

Second, borrowers in these markets often have limited access to the mainstream financial sector. Some borrowers who would likely qualify for a prime loan are not accessing credit at a bank. There may be a substantial number of borrowers currently borrowing in the subprime market who could qualify for a prime loan.[6] The Task Force saw evidence that older borrowers, having held prime mortgages from a bank for many years, received higher cost subprime loans to pay for repair work on their homes. In some inner-city areas, this may reflect the fact that banks have receded over time, and have been replaced by finance companies not subject to federal bank supervision. Subprime lenders may also effectively be capturing borrowers in these markets, effectively blocking borrowers from accessing the prime market. For example, borrowers' lack of access to the prime market may reflect a failure on the part of subprime lenders to report fully the payment history of their borrowers. This practice prevents borrowers from amassing a positive credit history that, over time, may allow them to obtain credit in the prime market.

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[3] ***As explained in Chapter IV, HUD's analysis focused primarily on home refinancing loans as they account for most (over 80 percent) subprime loans.***

[4] See Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending, April 2000; Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending, May 2000; Unequal Burden in New York: Income and Racial Disparities in Subprime Lending, May 2000; Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending, May 2000; and Unequal Burden in Chicago: Income and Racial Disparities in Subprime Lending, May 2000.

[5] These data, however, do not control for differences in the credit characteristics of individual borrowers.

[6] A 1996 unpublished draft report prepared by Freddie Mac found that for 10 to 35 percent of the subprime loans analyzed, the borrowers may have been eligible for a prime-rate loan. Freddie Mac's analysis relied on a sample of 15,000 subprime mortgages originated by four financial institutions.

These access problems remain despite the significant growth in mortgage lending nationwide by banks, thrifts and their affiliates to lower-income and minority borrowers and communities between 1993 and 1998. As documented in a recent Treasury report, these institutions increased their lending to low- and moderate-income borrowers and areas from $75 billion in 1993 to $135 billion in 1998 – an 80 percent increase.[7] As a result, the share of mortgage originations by banks, thrifts and their affiliates that went to these borrowers and communities grew from 25 percent in 1993 to 28 percent in 1998. Eight-four (84) percent of the growth in these institutions' lending to lower-income borrowers and areas occurred among lenders specializing in prime mortgage lending. Over the same time period, mortgage lending by these institutions to lower-income black borrowers grew by 76 percent, over twice the rate of increase for lower-income white borrowers.

Third, these practices are most often coupled with the deceptive or high-pressure sales tactics of unscrupulous mortgage brokers, home improvement contractors, realtors/developers or lenders themselves. Unscrupulous actors may take advantage of a borrower's lack of financial sophistication or vulnerable situation. They may hide disclosures from borrowers, begin work on a borrower's home and then "bait and switch" with new loan terms before the loan is closed, finance fees without borrowers' knowledge, or lead them to believe that they must purchase products such as credit insurance in order to close the loan.

B. The Effects of Predatory Lending

The dramatic growth in foreclosure actions in some neighborhoods that has accompanied the growth in subprime lending over the last several years suggests the potentially damaging effects of lending abuses. As explained later in Chapter IV, subprime borrowers are more likely to be become seriously delinquent in their payments. These delinquencies can, and in some cases do, lead to foreclosure actions against borrowers.

Although the vast majority of subprime borrowers pay on time and keep their homes, evidence from a number of cities demonstrates that foreclosure actions have grown at a disturbing rate in inner-city neighborhoods. In Baltimore, for instance, foreclosure petitions filed for homes increased from 1,900 in 1995 to over 5,000 in 1999. As detailed in Chapter IV, a large portion of the subprime mortgage market is accessed for consumer credit purposes, such as consumer debt consolidation or the financing of other non-home expenses. The rapid growth in foreclosures raises concern that subprime borrowers may not adequately appreciate the fundamental risk of converting unsecured consumer credit into home-secured credit: the downside risk is no longer just bankruptcy, but loss of a home. Consumers need to weigh this risk, and their overall abilities to repay, before refinancing mortgages or taking out home equity loans, and need to manage their finances carefully if they do.

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[7] Litan, Robert et al. *The Community Reinvestment Act After Financial Modernization: A Baseline Report.* US Department of the Treasury, April 2000.

Similarly, lenders should not lend to borrowers that do not have the capacity to repay the loans that the lender offers. The speed with which the subprime loans in these communities have gone to foreclosure suggests that some lenders may be making mortgage loans to borrowers who did not have the ability to repay those loans at the time of origination. HUD studied foreclosure petitions filed for homes in Baltimore during the first three months of 2000. It found that the mean time between the origination and foreclosure petition dates for subprime loans was only 1.8 years, as compared to 3.2 years for prime and FHA loans. Over a quarter of the petitions filed in that time period were for loans originated in 1999.[8] Studies of subprime foreclosures in Chicago and Atlanta reached similar findings.[9]

Greater levels of foreclosures can have devastating effects for individual families. For individual families, foreclosure results in the loss of the home, a family's most valuable asset. Many subprime borrowers with blemished credit already have a tenuous hold on homeownership. Elderly homeowners may lose the chance to spend their final years in their homes, and often have no realistic chance of financial recovery.

In an area where predatory practices may be driving families into foreclosure, the impact can be concentrated and felt throughout the community. Foreclosed homes frequently remain vacant for a prolonged period of time, during which they are poorly maintained. These vacant homes can contribute to neighborhood instability in terms of depressed property values and increased crime. Testimony from neighborhood development advocates documented the difficulty they have encountered in trying to encourage businesses to locate in neighborhoods where foreclosed properties remained vacant.

[8] Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending, May 2000.

[9] NTIC, Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures, September 1999; Abt Associates Inc., Analyzing Trends in Subprime Originations and Foreclosures: A Case Study of the Atlanta Metro Area, February 2000.

Chapter IV. Background on the Subprime Mortgage Market

Subprime mortgage lending is both part of the mortgage market and part of the consumer credit market. Subprime mortgages generally are made to individuals and households with impaired or limited credit histories, or high debt relative to their income. Subprime mortgages also are made to creditworthy borrowers with variable or hard-to-document income. A subprime mortgage may be a first mortgage (for either purchasing a home or refinancing an existing mortgage), a second mortgage, or a home equity line of credit.[10]

Generally, subprime mortgages serve as a source of home-collateralized consumer credit, and thus can also be thought of as part of the subprime consumer credit market. The primary purpose of over 50 percent of first lien subprime mortgages and up to 75 percent of second lien subprime mortgages is debt consolidation and/or general consumer credit, not home purchase, home improvement or refinancing the rates and terms of a mortgage.[11] The consumer credit market encompasses non-mortgage credit such as automobile loans and credit card loans, and the subprime portion of it generally refers to loans made to borrowers with impaired credit histories.

The Task Force focused on the subprime mortgage market, so this Report is limited to a discussion of subprime mortgage lending. The Task Force concentrated on subprime mortgage lending because it is in this market that concerns about predatory practices are greatest, and the consequences of such practices are the most severe.

Organization of Section. Section A establishes the main role of subprime lending. Section B describes the rapid growth of subprime mortgage lending and the loan and borrower characteristics of subprime mortgages. Section C discusses the major actors in the subprime market, from the lenders that originate loans to the investors that ultimately fund these loans. Section D examines the impact of subprime lending on urban neighborhoods and reports information on foreclosure of subprime loans. Section E offers some concluding observations.

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[10] Much of the data in this chapter are drawn from the following sources: various publications of Inside Mortgage Finance Publications, Bethesda, MD; the Mortgage Information Corporation, San Francisco, CA; data provided to HUD and Treasury by the National Home Equity Mortgage Association (some of which was derived from research prepared by SMR Research Corporation, Hackettstown, NJ and by David Olson Research, Columbia, MD); and HUD's analysis of mortgage data reported under the Home Mortgage Disclosure Act (HMDA). The Mortgage Information Corporation (MIC) maintains a database of subprime loan originations which contains about 1.5 million loans from many of the top 25 subprime lenders. Their quarterly newsletter, "The Market Pulse", publishes a number of statistics that allow a comparison of the performance of subprime loans to other types of loans.

[11] Data on first lien subprime mortgages are from MIC (Mortgage Information Corporation) and data on second liens are from the National Home Equity Mortgage Association.

A. The Role of Subprime Mortgage Lending

Subprime mortgage lending provides a source of funds for credit-impaired borrowers and other borrowers that are unable to obtain credit in the prime market. While subprime lending often involves lending to borrowers with past credit problems, the subprime market is more than that. A borrower may not qualify for a prime loan, yet may be eligible for a subprime loan, for reasons other than past credit performance. For example, a borrower may have a good credit history but have high monthly debt payments relative to income. Or, a borrower may have few or no assets other than current income to support loan payments. A borrower may also be self-employed, have variable income, or simply want to limit disclosure of their financial situation. These conditions may make it difficult for a borrower to obtain credit at prime rates, yet a subprime lender may be willing to take on the added risk in exchange for a higher interest rate. Consequently, there is no standard industry definition of a subprime loan, and the market may be defined in different ways by different analysts.

In most respects, lending in the subprime mortgage market follows the same principles as lending in other markets. Basic economic theory, not to mention common sense, tells us that a lender will only lend money to a borrower if the lender expects to be repaid. That repayment has two components: the return of the original amount lent (the principal), and compensation for the opportunity cost of lending the money and for taking the risk that the loan is not repaid as promised (the interest rate charged).[12] While a lender will not make a loan unless he or she expects to be repaid, clearly not all borrowers present a lender with the same risk of default. Thus, not all borrowers are charged the same interest rate for the same type of loan.

When a borrower applies for a mortgage, the lender assesses a borrower's capacity to repay the mortgage. This is called "underwriting" the loan. To underwrite a loan, a lender collects information on a borrower's income, assets, and financial obligations. A lender also evaluates a borrower's past credit history, typically using data obtained from credit reporting agencies. This history tells a lender about a borrower's past performance in repaying debt obligations and is an important indicator of a borrower's creditworthiness. Experience and statistical models demonstrate that a borrower who has missed loan payments or defaulted on loans in the past or simply has no credit history of any kind is a riskier prospect than an individual with an unblemished history of loan repayments.

Subprime lending generally has the following characteristics:

- Higher risk – Lenders experience higher loan defaults and losses by subprime borrowers than by prime borrowers.

[12] Repayment generally comes from payments made by the borrower but can also be wholly or partly recovered by foreclosure on the borrower's house. The transactions costs associated with foreclosure often are substantial to the lender and hence leave the lender with a loss on the loan. However, one type of lending practice associated with predatory lending (typically referred to as asset-based lending), involves loans made to individuals with large amounts of equity in their home but little capacity to repay the loan.

- Lower loan amounts – On average, loans in the subprime mortgage market are smaller than loans in the prime market. Estimates for average subprime loan size ranging between $58,000 and $85,000, as compared to an average of $133,000 for all mortgages.

- Higher costs to originate – Subprime loans may be more costly to originate than prime loans, as they often require additional review of credit history, a higher rate of rejected or withdrawn applications, and fixed costs, such as appraisals, that represent a higher percentage of a smaller loan.

- Faster prepayments – Subprime mortgages tend to be prepaid at a much faster rate than prime mortgages.

At least in part as a result of the above characteristics, subprime loans tend to have significantly higher fees and rates than for prime loans. (Even if the fees were the same for prime and subprime loans, since subprime loans generally are smaller than prime loans, the fees would be higher as a percentage of the loan amount.)

Within the subprime mortgage market, interest rates charged vary widely. The borrower's credit rating, the loan-to-value ratio, and whether the loan is a first or second lien factor into the loan rate. Generally, borrowers that present less risk receive lower interest rates. For example, the National Home Equity Mortgage Association reports that highest subprime credit classification (referred to as A-) generally pay only about one-half of a percentage point above prime rates while the lower classifications (referred to as C and D) pay as much as 4 percentage points above prime rates. Data from the Mortgage Information Corporation showed that, in the third quarter of 1999, 17 percent of subprime borrowers paid more than 4 percentage points above prime rates.[13]

B. Growth and Characteristics of the Subprime Market

Over the last decade, subprime lending has grown at a tremendous rate. This section documents the rapid growth in subprime lending and describes the types of subprime mortgages and the socioeconomic characteristics of subprime borrowers.

1. The Growth of the Subprime Market

Both industry estimates and data reported under the Home Mortgage Disclosure Act (HMDA) show a substantial growth in the subprime market since 1994.[14] According to one industry estimate, subprime loan originations increased from $35 billion in 1994 to $160 billion in 1999.[15] As a

[13] Mortgage Information Corporation, Market Pulse, 1999Q3.

[14] HMDA requires most mortgage lenders to report demographic characteristics of loan originations and applications to the federal government.

[15] Mortgage Market Statistical Annual for 2000, Inside Mortgage Finance Publications, Inc., vol. II, pages 1-2. Inside Mortgage Finance estimates that the total dollar volume of subprime loans outstanding at yearend 1998 was $426 billion. (Mortgage Market Statistical Annual for 1999, Vol. I, p. 111).

percentage of all mortgage originations, the subprime market share increased from less than 5 percent in 1994 to almost 13 percent in 1999. By 1999, outstanding subprime mortgages amounted to $370 billion, which was approximately 8 percent of the $4.8 trillion in single family residential mortgage debt.[16] Table 3.1 illustrates the growth in subprime lending.

Table 3.1: Subprime Mortgage Originations

Year	Subprime Originations	Total Originations	Subprime Originations as a Percent of Total Originations
1994	$35.0	$773.12	4.5 %
1995	$65.0	$635.77	10.2 %
1996	$96.5	$785.33	12.3 %
1997	$125.0	$859.12	14.5 %
1998	$150.0	$1,430.0	10.5 %
1999	$160.0	$1,275.0	12.5 %

Source: Inside Mortgage Finance, Mortgage Market Statistical Annual 2000, Volume II, p. 1-2.
Note: Origination data is reported in billions of dollars.

The substantial growth in subprime lending is also evident from HMDA data.[17] The number of home purchase and refinance loans reported under HMDA by lenders specializing in subprime lending increased almost ten-fold between 1993 and 1998 -- from 104,000 in 1993 to 997,000 in 1998. Home refinancing loans make up about 80 percent of the subprime loans reported to HMDA.[18] Between 1993 and 1998 the number of subprime refinance loans increased from close to 80,000 to almost 790,000.

[16] Mortgage Market Statistical Annual for 2000, vol. I, p. 125; and Federal Reserve, Flow of Funds 3/10/2000, Table L.218, p. 94.

[17] HMDA data does not specifically report information on subprime lending. To analyze the subprime market with HMDA data, HUD has developed a list of subprime lenders that are required to report under HMDA. For more information see Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

[18] Subprime lenders are also active in the home improvement market. Home improvement loans of subprime lenders were excluded from these comparisons.

Table 3.2: Number of Subprime Refinance Loans Reported Under HMDA

Year	Number of Subprime Refinance Loans
1993	79,693
1994	126,776
1995	158,395
1996	320,239
1997	551,396
1998	789,696

Source: HMDA data as reported by HUD, Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000.

Several factors contributed to the rapid growth of the subprime mortgage market, some of which will be described in greater detail later in this chapter. Among the factors contributing to this growth are:

- a rise in consumer credit problems, including the rising level of credit card debt and high consumer bankruptcy rates;
- the Tax Reform Act of 1986, which eliminated the deductibility of most consumer interest payments except for mortgage interest;
- increased capital flows to the subprime credit market, driven by the entrance of capital market investors through securitization of subprime loans; and
- the increased popularity of subprime first mortgages (prior to the 1990s, subprime mortgage lending generally meant second mortgages).

2. Subprime Mortgages and How They Are Used

Subprime mortgage lending used to be a second lien mortgage line of business but the majority of subprime mortgages are now first lien mortgages. While there is little hard data on how consumers use the proceeds of subprime mortgage loans, various surveys show that the primary purposes of such loans are debt consolidation and general consumer credit. Relatively few subprime mortgages are used to purchase a house, although the portion of subprime mortgages being made for that purpose has been increasing.

Up to the early 1990s, the subprime mortgage market was characterized by small balance, second lien loans.[19] A key development in the 1990s was the increased popularity of first lien mortgages in the subprime market. Indeed, data from the Mortgage Information Corporation shows that by 1999 more than three out of every four loans in the subprime mortgage market were first liens. Still, that same data also shows that the vast majority of these subprime first lien mortgages – 82 percent – were used for refinancing as opposed to purchasing a home. Of these refinance loans, a majority (59 percent) were "cash-out," indicating that borrowers used these loans for home improvement, for making other consumer purchases or for consolidating other forms of debt.

Similarly, a survey by the National Home Equity Mortgage Association found that approximately 45 percent of subprime home equity loans (second lien) are used for debt consolidation, 30 percent for covering medical, educational, and other expenses, and 25 percent for home improvement.

Subprime refinance mortgages have lower loan amounts than prime refinance mortgages. According to 1998 HMDA data, the median loan amount for a subprime refinance mortgage was $63,000 compared to $98,000 for a prime refinance mortgage.[20] Fixed-rate mortgages account for the majority of subprime mortgage originations but adjustable-rate mortgages account for a higher percentage of subprime mortgages than mortgages overall. Fixed-rate mortgages accounted for 60 percent of subprime mortgages in 1999 compared to 70 percent of mortgages overall.[21]

3 . Subprime Mortgage Lending, Consumer Debt and Bankruptcy

The data presented above clearly indicate that subprime mortgage loans are often used to consolidate debt or to fund other non-home purchases. As an important part of the consumer debt market, borrowing in the subprime market may have two opposing effects on consumer bankruptcy. First, subprime borrowing offers individuals in difficult financial situations a way to access their housing wealth to meet their financial needs; this additional liquidity can help people get through a bad period and avoid bankruptcy. Second, subprime borrowing allows consumers to consume their entire housing wealth over time, which could leave them in truly dire circumstances with no choice but to declare bankruptcy.

Household data are not available that combine information on subprime borrowing and bankruptcy. Nevertheless, we can gain some understanding of the possible impact of subprime lending on bankruptcy filings by examining the changing financial conditions of low-income households during the late 1990s when the subprime market expanded significantly. Bankruptcy filing takes two forms:

[19] Schorin, Charles, Steve Weinreich and Oliver Hsiang. 1998. Home Equity Loan Handbook, 1998 Edition. Morgan Stanley Dean Witter Fixed Income Research (November).

[20] The median loan amount in 1998 for home purchase subprime mortgages was $84,000 compared to $108,000 for home purchase prime mortgages.

[21] The adjustable-rate share of overall mortgages was 30 percent, based on the last six months of 1999. See National Association of Home Builders, Housing Market Statistics, April 2000.

Chapter 7, in which debtors' assets in excess of their statutory exemptions are distributed to creditors to repay debt, and Chapter 13, in which debtors' disposable income over a number of years is pledged to repay debt. In 1996, households with income below $25,000 represented a little over one-third of all households, but represented half of households entering Chapter 13 and two-thirds of households entering Chapter 7.[22]

The Survey of Consumer Finances reports detailed data on household assets and liabilities for 1998, 1995, and a number of previous years. The SCF data suggest that households with incomes above $10,000 and below $25,000 were drawing down their home equity between 1995 and 1998.[23] About one-quarter of the households in this income stratum held home-secured debt in 1998. The Survey shows that the median value of home secured debt for this group increased from $29,700 to $34,200 over this period. This $4,500 increase is larger than the $2,900 gain in the median value of homes for households in this income group who owned homes. Moreover, other forms of debt reduction and asset accumulation did not appear to accompany the increasing use of home equity, as median debt of all sorts increased for these households, while median net worth declined.

The Survey of Consumer Finances also presents evidence that some low-income households were struggling with a larger debt burden in 1998 than in 1995. In 1998, nearly 20 percent of households with incomes between $10,000 and $25,000 reported debt payments totaling more than 40 percent of their income, compared with 15 percent a decade earlier and 17 percent in 1995. The share of households in this income group who reported being more than 60 days late in payments due on their debt rose slightly from 11.3 percent in 1995 to 12.3 percent in 1998 (the same share as in 1989).

Heavily indebted consumers whose financial situations continue to deteriorate may end up filing for bankruptcy. In 1999, over 1.2 million households, or 1.2 percent of the total, filed for personal bankruptcy. Data on bankruptcy filers suggests that debtors who own homes extract all of their available home equity before filing; and, given their income and financial condition, most likely use subprime markets to do so. In 1996, about 40 percent of debtors entering Chapter 7 owned homes, as did about 60 percent of debtors entering Chapter 13.[24] However, average housing debt exceeded the average collateral value of the homes for these groups: mean housing-secured debt for Chapter 7 filers with debt was $112,000, while collateral averaged $105,000, and the corresponding figures for Chapter 13 filers were $97,000 and $94,000. Thus, home equity was completely gone by the time debtors entered bankruptcy. Since the average values of homes owned by the income group typical of bankrupt debtors increased during the 1995-98 period, it seems likely that debtors who declared bankruptcy had drawn down home equity.

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[22] Share of all households taken from Kennickell et al ("Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances", *Federal Reserve Bulletin*, January 2000). Share of bankruptcy filings taken from Barron and Staten ("Personal Bankruptcy: A Report on Petitioners' Ability to Pay", Monograph # 33, Credit Research Center, 1997), who analyzed a 1996 sample of bankruptcy filings.

[23] SCF data cited in this section are drawn from tables 1, 3, 8, 11, and 14 of Kennickell et al (January 2000). We exclude households with income below $10,000 because they are a small part of the sample and may involve unusual circumstances.

[24] This fact and the following ones are taken from Barron and Staten (1997).

While this data at best only suggests a link between growing subprime mortgage lending and growing consumer debt and bankruptcy among homeowners, it is important to consider the consequences that many American families ultimately face after borrowing extensively from home equity. Access to the subprime mortgage market has created new opportunities for many families to own homes and to pay for important expenses, but it also may have fueled significant growth in consumer debt that has left some families in an inferior economic position.

4. Characteristics of Subprime Borrowers

As one would expect, subprime borrowers as a group have lower credit quality than borrowers in the prime market. Consequently, the borrower demographics in the subprime market reflect those populations that may have low or volatile income or thin credit history. HMDA data and other data sources provide information on the characteristics of subprime borrowers. The main findings on the characteristics of subprime borrowers are discussed in this section.

a. Credit Characteristics

One common way by which lenders classify borrowers' credit characteristics is through FICO or other credit scores.[25] A credit score assigns a single quantitative measure, or score, to a potential borrower that represents an estimate of the borrower's future loan performance. This approach allows lenders to examine all of a borrower's credit characteristics at the same time and objectively measure potential default risk.

Lenders differ with respect to mortgage underwriting guidelines, but the typical "A" credit or prime borrower – that is, a borrower whose loan would be purchased by Fannie Mae or Freddie Mac under their guidelines – has a FICO score that exceeds 650, has no late mortgage payments, and no more than one 30 day late payment on consumer credit. Borrowers that do not meet these credit guidelines are often considered subprime borrowers and, as a group, they are characterized by worse credit histories than "A" borrowers. For example, in the third quarter of 1999, the average FICO score of the top prime issuers of 30-year mortgage pools (privately issued non-GSE mortgage-backed securities) was 721 compared to a 605 average FICO score for subprime issuers of fixed-rate pools.[26]

Within the subprime sector, borrowers are graded from the least risky "A-minus" borrower to the most risky "D" grade borrower. These grades are not well defined across the industry, but an "A-minus" borrower may have good credit generally but has had some minor payment delinquencies in the

[25] The acronym FICO comes from the name of the company that developed the leading credit scoring model – Fair Isaac Company of San Rafael, California. FICO scores range from 350 to 850, with higher scores indicating better past credit performance.

[26] See "Third Quarter 1999 FICO Score and Credit Support Levels for Residential Mortgages," www.standardandpoors.com/ratings/structuredfinance/fico.htm.

past year. A "C" or "D" borrower may have a marginal or poor credit history, including multiple payment delinquencies in the past year or past bankruptcies.[27]

Most subprime lenders focus on borrowers with better credit histories. Estimates of credit classifications within the subprime market vary, but tend to show that the "A-minus" segment accounts for a majority of subprime borrowers. The National Home Equity Mortgage Association reports that the "A-minus" segment makes up 60 percent, the "B" segment 30 percent, the "C" segment 9 percent, and the "D" segment 1 percent of the market. *Inside B&C Lending* reports that the "A-minus" segment makes up 73 percent, the "B" segment 13 percent, the "C" segment 9 percent, and the "D" segment 5 percent of the market.[28]

Borrowers with no or non-traditional credit histories and borrowers with atypical employment histories or income patterns also tend to use the subprime market. Several subprime lenders specialize in serving "low-doc" and "no-doc" borrowers who are unable to (or prefer not to) provide full documentation of income or employment history to the lender.

Subprime borrowers are more likely to have higher debt-to-income ratios than prime borrowers. Conversely, subprime borrowers have lower loan-to-value (LTV) ratios, especially at the lower credit grades, as lenders use the borrower's equity in their house to compensate for the borrower's poor credit quality. Subprime borrowers at the higher credit grades are likely to use subprime mortgages to repair blemished credit with the intention of refinancing at prime rates in the future. Subprime borrowers at the lower credit grades may be more interested in cash out than borrowers at the higher credit grades, and are more likely than others to refinance during periods of increasing interest rates.[29]

b. Delinquency and Foreclosure Characteristics

Delinquency and foreclosure data show that subprime mortgages are more risky than prime or FHA mortgages. From January 1998 through September 1999, delinquency rates (total loans past due) in the subprime market averaged 13.5 percent and foreclosure rates averaged 2.6 percent. In contrast, for prime mortgages, over the same period, delinquency rates averaged 2.8 percent and

[27] The "A-minus" and other risk grades are not always well defined, as a variety of thresholds for late payments and the FICO score have been used to describe subprime borrowers. Under one classification, an "A-minus" borrower has a FICO score between 620 and 650 and may have less than two late mortgage payments. Under another classification, a 580 FICO score has been used to describe the minimum credit score acceptable for "A-minus" credit. Still, the lower grade subprime borrowers are characterized by a history of more delinquencies on their credit obligations. Under one classification, "B" and "C" borrowers can have a minimum FICO score of 540 and may have four late mortgage payments in the past twelve months. See Jess Lederman, Tom Millon, Stacy Ferguson, and Cedric Lewis, "A-minus Breaks Away from Subprime Loan Pack," in Secondary Market Executive, May 2000, pages 1, 24-28.

[28] "Correspondents Reign Supreme in 1999," Inside B&C Lending, 3-10-00. The credit score floors used by *Inside B&C* to determine borrowers credit risk classifications were recently lowered, effectively moving more borrowers into the lower risk categories (toward "A-minus").

[29] See "Amresco Exec: Myths Abound in Subprime Business," Origination News, July 1998, p. 58.

foreclosure rates averaged 0.24 percent, while for FHA mortgages total delinquency rates averaged 8.5 percent and foreclosure rates averaged 0.62 percent.[30]

There is also substantial variation in risk across the different grades of subprime borrowers. For the third quarter of 1999, MIC reports that the serious delinquency rate (90-day delinquency plus foreclosure started) varied as follows: 3 percent for A-minus loans, 7 percent for B loans, 10 percent for C loans, and 21 percent for D loans.[31]

c. Borrower Demographics

Income and Race. Low-income and black borrowers account for a larger share of subprime refinance borrowers than of the mortgage market generally. According to 1998 HMDA data, low-income borrowers accounted for 41 percent of subprime refinance mortgages but only for 20 percent of conventional prime refinance mortgages.[32] Black borrowers accounted for 19 percent of all subprime refinance loans but only 5 percent of overall refinance mortgages. In contrast, white borrowers accounted for 70 percent of subprime refinance mortgages and 84 percent of all refinance mortgages.[33]

Combining the income and race of the borrower showed that more than half of low-income black borrowers refinance in the subprime mortgage market. In 1998, subprime lenders provided approximately 50 percent of all refinance loans going to low-income black borrowers. Low-income black borrowers accounted for 8 percent of subprime refinance mortgages, compared to only one percent of overall refinance mortgages.

Marital Status. According to 1998 HMDA data, 44.5 percent of all subprime borrowers were single applicants, versus 33.1 percent of prime borrowers. The same pattern holds for home purchase lending, where 50.2 percent of subprime lending was to singles and 38.1 percent of prime

[30] Prime and FHA data are from the Mortgage Bankers Association of America (as reported by Inside Mortgage Finance, Mortgage Market Statistical Annual for 2000, Volume I, p. 210). Subprime data are from the Mortgage Information Corporation (as reported by Inside Mortgage Finance, Mortgage Market Statistical Annual for 2000, Volume I, p. 215). Combining the MIC and MBA data also allow for comparisons between FHA and the "A-minus" portion of the subprime market. In September 1999, the serious delinquency rate (90-day delinquencies and foreclosures started) for "A-minus" subprime loans was 3.29 percent, which was higher than the 2.12 serious delinquency rate for FHA loans.

[31] Mortgage Information Corporation, "The Market Pulse," Winter 2000.

[32] See Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999. Loans where income was not considered by the lender for origination of the loan were excluded. A disproportionate percentage of FHA mortgages have missing income so only the comparison between conventional prime and subprime refinance mortgages is reported.

[33] Hispanic borrowers accounted for 6 percent of subprime refinance mortgages and 4 percent of refinance mortgages overall. The statistics reported here are calculated based upon the assumption that missing race data is distributed the same as loans where race was reported hy the applicant. The lender is not required to report the race of the applicant if the borrower does not provide the information in a mail or telephone application. Subprime applicants are more likely not to have reported race data in a mail or telephone application than mortgage applicants overall.

borrowing was to singles. Finally, refinance lending again shows the increased use of subprime lending for singles, rather than co-applicants. Although singles made up 28.2 percent of the prime borrowers, they made up 43 percent of subprime refinance borrowers.[34]

Gender and Race. According to 1998 HMDA data, female borrowers accounted for 29 percent of subprime refinance mortgages compared to 19 percent of all refinance mortgages.[35] Other studies report different figures for the female share of subprime loans. For example, Weicher reports that single females accounted for 19 percent of subprime refinance mortgages and Freddie Mac reports that females accounted for 45 percent of all subprime mortgages but only for 37 percent of prime mortgages.[36]

Black females accounted for a much larger share of borrowers refinancing in the subprime market than of the total borrower population. According to 1998 HMDA data, black females accounted for 8 percent of subprime refinance mortgages but only 2 percent of overall refinance mortgages. White females, on the other hand, accounted for similar shares of the subprime and overall markets – 17 percent of subprime refinance mortgages and 15 percent of overall refinance mortgages.[37]

Age. Subprime borrowers are more likely to be older than prime borrowers. Borrowers in the 45-54 age group accounted for 31 percent of subprime mortgages but only 22 percent of prime mortgages; borrowers in the 55 years and up age group accounted for 35 percent of subprime mortgages but only 21 percent of prime mortgages. Comparable statistics for borrowers in the 18-44 year age group were 34 percent for subprime mortgages compared to 57 percent for prime mortgages.[38] Using different age categories, the National Home Equity Mortgage Association reports

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[34] Source: "The Subprime Lending Industry and Allegations of Predatory Practices", SMR Group, April 2000, p. 62-66.

[35] The statistics reported here are based upon the gender of the primary borrower reported under HMDA. The statistics are also calculated based upon the assumption that missing gender data is distributed the same as loans where gender was reported by the applicant. The lender is not required to report the gender of the applicant if the borrower does not provide the information in a mail or telephone application. Subprime applicants are more likely to have missing gender data than mortgage applicants overall.

[36] See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000; and Weicher, John C., The Home Equity Lending Industry: Refinancing Mortgages for Borrowers with Impaired Credit, 1997 Hudson Institute, Indianapolis, Indiana.

[37] Black males accounted for 10 percent of subprime refinance mortgages but 3 percent of overall refinance mortgages compared to 52 percent of subprime refinance mortgages and 69 percent of overall refinance mortgages for white males. Again, the statistics reported here are calculated based upon the assumption that missing gender and race data is distributed the same as loans where gender and race were reported by the applicant. Subprime applicants are more likely to have missing gender and race data than mortgage applicants overall.

[38] See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000. Freddie Mac designed and commissioned a survey that was implemented by the Gallup Organization from a sample of borrowers who obtained mortgages between January 1996 and June 1997; the borrower sample was obtained from DataQuick, a firm that collects mortgage transaction data from county records. The Freddie Mac sample included first lien purchase and refinance mortgages and second mortgages. The differences in subprime percentages by age partially reflects the fact that younger borrowers are more likely to be obtaining home purchase loans while a greater percentage of older borrowers are refinancing mortgages. Also, subprime refinance loans accounted for a higher share of overall refinance loans during the January 1996 - June 1997 time period studied by Freddie Mac than in 1998, a year of low interest rates and high refinancing in the prime market. That is, the Freddie Mac survey may have been more likely to pick up borrowers who

the age characteristics of subprime borrowers as follows: under 35 years of age - 15 percent of the subprime market; borrowers between the ages of 35 and 49 - 50 percent; borrowers between the ages of 50 and 65 – 25 percent; and borrowers over 65 years of age – 10 percent.

Education. Subprime borrowers are less well-educated than prime borrowers. College graduates accounted for only 38 percent of subprime mortgages but 60 percent of prime mortgages. High school graduates and borrowers with some college account for 59 percent of subprime mortgages but only 39 percent of prime mortgages.[39]

C. Overview of the Subprime Lending Pipeline: From Borrowers to Investors

The subprime mortgage market is much more complicated than the simple interaction between a borrower and a lender. The market may be thought of as a pipeline that connects the ultimate source of funds (i.e., the investors) with the individual borrower. This pipeline may involve more than half a dozen types of participants. Understanding how this pipeline works is crucial to understanding the possible sources of predatory practices and the possible solutions to halting such practices.

At one end of the pipeline is the borrower being granted credit. There are a wide range of intermediaries involved in delivering the mortgage loan to the borrower. These intermediaries include participants in the subprime market that are likely to deal directly with the consumer such as home improvement contractors, mortgage brokers, finance companies, mortgage bankers, and insured depository institutions. It also includes companies that fund subprime lenders' warehouse lines of credit and securitize subprime loans such as commercial and investment banks. Credit life insurance companies participate in the subprime market by providing credit property, life, and disability insurance. Recently, mortgage insurance companies and government sponsored enterprises, have entered in the subprime mortgage market.

At the other end of the pipeline are the ultimate providers of funds. These providers are as varied as the components of the pipeline itself. Insured deposits and other depository liabilities are one source of funds. Capital market borrowing by depositories and finance companies is another source. And capital market investors may buy the subprime mortgages themselves, typically by purchasing asset-backed securities that constitute an ownership interest in an underlying pool of subprime mortgages. Thus, the ultimate source of funds includes depositors, pension funds, mutual funds, and other investors (both institutions and individuals).

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primarily refinanced to cash out than the typical borrower in 1998 who primarily refinanced to take advantage of more favorable mortgage terms. Weicher reports similar statistics for data obtained from members of the Home Equity Lenders Leadership Organization (HELLO). See Weicher, John C., The Home Equity Lending Industry: Refinancing Mortgages for Borrowers with Impaired Credit, 1997 Hudson Institute, Indianapolis, Indiana.

[39] See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000.

Any one transaction may involve one or more of these components of the pipeline. For example, a person undertaking a home improvement project may work directly with the contractor to initiate the credit process. The contractor may then interact with a broker, a finance company, a mortgage banker, or a depository institution to obtain the actual credit. A credit life insurance company may provide credit insurance on the loan, and an investment bank may assist in pooling the loan with similar loans and selling an asset-backed security to investors.

It is in this pipeline that we seek to identify predatory lending practices. Since not all firms in the pipeline actually undertake the credit risk of making the loan, they may be less concerned about the loan's ultimate repayment and more concerned with the fee income they may earn from the transaction.

1. Borrower Entry into the Lending Pipeline

Typically, a borrower's entry into the subprime lending pipeline involves interacting with an institution or an individual that either specializes in subprime loans or deals with subprime loans as part of overall business operations.

One method of entry into the subprime lending pipeline is through a borrower dealing directly with an institution that is the source of funds (either directly or indirectly by issuing securities to capital market investors). Some of these institutions include: finance companies, mortgage bankers, subprime affiliates of a prime lender, or insured depositories. In this case the borrower would likely discuss loan options with a loan officer that is employed by one of these institutions. Under this structure, the lender is accountable for its loan officers and has a responsibility to monitor their activities.

Another method of entry into the subprime lending pipeline is through a borrower dealing with intermediaries that bring borrowers together with funding sources. These intermediaries are not necessarily controlled by the funding sources, and include home improvement contractors and mortgage brokers. This structure is less regulated and may leave room for greater abuses in the subprime mortgage marketplace. Some lenders have claimed that they are not accountable for the resulting abuses because they have no control or responsibility over the practices that these intermediaries may employ.[40] These intermediaries are subject to varying degrees of federal and state regulation as described below.

The marketing practices of the various intermediaries also may be linked to abusive lending practices. Consumer advocates and borrowers have indicated some of these intermediaries, particularly

[40] For example, finance companies purchase loans from mortgage brokers, but claim that they cannot be held responsible for the practices of mortgage brokers. Recently, in settling a complaint brought by the Justice Department and HUD under the Fair Housing Act and RESPA, Delta Funding Corporation, a subprime lender, agreed that it was responsible for ensuring that mortgage brokers' compensation was reasonably related to the goods, facilities and services provided and that it would lower its yield spread premium or refuse to purchase a mortgage from a mortgage broker unless the compensation was reasonable.

in the subprime market, use aggressive or deceptive marketing techniques.[41] These advocates point out that because of aggressive sales techniques, borrowers who otherwise might not have sought home secured credit are introduced into the subprime mortgage market. Moreover, evidence from enforcement actions indicates that some less scrupulous intermediaries often target their efforts in predominantly minority neighborhoods.

Based on the work of the Task Force, two groups of intermediaries – home improvement contractors and mortgage brokers – appear to be significant sources of abusive lending practices.

Home improvement contractors in both the prime and subprime markets sell home improvements to consumers and frequently arrange the financing through mortgage brokers, finance companies, mortgage banks or other lenders. Borrowers and consumer advocates report that certain home improvement contractors who arrange subprime loans are extremely aggressive in face to face marketing. They target their efforts to consumers whose homes are most in need of repair and whose occupants are least able to shop because of age or infirmity. While a home improvement contractor may provide useful services to homeowners, some seek to convince homeowners to purchase repairs that are unnecessary or overpriced. Some arrange loans with abusive terms and perform shoddy and/or incomplete work once the loan is closed and their fees have been paid. In the worst cases, homeowners may increase their home-secured debt largely as a result of loan fees that may equal or exceed the costs of actual repairs. Home improvement contractors may be regulated under state and local law but are not ordinarily subject to Federal regulation.

Mortgage brokers arrange mortgage financing for borrowers with other mortgage loan providers (including finance companies, mortgage bankers, thrift institutions, credit unions, and banks). Few mortgage brokers act as agents or fiduciaries of borrowers, but mortgage brokers' services include counseling borrowers on suitable loan products, assisting with the borrower's application, obtaining credit and employment reports, and performing other necessary origination services. A mortgage broker ordinarily forwards a borrower's loan file to a lender for underwriting. Mortgage brokers may close loans in their own names using their own funds or warehouse lines of credit or they may close them in the name of a mortgage lender or other type of investor.[42]

The mortgage industry in recent years has seen a steady increase in the use of mortgage brokers. According to the National Association of Mortgage Brokers, mortgage brokers arrange financing for well over half of all home mortgages today.[43] The National Home Equity Mortgage

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[41] Some home improvement contractors and mortgage brokers market their services door to door, use signs and handbills, and/or mail and phone solicitations to target borrowers. Other intermediaries use direct mail or television and advertisements to attract customers.

[42] Generally, mortgage brokers are not highly capitalized entities and do not ordinarily provide funding for the loan. While some brokers utilize warehouse lines of credit to fund loans, most brokers' loans are "table funded." In table funding, a loan is processed and closed in the name of the broker. At or about the time of settlement, there is an advance of monies and a transfer of the loan to an investor, ordinarily a finance company, mortgage banker or depository institution.

[43] www.namb.org/CONSUMR2/facts.htm

Association also reports that about 50 percent of subprime loans are originated through mortgage brokers.

Brokers are paid for their services directly by the borrower, frequently as a percentage of the total loan amount and through other direct fees including, for example, application fees. Brokers are also frequently paid "indirectly" by the lender/investor based on the yield of the mortgage loan through a "yield spread premium." A yield spread premium is a payment a mortgage broker receives from a lender based on the difference between the interest rate and points of the loan the broker entered into with the borrower, and the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a par rate of 7.75% and no points).[44] Consumer advocates assert that this method of broker compensation provides an incentive for brokers to and higher rates. Brokers respond that indirect compensation allows brokers to charge lower direct fees to borrowers, permitting "no-cost" or "low-cost" loans.

In most states, mortgage brokers are subject to state regulation, but the degree of regulation may be modest as compared to other types of institutions involved in home financing. HUD has limited regulatory authority for settlement service providers under RESPA, including mortgage brokers.

The presence of a variety of intermediaries may create complexities in the subprime market, particularly for less informed borrowers. Because some of the intermediaries involved in the origination of a subprime mortgage loan do not actually take on the credit risk of making the loan, some may be less concerned about the loan's ultimate repayment, and more concerned with the fee income they earn from the transaction. The compensation arrangements of mortgage brokers and others may not be sufficiently transparent to borrowers, notwithstanding existing disclosure requirements under RESPA and TILA. Often substantial compensation to an intermediary is financed into the loan amount, reducing the transparency of these costs to the borrower and making the loan more costly in the long run. While most borrowers can compare interest rates, the fees and other charges levied by intermediaries may be less conspicuous and, particularly in a non-competitive setting, not readily comparable.

2. Sources of Funds

a. Pre-1990s: Finance Companies

Prior to the 1990s, the lending pipeline in subprime industry was more streamlined than it is today as the industry was dominated by traditional finance companies that originated loans and held them in their own portfolios. Historically, large finance companies financed subprime mortgages with secured and unsecured debt.[45] These companies relied on a variety of financing methods including equity capital, commercial paper, bonds, and commercial bank lines of credit. Finance companies also used both short and long-term debt, the exact mix depending on the terms of the loans they originated. Throughout the 1980s, commercial paper and long-term indebtedness were the principal liabilities of

[44] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premium or discounts to the broker.

[45] "B&C Mortgage Issuers Turn to High Yield Bonds," Origination News, December 1997, page 57.

finance companies, accounting for 37 percent and 35 percent, respectively, of total liabilities and capital.[46]

b. The 1990s: Securitization Becomes Important

By the 1990s, securitization – the process of pooling together a group of loans and issuing a security representing an ownership interest in the loans – had already become a major source of funding in the prime mortgage market. As investors became comfortable with these investment products, private firms began securitizing other residential and consumer loans. For example, the market for conventional loans above the conforming loan limit (so-called jumbo loans) was increasingly relying on securitization by the end of the 1980s. During the 1990s, multifamily loans, automobile, manufactured home, subprime mortgage loans, and community development loans have been securitized and sold to investors.[47]

During the 1990s, established finance companies continued to rely on a variety of debt instruments to fund loans but they also began to issue asset-backed securities with finance loans as the collateral. Automobile and other forms of consumer credit initially accounted for the majority of loans securitized by finance companies although home equity loans accounted for the majority of loans securitized by the mid-1990s. The securitization of subprime mortgages was a major reason for the rapid growth of finance companies and new entrants into the industry during the mid-1990s.

Inside Mortgage Finance has published data on the securitization of subprime loans since 1994. As shown in Table 3.4, securitization of subprime loans increased from $11 billion in 1994 to $83 billion in 1998 before dropping to $60 billion in 1999. As a share of total subprime mortgage originations, the securitization rate increased from 32 percent in 1994 to as high as 55 percent in 1998, before dropping to 37 percent in 1999. This drop most likely reflects the industry shakeout in 1998 (discussed below).

[46] Finance lenders that obtain the lowest cost of funds typically have a level of equity capital that is commensurate with the default risks of its loan portfolio. In 1988, the equity capital-to-asset ratio that the capital market required for finance lenders was at least 9 percent. See James A. Rosenthal and Juan M. Ocampo. Securitization of Credit: Inside the New Technology of Finance, John Wiley & Sons, Inc., 1988, page 6.

[47] Rosenthal and Ocampo, op. cit., discuss the benefits of securitization. Basically, securitization allows risk to be divided up and sold to investors with differing preferences for return and risk.

Table 3.4: Subprime Securitization: 1994 – 1999

Year	Estimated Subprime Mortgage Originations	Subprime MBS/ABS Securitization	Subprime MBS/ABS Securitization Rate
1994	$35	$11.05	32%
1995	$65	$18.47	29%
1996	$97	$38.16	40%
1997	$125	$66.19	53%
1998	$150	$82.58	55%
1999	$160	$59.88	37%

Source: Inside Mortgage Finance, Mortgage Market Statistical Annual for 2000, Vol. 2, p. 1-2

While securitization has provided a growing source of funds for subprime lending through the 1990s, portfolio lenders remain an important source of funding in today's subprime market.

3. Securitization Increases Wall Street's Participation in the Lending Pipeline

The process of securitization involves increased participation by Wall Street firms in the lending pipeline. For mortgage-backed securities created from subprime loans to have wide appeal to investors, they typically have some form of credit enhancement. Credit enhancement improves the credit quality of the security thereby broadening the pool of interested investors and lowering the yield required on the security, thus expanding the pool of investors that are interested in funding subprime mortgages. The market for providing credit enhancements is innovative and highly competitive, and many types of assets have been securitized.

Two common forms of credit enhancement for subprime mortgages are bond insurance and structural enhancements. Bond insurance is provided by financial guaranty companies (typically monoline insurance companies). Under this form of credit enhancement, the securitization would include a surety bond from a monoline insurance company so that the deal would achieve a AAA rating. With this type of transaction, the insurer, not the investor, holds the loans' credit risk.

The second common type of credit enhancement is structural enhancements, the most common of which is the senior-subordinate structure. Under a senior-subordinate structure, the underlying cash flows of a securitization are distributed first to the senior classes of the securitization. Thus, the subordinate pieces of the securitization serve as a form of credit enhancement in that they absorb losses before the senior pieces. Typically the level of subordination is set to allow the senior portion of the securitization to obtain an AAA rating.

The major rating agencies play an integral role in determining the amount of credit enhancement necessary for subprime securitizations. The rating agencies set the parameters for transforming subprime collateral into a AAA-rated security. One of their main functions is to determine the appropriate level of credit enhancement for subprime securities based on the characteristics of the collateral and the track record of the issuer and servicer. Because issuers provide them with loan-level data, the rating agencies are also one of the best sources of information on the risk characteristics of subprime loans.

Recently, these two types of credit enhancement have been used in roughly the same proportions. Moody's estimates that 53 percent of the subprime mortgage-backed securities issued from 1997 to 1999 carried bond insurance, while the rest involved senior-subordinate structures.[48]

Wall Street investment firms have always been the top subprime mortgage security underwriters. The primary function of security underwriters is to purchase securities from issuers and sell the securities to investors. The top eight Wall Street underwriters of subprime securities accounted for three-fourths of all subprime issues during 1999. Two affiliates of prime mortgage lenders were ranked in the top ten underwriters of subprime securities in 1999.

4. Changing Industry Fortunes in the Latter 1990s

Securitization expanded opportunities for both established lenders and new entrants into the subprime market. Wall Street investment firms and commercial banks provided new and established lenders with access to warehouse lines of credit and lenders used this short-term funding to originate and temporarily hold mortgages for later securitization. Lenders would either issue securities directly or act as correspondents for other subprime lenders that issued securities backed by subprime loans. Wall Street investment firms underwrote the securities and sold them to investors. As lenders grew they attracted long-term capital at lower costs through equity and debt markets by becoming publicly traded companies.

The subprime mortgage market became highly competitive in the mid-1990s fueled by refinancings and profitable spreads. Increased competition also led to more flexible underwriting standards – ultimately resulting in higher delinquency rates, default rates, and prepayment rates.

However, the success enjoyed by many subprime companies in the mid-1990s has been reversed in recent years as the subprime market experienced significant turbulence. Indeed, significant risks have arisen on three fronts: credit risk, liquidity risk, and reputation risk. First, many subprime lenders were slow to adopt best practice underwriting techniques for their loans, resulting in higher than expected defaults. Second, the volatile financial markets of 1998 put liquidity pressure on many already troubled subprime lenders. That is, their borrowing costs increased significantly and investor interest in the subordinated tranches of their loan securitizations evaporated. Lastly, media exposes and lawsuits

[48] Moody's Investors Services, Predatory Lending and Home Equity Securitizations, April 28, 2000, p. 2.

arising from alleged abuses by some subprime lenders spawned concern about "reputation risk" across the industry.

Both depository institutions and consumer finance companies have run into difficulties with subprime lending. While asset quality has affected both types of intermediaries, consumer finance companies that specialize in the subprime sector have also experienced trouble securing financing (debt and equity).

One key problem many finance companies faced was deterioration in the quality of their balance sheets as a result of income not materializing as expected. The primary source of income for many subprime lenders that securitize loans is the cash flow that comes from excess servicing. (Excess servicing arises from the interest rate on the mortgage being greater than the interest return that must be paid to the security holder and the fee for servicing the mortgage.) Using "gain-on-sale" accounting, lenders book the expected present value of excess servicing as current income -- although this value depends importantly on assumptions about default rates, loss rates, and prepayment rates.

Beginning in late 1997 and continuing through 1998, lenders that had under-estimated prepayment speeds and loan defaults were forced to restate the value of their servicing rights, resulting in a decline in their capital base. This, in turn, eroded investor confidence and the value of subprime lenders' outstanding debt and asset-backed securities declined. Congruently, the Asian financial crisis led to a general reduction of capital market liquidity and thus new sources of funds for subprime lenders either became more expensive or dried up entirely. In fact, during 1998, hedge funds and investment banks were said to have lost their appetite for subordinated portions of subprime securitizations, thus halting a large portion of secondary market activity in these loans.

Several subprime mortgage firms filed for bankruptcy protection during 1998. Other troubled specialty subprime lenders were acquired by more diversified mortgage lenders or by bank holding companies.

Trouble with subprime lending was not limited to consumer finance companies. According to the Federal Deposit Insurance Corporation (FDIC), the three most costly depository institution failures of 1999 (with loss rates over 50 percent) all involved subprime lending to some degree. These institutions were Best Bank (CO), Pacific Thrift & Loan (CA), and First National Bank of Keystone (WV). Furthermore, active subprime lenders (i.e., those with more than 25 percent of their equity capital in subprime loans) are over-represented on the FDIC's "problem bank" list. In fact, subprime lenders, by this definition, constitute one percent of FDIC-insured institutions, but make up some 21 percent of problem institutions. In response to growing concerns about the risks of subprime lending to *lenders*, the OCC, OTS, FDIC, and the Board issued joint guidelines on the nature and risks of subprime lending in March 1999.

5. New Entrants in the Subprime Market

The financial turbulence of the latter part of the 1990s altered the structure of the subprime market. One of the main features has been consolidation. Morgan Stanley reported in 1998 that "the subprime sector has been characterized over the past two years by increasing competition and, more recently, by the consolidation seen in the financial services industry generally."[49] In 1996, the top 25 lenders originated 50 percent of subprime loans. This percentage climbed to 62 percent in 1997 and to 70 percent in 1998 and 1999.[50] Financial turbulence in the subprime market also attracted new entrants, including prime lenders, private mortgage insurers, and the GSEs.

Prime Lenders. Prime mortgage lenders have accounted for a small share of the subprime market in the past but have become important participants in the wake of the industry shakeout in 1998.[51]

Banks and thrifts, which typically specialize in prime lending, are also increasing their profiles in the subprime market. Between 1993 and 1998, the number of subprime mortgages loans originated by banks and thrifts increased by 551 percent. The number of subprime loans originated by affiliates of banks and thrifts increased nearly 70-fold, from a very small base in 1993. Taken together, banks, thrifts and their affiliates accounted for approximately one quarter of all subprime mortgage originations in 1998.[52]

Prime lenders have played a smaller role in the subprime market until recently because originating and servicing subprime mortgages is much different than originating and servicing prime mortgages. For many prime lenders, their initial entry into subprime has been in the least risky (A-minus) tier of the market. Their marketing has been based on better pricing and a stable source of capital.[53]

Prime mortgage lenders have entered the subprime market by starting their own subprime mortgage divisions and through acquisitions of established subprime lenders. In addition to these types of direct involvement in subprime lending, prime lenders also:

- Issue and purchase subprime securities. These companies may play an increasingly important role in the securitization of subprime product because of their access to credit markets and their expertise in securitizing mortgages.[54]

[49] Morgan Stanley Dean Witter, Home Equity Loan Handbook 1998 edition, p. 5.
[50] Inside Mortgage Finance, Mortgage Market Statistical Annual Vol. 1, 1999, p. 117-123.
[51] See "Continuing Shake-Out in Subprime Market Expected To Create Opportunities for A Market Lenders in '98." Inside Mortgage Finance. January 15, 1999. Page 9. "New Year Spells New Opportunity, New Hope for Subprime Recovery." January 11, 1999. Inside B&C Lending. Pages 1,2.
[52] Litan et al., *op cit.*
[53] This discussion of the entry of prime lenders into the subprime market draws from Jess Lederman, Tom Millon, Stacey Ferguson, and Cedric Lewis, "A- Breaks Away from Subprime Loan Pack", in Secondary Marketing Executive, May 2000, pages 1, 24-28.
[54] There are other advantages to a bank or thrift charter. For example, Associates and Commercial Credit applied for thrift charters in late 1997 and early 1998. Both companies stated that the federal preemption of individual state regulations accorded federal savings associations was one reason for their application.

- Service subprime mortgage portfolios.
- Perform back office functions related to securitization (e.g., acting as a trustee for subprime securitizations).
- Provide warehouse lines of credit to subprime lenders.

Wall Street. In addition to Wall Street investment firms' traditional role as underwriters, beginning in late 1997 (in the wake of the shakeout in the subprime market) several firms also became important issuers of subprime securities. Wall Street investment firms obtain subprime loans through whole loan purchases from lenders that have been unable to profitably issue securities. Wall Street investment firms have also formed alliances with subprime lenders.

Private Mortgage Insurers. Private mortgage insurers first entered the subprime market in 1997, insuring "A-minus" loans as a way to expand their market.[55] However, the market for their subprime product really began to develop in late 1998 when prime lenders began moving into the "A-minus" market. Traditional subprime lenders, who focused on B and C loans, had never felt the need for mortgage insurance. Prime lenders saw an opportunity to expand into the "A-minus" market after a liquidity crisis in late 1998 led to the demise of many traditional B&C lenders. The growing use of automated underwriting at about the same time enabled prime lenders to assess risk more accurately, but they still wanted the comfort of mortgage insurance. In particular, portfolio lenders who face risk-based regulatory capital requirements have an incentive to use mortgage insurance. The availability of mortgage insurance also enabled existing "A-minus" lenders to stretch their product guidelines by increasing LTVs and maximum loan amounts, and by allowing lower credit scores.

The GSEs. Although the GSEs are not currently significant participants in the subprime market; Fannie Mae and Freddie Mac have shown increasing interest in the subprime market throughout the latter half of the 1990s. Both GSEs have begun purchasing "A-minus" and "Alt-A" mortgages..[56] The GSEs' interest in the subprime market has coincided with a maturation of their traditional market (the conforming conventional mortgage market), and their development of mortgage scoring systems, which they believe allows them to accurately model credit risk.

D. Subprime Lending and Low-Income and Minority Neighborhoods

[55] This discussion of the role of private mortgage insurers in the subprime market draws from Jess Lederman, Tom Millon, Stacey Ferguson, and Cedric Lewis, "A- Breaks Away from Subprime Loan Pack", in Secondary Marketing Executive, May 2000, pages 1, 24-28.

[56] Alternative – A (or Alt –A) mortgages are made to prime borrowers who desire low down payments or do not want to provide full documentation for loans.

This section reviews two important aspects of the growth in subprime lending. The first is the heavy reliance of low-income and minority neighborhoods on subprime lenders for their refinance loans. The second is the rapid increase in foreclosures of subprime loans in these same neighborhoods.

1. Subprime Concentration in Low-Income and Minority Neighborhoods

Analysis of HMDA data show that subprime lending is disproportionately concentrated in low-income and minority neighborhoods. Reasons for the disproportionate amount of subprime lending in certain neighborhoods likely results from the following factors: differences in credit characteristics of borrowers; differences in the types of loans (e.g., small balance loans); and less competition from mainstream lenders. Low-income and minority neighborhoods may be especially vulnerable to abusive lending practices because subprime lending tends to be concentrated in these neighborhoods. Not all subprime lending is predatory, but predatory practices are most frequently found in connection with subprime lending.

HUD's detailed study of the almost 1 million subprime mortgages reported to HMDA in 1998 focused primarily on home refinancing loans, which account for 80 percent of all subprime loans. HUD's study found that there has been a tremendous growth in subprime lending since 1993, and that this growth is concentrated in low-income and minority neighborhoods. In particular, borrowers in black neighborhoods rely heavily on subprime lending when refinancing their mortgages. This disparity between the share of borrowers in black and white neighborhoods refinancing in the subprime market holds even after controlling for neighborhood income (but not controlling for individual borrowers credit characteristics).

Low-Income Neighborhoods. Subprime loans are three times more likely in low-income neighborhoods than in high-income neighborhoods. Nationwide, 11 percent of refinance mortgages in 1998 were subprime, but in low-income neighborhoods, the percentage was more than double at 26 percent. In upper-income neighborhoods, only 7 percent of borrowers refinanced in the subprime market in 1998. In 1993, only 3 percent of subprime mortgages in low-income neighborhoods and 1 percent in moderate- and upper-income neighborhoods were subprime. In the poorest communities, where families make only 50 percent of the median income, fully 44 percent of borrowers refinanced in the subprime market in 1998.

Looking at individual borrower income rather than neighborhood income, the findings are similar. Low-income borrowers were almost 3 times as likely as upper-income borrowers to rely upon subprime refinancing (21 percent of low-income borrowers versus 8 percent of upper-income borrowers.)

Black Neighborhoods. The HMDA data indicate that borrowers in black neighborhoods are five times as likely to refinance in the subprime market than borrowers in white neighborhoods. In predominantly black neighborhoods, subprime lending accounted for 51 percent of refinance loans in 1998 – compared with only 9 percent in predominately white areas. Comparable 1993 figures were 8 percent in black neighborhoods and 1 percent in white neighborhoods.

Most notably, these disparities still exist if homeowners in black and white neighborhoods are compared while controlling for the income of the neighborhood.[57] Among borrowers living in upper-income white neighborhoods, only 6 percent turned to subprime lenders for refinancing in 1998. In contrast, 39 percent of borrowers living in upper-income black neighborhoods refinanced in the subprime market (i.e., borrowers in black neighborhoods were six times as likely to refinance with a subprime loan).[58] In fact, borrowers in *upper-income* black neighborhoods were twice as likely as homeowners in *low-income* white neighborhoods to refinance with a subprime loan. In 1998, 18 percent of borrowers living in low-income white neighborhoods relied upon a subprime loan, compared with 39 percent of borrowers living in upper-income black neighborhoods.

Individual Metropolitan Areas. HUD's analysis at the metropolitan area level reveals the same trends in subprime lending. A detailed analysis of the five metropolitan areas where forums were held by the Predatory Task Force showed the same income and racial patterns in the use of subprime lending at the metropolitan level as at the national level in 1998.

- In Atlanta, subprime refinancing during 1998 accounted for at least 25 percent of all refinancing in 101 of the 475 census tracts. In 94 of these 101 census tracts, the population was at least 30 percent black.
- Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 253 of the 1,641 census tracts in the Los Angeles metropolitan area. Census tracts where either blacks or Hispanics (or both) comprised more than 30 percent of the population accounted for 241 of the 253 census tracts with high subprime activity.
- In New York, subprime refinancing represented one in four loans in more than half of all census tracts, and black neighborhoods alone accounted for almost 50 percent of all subprime lending in the city.
- In Chicago, subprime refinancing account for at least 25 percent of all refinancing in 438 of the 1,767 census tracts. In 367 of these 438 census tracts, blacks accounted for at least 30 percent of the population.
- In Baltimore, almost one-third (or 156) of the census tracts had at least 25 percent subprime refinancing, with the greatest subprime refinancing activity occurring in the black neighborhoods (118 of the 156 tracts).

Banking regulators have recognized the need for more mainstream lenders in neighborhoods currently being served by subprime lenders, and have urged banks and thrifts to seek profitable lending opportunities in these communities. Ellen Seidman, Director of the Office of Thrift Supervision, recently echoed the sentiments of other banking regulators when she stated that, "Many of those served by the sub-prime market are creditworthy borrowers who are simply stuck with sub-prime loans or sub-prime

[57] This analysis did not control for differences in the credit characteristics of neighborhoods.

[58] This pattern is also present in neighborhoods of other income levels. Borrowers in low-income black neighborhoods are almost three times as likely as borrowers in low-income white communities to have subprime refinancing, and borrowers in moderate-income black neighborhoods are four times as likely to have subprime refinancing.

lenders because they live in neighborhoods that have too few credit or banking opportunities."[59] Similarly, Comptroller of the Currency, John D. Hawke, Jr. recently stated that, "We must target not just the predators themselves, but conditions that allow them flourish. That means encouraging responsible competition in the same markets in which the predators operate."[60]

2. The Effects of Foreclosure on Low-Income and Minority Neighborhoods

The growth in subprime lending over the last few years has been documented in the above sections. By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending can and does serve a role in the nation's economy. These borrowers typically have blemishes in their credit record, insufficient credit history or non-traditional credit sources. Thus, it is not surprising that, generally, , subprime loan borrowers present more credit risk as a class, and have higher rates of serious delinquency and default than mainstream conventional borrowers (see national data on delinquencies and foreclosures reported in Chapter IV.B.3 above).

This section reports findings about subprime foreclosures from studies of three individual metropolitan areas. These studies have found that in the areas studied, the growth in mortgage foreclosures paralleled the growth in subprime lending. They also found that subprime borrowers are quicker to default on their loans than are prime borrowers and default, leads to foreclosure by the lender. Like originations, foreclosures on subprime loans are concentrated in low-income and minority neighborhoods.

Chicago. The National Training and Information Center (NTIC) related subprime lending to foreclosure trends in its examination of mortgage markets in Chicago for the period 1993 to 1998.[61] The NTIC study found that:

- Between 1991 and 1997 the subprime share of the mortgage origination market rose from 3 percent to 24 percent. However, between 1993 and 1998, the subprime share of foreclosures increased from 1.3 percent to 35.7 percent.
- Foreclosures on loans originated after 1994 had higher average interest rates than foreclosures on loans originated before 1994. Between 1993 and 1998, the greatest growth in foreclosures was on loans with interest rates 4-8 percentage points above the 30-year Treasury rate.
- Fast foreclosures in the Chicago area grew rapidly in the subprime market. The vast majority of foreclosures on home loans less than two years old were foreclosed by subprime lenders.

[59] "Puzzling Through: Approaching Alternative Credit Responsibility." Remarks by Ellen Seidman. Director of the Office of Thrift Supervision. Interagency Conference on CRA. San Francisco, April 17, 2000.

[60] Remarks by John D. Hawke, Jr. Comptroller of the Currency. National Community Reinvestment Coalition Annual Convention. Washington, DC. March 21, 2000.

[61] NTIC, Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures, September 1999. The NTIC study focused on completed foreclosures between 1993 and 1998 in the Chicago area, including the City of Chicago, suburban Cook County, and DuPage and Will counties. NTIC obtained foreclosure data from the Foreclosure Report of Chicago, a private, for-profit company that collects foreclosure court filings. Unlike the studies of foreclosures by Abt Associates and HUD (discussed below) which focused on foreclosures initiated, the NTIC study focused on "foreclosures completed" where the property was sold at an auction.

Atlanta. Building on the NTIC study, Abt Associates recently conducted an analysis of mortgage foreclosures in the Atlanta metropolitan area.[62] Abt examined mortgages that were entering the foreclosure process between 1996 and 1999, and compared foreclosures of loans by subprime and non-subprime lenders.[63] The Abt study found that:

- Among lenders that report to HMDA, the overall share of foreclosures attributable to subprime lending increased from 5 percent in 1996 to 16 percent in 1999.[64] The subprime share of originations was 10 percent in 1996, 12 percent in 1997 and 9 percent in 1998.
- Over the 1996-99 period, loans with high interest-rate spreads (more than four percentage points over 30-year Treasury) represented 44 percent of the subprime loans entering foreclosure.[65]
- The median age of loans entering foreclosure was only two years for subprime loans, compared to 4 years for prime loans.
- Considering only foreclosures by HMDA reporters, subprime lenders accounted for 36 percent of all foreclosures in predominantly minority neighborhoods during 1999, compared to their origination shares of 28 percent in 1997, 31 percent in 1997, and 26 percent in 1998.

Baltimore. HUD examined all petitions to initiate foreclosure actions in Baltimore for the three month period of January to March 2000 and compared these results with available HMDA data on mortgage originations.[66] The HUD study found that:

- The subprime share of foreclosures in Baltimore is much larger than the subprime share of mortgage originations.[67] While subprime loans account for 45 percent of the foreclosure petitions, the subprime share of mortgage originations in Baltimore City was 21 percent in 1998.[68]

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[62] Abt Associates Inc., Analyzing Trends in Subprime Originations and Foreclosures: A Case Study of the Atlanta Metro Area, February 2000. The Abt study covered 12 of the 16 counties in the Atlanta metropolitan area.

[63] Abt obtained monthly data from the *Atlanta Foreclosure Report* (AFR) on advertisements for foreclosure sales; as Abt notes, the data may include some properties that avoid foreclosure. Thus, the term "foreclosure" in the Abt report should be interpreted as a loan entering the foreclosure process. See pages 12-16 of the Abt report for a discussion of the AFR data. Abt identified subprime lenders using HUD's list of lenders that primarily originate subprime loans.

[64] HMDA reporters accounted for about 70 percent of Abt's sample. Including all lenders in the Abt sample, the subprime share of loans entering foreclosure inereased from 3 percent in 1996 to 11 percent in 1999.

[65] However, Abt finds that foreclosures with high interest rate spreads have increased for all types of lenders. It is also important to note that Abt had data on interest rate spreads for only a quarter of the listed foreclosures.

[66] See the HUD report Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending, May 2000. HUD obtained the data on foreclosure petitions in conjunction with the staff of the St. Ambrose Housing Aid Center. The data was obtained from the files of the Circuit Court for Baltimore City. The data on foreclosures included the petition and origination dates, the interest rate, product type (FHA, VA, conventional), the name of the lender, and the address of the property. HUD used its subprime list of HMDA lenders to identify subprime lenders in Baltimore City. HUD also identified lenders that specialize in subprime lending but either do not report to HMDA or were not identified earlier by HUD.

[67] HUD's analysis was based on 1,251 petitions. The original file consisted of 1,889 cases. HUD excluded 14 foreclosure petitions from 1999, 51 that had missing petition dates, and 274 that had dates after March 31, 2000 -- leaving 1,550 foreclosure petitions. From these HUD excluded: 112 foreclosure petitions that had origination dates before 1990, 46 petitions in which the lender was missing, 65 petitions in which the lender was reported as the seller

- Subprime loans account for 50 percent of foreclosure petitions in low-income Baltimore City neighborhoods, compared with 33 percent of the mortgage originations.
- Subprime loans account for 57 percent of foreclosures in predominantly black neighborhoods, compared with 42 percent of mortgage originations in predominantly black Baltimore City neighborhoods.
- Subprime loans result in foreclosure during a shorter period of time after origination than prime and FHA loans. The mean lag between the origination date and the date that the foreclosure petition was filed is 1.8 years for subprime loans compared to 3.2 years for FHA and prime loans. Subprime loans originated in 1999 account for a substantial minority (28 percent) of all subprime foreclosure petitions.

As the above data show, as subprime lending has increased in many communities, so have foreclosure rates. In some cases, the shares of foreclosures in the subprime market exceeded the subprime share of originations. While a higher share of foreclosures in the subprime market should be expected given the higher risk characteristics of these loans, foreclosures can have a devastating impact on families, contribute to the deterioration of many communities, and be costly for lenders. For individual families, foreclosure results in the loss of the home, a family's most valuable asset. For communities, foreclosed homes frequently remain vacant for prolonged period of time, during which they may be poorly maintained. Foreclosed homes are often a primary source of neighborhood instability in terms of depressed property values and increased crime.

E. Concluding Observations

The characteristics of subprime lending – the higher rates and fees associated with such lending, and the population served by subprime lenders – suggest the positive and negative aspects of the subprime market. On the one hand, subprime lending is an important element of our financial system because it delivers credit to those that may otherwise be unable to obtain credit. On the other hand, it appears more susceptible to abusive lending practices than is the prime market. A subprime borrower may have few financial options available or less information on loan terms and conditions and less opportunity to shop for the best terms and conditions available.

For some borrowers, the subprime market is an opportunity to overcome past credit difficulties and obtain new credit. This opportunity carries with it the necessities of managing one's finances carefully, learning the options, terms and conditions available and considering one's capacity to repay

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of the property or a realty company, and 76 petitions that either did not have geocode information or were not located in Baltimore City. FHA loans accounted for 17 percent of the petitions excluded from the analysis.

[68] The subprime share reported for 1998 may be the most useful share when comparing the subprime share of foreclosures with the subprime share of originations since 61 percent of subprime foreclosures in Baltimore City were for subprime loans originated since 1998. The subprime share of the market is derived from purchase and refinance loans that are reported to HMDA since the foreclosure data includes purchase and refinance loans. As noted earlier, the subprime origination shares reported in this section for home purchase and refinance loans in Baltimore City differ from the subprime share of purchase and refinance loans in the Baltimore metropolitan area.

the loan. As in any credit market, subprime borrowers should exercise caution and judgment in selecting a lender, and should shop multiple lenders if possible to obtain the best deal available. Of course, lenders have a corresponding responsibility to ensure that their practices do not subvert a borrower's ability to exercise these judgements.

This chapter also illustrates two important obstacles in developing remedies for abusive practices in the subprime mortgage market: the lack of clear definitions and the constant change taking place in the mortgage market. For example, automated underwriting may lead to more finely-tuned risk-based pricing in both the prime and subprime market. Consequently, there may no longer be a single class of prime borrowers but multiple classes defined by a complex mix of borrower credit scores and other factors. As technology permits lenders to define risk along a continuum, rather than at a few discrete points, pricing and loan terms may become more tailored to the circumstances surrounding each individual loan. Market competition by larger numbers of reputable lenders will be key to assuring these developments work to benefit consumers. Enhancing competition is also an essential element of effort to drive predatory lending practices from the mortgage market.

Chapter V. Current Legal Context

The following section summarizes the status of existing laws designed to protect consumers from abusive practices in mortgage lending.

A. Home Ownership and Equity Protection Act (HOEPA)

The Home Ownership and Equity Protection Act (HOEPA), enacted as part of the Riegle Community Development and Regulatory Improvement Act of 1994, amended TILA to provide consumers enhanced protections for certain high-cost home loans. The origin of HOEPA was a concern about "reverse redlining", the targeting of residents of disadvantaged areas for credit on unfair terms. HOEPA does not prohibit loans with high interest rates or fees or cap rates or fees. Instead, it subjects certain loans, the rates or fees for which exceed specified rates or fees (HOEPA loans) to enhanced disclosures, restrictions on certain contract terms, and private and administrative consumer remedies for violations of the act.

HOEPA loans. HOEPA covers closed-end loans made to refinance existing mortgages and closed-end home equity loans that charge either (i) an annual percentage rate (APR) of more than 10 percentage points above the yield on Treasury securities of comparable maturities (although the FRB may adjust this trigger down to eight percent or up to 12 percent), or (ii) points and fees (including compensation to mortgage brokers, but excluding certain *bona fide* third party fees) that exceed the greater of 8 percent of the loan amount or $400 (adjusted for inflation – for calendar year 2000, $451). HOEPA excludes from its coverage purchase money mortgages (i.e., loans to purchase or construct a residence), open-end credit, and reverse mortgages. HOEPA's restrictions apply to any creditor that originates two or more HOEPA loans, or one or more such loans through a mortgage broker, in any 12-month period.

Disclosures. HOEPA loans require certain disclosures in addition to those required by TILA. These disclosures, moreover, must be in conspicuous type size and given to the consumer at least three days before the closing. The lender must disclose that the consumer is not required to complete the agreement even though an application has been signed, and that the transaction creates a mortgage on the consumer's home that could result in the consumer's losing the home and any equity in the home if the loan is not paid. The lender must also disclose the APR and amount of the regular monthly payment (including any balloon payment), and, in the case of a variable rate loan, that the monthly payment may increase and the maximum monthly payment that is possible under the maximum interest rate allowed by the loan agreement.

Restricted terms. HOEPA also constrains the use of certain provisions in HOEPA loans. A HOEPA loan may be subject to a prepayment penalty only if (i) at the time the loan is consummated, the consumer's total monthly debt payments are not greater than 50 percent of the consumer's monthly gross income and there is appropriate verification of the consumer's income and expenses; (ii) the prepayment is not made with funds borrowed through a refinancing from the same creditor or an affiliate; (iii) the penalty does not apply more than five years after the mortgage was consummated; and

(iv) the penalty is not prohibited by any other law. A HOEPA loan may not: have, after default, a rate of interest higher than the rate before default; in most circumstances, require a balloon payment on a loan with a term less than five years; contain terms creating negative amortization; or require prepayment at closing of more than two periodic payments. A lender may not engage in a pattern or practice of extending HOEPA loans based on the home without regard to the consumer's ability to repay from other sources (e.g., income) – a provision that has been interpreted by the Federal Reserve Board ("the Board") to forbid a pattern or practice of lending to consumers unable to repay from sources other than home equity. In addition, where a home improvement contract is involved, the creditor may not pay the contractor directly but must use a check payable jointly to the consumer and the contractor or, at the consumer's election, make payment through an escrow agent pursuant to certain requirements.

Rulemaking Authority. HOEPA gives the Board broad regulatory authority with regard to HOEPA loans. It grants the Board authority to expand or contract HOEPA's coverage by adjusting the APR trigger (now at 10 percentage points above comparable Treasury securities) between eight percent and 12 percentage points and including in the points-and-fees trigger. additional charges not specified in the statute In addition, the act requires the Board to prohibit acts or practices in connection with mortgage loans that it finds to be unfair, deceptive, or designed to evade HOEPA's provisions, and acts or practices in connection with refinancing of mortgage loans that it finds to be associated with abusive lending practices or not otherwise in the interest of the borrower. This authority to regulate unfair, deceptive, and abusive practices extends to all consumer mortgage loans, not just those covered by HOEPA.

Liability and Enforcement. In case of a violation of HOEPA, a borrower has available the same remedies available under TILA (see part B., below) and, in addition to those remedies, a borrower may also recover an amount equal to the sum of all finance charges and fees paid by the consumer, unless the creditor can show that the failure to comply is not material. (This amount may also be recovered for consumers by the Federal Trade Commission.) HOEPA preserves a borrower's claims and defenses against a purchaser or assignee of a HOEPA loan that violates HOEPA, unless the purchaser or assignee can demonstrate that a reasonable person could not have determined the mortgage was subject to HOEPA. The administrative and judicial remedies available to federal agencies against lenders that violate TILA are also available against lenders that violate HOEPA. In addition, state attorneys general are authorized to enforce violations of HOEPA in federal or state court.

B. Truth in Lending Act (TILA)

The Truth in Lending Act (TILA) was enacted to provide consumers with meaningful information about credit transactions. TILA requires creditors to disclose to consumers for closed-end credit loans, inter alia, (1) the finance charge, (2) the Annual Percentage Rate (APR), (3) the amount financed, and (4) the total of all payments. The finance charge is the cost of credit disclosed to the consumer as a total dollar amount, including the interest for the loan and other costs of the loan such as origination fees, discount points, and private mortgage insurance (PMI). The APR for closed-end credit is the finance charge expressed as an annualized percentage rate. Before TILA was enacted, creditors could advertise the same interest rate but calculate it by different means. The APR is designed to provide a

benchmark figure for consumers to consider the real costs of credit for a loan and to facilitate comparison shopping for credit. Assuming the existence of additional costs of a loan beyond the interest charged, the APR will be greater than the interest rate on the loan.

TILA, which applies, *inter alia*, to all transactions that involve a mortgage on a consumer's personal residence, requires uniform disclosure of credit terms, including an annual percentage rate (APR). The act grants consumers a right to rescind certain mortgages within three days of the later of (1) closing, (2) the provision of accurate material disclosures, or (3) the giving of notice of the right to rescind. Regulatory agencies can obtain certain administrative and (in the case of the Federal Trade Commission) judicial remedies for TILA violations. An individual plaintiff may recover actual damages; statutory damages in the amount of twice the finance charge, although this remedy cannot be greater than $2000 or less than $200; and costs and reasonable attorneys fees.

C. Real Estate Settlement Procedures Act (RESPA)

RESPA requires the disclosure of settlement costs to consumers for federally-related mortgage loans at the time or soon after a borrower applies for a loan and again at the time of real estate settlement. Section 8 of RESPA prohibits payments by settlement service providers for the referral of settlement service business and unearned fees and splits of fees for such services. In enacting RESPA, Congress intended to curb abuses that lead to increased settlement costs. RESPA also limits amounts held in borrowers' escrow accounts and requires notices to borrowers of affiliated businesses and transfers of mortgage servicing.

RESPA currently requires creditors (or mortgage brokers) within three days of loan application to provide all applicants for "federally related mortgage loans" with an estimate (the "Good Faith Estimate" or GFE) of the amount or the range of charges for specific settlement services in mortgage transactions. These charges include creditor-imposed fees, such as loan origination fees; charges by third parties, such as appraisal or title insurance fees; and amounts the consumer is required to put into an escrow account for items such as property taxes or insurance.

The GFE allows consumers to understand how the total amount of closing costs will be allocated. It also provides an opportunity for consumers to shop for some of the services (for example, the services of a settlement agent or title insurer). At or before settlement, consumers receive a second RESPA disclosure -- the uniform settlement statement (the HUD-1) -- that enumerates the final costs associated with both the loan and, if applicable, the purchase transaction.

HUD has interpreted RESPA to require that the charges disclosed on the GFE must bear a reasonable relationship to the actual charges. The figures disclosed on the GFE, however, need not be firm or guaranteed. Moreover, RESPA does not impose liability on a creditor for an inaccurate or incomplete estimate, or for failing to provide one.

Section 8(a) of RESPA prohibits kickbacks and referral fees. Section 8(b) prohibits unearned fees. These provisions have provided a legal basis for addressing certain abusive and predatory practices

under the RESPA statute. (Section 8(c) permits bona fide compensation for goods and facilities actually provided and services performed.)

The statute provides criminal penalties for violation of Section 8, private rights of action for damages and limited injunctive relief. However, the statutes of limitations are short. The disclosure provisions of the statute concerning settlement costs do not include sanctions for violations.

Chapter VI. Recommendations for Reform

Testimony from consumer advocates, the industry and borrowers at the HUD-Treasury Task Force forums demonstrated that an unfortunate combination of circumstances often drives consumers into abusive loans. The testimony and our research suggest that predatory lending stems from problems in four major areas:

1. Inadequate consumer literacy and disclosure – Many victims of abusive lending practices are not informed of the basics of mortgage credit, how to shop among lenders, and how best to finance household debt. While lack of knowledge is one important part of this problem, complicated and uneven disclosures of loan costs and terms can further confuse even the most knowledgeable borrowers in the market.

2. Harmful sales practices – Unscrupulous actors in the lending market, including lenders, brokers, contractors and appraisers, engage in abusive sales practices that harm consumers, but that may not be prohibited under current law. Examples of these practices may include loan "flipping," lending to borrowers without regard to their ability to repay, and incomplete reporting of borrower payment history to the credit bureaus.

3. Abusive or deceptive terms and conditions – Certain terms and conditions of some loans sold in the subprime marketplace are so burdensome to borrowers as to be injurious in all cases. Other terms and conditions may become abusive when they are combined with other practices or high costs.

4. Imperfect market structure – Borrowers who fall victim to predatory lenders often live in neighborhoods where competition among lenders is inadequate. Other borrowers in the subprime market might be able to qualify for prime loans, but are unaware of or lack access to the mainstream financial sector. Furthermore, our knowledge of the prime and subprime lending markets is currently inhibited by a lack of data on these markets.

HUD and Treasury believe that problems in these four areas call for the following types of actions through legislation, regulation and other initiatives:

1. Increasing the transparency of mortgage transactions, while mounting new efforts to educate borrowers, can compensate for the information asymmetries that may disadvantage less informed borrowers.

2. Strengthening enforcement of existing law and prohibiting certain practices that injure consumers can help to curb the deceptive, fraudulent and abusive practices that lead borrowers into taking these loans.

3. Identifying and restricting certain terms and conditions that are associated with many of the more abusive transactions in this market can reduce opportunities for predatory lenders to exploit some borrowers' lack of knowledge.

4. Expanding borrowers' access to the prime market, increasing information about the mortgage market and enforcing private market discipline to curb abusive practices can help to correct for the market failures that allow predatory lending to persist.

The following section discusses a variety of specific problems in each of the four problem areas described above. For each of these problems, this section:

- Offers background on the practice/term/product, including data and other evidence that informed HUD's and Treasury's recommendations in that area;
- Discusses the policy problem, why it should be addressed and challenges for reform; and
- Provides HUD's and Treasury's recommendations for addressing the problem.

A. Consumer Literacy and Disclosure

1. Need for Greater Financial Literacy

Background

The testimony at the Task Force forums suggests that consumer education is a necessary strategy for reducing predatory lending. Many victims of predatory lending lack information on the basics of finance or how to shop for loans and evaluate the often complex terms and conditions associated with most lending. Consumers are often not aware of the abusive terms and conditions of predatory loans. The terms and conditions of these loans suggest that if borrowers better understood these transactions, they would not enter into them. Thus, efforts to extend consumer education and improve the financial literacy of consumers are important strategies for reducing predatory lending.

Since the abuses identified by the Task Force tend to occur in the subprime market, one effective way to stem these abuses might involve helping more borrowers to retain or to obtain good credit ratings so that they could find loans in the prime market. Additionally, because up to three-quarters subprime loans used for debt consolidation or "cash-out" refinancing, it is appropriate to consider how borrowers could avoid needing these loans in the first place. Both of these approaches involve educating consumers more broadly about credit, and empowering them to have better credit options and to make better choices in the market.

What is the Problem?

There is mounting evidence that consumers could benefit from increased information about credit markets, managing credit and the benefits of maintaining good credit:

- Studies indicate many subprime borrowers tend to be unfamiliar with financial concepts and not well-informed about the mortgage origination process. In one survey, 12 percent of subprime

borrowers said they were not familiar with basic financial terms such as the interest rate and the principal of the loan.[69] One-third of subprime borrowers said they were not familiar with the types of mortgage products available.

- Evidence from the 1998 Survey of Consumer Finances indicates that family debt burdens are rising, especially in the home-secured consumer debt market. The proportion of families with home-secured debt rose more quickly between 1995 and 1998 than the homeownership rate. Additionally, the median home-secured debt held by families with such debt rose more quickly during this period than home prices. Rising debt burdens may put families at greater risk of default or bankruptcy.

- The same survey showed declines in the median value of financial assets for lower-income families and non-homeowners between 1995 and 1998. Borrowers with lower levels of savings can be charged higher prices or be shut off from credit in the prime market if their down payments leave them with too high a loan-to-value ratio. Saving to build assets should be a key component of any family's long-term financial plan.

Educating and empowering consumers in the credit market can reduce the demand for loans with potentially abusive terms, and should be a component of any strategy to curb predatory lending practices.

Policy Recommendations

a) **Create a consumer credit task force at the National Partners for Financial Empowerment** – Treasury recently announced the formation of the National Partners for Financial Empowerment (NPFE), a consortium of government agencies, financial services providers, and consumer and community organizations dedicated to improving financial literacy efforts in the US. Treasury and HUD, both members of the NPFE, will work with their partners to develop a special focus on enhanced curricula around consumer and mortgage credit, including anti-predatory lending education.

b) **Support local consumer education initiatives regarding mortgage lending** – Programs to assist community and faith based organizations that provide training to consumers in credit management deserve increased attention from the federal government. In addition to helping borrowers to maintain better credit over the long term, new consumer awareness initiatives may help credit-impaired borrowers to avoid abusive lending practices in the short term. For instance, the city of Boston is promoting a "Don't Borrow Trouble" message in TV and print media. A similar national campaign could also deliver the message to less creditworthy borrowers that consolidating credit card debt by borrowing against their home equity puts their homes at risk in the event of default.

[69] Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000.

2. Need for Housing Counseling

Background
Understanding the terms of a home loan – and taking the time to seek the best available loan – are basic steps that borrowers must take to avoid being victimized by unscrupulous market players. Because home loans represent the largest transactions that most families will ever undertake, and because they put at risk families' ownership of their homes, informed consumer behavior in the home mortgage market takes on even greater importance.

For even the most knowledgeable borrowers, the process of obtaining a home loan can be an intimidating one, filled with confusing terminology and complex tradeoffs between loan features. The task may be even more challenging for borrowers in the subprime market. People shopping for a loan in the subprime marketare more likely to have experienced problems understanding credit in the past, or they may have little to no experience with credit at all. Additionally, as detailed in Chapter IV, borrowers in the subprime market have less formal education on average than borrowers in the prime market.

The gap in borrower financial literacy and the need for increased counseling are supported by evidence that there may be a substantial number of borrowers in the subprime mortgage market that may qualify them for a prime mortgage loan. While some of these borrowers may face inadequate lender competition in their communities, others may not know that they could qualify for lower-cost credit.

What is the Problem?
Testimony at the regional forums from borrowers who received abusive loans revealed that, in almost every case, the borrower did not understand all the terms of the loan. This was often due in part to the misleading and aggressive tactics of the individuals who sold them the loans, who in many cases discouraged the borrowers from reading the relevant forms. Evidence indicates that in some low-income and predominantly minority neighborhoods, unscrupulous contractors and mortgage brokers go from door-to-door to find borrowers who need credit, selling them loans at exorbitant and/or unaffordable rates. At the same time, borrowers' lack of knowledge also highlighted a need for greater access to education about how to shop for a loan, and guidance as to what loan terms and conditions may/may not be to their advantage. Such education could help borrowers to identify and avoid predatory lending practices, and to find credit on better terms.

One option for educating consumers is to make pre-transaction counseling available. Consumers who obtain pre-transaction counseling may be less likely to enter into mortgage loans that they cannot afford. Current federal law requires pre-loan counseling for reverse mortgages provided under HUD's Home Equity Conversion Mortgage (HECM) program, due in part to the complex nature of these mortgages and the financial implications of the transaction.[70] In other situations, such as default on an FHA loan,

[70] 12 U.S.C. § 1715z-20(f).

lenders are required to provide borrowers with information about the availability of approved counselors, but borrowers are not required to seek counseling.

Pre-transaction counseling might be especially beneficial for high-cost loan borrowers. It would educate credit-impaired borrowers about home mortgage credit. It would also provide counselors an opportunity to review the terms of applicants' potential loans, and advise borrowers whether they have the financial capacity to enter into the loans (and whether the loans contain potentially abusive terms). Knowing that a borrower would seek counseling might deter less scrupulous creditors from attempting to entice the borrower into a loan that might not be to his/her benefit.

Challenges for Reform

The primary challenge to delivering pre-transaction counseling to high-cost loan borrowers is the additional cost of such services. If the government assumes the cost of funding counseling, through expanded HUD grants, that funding should be targeted toward the borrowers who need those services most. It may be reasonable to target counseling at those borrowers converting lower cost FHA or other subsidized loans to subprime loans, those entering into non-FHA reverse mortgages or balloon loans and those whose particular debt to income ratio demonstrates the possibility that income may be insufficient to meet a loan's demands. In addition, further inquiry should identify other ways to finance the costs of valuable counseling. While not all undereducated borrowers have high-cost loans, as a starting place, it is reasonable to target counseling resources at the most credit-impaired individuals borrowing against their home equity.

An expanded role for pre-transaction borrower counseling would require adequate resources dedicated to the effort. The existing base of affordable counseling available to borrowers is small. Through its Housing Counseling Assistance program, HUD will be able to provide counseling to 250,000 families in 2000 with the $15 million in funding dedicated to this program. Those benefiting from this counseling are by and large FHA homebuyers.

As explained later in this section, HUD and Treasury are recommending that HOEPA triggers be lowered to give protections to more borrowers of high-cost mortgages. Assuming that up to 20 percent of the subprime mortgage market could be covered under the lowered triggers, as many as 500,000 mortgage loans per year might qualify as high-cost.[71] While not all of these borrowers may need counseling, providing free counseling services to even a fraction of these borrowers would require that new resources be dedicated to the effort – for certifying counseling providers, and for hiring, training and retaining qualified counselors.

A corollary challenge is certifying the federal or state level that the entities providing the counseling are qualified to do so, and are following guidelines for providing the best possible homebuyer counseling.

Policy Recommendations

[71] Based on 1999 estimate of $160 billion in subprime mortgage originations and average loan size of $60,000 (source: Inside B&C Lending), and estimate that lowered APR trigger could cover 20 percent of subprime mortgage loans. See Section VI.C.1.

a) **Congress should require creditors to recommend certified home counseling to high-cost loan applicants**– Individuals who may become borrowers of the highest-cost loans may be most in need of pre-closing home counseling. Their credit may be more damaged, the implications of their taking the loan may be more significant, and they may be more at risk of having been exposed to abusive lending practices. Treasury and HUD believe that creditors should be required to give all HOEPA loan applicants a list of approved home counselors pre-closing, and to recommend that the borrower seek their services. Counselors must be certified by HUD, or its designees, USDA, Neighborhood Reinvestment Corporation or the appropriate state housing/financial regulators.

b) **Congress should fund the provision of additional HUD-certified home mortgage counseling** – The President's FY 2001 budget includes $24 million, a $9 million increase over funding for FY 2000, for the Housing Counseling Assistance program. This program provides comprehensive housing counseling services to homeowners, including pre-purchase and default counseling. In order to reach more borrowers who may be vulnerable to predatory mortgage lending practices, Congress should fully fund the President's FY2001 budget request in this area. Home counseling can play an important role in helping more borrowers to overcome the lack of information and bargaining power they may face in the higher-cost loan market.

c) **HUD will study ways to improve the counseling process.** HUD will study ways to maximize the effectiveness and use of counseling as a means for discouraging borrowers from taking on predatory loans.

3. Improving Disclosures and Remedies

a. RESPA/TILA Reform

1) Improving Disclosures

Background

As discussed above, RESPA and TILA seek to ensure, respectively, that consumers obtain timely and standardized information about the cost of real estate settlement services and the cost of credit. RESPA requires that within three days after applying for a mortgage loan, an applicant receive a HUD Special Information Booklet containing information to help him/her understand the nature and costs of settlement services and a Good Faith Estimate (GFE) of settlement costs specific to the borrower's loan application. (At this time the consumer also receives a RESPA initial transfer of servicing disclosure describing whether or not the loan's servicing may be transferred. The consumer also receives the TILA cost disclosure containing the APR and related information (home purchase only).

At settlement, or one day prior to settlement upon request, consumers receive another RESPA disclosure – the uniform settlement statement (the HUD-1) – that itemizes the final costs associated with both the loan and, if applicable, the purchase transaction. (If an escrow account has been established in

connection with the loan, under RESPA, the consumer receives an initial escrow account statement at closing or within 45 days after settlement.)

At or before consummation,[72] the consumer must receive a TILA disclosure. In the case of a refinancing or home equity loan, the consumer must receive the TILA disclosure for the first time at or just before closing. For certain home equity loans and refinancings, the consumer must also receive a notice of the right to rescind under TILA.

TILA requires disclosure, *inter alia*, of the Annual Percentage Rate (APR) and the finance charge on mortgage loans. Consumers must receive such a disclosure at least once before becoming obligated on a closed end loan. The finance charge is the cost of credit, disclosed to the consumer as a total dollar amount which includes, *inter alia*, the interest for the loan and other costs of the loan such as the origination fees, discount points and private mortgage insurance (PMI).

The APR for closed end credit is the finance charge, expressed and disclosed as an annualized percentage rate that equates mathematically the stream of payments made over the life of the loan to its present value (the amount financed). The APR is intended to provide a benchmark figure to enable the consumer to consider the real costs of credit and to compare loans before entering into a financial transaction.

What is the Problem?

Consumers are confronted with numerous disclosures during the real estate settlement process from the time of application to settlement. The Federal disclosures under RESPA and TILA comprise only 3-5 forms out of what can involve up to 50 documents, most required by the lender or possibly state law disclosures. The HUD/Fed Report recommended that the RESPA/TILA disclosure scheme be improved so that the information on these disclosures is simpler, more reliable and more timely to facilitate shopping by consumers, competition and lower settlement costs.

HUD has interpreted RESPA to require that the GFE cost disclosures bear a reasonable relationship to the actual charges at settlement. However, RESPA does not impose liability for an inaccurate or incomplete GFE, or even for failing to provide one. Thus, there are few incentives for creditors to incur costs to ensure compliance or increase accuracy. In some transactions, unexpected closing charges result from unanticipated events or circumstances. In other cases, however, actual charges are higher either because the estimates were prepared with insufficient regard for their accuracy, or were purposely understated. Many borrowers with high-cost loans that have been characterized as abusive have complained that final disclosures of settlement charges differed substantially from the charges originally described and disclosed on the GFE.

[72] TILA uses the term "consummation" (closing), while RESPA uses the word "settlement" for this report the terms are used interchangeably. Consummation (or closing) and settlement ordinarily occur simultaneously.

Reliability of Settlement Cost Disclosures

In order to make settlement cost disclosures more reliable and more useful to consumers, the HUD/Fed report recommended that creditors and others be given a choice between guaranteeing settlement costs and providing estimated closing costs that are accurate within a prescribed tolerance as follows:

Guaranteed Settlement Costs

One means of ensuring that consumers receive an accurate disclosure of loan closing costs is for creditors to guarantee them. The guaranteed-cost option has been advocated by various segments of the mortgage industry, including many of the nation's largest creditors. According to these creditors, consumers do not shop for individual settlement services. These creditors say that consumers are more interested in the overall price of settlement and that consumers would shop if all they needed to compare was a single guaranteed price for required settlement services. To arrive at a price, these creditors envision entering into volume-based contracts with affiliated and other settlement service providers for such services as appraisals, and "packaging" all the services needed for the loan. They believe that by doing so they will be able to secure discounts that could ultimately be passed on to consumers. Packaging services will keep costs down more effectively than RESPA's anti-kickback provisions, they say, because it will better enable consumers to comparison shop and will encourage creditors and others to package competitively and to pass along discounts. To facilitate guaranteed costs, fees paid and arrangements entered into by creditors and other settlement service providers could be exempt from Section 8 of RESPA so long as certain conditions were met. Those not meeting the conditions would remain subject to Section 8.

Guaranteed costs would capture all charges for creditor-performed services, such as application, underwriting, and origination. They would also include third-party fees for such items as surveys, appraisals, credit reports, and mortgage broker services. Official fees associated with filing or recording a mortgage or release which can be determined easily would be included. To ease compliance for creditors, charges included in the guaranteed costs could generally track TILA's definition of finance charges.

As with the finance charge, disclosed under TILA, not all fees would be captured in the guaranteed costs. For example, the cost of hazard insurance would not be included because the cost depends upon consumers' choices unrelated to the credit transaction (such as the purchase of additional personal property or liability coverage). Charges assessed in a comparable cash transaction, such as taxes, also would be excluded from the guaranteed amount (although they would continue to be disclosed as "other costs"). (Alternatively, HUD suggested in the Report that some costs excluded from TILA's finance charge such as for recording a deed could be included in the guaranteed amounts.) Some costs like per diem interest, which fit within the definition of finance charge, could be excluded from guaranteed costs because they are dependent on the borrowers' choice of settlement. These amounts as well as optional costs would, however, be separately disclosed.

RESPA Section 8 Relief

Under the guaranteed cost approach, HUD and the Board recommended that an exemption from RESPA Section 8 be offered to creditors who provide a package of settlement services at a guaranteed price. To carry out this purpose, HUD specifically recommended that an exemption from Section 8 should be made available to creditors and others that meet appropriate conditions including:

- Offering consumers a comprehensive package of the settlement services needed to close a loan;
- Providing consumers with a simple prescribed disclosure that gives the guaranteed maximum price for the package of services through closing; and
- Disclosing the rate and points offered to the consumer for the loan with the guarantee that rates and points would not increase subject to prescribed conditions (e.g., market changes in rates).

GFE Tolerance

A second way to provide consumers with more reliable information is to impose an accuracy standard on the GFE and establish remedies for noncompliance. The tolerance could be based on a percentage of the total estimated closing costs. If the actual costs exceed the sum of the estimated costs and the amount of the tolerance, the creditor would be held liable. Alternatively, the tolerance could be limited to certain categories of costs, for example, costs not within the creditor's control; charges imposed directly by the creditor would have to be accurate.

In either case, an increase in costs resulting from a consumer's choice would not count against the creditor in determining whether the total closing costs exceeded the tolerance. Neither would increased costs associated with specified changes to the transaction, such as an increase in the loan amount. But increased charges resulting from a creditor's decision (for example, to require a pest inspection after reviewing the appraisal) could not exceed the tolerance.

Adopting an accuracy standard for GFE disclosures would require little or no change to the current GFE form. The GFE would retain the item-by-item listing of those charges that consumers are expected to incur in connection with closing. Because the closing costs would not be guaranteed, there would be no relief from Section 8 liability.

Timing of Settlement Cost Disclosures

The generic disclosure, the special information booklet, is given at the time of loan application only for home purchase transactions. It may be more valuable to the consumer if it is given or offered earlier such as when the consumer first contacts a creditor, realtor or other settlement service provider. Additional booklets for other types of transactions would also be useful. A more significant problem is the timing of the specific cost disclosures. Currently, consumers receive the GFE within 3 days after application after they have paid an application fee and are committed to a loan provider.

HUD stated in the HUD/Fed Report that consumers need firm information early in the loan process so that they can compare the products of one settlement service provider with another. If consumers receive firm information but it comes too late in the loan process, they will not have the opportunity to

shop. Moreover, if the information is available but the consumer must pay a significant fee to obtain it, consumers may be disinclined to seek comparable information from multiple sources.

To determine the interest rate and points of the loan, the creditor generally must evaluate the consumer's creditworthiness. To determine the other costs to close the loan, the creditor must ascertain what services are needed and their price. Advances in technology make these determinations easier.

For the guaranteed cost approach, HUD encourages approaches where consumers arrange for credit information to be made available to creditors to enable them to make a guaranteed offer of interest rate, points, and closing costs early in the shopping process. While earlier disclosures are needed, in some cases (because of the consumer's credit or employment circumstances) there will be an inevitable "trade-off" between providing an early disclosure and providing a disclosure that is firm and complete enough to allow the consumer to shop and to protect against any later increase in cost. For such cases, timing requirements should be flexible enough to allow time to provide guaranteed information.

In the report HUD said consumers should be provided initial disclosures under the estimated cost approach as early as possible, as early as technology will permit.

Timing for subsequent settlement cost disclosures also could be improved. Currently, the consumer may have only one day before closing to review the settlement statement and discuss with the creditor any changes to the terms of the transaction. Material changes to the settlement charges may also not be readily apparent to the consumer. Additionally, consumers may not know that they have the right to the settlement information, since it need not be provided except at the consumer's request.

The APR

The APR was designed to provide consumers a uniform benchmark figure for credit costs, enabling them to compare the costs of different loans using one variable. While a single figure is easy to use, as presently designed, the APR excludes certain costs and does not therefore fully reflect the cost of credit. Congress has excluded, for example, title insurance, appraisal and document preparation fees. The Board has excluded application fees. Even if the APR included all costs, it would have limitations. For example, the APR is not designed to assist consumers in determining whether they should pay points up-front or bear the credit costs over the life of the loan, and it does not provide information on the financial impact of the amount of the monthly payment or down payment. In measuring the cost of any particular loan, the APR does not account for an early payoff.

Challenges for Reform

A better disclosure scheme could be useful to prime borrowers and many subprime borrowers as well. Improved cost disclosures of the type envisioned by HUD and the Board, including an improved APR, would simply and more reliably explain the costs of the loan. However, better disclosures alone will not be sufficient to curb abusive and predatory lending. Disclosure of costs does not, by itself, prevent unfair terms and other abuses. In fact, in many of the situations the Task Force studied, lenders and other participants in the loan origination process sought to ensure that the required written disclosures

were provided to borrowers and maintained in the loan files. Nevertheless, the borrowers testified that they often did not understand, and were unpleasantly surprised by, the costs or terms of their loans. The fact is that written disclosure requirements, without other protections, can have the unintended effect of insulating predatory lenders where fraud or deception may have occurred. Moreover, merely simplifying disclosures to those consumers unlikely or unable to shop for a loan (i.e., those borrowers who are older, infirm, less informed, or who, in fact, have fewer credit options available to them) cannot be expected to protect them from abuse.

Borrowers, particularly those in the subprime and high-cost mortgage market, could benefit from earlier, simpler, and more reliable disclosures. While such disclosures will not, in themselves, prevent abusive lending practices, in combination with the other recommendations in this report, improved disclosures could increase consumer awareness and enable borrowers to protect themselves with regard to one of the most important financial transactions they are likely to undertake. Improvements to and greater understanding of the APR could make it a more useful tool for consumers.

Policy Recommendations

a) **Simplify and improve the RESPA disclosure scheme as recommended by HUD and the Board provided that sufficient substantive protections against abusive lending practices are adopted** – HUD and Treasury support the recommendations in the HUD/Fed Report for statutory reforms to the Real Estate Settlement Procedures Act and the Truth in Lending Act to make information provided to consumers more reliable, more timely and more helpful in comparison shopping for all services required to finance a home. These recommendations must be considered as part of a broader package to provide additional consumer protections against abusive lending practices. More specific recommendations with respect to RESPA disclosures follow.

b) **Require Creditors to Guarantee the Closing Costs or Provide Firmer Good Faith Estimates**. The HUD/Fed Report recommended that creditors and others be given a choice between guaranteeing closing costs and providing estimated closing costs that are accurate within a prescribed tolerance Treasury and HUD recommend that in the context of a comprehensive package of reforms addressing abusive lending, the Report's recommendations that an exemption from Section 8 be granted to any entities offering a package of settlement services at a guaranteed price should be implemented. Consistent with HUD's recommendation, the exemption should be available to entities that offer consumers a comprehensive package of the settlement services needed to close a loan; provide consumers with a simple prescribed disclosure that gives the maximum price for the package through closing; and disclose the rate and points offered to the consumer for the loan, together with a guarantee that the rates and points will not increase, subject to prescribed conditions. If consumers are required to pay a significant up-front fee to the creditor in order to obtain firm information, it serves as a deterrent to shopping.

c) **Improve Timing for Generic Disclosures** - The Settlement Booklet could as easily be provided at application or given or offered earlier, such as when the consumer first contacts a creditor,

realtor, or other settlement service provider. Either change would simplify the disclosure scheme for creditors and would improve it by providing educational material to consumers earlier.

d) **Improve Timing of Initial Disclosures Under the Guaranteed Cost Approach and the Estimated Cost Approach.** HUD and the Board recommended that consumers be given initial disclosures as early in the shopping process as possible. Under a guaranteed cost approach, HUD stated that the initial guaranteed information about interest rate, points, and other closing costs should be given to consumers early enough so that they can shop and make informed choices--ideally at first contact with a creditor. To effectuate this, the agencies support approaches where creditors and others would have sufficient credit information to make a guaranteed offer early in the shopping process. Consumers should be provided initial disclosures under the estimated cost approach as early as possible. In the interest of promoting shopping, initial disclosures should be provided before the consumer pays any significant fees.

e) **Improve timing of subsequent disclosures at closing** – Several changes could help consumers avoid unexpected costs at closing including:

   i) **Providing the HUD-1 settlement statement earlier**– The time for providing the settlement statement could be moved from one day to three days before closing (this would track the current timeframe for providing the HOEPA disclosures). This would allow consumers to have information in time to review it before closing and make any necessary arrangements, or engage in discussions and negotiations with the creditor, if the terms of the transaction are different from what had been disclosed previously.

   ii) **Provide the HUD-1 settlement statement automatically** – The settlement statement could be provided automatically, rather than on request a day before closing, and the right to the information should be expanded to include any necessary re-disclosure of material terms such as the APR. This would eliminate any concern about consumers not knowing whether they have a right to the information.

   iii) **Require re-disclosure of charges on the HUD-1 that have changed materially** – The quality of closing cost information could be improved by encouraging that disclosures be accurate for all charges. In any instance where there is a material change from the disclosures provided three days before closing, re-disclosure at closing would be mandatory. It could be provided that a loan not be closed until the borrower has had three full days to consider the final loan disclosures.

f) **Enact essential reforms to the mortgage scheme if major reform is not enacted along the lines proposed** – Whether or not Congress chooses to enact major RESPA reform along the lines outlined in this section, an essential reform package should be enacted. This package should: (1) require dissemination of educational booklets to consumers for various types of loan transactions including refinancings and subordinate liens early in the home-buying and mortgage process; (2) combine and simplify the RESPA and TILA disclosure forms to be provided to consumers; (3)

coordinate the timing of RESPA and TILA disclosures to the greatest extent feasible; (4) require more accurate estimates of settlement costs using tolerances or similar mechanisms; (5) establish new remedies to protect consumers against nondisclosure or misdisclosure; and (6) new remedies for violations of RESPA.

g) **Require that originators disclose the borrower's credit score and index to the borrower, if requested, along with an explanation, where applicable, of the role that credit score plays in pricing the loan. Originators should be required to disclose the availability of this option to borrowers.** Mortgage originators should be required under RESPA to disclose this information to a borrower, if requested, along with an explanation that credit score is one of several factors used to price the borrower's loan, and that his/her credit score may vary depending upon the particular scoring system used by the lender.

h) **Retain and Improve the APR Disclosure Under TILA and Educate Consumers Further About its Significance** - The HUD/Fed Report recommended that that the APR be retained and improved by: (1) amending the law to require that the full costs of credit be included in the APR, (2) adding the interest rate on the note as a new disclosure, and (3) educating consumers regarding the significance of the APR. This "all in approach" would improve the APR's usefulness and at the same time lessen the compliance burden for industry. The disclosure of the note rate on the loan would facilitate consumer education and additional education could advise consumers of the APR's significance and relevant considerations for using the APR in light of an individual borrower's own circumstances.

i) **Undertake efforts to improve the entire mortgage disclosure scheme.** While simplification and streamlining of RESPA and TILA disclosures may improve the transparency of the mortgage process for borrowers, as described earlier in this section, these disclosures represent a fraction of the paperwork involved in closing a loan. HUD and Treasury will facilitate efforts by state governments and attorneys generals, the mortgage lending industry, and consumer groups to improve and simplify the information the consumer receives at or before closing.

h) Carry Out Efforts Under RESPA to Curb Lending Abuses. Absent statutory changes revising RESPA and the enactment of substantive protections against abusive lending, HUD will act to implement its existing authority under RESPA to improve the RESPA disclosure scheme to the extent feasible and will take such other enforcement and regulatory actions as are warranted to curb lending abuses.

2) Improving Remedies Under RESPA/TILA/HOEPA

Background

The remedies available under HOEPA, RESPA and TILA are described in Chapter V. above.

What is the problem?

There is concern that, as currently structured, the remedies available under RESPA, TILA and HOEPA

may be inadequate in a number of ways:

- *Insufficient Penalties and Damages Available* – The penalties that may be levied on parties who violate RESPA, TILA, or HOEPA, and the damages available under TILA and RESPA to borrowers harmed by these parties, may not be sufficient to deter unscrupulous lenders and brokers from engaging in practices that are illegal under these laws.

- *Inadequate Enforcement* – There may not be an adequate level of resources – at the federal or state level – dedicated to enforcing these laws, or to scrutinizing those market participants who may pose the greatest threat of violating them.

- *Inconsistencies and Differences Among and Within Statutes* – There are inconsistencies in the treatment of certain violations within RESPA: there are penalties for some egregious violations and not others. Additionally, there are differences between RESPA and TILA with respect to which parties and transactions are covered.

Policy Recommendations

a) **Congress should expand penalties for violations of TILA, HOEPA and RESPA, and increase damages available to borrowers harmed by such violations** – Changes to penalty and damage provisions in these statutes would enhance their deterrent effects, and allow borrowers to recover damages sufficient to compensate for their monetary losses:

   i) Increase the cap on statutory damages under TILA.

   ii) Authorize the FTC, with respect to HOEPA, and HUD, with respect to RESPA, to collect civil money penalties for violations of these statutes. Under both statutes, authorize civil penalties of at least $2,500 per violation.

   iii) Authorize a consumer who may have been harmed by a violation of RESPA to seek three times the amounts charged for any settlement service for which a violation is found. Also permit private causes of action for damages, specific performance, reasonable attorneys fees and costs, and any other relief as the court would deem just and equitable (e.g., enforcement of creditor responsibilities when tolerance level in GFE or combined GFE/TILA document is exceeded).

   iv) Add to RESPA penalties for servicers' negligent or intentional failure to make timely disbursements from escrow accounts, or to return escrow funds within a specified period of time after payoff.

   v.) Update the amount of the criminal misdemeanor penalty under Section 8 of RESPA so that it is consistent with similar consumer protection laws.

b) **Congress should provide for and encourage additional enforcement actions against creditors in violation of TILA, HOEPA and RESPA** – While federal agencies should devote increased attention to bringing actions against unscrupulous market participants, additional agencies at the state level should be given authority to enforce these statutes. The regulators should also use their examination authorities to detect and discourage predatory lending practices.

   i) Expand enforcement and injunctive authority of state agencies. Authorize state attorney generals, who have the power to enforce HOEPA, to enforce RESPA and TILA. Empower state banking commissioners and similar state agencies to enforce all three statutes.

   ii) Encourage the FTC to conduct investigations and examinations of lenders not otherwise subject to routine federal examination that originate high concentrations of high-cost loans, as determined by FTC.

   iii) Encourage Fed to conduct routine risk-based examinations of non-bank subprime lenders that are subsidiaries of bank holding companies to ensure safe and sound lending practices [see **VI.F** for further details].

   iv) Encourage state banking regulators to expand routine examinations of lenders not otherwise subject to routine federal or state examination that originate a significant number of high-cost mortgages.

c) **Congress should provide for greater consistency among statutes** – The statutes could be modified to provide more equal treatment of equal violations, and to cover similar parties and transactions:

   i) Harmonize coverage between RESPA and TILA/HOEPA regarding transactions/parties covered. Statutes should cover: transactions secured by one-to-four family residence; party to whom note is made payable. Mortgage brokers taking loan applications should be required to provide disclosures if the brokers, meet the same numerical tests (interms of numbers of loans) as other parties covered by TILA and RESPA.

   ii) Make statute of limitations period uniform, for all sections of RESPA – 3 years for private actions; 6 years for agencies – and treat each transaction as a separate violation.

B. Harmful Sales Practices

1. Targeting Minority, Female, Elderly and Low-Income Borrowers

Background

Predatory lenders often engage in "reverse redlining" – specifically targeting and aggressively soliciting homeowners in predominantly lower-income and minority communities who may lack sufficient access to mainstream sources of credit.

Predatory lenders often target people that are "house rich but cash poor," usually the elderly. Elderly homeowners are likely to have built up significant equity in their homes, the values of which may have appreciated substantially over time. Some elderly homeowners living on fixed incomes need cash for medical and other expenses, but lack an adequate understanding of the complexities of financial transactions, the usual cost of home repairs, or their own credit-worthiness. Some elderly are widows who may have little or no experience with finances prior to the death of a spouse. In addition, some elderly borrowers suffer from medical problems, diminished faculties, and isolation that impair their ability to understand loan terms and/or make them especially vulnerable to aggressive sales tactics. Frequently unable to perform household repairs, some elderly appear to be specifically targeted by predatory lenders engaged in home improvement scams. Because of these particular vulnerabilities, predatory lenders may charge these homeowners rates that do not correspond to their levels of risk, or convince them to take out loans that are larger than necessary or inappropriate for their needs.

What is the Problem?

In some low-income and minority communities, especially where competition is limited, predatory lenders may make loans with interest rates and fees significantly higher than the prevailing market rates, unrelated to the credit risk posed by the borrower. Some consumer advocates allege that these predatory lenders are engaged in "steering" – the practice of directing consumers to high rate/high cost loans based simply on their race or economic status and their lack of information, rather than based on their credit histories or credit risks.

Some targeted predatory lending may violate the fair lending laws, which prohibit discrimination on the basis of, *inter alia*, race, gender, national origin, and, in the case of the Equal Credit Opportunity Act, age. Testimony at the forums strongly indicates that many predatory lenders may have engaged in reverse redlining, or targeting abusive practices to protected groups. There is also some evidence that predatory lenders may charge different fees based on race or gender. One highly publicized case, Delta, involved allegations that African-American women were being charged more than other white borrowers with similar credit histories. The Department of Justice, HUD, and the FTC, in March 2000, entered a consent decree with Delta Funding Corporation, under the Fair Housing Act and the Equal Credit Opportunity Act, for charging higher fees to African American females than charged to similar white males. The consent decree also addressed claims that Delta had violated RESPA for allowing unreasonable broker fees on loans, and the HOEPA, for engaging in asset-based lending. United States v. Delta Funding Corporation, CV00-1872, (E.D. N.Y. March 20, 2000)

One obstacle to identifying practices of this kind is that most non-depository institutions are not subject to regular examinations for compliance with consumer or civil rights laws. However, these lenders are subject to the Fair Housing Act and other Federal civil-rights and consumer-protection statutes, that – with respect to these types of lenders – are enforced at the federal level by the Federal Trade

Commission, the Department of Justice, and HUD.

Finally, the concentration of predatory loans in low-income and minority neighborhoods also means that the effects of predatory lending, such as increased foreclosures, and vacant properties that diminish neighborhood safety and property values, are concentrated in these neighborhoods.

Challenges for Reform

Products should be priced based upon the potential borrower's individual credit and income characteristics, rather than upon the borrower's race, ethnicity, national origin, gender, age or residence in a minority neighborhood. Discriminatory pricing is already illegal under federal fair lending laws; however, these anti-discrimination cases can be complex and expensive, and as a result, are not frequently brought by individual borrowers or fair housing advocacy and civil rights groups with limited resources. Additional data and information is essential to assist the enforcement agencies in monitoring compliance with fair lending laws.

Policy Recommendations

a) **Congress should increase funding for enforcement of federal fair lending laws** – HUD's office of Fair Housing and Equal Opportunity has an established network of agencies, which it funds to conduct private fair housing enforcement and education under its Fair Housing Initiatives Program (FHIP). FHIP-funded agencies have contributed successfully to highlighting the significant problem of predatory lending in minority communities. Funds for these organizations who perform this work are extremely limited, however. In FY 1999, over 50 organizations had to share a pool of approximately $15 million. A set-aside of FHIP funds specifically to address predatory lending would help address the civil rights implications of minority neighborhoods targeted for these abusive lending practices.

b) **The Federal Reserve Board should consider using its authority under HMDA to require additional data disclosure** – Additional data would promote increased scrutiny of the kinds of loans being made, the kinds of borrowers receiving them, and any concentration of the loans in minority neighborhoods. See Section VI.D.1. The reporting of additional HMDA data elements as recommended in Section VI.D.1 would enhance the ability of HUD and other public and private fair housing groups to monitor mortgage lending to minorities and in low-income communities.

2. Loan "flipping"

Background

Loan flipping generally refers to repeated refinancing of a mortgage loan within a short period of time with little or no benefit to the borrower. Loan flipping typically occurs when borrower is unable to meet scheduled payments, or repeatedly consolidates other unsecured debts into a new, home-secured loan at the urging of a lender. Lenders who flip loans tend to charge high origination fees with each successive refinancing, and may charge these fees based on the entire amount of the new loan, not on just the incremental amount (if any) added to the loan principal through the refinancing. In addition, each refinancing may trigger prepayment penalties, which could be financed as part of the total loan amount,

adding to the borrower's debt burden.

One lender may be responsible for flipping a loan multiple times, or one or more mortgage brokers may engage in flipping a borrower's loan among different lenders. There is no existing federal-law prohibition on loan flipping per se. HOEPA attempts to curb the flipping of high-cost loans by restricting the terms that may make such loans unaffordable in the first place (such as prepayment penalties, short-term balloon payments and negative amortization), and that can also add to refinancing costs.

What is the Problem?

When a loan is flipped, a borrower refinances on terms that are not economically beneficial to him or her, due to the financing of points, fees and prepayment penalties that accompany such loans. A borrower may receive modest additional funds or a slight reduction in the interest rate, but the points and fees that accompany such transactions in the end make the total transaction more costly to the consumer. For example, reducing a borrower's monthly payment by a small amount, say $30 may cost the borrower thousands of dollars in up-front costs and interest over the life of the loan. The high fees derived from flipping attract unscrupulous originators who deceive borrowers about the true cost of the loan. Borrowers who have been victimized by predatory lending in the past often find themselves victimized yet again by flipping, when they are flipped into a new loan in an attempt to avoid default. Each time the loan is flipped, more equity is lost in the home. Several witnesses at the regional forums (including Ms. H. in Baltimore – see Section II for description) had refinanced more frequently than once every two years.

Moreover, some creditors may extend credit knowing that the consumer cannot afford the scheduled monthly payments or a large balloon payment due at the end of the relatively short loan term. This practice guarantees that the loan will have to be refinanced within a short time and thereby initiates a cycle of successive refinancings that either erode the borrower's equity, or in the worst cases, simply delay inevitable default while increasing the borrower's debt.

Challenges for Reform
Proposals to address loan flipping should promote borrower options and continued access to credit through loan refinancing. For instance, blanket prohibitions on financing points and fees on a loan refinance may discourage refinancing that is beneficial to the borrower.

Policy Recommendations

a) **Congress should require a borrower to derive a tangible net benefit from short-term refinancing into a HOEPA loan** – The crux of the problem with loan flipping is that the borrower derives no economic benefit from the refinanced loan. Therefore, lenders should be prohibited from refinancing any mortgage into a HOEPA loan within 18 months of the mortgage closing unless there is a tangible net benefit to the borrower. The Board should be given the authority to define an appropriate safe harbor where a net tangible benefit is assumed. In defining the safe harbor, the

Board should consider items such as a minimum necessary decrease in APR, or limits on points and fees charged for loans where the APR does not reflect such a decrease.

b) **Congress should specify that for refinances of any loan into a HOEPA loan within 18 months, creditors are permitted to charge points and fees only on the amount of the new advance, if any** – Evidence from the regional forums demonstrated that some borrowers were charged exorbitant fees upon refinancing into a high-cost mortgage, even if the creditor was adding only a small amount of principal to the existing mortgage. Creditors should be permitted to charge points and fees only on the amount of the new advance; this will prevent creditors who charge expensive origination fees from evading HOEPA by calculating points and fees as a percentage of the entire principal.

c) **Congress should restrict modification or deferral fees on HOEPA loans** – Unscrupulous brokers and lenders might seek to evade flipping restrictions by modifying the terms, instead of refinancing a borrower's loan and charging high fees to do so. If the modified loan is a HOEPA loan, creditors should be prohibited from levying modification or deferral fees, unless the APR on the loan decreases by 1.5 percentage points.

d) **The Federal Reserve Board should consider using its authority to define loan flipping as an unfair, deceptive or abusive practice** – HOEPA expressly grants the Board broad authority to issue rules to regulate unfair, abusive, or deceptive acts or practices. The Board is *required* by HOEPA to: (1) "prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair, deceptive, or designed to evade" HOEPA's provisions; and (2) "prohibit acts or practices in connection with...refinancing of mortgage loans that [it] finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower." 15 U.S.C. § 1639(l)(2).

The Board could adopt a rule forbidding refinancings within a specified time period that are not of tangible net benefit to the borrower. The Board should require that the determination of tangible net benefit take into account specified circumstances of the loan, such as the terms of the new and the refinanced loans, the cost of the new loan, and the ability of the consumer to repay the new loan. A safe harbor under the tangible net benefit test might be constructed by considering the factors outlined in recommendation (a).[73]

[73] The HOEPA Conference Report acknowledged the testimony Congress had heard "concerning the use of refinancing as a tool to take advantage of unsophisticated borrowers. Loans were 'flipped' repeatedly, spiraling up the loan balance and generating fee income through the prepayment penalties on the original loan and fees on the new loan." Conf. Report, No. 103-652, 103d Cong., 2d sess. (Aug. 2, 1994), p. 162. Importantly, the report declared that "[s]uch practices may be appropriate matters for regulation under this subsection." *Id.*

3. Lending to Borrowers without the Ability to Repay: Asset-Based Lending

Background

A creditor's decision on whether to originate a mortgage loan should be guided by his/her assessment of the borrower's ability to repay the loan from liquid sources (e.g., income and non-housing assets). Other factors, such as the overall size of the loan, the borrower's credit history and the value of the collateral play into the decision as well. There is widespread concern, however, that some unscrupulous creditors are making loans to borrowers who clearly cannot afford to repay them.

The motivation for lending to a borrower who cannot afford to repay the loan may vary. For some unscrupulous brokers, the incentive to originate such a loan may be the potential for fees, which are levied in direct proportion to the loan's size. In some predatory lending cases, brokers may misrepresent a borrower's income on the loan documents and the lender may have inadequate controls to detect the problem. For unscrupulous lenders, the attraction may be the equity the borrower has in his/her home. Predatory lenders may dislodge long-standing residents and provide an opportunity for resale at a high profit.

HOEPA prohibits creditors from engaging in a "pattern or practice" of making high-cost mortgages to consumers based on the consumer's collateral without regard to the borrower's ability to repay (based upon the consumer's current and expected income, current obligations and employment status). This type of lending is often referred to as "asset-based lending." Although a borrower may be only seeking to forestall losing his or her home as the result of not being able to meet the monthly payments, his/her burden of proof under HOEPA is to establish that such asset-based lending constitutes a pattern or practice of the originator.

What is the Problem?

In the regional forums, HUD and Treasury heard testimony from numerous borrowers with loans that they clearly could not afford at the time of origination. In many cases, these loans were made to older borrowers living on fixed incomes, replacing low-cost, low-principal loans these borrowers had previously held. The increases in these borrowers' monthly payments caused by the new loans were clearly too much for these borrowers to afford on their fixed incomes. In some cases, the monthly payments equaled or exceeded the borrower's monthly income. Some of these loans were originated due to a combination of deceptive mortgage broker tactics (such as falsifying borrower income on the application) and lender underwriting systems that are not adequate to detect these tactics.

Lending with no reasonable expectation of repayment other than recourse to the underlying collateral is not a practice engaged in by safe and sound lenders.[74] Similarly, responsible mortgage brokers do not broker loans to borrowers where the borrower can't repay. Asset-based lending can have significant social implications, particularly in home-secured transactions. Borrowers not only risk losing their homes to foreclosure, but also their accumulated equity in their homes, a major source of wealth for many Americans. In addition, foreclosure has the potential to destabilize neighborhoods by generating vacant properties.

One potential barrier to fully addressing the problem of lending to borrowers without regard to their ability to repay is the interpretation of HOEPA's "pattern or practice" requirement. The one court to address the meaning of this requirement in the HOEPA context in a published opinion has ruled that to prove such a pattern or practice requires "an empirical analysis of a representative sample of all of the lender's loans."[75] It can be difficult for an individual to obtain the evidence necessary to satisfy this standard, which may chill individual attempts to obtain relief. Elimination of the pattern or practice standard would allow consumers to obtain redress solely on the factual circumstances of their own loan.

Challenges for Reform

If the pattern or practice standard were eliminated, lenders would be required to assess each HOEPA loan applicant's ability to repay the loan. It would be important to preserve the lender's flexibility to formulate its own underwriting standards and to accommodate borrowers in unique situations. Imposing standards that are too vague or too stringent could directly limit access to credit for many subprime borrowers.

Policy Recommendations

a) **Congress should repeal the "pattern or practice" requirement under HOEPA and create a safe harbor** – The "pattern or practice" requirement sets an unreasonably high bar for an individual hoping to demonstrate that the lender made a loan that she could not afford. The requirement should be repealed, but a safe harbor created. The safe harbor should be structured to give a lender appropriate flexibility to consider a borrower's alternative sources of income in its underwriting process:

   i) Establish a conclusive presumption that a loan in which the borrower's total monthly debt payments-to-monthly income ratio is less than 50 percent is NOT asset-based, unless his/her household residual income did not meet or exceed the guidelines established for purposes of housing loans guaranteed by the U.S. Veterans Administration, or the borrower was already in

[74] See Statement of John D. Hawke, Jr., Comptroller of the Currency, before the Committee on Banking and Financial Services, US House of Representatives, May 24, 2000.

[75] Newton v. United Companies Financial Corp., 24 F.Supp 2d. 444, 457 (E.D. Pa. 1998). This appears to be a stricter interpretation than courts usually have given the statutory "pattern or practice" standard in civil rights cases. See, e.g., United States v. Balistrieri, 981 F.2d 916, 929-30 (7th Cir. 1992).

serious delinquency or default on an existing loan.[76] The Board should be given the authority to adjust the 50 percent threshold within a five (5) percentage point tolerance.

ii) Additionally, the Board should define the criteria that creditors must consider and processes creditors must follow in originating high-cost mortgages. At a minimum, the Fed should require that lenders consider and document in the loan file borrower income, employment, other (non-home) financial assets, credit history and credit score. A finding that a creditor failed to consider these criteria and follow these processes would constitute a violation of HOEPA. The Board should also be required to alter or eliminate the safe harbor if the Board finds that creditors are making loans without regard to the borrower's ability to repay.

b) **The Federal Reserve Board should consider using its authority to place new restrictions on asset-based lending** – HOEPA grants the Board broad authority to "issue such regulations as may be necessary to carry out" HOEPA. P.L. 103-325 § 155, 108 Stat. 2190, 2197 (Sept. 23, 1994). Under this authority, the Board could address asset-based lending by amending its regulation implementing the provision of HOEPA that prohibits lenders from "engag[ing] in a pattern or practice of extending credit to consumers under [HOEPA-covered mortgages] based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment." 15 U.S.C. § 1639(h). At present, the regulation forbids a pattern or practice of extending credit based on collateral if the consumer "will be unable to repay." 12 C.F.R. § 226.32(e)(1).

The Board could clarify that a "pattern or practice" does not have to be proved by a statistically significant, random sample, and that the phrase should be given the same meaning that the same phrase in the Fair Housing Act (FHA), 42 U.S.C. § 3614, has been given. The courts have ruled that the FHA pattern-or-practice requirement can be satisfied by proof of several instances of a prohibited conduct in a relatively short period of time.[77]

The Board could also propose a rule interpreting the pattern or practice requirement as creating two, alternative bases for demonstrating a violation of the statute. Such a rule could clarify that a practice may be proved by evidence of a lender policy of asset-based lending even if there were not sufficient evidence to prove a pattern.

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[76] See 38 C.F.R. 36.4337(e).

[77] The only court to have interpreted the "pattern or practice" requirement of HOEPA in a published decision has given it a stricter interpretation than the courts have given the same requirement of the Fair Housing Act. As it is used in HOEPA, the phrase has been interpreted by a district court to require proof of "a representative sample of [the lender's] loans analyzed empirically." Newton v. United Companies Financial Corp., 24 F. Supp. 2d 444, 457 (E.D. Pa. 1998) (holding proof inadequate despite evidence of asset-based lending by defendant to several plaintiffs). Although the Fair Housing Act's pattern-or-practice requirement cannot be satisfied by isolated instances, it *can* be satisfied by proof of several examples of such conduct, at least if they occur within a relatively short period. See, e.g., United States v. Balistrieri, 981 F.2d 916, 929-30 (7th Cir. 1992) (holding evidence of discriminatory treatment of five black testers over a little more than a month sufficient).

4. Mortgage Broker, Home Improvement Contractor and Appraiser Misconduct

Background
Federal laws such as RESPA and TILA govern the disclosures regarding fees that mortgage brokers must make to borrowers. Most regulation of mortgage broker, home improvement contractor and appraiser practices, however, traditionally occurs at the state level. Table 6.1 below shows the characteristics of state regulation of mortgage brokers and home improvement contractors.

Table 6.1. State Regulation of Mortgage Brokers and Contractors

Participant	Type of Regulation	# of states
Mortgage broker	Licensing/registration	39
	Fee/proof of net worth	29
	Competence test	6
Home improvement contractor	Licensing/registration	30
	Proof of net worth	14
	Competence test	21

Sources: 75 Wash U.L.Q. 1737; *Home Improvement Contractors: A Model State Law*, AARP Public Policy Institute, 1999.

What is the Problem?
Nearly all of the borrowers who gave testimony at the regional forums were taken advantage of not only by a lender but also by an unscrupulous mortgage broker and/or a home improvement contractor who solicited them directly, often in their homes:

- *Aggressive Tactics* – Based upon reports from consumer advocates, a very large number of third parties that participate in the origination of predatory loans employed aggressive marketing and solicitation tactics. In some instances, aggressive sales tactics may rise to the level of fraud or illegal deception, such as misleading or incomplete disclosures of loan terms, "bait and switch" tactics, and improper solicitation of fraudulent gift letters and co-signers who cannot realistically be considered as part of the borrower's ability to repay the loan. In other cases, aggressive practices range from traditional "fast-talking," such as misleading the potential borrower that time to consummate the loan is limited, to providing "expedited services" such as home delivery of loan documents or transportation to a lender's office that are in fact, simply designed to close the deal before a borrower has time to reconsider. These practices interfere with, and in some cases, deprive borrowers of the opportunity to understand the terms of a proposed loan.

- *Neighborhood Targeting* – There were many anecdotes of unscrupulous contractors canvassing inner-city neighborhoods, where housing stock is older and often in need of repair, offering to refinance unsuspecting borrowers' mortgages to fund home improvement projects. Borrowers testified that the work done by these contractors was shoddy, incomplete, and sometimes commenced before the loan was closed (giving unscrupulous lenders the opportunity to modify the

loan terms to the borrower's disadvantage once work had begun). Lenders themselves may also engage in such targeting. Some low-income and minority neighborhoods in Baltimore are blanketed with posters for subprime loans, such as those that ask: "Got an FHA/VA Loan - Need Cash?" These advertisements have the potential to mislead consumers into believing that there is some affiliation between the lender and these federal agencies, when in fact there is not.

- *Excessive and Concealed Fees* – Unscrupulous brokers may receive unreasonably high compensation as a result of inflated up-front fees paid by borrowers and indirect fees paid by lenders. According to the testimony of many borrowers at the regional forums, these fees may constitute more than 10 percent of the loan amount. Brokers and lenders may also structure fees so that they are less transparent to the borrower, through the use of mechanisms such as yield-spread premiums, which may disguise the true cost of credit.[78]

- *Outright Fraud* – In inner-city Baltimore and other cities, some appraisers, lenders, investors and real estate brokers have colluded in abusive lending in the purchase money mortgage context. One practice, commonly known as "asset flipping" frequently entails the purchase of dilapidated properties by a development company and/or contractor, which performs cosmetic repairs and then places the properties on sale at a dramatically increased price justified by a fraudulent appraisal. Parties to these scams are aware of the fraud, but allow the borrower to take on far more debt than the property is actually worth. In the FHA context, predatory brokers and lenders that collaborate in this type of fraud have incentives to structure loans that the consumers cannot afford. For these mortgages, the lender can collect on the FHA insurance after foreclosure, and then begin the flipping process all over again with a new buyer, another set of origination fees, and potentially, another FHA payout.

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[78] Yield-spread premiums compensate a mortgage broker for putting a borrower into a home loan with a higher interest rate than the par rate established for the purchase of the loan by the lender. As explained above, a yield spread premium is a payment a mortgage broker receives from a lender based on the interest rate and points of the loan the broker entered into with the borrower as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a par rate of 7.75% and no points).The broker receives payment for the value of the extra increment of interest, while the lender receives the higher rate of interest over the life of the loan. While yield spread premiums must be disclosed under RESPA, the form of the disclosure may not adequately communicate the nature of the fee to the borrower (on the GFE and HUD-1, the yield spread premium is often abbreviated "YSP").

RESPA Statement of Policy 1999-1 sets forth HUD's position on the legality of lender payments to mortgage brokers in connection with federally related mortgage loans under RESPA. HUD stated that such payments are not illegal *per se*. In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been performed does not itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test HUD stated that it believes that total compensation should be scrutinized to ensure that it is reasonably related to goods, facilities or services performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, including those that are derived from the interest rate paid by the borrower, or a combination of some or all.

State oversight of brokers, appraisers and contractors is uneven, and in some cases non-existent. Even if state enforcement in these areas were heightened, interstate problems might remain. Legal aid attorneys at the regional forums testified about unscrupulous, thinly capitalized brokers, contractors and lenders who abused consumers, declared bankruptcy, moved to new states and began operating there under different names.

Challenges for Reform

Imposing additional regulations on brokers, contractors and appraisers will impose costs on all of these parties, not just those who engage in abusive practices. New regulations should seek to protect vulnerable consumers, while not imposing undue compliance burdens on honest market participants.

The FHA and other federal programs may provide a mechanism for regulating some brokers, contractors and appraisers as a condition of participation in these federal programs; however, such strategies would not reach parties that do not participate in the these programs. The reforms that HUD has proposed to address fraud by brokers and appraisers in the FHA context, particularly in connection with property flipping, are outlined in Section IX.A.2.

In all other respects, the regulation of brokers, contractors and appraisers is primarily a matter for state law. Any policies developed at the federal level must recognize the traditional authority of states to regulate the registration, licensing, and practices of these market participants. At a minimum, efforts to increase financial literacy, discussed in Chapter VI.A. will make borrowers more resistant to aggressive, and misleading sales tactics. In addition, the reforms discussed below would help to protect prospective borrowers against being pressured or misled into loans with oppressive terms.

Policy Recommendations

Federal Actions

a) **The Federal Reserve Board should consider using its authority to prohibit blatantly abusive practices by lenders and third parties** – Under HOEPA, the Board is *required* to define unfair and deceptive practices. The Board should use it authority to prohibit practices including: (1) forging signatures or obtaining signatures on blank documents; (2) falsifying loan applicants' income or the appraised value of the property; (3) overcharging consumers with illegitimate fees; (4) selling credit life or disability insurance to consumers who do not qualify for the insurance, or writing policies for amounts that exceed the consumer's indebtedness; (5) fraudulently conveying title in the property to third parties to facilitate the diversion of loan proceeds; (6) employing bait and switch tactics; (7) general fraud and misrepresentation; and (8) evasion of HOEPA.

b) **The FTC should increase federal investigations of fraudulent trade practices** – Under its unfair and deceptive trade practices authority, the FTC may bring suit against these market participants for many of the practices outlined above. However, to bring actions against the growing number of unscrupulous actors in the marketplace, the FTC requires additional staff resources. Congress should fund the FTC at the level requested in the President's FY 2000 budget

to ensure that adequate resources may begin to be devoted to these enforcement activities. In the future, the federal government should pay increased attention to the role that the FTC can play in deterring abusive lending practices.

c) **Congress should require brokers to document the appropriateness of the loan for the borrower and disclose this information** – Just as lenders have an obligation to assess the borrower's ability to repay the mortgage loan (see Chapter VI.2.d), mortgage brokers should assume similar responsibilities in their origination processes. For HOEPA loans, a mortgage broker should be required to document in a plain English disclosure: (1) the information he/she considered in approving the loan, including the borrower's income, credit score, debt, and, as appropriate, other financial assets; and (2) all fees received or to be received by the broker in connection with the mortgage transaction. The broker and the borrower should be required to review and sign this document three (3) days prior to closing. This requirement is similar to a requirement imposed on securities brokers before they effect transactions in high-risk "penny stocks" for certain customers. 17 C.F.R. § 240.15g-9(b).

d) **Congress should expand the definition of "creditor" under HOEPA** – Expanding the types of parties who can be penalized for HOEPA violations could serve to stem abusive practices in the subprime market. In particular, defining a "creditor" to include any individual who controls the lending practices of a company would broaden the universe to include thinly capitalized entities that dissolve or declare bankruptcy to avoid liability under HOEPA. The President recommended this expanded definition in his May 1999 consumer protection plan.

e) **Congress should establish lender liability for illegal broker/contractor acts** – Lenders should be made liable for broker or home improvement contractor malfeasance if such party acts as the lender's agent, has an ongoing financial relationship with the lender, or if the lender knew, or should have known, of broker or contractor malfeasance.

f) **Congress should require a licensed or certified appraiser to appraise properties that are to secure a HOEPA loan** – Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, properties with a value above $250,000 must be appraised by a licensed or certified appraiser. Since many of the abuses occurring in Baltimore and other urban markets involve high-cost loans and fraudulent appraisals, it would be beneficial to introduce qualified appraisers into this arena. The requirement for a licensed or certified appraisal should be extended to a property that is intended to secure a HOEPA loan.

g) **The FFIEC should encourage development of education and qualifications for Urban Appraisers** – Because of the heterogeneous nature of housing stock – and neighborhoods generally – in the inner city, special expertise may be needed in order to issue a high-quality appraisal of a property located there. The Federal Financial Institutions Examination Council (FFIEC) maintains an Appraisal Subcommittee to provide monitoring and funding (on a line item basis) to the Appraisal Foundation. The Foundation is authorized by Congress to establish and maintain the minimum standards for appraisers and appraisal practice. The FFIEC could fund an Urban Appraiser effort

that would develop minimum requirements (experience and education) for appraising inner-city properties, create standardized tests that include fair lending and subsidized housing material, and market literature on appraiser selection to consumers.

State/Local Actions

a) **The federal government should foster development of model state laws for registration, licensing and regulation of mortgage brokers, home improvement contractors and appraisers** – While the details of model state laws for each of these market participants would vary, each could include provisions regarding: licensing and registration, bonding and insurance, prohibited acts and contract provisions, recovery fund, enforcement agency, penalties (criminal and civil), hearings and private rights of action.[79] The federal government should foster development of these laws.

b) **The federal government should encourage and work with state/local task forces to combat predatory lending** – Enforcement efforts at the state and local levels can help to prevent many abusive practices in this marketplace, especially among smaller-sized market participants like brokers and contractors. The federal government should encourage the activities of these local task forces, and the federal agencies should provide advice and technical assistance where appropriate.

c) **States should increase prosecution and enforcement of state consumer protection laws governing fraudulent and aggressive sales practices** – Through the regional Task Force forums, HUD and Treasury learned that the exact nature of abusive lending practices often varies from community to community. State regulators and enforcement agencies should give increased focus to the growing problem of fraudulent, unfair and deceptive practices in the mortgage lending market, as they may be best equipped to understand the roots of the problems that exist within their own borders.

d) **States should cooperate in the creation of national computerized registries of mortgage brokers and home improvement contractors** – Such databases would include information on individual brokers and contractors respectively, as well as complaints and actions taken against the registered parties. Maintaining this information in a centralized location may reduce opportunities for an unscrupulous actor to "close up shop" in one state where it has been engaging in abusive practices and to start business in another state under a different name. Such action could build on the National Association of Mortgage Brokers-led effort to establish a national registry of its mortgage broker members.

[79] For example, in a 1999 report, the AARP developed a model state statute for home improvement contractors.

5. Lenders' Incomplete Reporting to Credit Bureaus

Background
Currently, the consumer reporting system used by lenders operates on a voluntary basis. Mortgage lenders enter into agreements with credit bureaus to report borrower payment information and to access borrower credit history.

What is the Problem?
There is evidence that, in an effort to keep good customers, some subprime mortgage lenders have adopted a policy of not reporting to consumer reporting agencies their borrowers' credit lines, high balances or loan payment behavior. When this information is not reported to the national credit bureaus, borrowers may not be able to establish or repair their credit history. Consequently, borrowers who deserve more favorable, more competitively priced loans will not be in a position to learn about or qualify for such loans from other market participants. The business reason for not reporting this information to the credit bureaus is clear – less scrupulous lenders wish to keep customers captive and not reveal business opportunities to their market competitors.

In addition, non-reporting could have broader safety and soundness implications for the banking industry. Lenders that rely on credit bureau reports have incomplete information on credit applicants and incomplete prescreened lists which could skew lending decisions and possibly compromise the integrity of risk management processes.

Policy Recommendations

a) **Congress should amend the Fair Credit Reporting Act (FCRA) to require lenders who regularly report to a credit bureau to report full-file payment information for borrowers** – FCRA should be amended to require lenders to provide borrowers' full payment histories for all mortgage products. The only reason for lenders not to report on-time payment information is to trap borrowers in more expensive products than they would otherwise qualify for, clearly an abusive practice.

C. Abusive or Deceptive Terms and Conditions

1. Limited set of borrowers benefit from HOEPA's protections

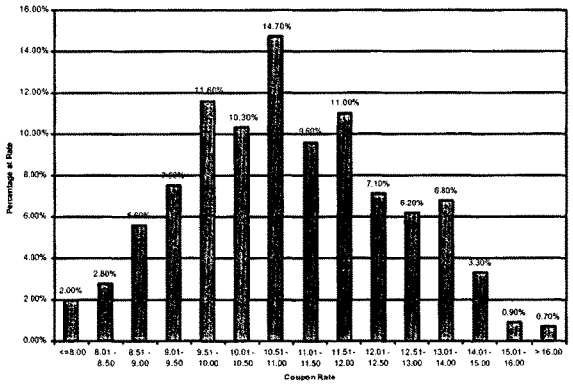
Background
As discussed in Chapter V, HOEPA defines a set of "high-cost" mortgage loans, for which certain terms and conditions are restricted and heightened disclosures are required. HOEPA applies to home mortgage refinance and closed-end home equity loans, but not to purchase money mortgages or home equity lines of credit.

What is the Problem?

HOEPA's disclosures and restricted loan terms and conditions are intended to increase the amount of information available to consumers about a set of high-cost loans, and to protect them from potentially abusive terms such as short-term balloon payments and negative amortization. However, evidence suggests that due to the high thresholds that a loan must exceed in order for HOEPA to apply, very few consumers in the subprime market benefit from the law's provisions. Anecdotal evidence, including testimony at the Task Force forums, also suggests that abuses often occur in loans just below the HOEPA triggers.

The available data on interest rates charged in the subprime market indicate that a very small percentage of loans currently exceed the HOEPA APR threshold. Figure 6.1 shows coupon rates for subprime mortgage loans originated from July through September 1999. With the yield on 30-year Treasury securities averaging 6 percent during this period, only the 0.7 percent of subprime loans with an interest rate greater than 16 percent would have met the HOEPA APR threshold. Data on points and fees charged on mortgage loans in the subprime market are not available.

Figure 6.1. Very Few Subprime Loans Exceed HOEPA's Interest Rate Threshold



Source: MIC LPS, data from 1999Q3

The HOEPA fee threshold excludes certain "reasonable" fees paid to third parties, and mortgage broker fees that are not paid directly by the consumer. There is concern that this exception in some cases may create room for abuses, such as substantial "indirect" compensation to mortgage brokers through yield-spread premiums.[80]

[80] In a commentary accompanying its proposed rule implementing HOEPA, the Fed stated, "The Board believes that Congress intended a very broad application of the term 'compensation,' including, for example, amounts paid to brokers by creditors (in addition to amounts paid by consumers)." 59 FR 61832, 61834 (December 2, 1994). The Board's Staff Commentary, however, has been interpreted to exclude yield spread premiums from the points-and-fees trigger. See Commentary ¶ 32(b)(1)(ii).

Challenges for Reform

The primary challenge in opening up additional loans to HOEPA's restrictions is ensuring that an adequate amount of credit still flows to borrowers who cannot qualify for lower-cost loans. By increasing required disclosures and restricting certain terms, HOEPA may increase some creditors' costs, and many might choose to exit entirely the business of originating these loans if the triggers were lowered. Bringing more loans under HOEPA, however, would require lenders who remain in the market to provide more transparent credit to their most credit-impaired borrowers.

Policy Recommendations

a) **Congress should lower the HOEPA APR thresholds to 6 percentage points above Treasury securities for first liens and 8 percentage points above Treasury securities for second liens** – So that more loans would be subject to HOEPA's disclosures and restrictions on abusive practices, the APR trigger should be lowered. The impact of lowering the interest rate trigger by one or more percentage points can be estimated from Figure 6.1.

   The evidence from Figure 6.1 suggests that lowering the interest rate threshold to 6 percentage points above comparable Treasury securities for first liens, and 8 percentage points above comparable Treasury securities for second liens, could capture the most credit-impaired borrowers in the subprime mortgage market. Most of the testimony on abusive lending practices at the HUD-Treasury Task Force's regional forums pointed to problems in the home refinance (first lien) market, indicating that lower triggers in that market may be appropriate. Lowering the APR trigger to these levels would provide HOEPA's protections to about one in five subprime borrowers based on interest rate. Evidence indicates that this may closely track the portion of C-risk and D-risk borrowers in the subprime market.[81]

b) **Congress should expand the definition of high-cost loan under HOEPA to include high-cost purchase money mortgages, reverse mortgages, and home equity lines of credit** – Although the subprime market traditionally focused on home equity loans, an increasing share of subprime loans are being originated for home purchase. Expanding HOEPA to apply to purchase money mortgages and home equity lines of credit would grant equivalent consumer protections for homebuyers and homeowners accessing the equity in their homes, and place subprime lenders that specialize in home purchase and subprime lenders that specialize in home refinance/home equity on a more equal footing. Reverse mortgages are also exempt from HOEPA rules for high-priced loans, but are subject to an alternative disclosure scheme. As the population ages, the demand for reverse mortgages will likely increase, and high-cost reverse mortgages may require additional protections. HUD and Treasury thus recommend that the definition of "high cost" mortgages be expanded to apply to purchase money mortgages, to open and reverse mortgages (recognizing that modifications will have to be made for reverse mortgages, e.g., restrictions against negative amortization should not apply for these mortgages).

[81] Mortgage Information Corporation, *The Market Pulse*, Web edition, Winter 2000.

c) **Congress should expand the definition of points and fees included in the HOEPA fee threshold** – Including points paid if any to reduce the interest rate and any additional fees paid to third parties in the HOEPA fee threshold would increase transparency to consumers while reducing the potential for creditors to levy exorbitant indirect compensation charges on high-cost loans. Fees considered towards the threshold should include: (1) fees and amounts imposed by third party closing agents (except payments for escrow and primary mortgage insurance); (2) prepayment penalties that are levied on a refinancing; and (3) all compensation received by a mortgage broker in connection with the mortgage transaction, whether or not the mortgage broker originates the loan in his/her own name in a table funded transaction. If single premium credit insurance (and similar products) is not prohibited altogether (see VI.3.b), its costs should also be counted toward the HOEPA fee threshold.

d) **Congress should lower the HOEPA fee threshold to the greater of 7 percent of the loan amount or $1,000** – Combined with revising the HOEPA fee trigger to include almost all costs of credit, lowering the fee trigger by a modest amount would expand HOEPA's protections to more borrowers in the subprime market. At 7 percent, the trigger should be sufficient to allow originators to recover all costs for originating smaller sized loans as well.

e) **Congress should consider the fully-indexed spread for purposes of the HOEPA APR trigger** – The HOEPA APR trigger is based on the rate of the loan at closing. However, a substantial portion of mortgages in the subprime market – 23 percent in the third quarter of 1999 – are adjustable rate. If the loan carries a low fixed rate for the first two years, but will shift to an adjustable rate plus a significant spread thereafter that exceeds the HOEPA interest rate threshold, it is important that the consumer receive the same disclosures and protections against potentially abusive terms that he/she would receive under HOEPA. To accommodate these loans under HOEPA, the APR considered for purposes of the threshold for adjustable-rate mortgages should take into account the fully-indexed spread – the spread above comparable Treasury securities once the initial or "teaser" rate has expired. Similarly, some predatory loans may involve low interest rates followed by loan terms that set the amount owed as a function of the value of the home. Congress should also set the HOEPA triggers to take account of such loans.

f) **The Federal Reserve Board should consider using its authority under HOEPA to lower the APR trigger** - HOEPA expressly grants the Board authority to expand HOEPA's coverage by lowering the APR trigger and broadening the class of costs counted toward the fees trigger. The Board is authorized to lower the APR trigger (which is now 10 percentage points over comparable Treasury securities) to as low as 8 percentage points over such securities, 15 U.S.C. § 1602(aa)(2). According to recent data, an estimated five (5) percent of subprime mortgage loans have interest rates that would exceed such a threshold and, therefore, come under HOEPA were the Board to make such a change.

g) **The Federal Reserve Board should consider using its authority under HOEPA to include additional fees in the HOEPA points-and-fees trigger** – HOEPA expressly grants the Board

authority to include in the points-and-fees trigger, in addition to charges enumerated in the statute, "such other charges as the Board determines to be appropriate," 15 U.S.C. § 1602(aa)(4)(D). There are two types of charges that the Board should specifically consider counting toward the HOEPA points-and-fees trigger:

i) ***Single Premium Credit Insurance and Similar Products*** – As explained in the following section, single premium insurance products are thought to injure consumers because they unnecessarily increase consumers' total borrowing costs, and disguise the true cost of the insurance on a monthly basis. Evidence also suggests that some lenders may "pack" insurance into the mortgage loan without the borrower's knowledge.[82] If the sale of this type of product is not prohibited altogether, either through legislation or regulation, the Board should strongly consider including it for purposes of calculating the HOEPA points-and-fees trigger. Congress intended that, pursuant to the Board's authority to add "other charges as [it] determines to be appropriate," the Board could include in the points-and-fees trigger the cost of single premium credit insurance. According to the Conference Report, "The Board has authority to include additional charges in calculating the triggers, *such as credit insurance premiums*, if evidence establishes that such charges are being used to circumvent or evade the provisions of this legislation." Conf. Report, No. 103-652, 103d Cong., 2d sess. (Aug. 2, 1994), at p. 159 (emphasis added).[83] The evidence that creditors may be "packing" insurance into mortgage loans and earning significant commissions, presented at the HUD-Treasury regional forums, suggests that these products may indeed be used to evade HOEPA.[84]

   The Board may also choose to consider including other types of financed, lump-sum products, including debt cancellation or suspension agreements, in the points-and-fees trigger.[85] These alternative products may be even more expensive than credit insurance, the price of which is regulated in some states.[86] Anecdotal evidence indicates that, as with single premium credit insurance, creditors may use these products to generate significant fee income while making loans below the HOEPA triggers. Should the Board choose to include in the HOEPA points-and-fees trigger the costs of single premium credit insurance, but not the costs of other lump-sum products, creditors may shift their sales activity toward these other products, with the result that HOEPA will not protect more consumers.

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[82] According to an industry-funded study that considered consumer loans, which typically involve much less paperwork than mortgage loans, almost 40 percent of borrowers either did not know that they had received credit insurance or were not told that it was optional. *Credit Insurance: Rhetoric and Reality*, Credit Research Center, Krannert Graduate School of Management, Purdue University, 1994.

[83] A Senate committee report described charges for credit insurance as "charges that have been used to exploit unwitting consumers but are not part of the finance charge under Truth in Lending." Sen. Rep. 103-169, Committee on Banking, Housing, and Urban Affairs, 103d Cong., 1st sess. (Oct. 28, 1993), at p. 24.

[84] Consumers Union reports that creditor commissions for credit life and credit disability insurance average over 30 percent.

[85] In addition to credit insurance, according to FTC staff, products sold in a lump sum with subprime mortgage loans include accidental death and dismemberment insurance, accident and health insurance, and involuntary unemployment insurance.

[86] For example, rates for credit life and credit disability in Kentucky are capped by statute. See K.R.S. § 304.19-080.

ii) ***Yield Spread Premiums*** – A yield spread premium is a payment a mortgage broker receives from a lender based on the difference between the interest rate and points of the loan the broker entered into with the borrower, and the par rate offered by the lender. Including yield spread premiums in the points-and-fees trigger would prevent lenders from evading HOEPA by charging a rate higher than they otherwise would, but still lower than the APR trigger. The Federal Reserve Staff Commentary has been interpreted to exclude yield spread premiums from the points-and-fees trigger. See 12 CFR 226, Supplement I Commentary ¶ 32(b)(1)(ii). The Commentary could be revised to make clear that yield spread premiums paid by lenders to brokers are included in the trigger. Such a rule is: a reasonable interpretation of Congress' requirement, echoed by the regulation, that "*all* compensation paid to mortgage brokers" be included in the trigger, 15 U.S.C. § 1602(aa)(4)(B) (emphasis added), 12 C.F.R. § 226.32(b)(1)(ii) (same phrasing as statute); a reasonable implementation of Congress' direction to include "such other charges as the Board determines to be appropriate," 15 U.S.C. § 1602(aa)(4)(D); and a proper means to regulate "mortgage loans designed to evade the provisions of [HOEPA]," § 1639(l)(2)(A). Section 1602(aa)(4)(B) does not distinguish between compensation paid to brokers by borrowers and compensation paid to brokers by lenders.[87] Moreover, it may be appropriate to include yield spread premiums in the points-and-fees trigger because they are an integral part of the loan transaction: they reflect a premium paid by the borrower in the interest rate.[88]

2. Credit Insurance and Other Insurance Products Paid in a Single Premium from Loan Proceeds

Background

There are four common types of credit insurance: credit life, credit disability, involuntary unemployment, and credit property. Credit life insurance pays off the remaining mortgage balance upon the death of the borrower during the period of coverage and credit disability pays the borrower's monthly mortgage payments in the event of an accident or health problem that incapacitates the borrower. Insurance coverage is typically for the first five to seven years of the mortgage.[89]

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[87] The Board, itself, has stated that it "believes the Congress intended a broad application of the term 'compensation,' including, for example, *amounts paid to brokers by creditors* in addition to amounts paid by consumers." 60 Fed. Reg. 15,463, 15,466 (March 24, 1995) (emphasis added).

[88] For this reason, a yield spread premium is "payable by the consumer" within the meaning of 15 U.S.C. § 1602(aa)(1)(B). Although it is not payable directly by the consumer, it is payable indirectly by him/her through the interest rate on the loan. HUD pointed out in its RESPA Policy Statement on lender payments to mortgage brokers that all compensation to the broker is ultimately paid by the consumer, either in the form of fees or points, directly or by addition to principal, or derived from the interest rate of the loan paid by the borrower. In addition, the yield spread premium paid in a table-funded transaction is "payable at or before closing," as § 1602(aa)(1)(B) also requires. Under RESPA, lender-paid fees to mortgage brokers as well as borrower-paid fees to brokers are required to be disclosed on the GFE and the HUD-1 and are otherwise subject to RESPA, including Section 8. See 24 C.F.R. part 3500, Appendix B, Fact Pattern 13.

[89] Coverage is sometimes as long as ten years. Coverage beyond ten years falls outside the coverage limit set by state laws that govern credit-related insurance.

Credit insurance is often described as "single-premium" or "lump-sum" credit insurance because premiums for the entire coverage are typically collected up-front at closing and financed in the loan. When financed, single-premium credit insurance effectively reduces the borrower's monthly payment as compared to what the borrower would pay for the insurance on an installment basis, because the cost of a five to seven year policy is financed over the 15 or 30 year life of the mortgage.

Credit insurance is a very profitable product for insurers. The Consumer Federation of America reported in 1999 that the credit insurance industry had a loss ratio (the ratio of claims to premiums) equal to 40 percent for credit life and credit disability insurance in the 1995 to 1997 period, compared to the 60 percent recommended by the National Association of Insurance Commissioners (NAIC). Consumers Union reported that only three states (New York, Maine, and the District of Columbia) had loss ratios above 60 percent for the same period.[90]

TILA contains no limitations regarding the sale of credit life insurance, except that disclosures of the premium amount must be provided, and need not be included as part of the disclosed finance charge if the insurance is optional and certain other conditions are satisfied.

What is the problem?

There are number of problems related to credit insurance. First, the low loss ratios in the industry imply that these products may be a bad deal for consumers. Credit insurance companies typically sell lenders group insurance products and the lender passes the premiums on to the consumer. Credit insurance companies must compete to attract lenders not borrowers and since lender compensation is generally based on commissions or a percentage of profits, the lender has little incentive to seek out insurance companies with the lowest premiums.

Second, single-premium credit insurance is typically added to the loan amount, increasing the total finance charges paid by the consumer. Lump-sum insurance products, when financed into the cost of the loan, provide no actuarial benefit to the consumer.

Third, consumers have reported experiencing a number of abuses associated with credit insurance. Some of these abuses are the result of high pressure sales tactics that would not be effective if credit insurance was sold after the loan is closed. For example, lenders may mislead consumers into believing that credit insurance is a requirement for approval of the loan. An industry-funded report found that 18 percent of those surveyed did not remember being told that credit insurance was optional.[91] In some instances, borrowers have been unaware that they have purchased credit insurance. Even if borrowers understand that they are purchasing the product and do so voluntarily, the lender may mislead the consumer into thinking that coverage is for the entire life of the mortgage when the policy is only in effect for the first five to seven years of the loan.

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[90] *Credit Insurance: The $2 Billion a Year Rip-Off.* Consumers Union and the Center for Economic Justice, March 1999.

[91] Credit Research Center study, 1994, Purdue University.

Other anecdotal evidence suggests that consumers may be experiencing difficulty in canceling credit insurance. Consumers have also complained that it is difficult to obtain a rebate on the unearned premium when the insurance is canceled or the mortgage is prepaid.

Policy Recommendations

a) **Prohibit the sale of single-premium insurance products with mortgage loans** – The sale of single premium insurance products should be prohibited for all mortgage loans, not just HOEPA-covered loans. These products should be payable only on a monthly basis, not on an up-front, lump-sum basis, and lenders should disclose to borrowers any right they have to cancel such insurance. Legislation should grant the Board the authority to define a group of single-premium products (such as credit life, debt cancellation, and debt suspension) which creditors would be prohibited from selling with these loans.

b) **Restrict the sale of non-mortgage products to post-closing** – Consumers are sometimes led to believe, or at least allowed to believe, that purchasing an insurance product is required in order to close a home mortgage loan. In his May 1999 consumer protection plan, President Clinton called for prohibiting the solicitation of credit life insurance until the lender has approved the loan application and communicated approval to the borrower. We recommend the same approach for the group of products the Board defines here.

c) **The Federal Reserve Board should consider prohibiting/restricting the sale of single-premium insurance products in mortgage transactions** – As explained in VI.B.2.d. (on "loan flipping"), HOEPA expressly grants the Board broad authority to issue rules to regulate unfair, abusive, and deceptive acts or practices – and, in the case of refinancings, acts or practices "not in the interest of the borrower." Moreover, as explained above, lump-sum products are arguably inherently "unfair" because they provide the borrower no net economic benefit; for the same reason, they are almost always not in the interest of the borrower. In addition, the sale of lump-sum products at closing is arguably inherently deceptive, because so many borrowers conclude that they must purchase the products in order to close the loan, or fail at all to notice the products among the lengthy settlement documents. Therefore, the Board could require lenders to "de-link" the sale of lump-sum products from the loan application and closing processes and prohibit lenders from selling such products at or before closing. Such a rule would effectively prohibit the financing of lump-sum products with mortgage proceeds in a mortgage transaction. The Board could also require lenders to disclose to consumers any right they may have to cancel the insurance.

3. Negative Amortization

Background

In a negatively amortizing mortgage, a consumer's regularly scheduled payments do not cover the full amount of interest due, causing the outstanding principal balance to increase. Generally, no data exist on the prevalence of negative amortization in the subprime market. Secondary market participants

report that the loan pools they securitize generally do not contain negatively amortizing loans. Negative amortization is not permitted in the context of HOEPA loans. Expanding HOEPA coverage would extend its prohibition against negative amortization to more loans.

What is the Problem?
Since the borrower actually loses equity in her home under a negative amortization payment schedule, there seems to be little economic rationale under most circumstances for choosing such a feature.[92] The existence of such a schedule (except in the case of a reverse mortgage) may indicate a lack of understanding on the part of the borrower or misleading lender practices. There is anecdotal evidence in both the subprime and prime markets that some borrowers have unwittingly wound up in home mortgages with negative amortization features.

Reverse mortgages in HUD's Home Equity Conversion Mortgage program employ a special type of negative amortization that allows older homeowners to increase their standard of living by converting their home equity to an income stream. Notably, the complexity of these loans caused Congress to require that borrowers receive special counseling before entering into such a mortgage. No counseling requirements exist for borrowers who receive a non-FHA reverse mortgage with an increasing balance feature.

Policy Recommendations

a) **Congress should retain the existing prohibition of negative amortization on expanded definition of HOEPA loans** – Negative amortization can reduce a HOEPA loan borrower's principal rapidly due to the high interest rates often charged on such loans. HOEPA borrowers may also be less likely to understand fully the significant implications of reducing their equity in their homes. Retaining this prohibition using the broader definition of HOEPA loan recommended in VI.C.1 would reduce the opportunities for abuse of borrowers in the high-cost loan market.

b) **Congress should expand disclosures on negative amortization for all loans**– Under TILA, creditors are required to make added disclosures to any borrower whose open-end consumer credit plan (secured by a home) may result in negative amortization. Those disclosures must state that negative amortization increases the principal balance and reduces the consumer's equity in the dwelling. These disclosures should be made available to all mortgage borrowers, not just those with an open-end home equity loan.

4. Prepayment Penalties

Background

[92] Negative amortization may, however, make sense in some cases outside of high-cost loans. For instance, the cost-of-funds index ARMresults in short-term negative amortization for borrowers when interest rates are rising because of the scheduled delay between the change in the interest rate on the loan and the interest paid by the borrower as part of the monthly payment.

A prepayment penalty is assessed against a borrower who repays his/her loan before the end of the loan term. Prepayment can occur as the result of the mortgage borrower moving, refinancing the loan, or paying on an accelerated basis. For lenders, a prepayment penalty is designed to reduce the risk of prepayment and compensate the lender for any cost resulting from prepayment. Penalties are typically assessed only for prepayment within a specified period of years after the loan is closed.

Industry analysts note that prepayment penalties are typically applicable for the first two, three or five years of the loan, depending in part on the applicable state law. While there is no industry standard for prepayment penalties, industry sources told us that prepayment penalties typically decline as the loan seasons. The prepayment penalty could be expressed as a percentage of the prepaid loan amount (e.g. 5 percent in year one, 4 percent in year two…) or as a fixed amount of remaining interest payments (e.g. six months of interest on the prepaid balance). For high-cost loans, HOEPA prohibits prepayment penalties for prepayment more than five years from closing and for borrowers with a debt-to-income ratio of over 50 percent.

Some subprime lenders offer borrowers a choice between a loan carrying a prepayment penalty and a loan carrying other, higher costs. For instance, one large subprime lender lowered the interest rate on a loan by 75 basis points in April 2000 for those borrowers who accepted a prepayment penalty. [93] In cases where borrowers are offered and aware of such a choice, the market is allowing individuals to assess their own risk of prepayment, and to select the product that works best for them. In this way, the cost of prepayment can be borne by those borrowers who are more likely to prepay.

It is unclear, however, whether most borrowers in the subprime market are either aware of or given the opportunity to make this sort of trade-off. Mortgage-backed securities analysts estimate that about 70 percent of loans in the subprime mortgage market carry a prepayment penalty.[94] Data from the third quarter of 1999 indicate that 76 percent of subprime mortgage originations that quarter carried a prepayment penalty (see Figure 6.2). Interestingly, the prevalence of prepayment penalties appears to decline as loan interest rate increases. Only 17 percent of the loans that exceeded the HOEPA interest rate threshold in the third quarter of 1999 (i.e., 17 percent of the 0.7 percent of subprime loans that exceeded the APR threshold based on interest rate) carried a prepayment penalty. This suggests that higher interest rates may in part reflect lenders "pricing in" the prepayment risk, or that the debt-to-income ratio for these borrowers may exceed 50 percent (thus effectively prohibiting prepayment penalties on these borrowers' loans).

In contrast to the subprime market, prepayment penalties are not prevalent in the prime market – analysts estimate that only between 1 and 2 percent of conforming loans carry such a penalty.[95] As described in Chapter IV, borrowers in the subprime market are more likely, on average, to prepay than borrowers in the prime market, although prepayment in the prime market is more sensitive to interest rate fluctuations than in the subprime market.

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[93] Information from New Century Mortgage Corporation website, www.newcentury.com.

[94] MIC LPS, 1999Q3;

[95] Approximately 0.5 percent of Freddie Mac's purchases, and 2 percent of Fannie Mae's purchases, carry prepay penalties.

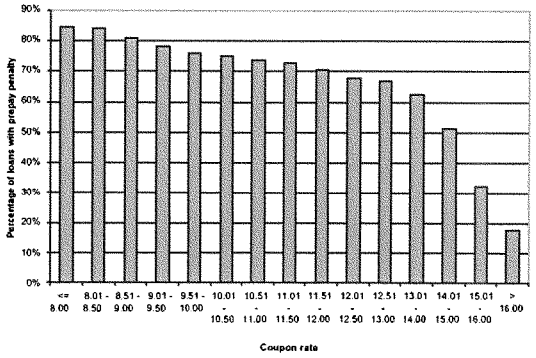
What is the Problem?

Seven out of every ten borrowers in the subprime market have a prepayment penalty on their loan. One study has found that subprime loans that carry prepayment penalties are prepaid at about 90 percent of the rate that other subprime loans without prepayment penalties are prepaid, Industry sources indicated to us that this small difference may result from lenders waiving prepayment penalties in order to retain the borrower and state laws that limit the size of prepayment penalties, thereby rendering them not much of a financial deterrent to prepayment.

Nevertheless, in some cases, the existence of a prepayment penalty may inhibit the ability of a borrower to refinance his or her loan at a lower rate. This can be especially problematic in cases where a good payment history may allow the borrower to "graduate" to a lower-cost loan. For this reason, HOEPA restricts prepayment penalties in the high-cost subprime mortgage market, where borrowers may have the greatest need to access lower-cost capital as it becomes available to them.

In cases where the borrower refinances a loan with a prepayment penalty, the cost of that penalty may be financed into the new loan balance, driving up the overall price of the loan to the borrower. The discussion of "loan flipping" in Section VI.B.2.d describes how high fees repeatedly financed into the cost of successive loans may weaken a borrower's equity position in her home.

Figure 6.2. Percentage of Subprime Loans with Prepayment Penalty, by Coupon Rate



Source: MIC LPS, 1999Q3

Challenges for Reform

Further restricting prepayment penalties on HOEPA loans requires the entire pool of HOEPA loan borrowers to bear a greater portion of the costs associated with the risk that some portion of them will

prepay. This requires non-prepayers to pay more for their mortgage than they otherwise would. The cost to the portion of subprime borrowers who carry loans without penalties (30 percent of the entire subprime market) of spreading this risk must be appropriately balanced with the potential benefit of lowered cost and increased refinance flexibility for other high-cost loan borrowers.

Depending upon how existing restrictions are modified, additional measures should be employed to stem any unintended consequences:

- The high incidence of prepayment penalties in the subprime market indicates that secondary market models have been built around the existence of these penalties. Significant restrictions or prohibitions of such penalties in the high-cost loan market could serve to inhibit the flow of credit to these borrowers, at least temporarily, by forcing the secondary market to retool its securitization strategies and climb the subprime "learning curve" again. To the extent possible, new restrictions on prepayment penalties should be tailored to minimize the impact on overall market liquidity.

- Assuming that borrowers are aware that their loans contain prepayment penalties, these penalties could actually reduce the incidence of loan flipping by making refinancing less attractive. An unscrupulous broker looking to refinance a borrower's loan on abusive terms may be less likely to make the effort, or the borrower may be less interested, if the loan carries a prepayment penalty. Further restrictions on prepayment penalties must be accompanied by new measures to curb abusive loan flipping practices.

Policy Recommendations

a) **Congress should place further restrictions on prepayment penalties on HOEPA loans** – For borrowers with HOEPA loans, further restrictions on prepayment penalties may make it more economical for some families to refinance their loans. The ability to refinance at successively lower interest rates over time may allow more borrowers to graduate from the subprime to the prime market. As detailed in VI.B.2, the financing of prepayment penalties, as well as points and fees, can erode home equity through successive refinancings.

   Under HOEPA, a pre-payment penalty cannot be assessed after five years post-loan closing. Congress should shorten this period and restrict the price of prepayment penalties so that such restrictions would (1) curb predatory lending, and (2) not unduly inhibit the flow of credit to subprime borrowers (i.e., the costs of the inhibition of the flow of credit, if any, are outweighed by the benefits of stemming a practice that is used in a predatory manner).

b) **Congress should require creditors to ensure that HOEPA borrowers derive some benefit from accepting a prepayment penalty on loan** – Not all borrowers in this market may be afforded the choice between lower loan costs with a prepayment penalty and higher loan costs without a penalty. For HOEPA loans, creditors should be required to offer borrowers a trade-off between waiving the prepayment penalty and accepting a higher APR on the loan, or accepting the penalty and receiving a lower APR on the loan.

c) **Congress should create "safe harbors" for prepayers** – HOEPA loan borrowers should have the right to accelerate payments – up to 20 percent of the loan amount annually – without having to pay a prepayment penalty. In addition, prepayment penalties should not be assessed upon move or default, only upon a refinancing. Legislation should create these "safe harbors" from prepayment penalties for borrowers with high-cost loans.

5. Balloon Payments

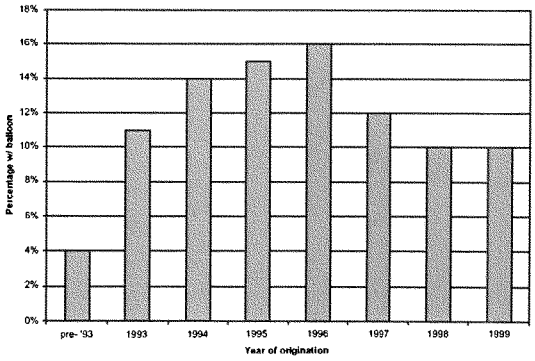
Background

Balloon payments occur at the end of a fixed-rate loan term when regular monthly payments do not fully amortize the loan principal. The regular monthly payments on a HOEPA loan with a term of five years or less must fully amortize the loan principal (thus effectively prohibiting balloon payments within five years of closing).

About 10 percent of subprime loans originated in 1999 had a balloon term, about the same percentage as in 1993, and down from 16 percent in 1996 (Figure 6.3). Only 1 percent of the subprime mortgages originated in the third quarter of 1999 that met the current HOEPA interest rate threshold carried a balloon term.

The evidence also indicates that the use of balloon terms varies significantly from one lender to the next. According to Morgan Stanley's 1998 Home Equity Loan Handbook, one originator issued securities backed by approximately 60,000 fixed-term subprime mortgage loans. About 50 percent of these loans carried a balloon term, far above the market average.

Figure 6.3. Share of Subprime Loans with a Balloon Term, pre-1993 to 1999



Source: MIC LPS, data through 1999Q3

As with prepayment penalties, borrowers who choose to take on a loan with a balloon payment can benefit from lower loan costs, over the short run. Deferring the payment of a portion of the loan principal can make a loan more affordable over the shorter term by reducing the borrower's monthly payments. For elderly borrowers, and borrowers who anticipate that their incomes will increase over time, a balloon payment may be a reasonable option.

What is the Problem?

In the high-cost loan market, borrowers typically must refinance their loans in order to cover balloon payments or they risk default because of inability to make the payment. Even with HOEPA's existing restriction on balloon payments, balloon terms can remain onerous in connection with certain other terms or practices:

- In refinancing a loan to cover a balloon payment, a less scrupulous lender may charge the borrower high points, fees and closing costs. Financing these points and fees may saddle the borrower with higher payments, and present the lender with more opportunities to engage in loan "flipping."

- From the testimony that HUD and Treasury heard at some of the regional forums, it appears that some higher-cost loan borrowers do not know that their loans include a balloon payment, or may not understand that as a practical matter, such a term means that they will need to refinance their loans. A lack of disclosure by the originator or inadequate borrower understanding may thus disadvantage borrowers with balloon loans.

- If the lender reports a borrower's late payments – but not his/her on-time payments – to a credit bureau, the borrower may not be able to qualify for lower-cost credit when the balloon payment is due.

The market should apportion balloon payments to those borrowers who, in assessing the trade-off between lower monthly payments and fully amortizing the mortgage, place a higher value on the former. The fact that only one percent of borrowers with loans whose interest rate exceeded the HOEPA APR threshold in the third quarter of 1999 had a balloon term indicates that abuses of this sort may not be widespread. However, the sorts of practices described above create information disadvantages in which this fraction of subprime borrowers cannot accurately assess the tradeoff. Further restricting balloon payments may allow borrowers to escape a cycle of high-cost refinancings, and reduce borrower exposure to loan "flipping."

Challenges for Reform

As with restricting prepayment penalties, restricting or prohibiting the use of balloon payments in the high-cost loan market would increase the cost of borrowing for people who could reasonably choose this repayment option. These costs must be weighed against the benefits to borrowers whose balloon

terms have forced them into a series of refinancings, the long-term price of which can be substantial. Reforms should also take account of the disparate impact that new restrictions on balloons could have on lenders who specialize in originating loans with these terms.

Policy Recommendations

a) **Congress should restrict the timing of balloon payments on HOEPA loans to no less than 15 years** – Balloon payments are most onerous when they are due within a short period of time from closing. High-cost loan borrowers may not have had enough of a chance to repair their credit, and may, as a result, be limited to similarly onerous terms on their refinancings. They also may not have had adequate opportunity to experience increases in income, or to accumulate savings to pay off a portion of the balloon payment. Pushing balloon payments out to year 15 at a minimum would help to alleviate these problems, while allowing the industry to offer a product that may make sense for some HOEPA borrowers.

6. Mandatory Arbitration

Background

A mandatory arbitration clause in a loan agreement requires, as a condition to receiving a loan, that the borrower agree to resolve any dispute arising out of the loan through arbitration, rather than in-court litigation. As a practical matter, currently there are no restrictions on mandatory arbitration clauses, at least so long as they clearly set forth the procedures under which the arbitration will be conducted.[96]

What is the Problem?

Some features of mandatory arbitration clauses in high-cost loans disadvantage the consumer: (1) the arbitration process may limit the borrower's right to factual discovery; and (2) provisions may include requiring the borrower to pay all arbitration costs; not specifying who will pay arbitration costs; or requiring arbitration to be in a location far away from the borrower's residence.

To sign a mandatory arbitration clause at closing, before any dispute has occurred, limits the borrower's flexibility to choose the forum that may provide the best opportunity for resolving the controversy. Many high-cost loan borrowers may not understand at the time of closing the significance of agreeing to arbitration and various associated terms, such as cost allocation and forum location. Consumers may not recognize a mandatory arbitration clause buried in the voluminous loan documents at closing. In addition, private arbitration circumvents the development of clear and uniform standards for compliance with federal fair lending and consumer protection law through the decisions of an independent judiciary.

[96] The Supreme Court has agreed to grant review in a case in which the lower court declared a mandatory arbitration clause unenforceable because it failed to specify who would pay the arbitration costs. Green Tree Financial v. Randolph, 178 F.3d 1149 (11th Cir. 1999), cert. granted, 68 U.S.L.W. 3629 (U.S. April 3, 2000)(No. 99-1235).

There are other procedural and substantive distinctions between arbitration proceedings and in-court litigation that lend support to further restrictions in this area:

- Individual borrowers with a mandatory arbitration clause in their loans are not able to collectively initiate or join class action lawsuits.
- Mandatory arbitration may make unavailable, or may delay, emergency relief that a court can order, such as a temporary restraining order or preliminary injunction, which may be important in lending disputes.
- An arbitration typically does not result in broad injunctive relief designed to reform a company's unlawful practices to prevent future violations.

Challenges for Reform

In some contexts, arbitration has proven to be an efficient and streamlined process for resolving disputes that minimizes costs and deters frivolous claims. A competitive marketplace might allow borrowers to shop among loans that involve tradeoffs between arbitration clauses and loan costs, but evidence suggests that the subprime market has not yet achieved this level of efficiency. Therefore, some level of restriction may be required.

Policy Recommendations

a) **Prohibit mandatory arbitration for high-cost loans** – The most vulnerable borrowers in the subprime market may be the least likely to understand adequately the implications of agreeing to mandatory arbitration. Since they may also be the most likely borrowers to default or be foreclosed upon, it is especially important that they retain the rights afforded them under federal fair lending and consumer protection laws. In the high-cost loan market, the difference in bargaining power between lenders and borrowers is particularly acute, making pre-dispute mandatory arbitration an unwise option for these consumers.

7. Financing of Points and Fees

Background

HOEPA does not restrict the financing of up-front points or fees into the cost of a loan. In a HOEPA-covered loan that contains a prepayment penalty, the penalty may not apply to prepayments made with amounts obtained by a refinancing from the same creditor or affiliate. 15 U.S.C. § 1639(c)(2)(B).

What is the Problem?

Financing points and fees may disguise the true cost of the loan to the borrower. Restricting the amount of points and fees financed on HOEPA loans would increase transparency to the borrower by forcing more of the lender's costs into the interest rate.

Policy Recommendations

a) **Congress should restrict the financing of points and fees on a HOEPA loan** – By restricting

the financing of points and fees to the greater of 3 percent of the loan amount and a de minimus dollar amount for HOEPA loans, the cost of the loan would be more accurately reflected in the interest rate. Borrowers in the high-cost mortgage market would be better able to understand the cost of credit, and to shop for better loan terms.

D. Market Structure

1. Inadequate Data Collection

Background

The Home Mortgage Disclosure Act, and the Board's Regulation C that implements the Act, specify a number of data items that creditors must report to the financial institution regulators with regard to the home mortgage loans they originate.[97] Reporting lenders must provide information on mortgage loans whose purpose is home purchase or home improvement, including refinancings of these loans.[98] At their option, lenders may report on home equity lines of credit.

For loans originated by reporting lenders, information collected under HMDA includes:

- Loan purpose
- Loan amount
- Geography (MSA, state and county and census tract)
- Applicant data (race/ethnicity, sex, income)
- Loan purchaser (if loan was sold – e.g., Fannie Mae, Freddie Mac, bank, thrift, etc.)

What is the Problem?

While HMDA data have been a crucial tool allowing policy makers, regulators and the public to understand mortgage lending patterns, additional data not now required to be reported would more completely describe mortgage markets – the subprime market, in particular. Greater transparency in this market would promote more informed policy making and regulation, and may itself help to improve practices of lenders. There are three general areas in which current HMDA data may be inadequate:

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[97] 12 U.S.C. Chapter 29; 12 C.F.R. § 203.

[98] Mortgage lenders required to report annually under HMDA generally include depository institutions and other for-profit non-depository mortgage lenders. Banks, thrifts, and credit unions must report if they (1) have a home or branch office in an MSA on the preceding December 31; (2) have assets of more than $30 million on the preceding December 31; (3) originate at least one home purchase loan (including a refinancing) in the preceding calendar year; and (4) are federally insured or regulated, or make loans that are federally insured, guaranteed, or supplemented, or intended for sale to FNMA or FHLMC. Non-depositories must report if they (1) either have a home or branch office in an MSA on the preceding December 31, or receive applications for, originate, or purchase 5 or more home purchase or home improvement loans on property located in an MSA in the preceding calendar year; (2) have home purchase loan originations (including refinancings) that equal or exceed 10 percent of total loan originations, measured in dollars; and (3) either have assets (when combined with the assets of any parent corporation) exceeding $10 million on the preceding December 31, or originate 100 or more home purchase loans (including refinancings) in the preceding calendar year.

- **Unclear distinction between prime/subprime**. In order to estimate subprime mortgage lending volumes, researchers today identify subprime loans in the HMDA data using a list of lenders, developed by HUD, that are believed to originate primarily subprime loans. Each loan originated by these lenders is assumed to be a subprime loan, and loans not originated by these lenders are assumed to be prime loans.[99] While this methodology for classifying loans is widely used, subprime lenders may originate some mortgage loans to borrowers on terms that would be considered appropriate in the prime market, and banks/thrifts labeled as prime lenders may increasingly be originating loans in the subprime market.

  Similar methodology is also employed to identify manufactured home loans, which are usually originated by lenders who specialize in financing the purchase of prefabricated and mobile homes, and similar inaccuracies may result.

- **Incomplete coverage of lenders in the subprime market**. Under the coverage tests, Regulation C contains a two-part standard to capture lending institutions other than banks, thrifts and credit unions that originate a significant volume of mortgage loans. A for-profit non-depository lender does not have to report under HMDA if: (1) its assets are $10 million or less and it originated fewer than 100 mortgage loans in the prior year; OR (2) less than 10 percent of the dollar volume of its loan originations in the prior year was for home purchase loans (or refinances of such loans).

  There is anecdotal evidence that some of the largest and fastest growing mortgage providers in the country, especially in the subprime market, hold large enough consumer loan portfolios relative to their home purchase and refinancing loans that they fall within the 10percent exemption. Thus, current reporting requirements may omit an important class of lenders originating subprime mortgage loans.

- **Limited data on loan price and other features**. Publicly available data offers little information on loan prices or features. For instance, no public information exists that would allow the regulators to determine the portion of a lender's portfolio that meets the HOEPA triggers. Since abusive practices mostly occur in the high-cost loan market, this lack of information may inhibit the ability of regulators and the public to scrutinize lenders for abusive practices, including potential lending discrimination. Other information on loan terms, such as loan-to-value ratios, would improve the regulators' ability to identify potential fair lending violations.

Congress granted the Board the authority to "prescribe regulations as may be necessary to carry out the purposes" of HMDA, and provided further that such regulations "may contain such classifications, differentiations, or other provisions . . . as in the judgment of the Board are necessary and proper to effectuate the purposes" of HMDA. 12 U.S.C. § 2804(a). In order to carry out the Act's express

[99] See Randall M. Scheessele, *1998 HMDA Highlights*, Housing Finance Working Paper No. 9, Office of Policy Development and Research, US Department of Housing and Urban Development, October 1999.

purpose of helping to determine whether lenders are meeting the housing needs of the communities in which they operate, the Board should require the reporting of additional information under HMDA.[100]

Lenders that are not federally insured and that are not affiliates of federally insured depositories, while required to report under HMDA, may not have adequate incentive to provide complete reports, or to report at all. Enforcement authority under HMDA with respect to reporting by such lenders is vested in HUD. Enforcement authority with respect to banks, thrifts and credit unions rests with the federal financial institution regulators (i.e., Federal Reserve, OCC, OTS, FDIC and NCUA). However, HUD has no authority under HMDA to assess penalties against non-depository lenders that fail to report conventional (non-government-insured) loans. Therefore, many non-federally insured, unaffiliated mortgage companies – including many of the lenders that specialize in originating subprime loans – face no sanctions for incomplete reporting or non-reporting under HMDA.

Challenges for Reform

Collecting additional data items may result in increased costs for both lenders and the collecting agencies (the federal banking regulators and HUD). These costs would need to be weighed against the benefits that increased understanding of the mortgage market could bring to the public and private sectors, and the possibility that potentially predatory practices – which damage both consumers and the reputation of the market – could more easily be identified.

Policy Recommendations

The Board should implement a series of essential revisions to Regulation C to address the problems outlined above.

a) **Repeal the 10 percent rule** – The Board should revise Regulation C to repeal the 10 percent rule and expand the universe of mortgage lenders reporting under HMDA. Increasing the number of reporting lenders that are active in subprime mortgage originations could greatly improve the accuracy of our understanding of the subprime mortgage market.

b) **Collect information on loan price and disclose information on month loan originated** – Prescribing the collection of additional loan level data on loan features under Regulation C would improve understanding of the incidence of subprime and high-cost loans, and of the need for further scrutiny of such loans in the mortgage market. The price of the loan could best be captured by requiring the collection of two additional data items: (1) APR, which is already calculated by the lender for purposes of TILA disclosures; (2) the cost of credit, which would include all charges included under the TILA finance charge (12 U.S.C. 1605(a)), costs of single-premium insurance (if not prohibited), fees and amounts imposed by third-party closing agents and all fees collected by a

[100] "The purpose of this chapter is to provide the citizens and public officials of the United States with sufficient information to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located and to assist public officials in their determination of the distribution of public sector investments in a manner designed to improve the private investment environment." 12 U.S.C. § 2801(b).

mortgage broker in connection with the transaction. This information would allow users to define which loans qualify as "subprime" using information on the price charged to the borrower, and paired with information on the month the loan was originated (currently collected under Reg C but not publicly disclosed), this price information would allow regulators to identify lenders that originate high concentrations of HOEPA loans.

c) **Distinguish manufactured home loans** – As President Clinton recommended in his May 1999 consumer protection plan, the Board should require HMDA reporters to indicate those loans that are used to purchase a prefabricated or mobile home, or to refinance such a loan. This would greatly improve estimates of the size of the manufactured home lending market, and would not impose an undue reporting burden on institutions who originate manufactured home loans.

d) **Require reporting of reasons for denial** – The Board should propose the amendments to Regulation C that Treasury, Justice, HUD, OCC, OTS and the FTC recommended in their joint response to the Board's 1998 ANPR. These recommendations included requiring creditors to report, for loans that have been denied, the reasons for such denial. Data on reasons for denial would assist supervisory agencies in evaluating whether patterns of loan denials may reflect discrimination, and allow them to focus their efforts where disparities by race are the greatest. Requiring the collection of this data under HMDA would not be unduly burdensome, since the HMDA registers already contain a field for this information, and since creditors must already keep for at least 60 days a record of the reasons for denial to ensure compliance with the Equal Credit Opportunity Act. Institutions regulated by the OCC and the OTS currently report reasons for denial under HMDA for all denied applications.

e) **Collect name of parent institution on transmittal form** – Reporting the name of the parent institution on the HMDA transmittal sheet would impose little burden, and would provide researchers with a much simpler way to identify parent-sub relationships than going through the Federal Reserve's National Information Center database.

f) **Collect loan-to-value ratio** – This data would assist regulators and other agencies in assessing whether there are variations in LTV between different classes of borrowers or borrowers in certain geographies that may suggest fair lending violations.

Additionally, through a statutory change:

g) **Congress should grant HUD specific authority to assess penalties to enforce HMDA with respect to non-federally-insured, non-bank-affiliated lenders** – Revisions to HMDA could increase the incentives for non-depository, unaffiliated mortgage companies to report under the Act by granting HUD the authority to impose sanctions on these lenders for non-reporting or incomplete reporting.

Additionally, HUD and Treasury recommend that the Board consider how the collection of other data items under Regulation C could improve understanding of the subprime mortgage market, and the high-cost segment of that market in particular:

a) **Debt-to-income ratio (for HOEPA loans)** – This data item would allow regulators to identify those HOEPA loans that may be least affordable for borrowers, and may discourage lenders from originating loans that borrowers may not have the ability to repay.

b) **Indicator for whether loan was originated by a broker** – Knowing which lenders use brokers, and for which loans, would assist the agencies in investigating potentially abusive practices among brokers.

2. The Prime Market

Background
Prime lenders - banks thrifts and credit unions generally - could play a potentially important role in curbing predatory practices:

- As detailed in Chapter IV, banks, thrifts, credit unions and their affiliates are increasingly important players in the subprime mortgage market. Banks and thrifts themselves accounted for approximately 13 percent of all subprime mortgage originations in 1998; together with their affiliates, they accounted for a little more than one out of four subprime originations in 1998.

  This share may be increasing, as a number of the largest subprime lenders are affiliates of prime lenders or have recently been acquired by banks. The relationship between prime lenders and their subprime affiliates may have implications for borrowers in either market.

- A number of prime lenders are beginning to enter the subprime market directly by offering products that cater to borrowers with blemished credit histories. These mortgage products are more expensive than comparable prime products, but often automatically reduce in cost over time as the borrower's credit history improves with on-time payments.

- In addition to originating subprime mortgages either directly or through affiliates, prime lenders play an indirect role in supporting the activities of subprime lenders in a number of ways. They purchase and service subprime loans, issue securities backed by subprime loans, and provide warehouse lines of credit to subprime lenders.

What is the Problem?
There may be two ways in which the prime market, either purposely or inadvertently, allows predatory lending to occur: (1) by not adequately competing for borrowers who may qualify for prime credit but are being served by the subprime market; and (2) by supporting the origination of predatory loans, through affiliates, purchases or other support for unscrupulous lenders.

- *Inadequate Competition* – One pattern that emerged from evidence on predatory lending practices at the regional forums was a lack of competition from prime lenders in the neighborhoods where these practices occur most often. This evidence was buttressed by HUD research that showed large market shares for subprime refinance lending in these neighborhoods. While subprime lending is not synonymous with predatory lending, the subprime market is where predatory lenders are found. The penetration of subprime lending in these areas is owed, in part, to the lower family incomes there. However, the research consistently revealed that, controlling for income, predominantly non-white census tracts showed much higher subprime refinance penetration rates than predominantly white census tracts.[101]

  Income, of course, is only one factor to consider in assessing borrower risk and determining whether he or she may qualify for credit in the prime market. A borrower's credit score is designed to capture a discrete set of elements that contribute to risk, and in addition to the loan terms is the primary metric that lenders use to price a loan. On this note, it is revealing that 28 percent of the borrowers in the MIC Subprime Loan Performance System database in September 1999, the largest data source tracking subprime loans, had credit scores of 640 or above.[102] While some portion of these borrowers may have been unable to access credit in the prime market because of their loan characteristics (e.g., high LTV's, low loan amounts or other credit factors such as income), some portion likely carry credit at a higher price than that for which they would be eligible in the prime market.

  One market deficiency that may contribute to this misdirection of borrowers is that most financial institutions have no processes in place that serve to refer borrowers who qualify for prime credit "upstream" from subprime affiliates to their parent banks and thrifts. The activities of banks' and thrifts' non-bank affiliates are not generally examined by the regulators under the Community Reinvestment Act. However, the purpose for the CRA – encouraging banks and thrifts to meet the credit needs of the communities in which they do business – is broadly consistent with the principle that banks and thrifts should have in place policies to improve borrower access to prime market borrowing opportunities.

  Clearly, borrowers in certain neighborhoods could benefit from increased competition among lenders, including banks, thrifts and other prime lending specialists. In addition, the prime market could do more to help "graduate" borrowers from the subprime to the prime market by offering loan products that over time will connect those borrowers to credit in the financial services mainstream.

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[101] HUD's research, performed on a nationwide basis in *Unequal Burden: A Profile of Subprime Lending...*, was based on work completed by the Woodstock Institute in its November 1999 report, *Two Steps Back....* That report found that 18 of the top 20 lenders in predominantly white census tracts in Chicago were prime lenders, while 18 of the top 20 lenders in predominantly black census tracts were subprime lenders. *Two Steps Back* did not control for census tract income or borrower credit history.

[102] As described in Section IV, A-credit borrowers typically have FICO scores exceeding 650.

- *Supporting the activities of predatory lenders* – Banks, thrifts and other prime lenders may not have in place adequate processes to ensure that they do not support predatory lending through their loan purchases, securitizations or lines of credit issued to other lenders. As these institutions increasingly become involved in the subprime mortgage market through their affiliates, opportunities for abusive lending activities to occur at the affiliate level may also increase. By refusing to support unscrupulous lenders and abusive lending activities in any of these ways, the prime market could do much to force these abuses out of the marketplace.

Policy Recommendations

a) **The regulators should award banks and thrifts CRA credit for products that "promote" borrowers from the subprime to the prime markets** – The regulators should publish guidance directing examiners to award CRA credit to banks and thrifts that offer products and procedures, either directly or through their affiliates, that serve to graduate borrowers who make on-time payments from the subprime to the prime mortgage market. The OTS, for example, is exploring ways to give positive CRA lending test consideration for thrifts' responsible subprime lending to low-income borrowers, while discouraging the origination or purchase of loans that have abusive terms. The OCC has issued similar guidance relating to the responsible conduct of subprime lending activities.

b) **The regulators should deny banks and thrifts CRA credit for origination or purchase of loans with predatory terms** – Subprime loans are originated for more credit-impaired borrowers, and thus often serve a low-income population that banks and thrifts may receive credit for serving under the CRA lending test, either through directly originating or purchasing these loans. However, where there is evidence that unlawful predatory practices are associated with the loans originated by the bank or thrift, this should be reflected in the institution's CRA evaluation. This measure should serve as a deterrent to predatory lending. The OTS is developing a predatory lending "overlay" to its compliance procedures to give examiners guidance on identifying the existence of potentially predatory lending practices, and coordinating the various compliance examination procedures – including fair lending, RESPA and TILA – to reach conclusions and recommend corrective action. The OCC has announced that it is prepared to take action against national banks or their subsidiaries who engage in unfair or deceptive lending practices.

c) **The regulators should, in the context of CRA examinations, consider banks' and thrifts' other market activities that may support predatory lending** – The federal financial institution regulators should consider, in the context of their CRA examinations of banks and thrifts, whether those institutions may be supporting predatory lending through activities other than loan origination/purchase.

d) **The Federal Reserve Board should consider conducting examinations of subprime lenders that are subsidiaries of bank holding companies** – Of the 239 lenders who report that they specialize in subprime lending, 15 percent (including a number of the larger ones) are banks or

nonbank subsidiaries of bank holding companies.[103] This figure does not include the various lenders who engage in subprime lending, but who do not report that they "specialize" in subprime lending. Thus, a significant amount of subprime lending is being conducted by nonbank affiliates of bank holding companies.

Under the "Fed-lite" provisions of the financial modernization act, the Board may examine a non-bank subsidiary of a bank holding company to inform itself of: 1) "the nature of the operations and financial condition" of the subsidiary, 12 U.S.C. § 1844(c)(2)(A)(i), and 2) "the financial and operational risks within the holding company system that may pose a threat to the safety and soundness" of any affiliated bank and the "systems for monitoring and controlling such risks," 12 U.S.C. § 1844(c)(2)(ii). The Board may also examine such subsidiary "to monitor compliance with ... any ... Federal law that the Board has *specific jurisdiction to enforce against such a ... subsidiary* and those governing transactions and relationships between any depository institution subsidiary and its affiliates," 12 U.S.C. 1844(c)(2)(A)(iii) (emphasis added).[104]

The Board should consider conducting risk-based examinations of non-bank lending subsidiaries of bank holding companies where it has a basis to believe that such subsidiaries are violating HOEPA or otherwise engaging in predatory lending.

e) **The regulators should adopt an interagency policy statement on predatory lending enforcement** – The Interagency Policy Statement on Predatory Lending being considered by the interagency group on predatory lending could 1) deter predatory lending; 2) promote more effective enforcement of existing laws with respect to those lenders; and 3) promote fair and responsible lending under the purview of the federal financial institution regulators.

3. The Secondary Market

Background

Chapter IV explored the evolution of the secondary market for subprime loans. Subprime loans may be purchased in the secondary market either whole (in the whole loan market) or through a mortgage-backed security, which gives the buyer an interest in a pool of loans. About 35 percent of subprime lending by dollar volume in 1999 was securitized. The volume of subprime loans purchased outright in the whole loan market is not known, though it likely represents a substantial remainder of the non-

[103] See Randall M. Scheessele, 1998 HMDA Highlight, Department of Housing and Urban Development, Housing Finance Working Paper Series HF-009 (1999).

[104] The Board may examine a lending affiliate to monitor compliance with HOEPA, if the Board has *specific jurisdiction* to enforce HOEPA against such company. Although the Federal Trade Commission has jurisdiction generally to enforce HOEPA against nondepository lenders, the Board is authorized under Section 8(b)(3) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b)(3), to bring certain enforcement actions against any bank holding company or nonbank subsidiary for violation of any law, rule or regulation, in the same manner as it could against a state member bank. Arguably, this authority constitutes "specific jurisdiction" for the Board to enforce HOEPA against a nonbank subsidiary, within the meaning of section 5(c) of the BHCA, although this newly enacted provision has yet to be interpreted.

securitized portion of the market.

GSE Statements on Subprime Purchases

Although the GSEs play a relatively small role in the subprime market today, they are beginning to reach out with new products in this marketplace. Both GSEs recently pledged not to purchase loans with certain identified predatory features. Fannie Mae has established greater limitations on its subprime activities than has Freddie Mac, but Fannie Mae has been less involved in the subprime market to date. Fannie Mae, through its Lender Letter LL03-00 ("Eligibility of Mortgages to Borrowers with Blemished Credit Histories," 4/11/00), has announced guidelines that, among other things, restrict lenders from selling loans to the enterprise that contain the following characteristics: excessive points and fees; single-premium credit life insurance; and, prepayment penalties, unless they provide some benefit to the borrower. Fannie Mae has also announced that it will not purchase loans from lenders who steer borrowers to higher-cost products if those borrowers qualify for lower-cost products. Freddie Mac, through two industry letters (Reports to Credit Repositories, 2/22/00; Single-Premium Credit Insurance Products, 4/21/00), has announced that it will not purchase HOEPA loans nor will it purchase mortgage loans with single-premium credit life insurance. Both GSEs have announced that they will require lenders who sell them loans to file monthly full-file credit reports on every borrower.

What is the Problem?

The secondary market may, knowingly or unknowingly, support the activities of predatory lenders by purchasing or securitizing the loans that these lenders originate. For instance, loans with predatory terms may form part of a pool of subprime loans that a secondary market participant securitizes or insures. Alternatively, a financial institution or one of the GSEs may purchase or fund a loan that has predatory features.

While the secondary market could be viewed as part of the problem of abusive practices in the subprime mortgage market, it may also represent a large part of the solution to that problem. If the secondary market refuses to purchase loans that carry abusive terms, or loans originated by lenders engaging in abusive practices, the primary market might react to the resulting loss of liquidity by ceasing to make these loans.

GSE Purchase Restrictions

Restrictions on the loans the GSEs can purchase are consistent both with their public mission and past practice. Fannie Mae and Freddie Mac are prohibited from purchasing loans above the conforming loan limit (currently $252,700) because such purchases do not serve their statutory missions. One could just as easily conclude that purchases of loans with particularly onerous terms do not serve this mission, and the recent announcements by Fannie Mae and Freddie Mac are consistent with that conclusion.

Pledges alone, however, may not be sufficient to ensure that mortgages with abusive features are not purchased by the GSEs. First, although nine of the Federal Home Loan Banks, which are also government-sponsored enterprises, now participate in a program whereby they purchase or fund loans at origination, none of them has made a corresponding commitment. Only legislative or regulatory

restrictions can ensure a level playing field among the GSEs. Second, while Fannie Mae and Freddie Mac have issued broad guidelines describing the types of loans that they intend to make ineligible for purchase, these pledges still lack important details. Regulations can be used to make explicit both the precise nature of the restrictions and the mechanisms by which the GSEs would monitor and enforce these restrictions.

Policy Recommendations

a) **The secondary market should not support illegal practices in mortgage lending** – Under the existing TILA/HOEPA requirements, any civil action for violation of TILA that may be brought against a creditor may be maintained against an assignee of such creditor if the violation is apparent on the face of the disclosure statement. Additionally, HOEPA provides that purchasers or assignees of mortgages covered by HOEPA are subject to the claims and defenses with regard to the mortgage that consumers could assert against creditors, unless ordinary due diligence would not have revealed that the mortgage came within HOEPA's thresholds. Secondary market participants must be mindful of these requirements and should have the appropriate procedures in place to address these provisions and thereby protect against HOEPA violations. Similarly, discrimination in residential real estate related financing transactions is prohibited under Section 805 of the Fair Housing Act and the secondary market is subject to these provisions.

   In addition, Congress should consider legislation to require that:

   (i) Loan sellers disclose to the rating agency/bond insurer/issuer of security the number of HOEPA loans in the mortgage pool, plus other data items for HOEPA loans to be determined by regulation.

   (ii) Issuers of mortgage-backed securities disclose in their offering documents the incidence of HOEPA loans in the mortgage pools.

b) **Congress should clarify HUD's and the Federal Housing Finance Board's authorities to regulate the GSEs to prohibit their purchase of loans with predatory features** – HUD has existing general regulatory authority to ensure that the GSEs carry out their Charter purposes. Under this authority, HUD believes it may restrict the GSEs from funding loans with predatory features. Such loans may undermine the availability of mortgage credit to low- and moderate-income families.

   Because predatory practices are constantly changing, sufficient regulatory power and its exercise are the best means of addressing these practices. Accordingly, Congress should enact legislation to clarify that HUD, as the mission regulator of Fannie Mae and Freddie Mac, has the authority to prohibit the purchase by these entities of loans with predatory features. The Federal Housing Finance Board, as the mission regulator of the Federal Home Loan Banks should, to the extent necessary, be given similar authority with respect to these entities. Congress should also require that

the two regulators work to ensure consistency in regulation of the GSEs' activities in this area.

Regulations in this area should address the restrictions already voluntarily undertaken by Fannie Mae and Freddie Mac:

- Prohibiting purchases of mortgages with excessive fees. Fannie Mae recently pledged not to purchase any loan if the total points and fees charged to a borrower exceed 5 percent of the loan amount, or to purchase high cost mortgages.

- Prohibiting purchase of mortgages with prepayment penalties, except where: the mortgage provides some demonstrated benefits to the borrower (e.g., such as rate or fee reduction for accepting the prepayment premium); the borrower is offered the choice of another mortgage that does not contain payment of such a premium; the terms of the mortgage provision containing the prepayment penalty are adequately disclosed to the borrower; and the prepayment penalty is not charged when the mortgage debit is accelerated as the result of the borrower's default in making his or her mortgage payments.

- Prohibiting purchases of mortgages made in conjunction with prepaid single-premium credit life insurance.

- Prohibiting purchases of any further mortgages from a seller/servicer that fails to document on a monthly basis that it is submitting payment information to a credit bureau.

E. Other Issues

1. Foreclosure Prevention[105]

Background
The procedures that a creditor must follow for foreclosure are generally governed by state law, local practice and the terms of the contract documents. This includes the amount or type of notice that consumers are entitled to receive about an impending foreclosure. Some states require creditors to provide an actual notice to the consumer of the foreclosure, but in other states notice by publication is deemed sufficient. In some states a judicial process is followed; the creditor must file a lawsuit and obtain a judgment in order to obtain permission to sell the property. Other states allow the use of a non-judicial process, where the creditor merely notifies the borrower that the home will be advertised and sold, thereby placing the burden on the homeowner to take legal action to prevent the sale if possible.

Some states go further, affording consumers the right to "cure" a delinquency or default and avoid foreclosure by bringing the obligation current.[106] Even after the time to cure the delinquency has passed,

[105] The descriptions in this section are adopted from the HUD/Fed 1998 report.

consumers generally have the right to "redeem" the property prior to the foreclosure sale by paying off the full amount of the mortgage plus any fees and expenses related to foreclosure. This is sometimes possible through a refinancing or private sale of the property. A few states even allow redemption of the property after the sale.

What is the Problem?

Not all states may adequately protect consumers from abusive practices in connection with foreclosures. Evidence presented in this report on rapidly increasing foreclosures in inner-city neighborhoods suggests that consumers in the subprime mortgage market may benefit from better notices with regard to foreclosure, and from increased protections against foreclosure under state laws. Borrowers in the high-cost loan market may be most in need of procedures to help them avoid foreclosure, especially where those procedures may give them the opportunity to qualify for financing on more affordable terms.

Policy Recommendations

a) **Require certain minimum standards for the notice creditors must provide in home foreclosures** – New federal legislation should establish notice requirements that maximize opportunities for borrowers to cure a delinquency or arrange other financing. Prior to any foreclosure sale, a borrower should receive a written notice that: (1) explains the consumer's substantive rights under state law and how he/she may avoid foreclosure; (2) the process that will be followed if those rights are not exercised; and (3) information about the availability of third-party foreclosure counseling.

b) **Encourage states to adopt foreclosure statutes modeled on "best practice" state laws** – The Task Force will work with states to develop model legislation to provide consumers with new pre-foreclosure protections. This legislation could be modeled on existing state laws that afford consumers substantive pre-foreclosure rights.

F. Actions that the Federal Reserve Board Should Take to Curb Abusive Lending Practices

Throughout Chapter VI, we recommend that the Federal Reserve Board use its existing authority to issue regulations and take new enforcement steps to prevent abusive practices. For ease of reference, this section summarizes HUD's and Treasury's recommendations to the Board.

1) Lower the HOEPA APR threshold to 8% above comparable Treasuries.

2) Include additional fees in the point-and-fee trigger, including costs of single-premium insurance products (if not prohibited) and all compensation received by the mortgage broker.

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[106] A right to cure the default may be subject to limits on how many times or how often the consumer may exercise the right.

3) Define as unfair, deceptive, or abusive practices and prohibit: loan flipping; sale of single-premium products along with mortgage loan; lending without regard to the borrower's ability to repay.

4) Collect additional data items under Regulation C, including manufactured home loan indicator; APR and "all-in" cost of credit; reasons for denial; name of parent institution on transmittal form; loan-to-value ratio.

5) Repeal the Regulation C 10 percent rule.

6) Consider conducting risk-based examinations of non-bank lending subsidiaries of bank holding companies where it has a basis to believe that such subsidiaries are violating HOEPA or otherwise engaging in predatory lending.

VII. Recommendations for Appropriations

It was clear from the five public forums and the testimony of the experts on our National Task Force that funding would help in our fight against predatory lending. Funding directed towards foreclosure counseling, fair housing initiatives, legal services, and regulatory enforcement would be especially helpful.

A. Housing Counseling

HUD's housing counseling program, currently funded at $15 million, provides a wide variety of counseling services to homebuyers, mostly those venturing into the mysterious world of homebuying for the first time. By learning more about mortgage applications, credit histories, and financing options, over 250,000 consumers are making better informed decisions each year. HUD has asked that this budget be increased by $9 million for FY 2001, to help another 150,000 families move into homeownership. Congress should approve this budget request.

B. Local Fair Housing Initiatives

The testimony at our public forums and the data we do have on predatory lending is clear: minorities and minority communities are frequent targets of predatory lenders. HUD's already expanded enforcement of the Fair Housing Act will help address some of this problem. But, as the last month has made clear, we also need to educate more people specifically on the techniques and signs of predatory lending. HUD's Fair Housing Initiatives Program (FHIP) funds private, nonprofit fair housing groups to help HUD monitor, enforce, and educate the public about the Fair Housing Act. HUD has asked that the Congress increase the FHIP funding in 2001 by $5 million bringing the total to $29 million.

C. Legal Services

One of the most important findings of the field hearings was that Legal Services Attorneys throughout the United States are in the front line addressing the explosion of foreclosures confronting low- and moderate-income families. By increasing their training and expertise, we will directly help more consumers avoid and escape from the clutches of predatory lenders. The President's FY 2001 budget requests $340 million for the Legal Services Corporation, a $36 million or 12% increase over the FY 2000 enacted level.

D. Regulatory Enforcement

Congress should fully fund the President's requested increase in the budget for the Federal Trade Commission. Full funding will help the agency to meet the urgent need to increase its focus on combating abusive home mortgage lending practices.

VIII. Recommendations for FHA and Other Initiatives

There are several policy decisions that can be made and put into action without waiting for new legislation, expanded funding or regulatory changes. HUD's FHA has already done intensive work on predatory lending in Baltimore in the last few months. HUD and Treasury together have also developed new ideas from the public forums. In most instances, these ideas can take effect in the next few weeks and begin to have an immediate impact on predatory lending.

A. New Initiatives from the Baltimore Task Force

In March, 2000, United States Senator Barbara Mikulski held a hearing in Baltimore that focused on abusive real estate practices, including asset flipping and the sale of homes at inflated prices. The hearing revealed that predatory practices were being visited upon both subprime and FHA borrowers. Of great concern to Senator Mikulski was the blighting effect that these practices, and the resulting wave of foreclosures, were having on low- and moderate-income communities, and the financial hardship imposed on Baltimore families. In partnership with HUD Secretary Andrew Cuomo, Senator Mikulski proposed the creation of a Baltimore Task Force to learn more about these abuses. The Task Force's goals were to use Baltimore as a laboratory to gather information on the cause and extent of mortgage scams and resulting foreclosures, and develop recommendations that would benefit Baltimore and serve as a model for FHA programmatic reform throughout the nation.

Working with the Baltimore Task Force, FHA developed a series of new initiatives to address predatory practices targeted at FHA and its borrowers, including inflated appraisals, fraudulent underwriting, asset flipping and other lending abuses. FHA's reforms to protect homeowners from predatory lending focus on two main areas: (1) providing relief to those FHA borrowers already in distress, especially those who have been victimized by abusive lending practices; and, (2) strengthening FHA endorsement and fraud detection procedures to prevent predatory practices from occurring in the first place. The new reforms build on existing FHA efforts to streamline operations and eliminate abusive practices including Credit Watch, the Homebuyer Protection Plan, and a variety of reforms of the FHA property disposition program including the new Marketing and Management Contractors, the Good Neighbor Sales Program, and the Teacher and Officer Next Door Programs.

In some instances, the new initiatives will be immediately available on a national basis. In other instances, FHA will operate pilot efforts in Baltimore and other selected "Hot Zone" cities (defined as those with excessively high default and claim rates) to further test and refine the concept before moving to national implementation. In all cases, this new Fraud Protection Plan will better protect FHA, FHA borrowers and the communities FHA serves from the harmful effects of the rampant growth of predatory practices in the home finance market. Details of these initiatives follow.

1. Helping Victims Avoid Foreclosure and Retain Their Homes

Although the goal of FHA's reform initiatives is to prevent predatory lending practices from occurring in the first place, FHA also is developing a full array of tools to help those borrowers who already have been victimized to avoid foreclosure, retain their homes with a reasonable level of debt and, if necessary, repair their credit. New initiatives to help the victims of predatory lending include:

a. Counseling Borrowers in Default. HUD's network of more than 1,200 approved counseling agencies nationwide help thousands of families every year make well-informed home purchase decisions. But the availability of counseling services is uneven across geographic areas, and there are far too few agencies with the capacity to provide specialized foreclosure avoidance counseling to borrowers in default. Therefore, FHA is launching a new initiative to directly fund default counseling in select "Hot Zones". Through this program, FHA will offer borrowers in default a voucher for counseling services, redeemable at their local HUD-approved counseling agency. Once completed, the counseling provider agency can redeem the voucher with HUD to receive payment. As an eligible FHA foreclosure avoidance effort, this initiative will be funded from FHA's mortgage insurance fund.

b. Restructuring Inflated Mortgages. Once FHA identifies a mortgage based on a fraudulent appraisal, FHA will move to force the lender to write the mortgage down to a level consistent with true market value. If needed, the family will be provided a 203k purchase rehab loan to fund the cost of needed repair. In the case of a recalcitrant lender, FHA loss mitigation specialists will intervene directly, cancel the insurance, take possession of the deed, and resell the property with FHA insurance to the family for the fair market price.

c. Repairing Credit of Abused Borrowers. In cases of default or foreclosure linked to fraudulent appraisals or underwriting, FHA will instruct the lender to issue a "credit repair letter" to the borrower and notify the credit reporting agencies of this action.

d. Approving New Software to Empower Default Counselors. Working in cooperation with national venders, FHA has developed guidance on new computer software which assists default counselors in examining FHA foreclosure avoidance options and advising clients as to the best course of action. The first software package approved for use under this new initiative, "BackInTheBlack" loss mitigation application, was developed by a Baltimore based company, and is available free of charge to local housing counseling agencies. FHA is also currently reviewing additional software programs at the request of other developers. FHA is pleased to participate in the development of these foreclosure avoidance software packages which, when used properly, promote effective early response and appropriate use of FHA's foreclosure avoidance actions.

e. Focusing Resources on Loss Mitigation Assistance. In "Hot Zone" areas with high default and foreclosure rates, FHA will establish teams of loss mitigation specialists to work with lenders and borrowers to ensure that every effort is made to help families remain in their homes.

2. Protecting FHA Homeowners From Predatory Lending

FHA's new preventive measures include initiatives designed to: (1) strengthen FHA loan endorsement policies and procedures; and, (2) enhance FHA's ability to identify and discipline perpetrators of fraud and predatory lending practices.

a) Initiatives to Strengthen FHA Endorsement Policies and Procedures

1. Identifying Flipped Properties Prior to Loan Endorsement. One of the most prevalent predatory practices among some FHA lenders in Baltimore is financing property flips. This occurs when a property is purchased by an investor for a relatively low price then quickly resold, or flipped, to an unsuspecting purchaser for a much higher, inflated price with little or no improvements to the property. With an inflated appraisal and loan amount, the ultimate purchaser pays too much for their home and is set up for failure. To prevent this practice, FHA will use newly available data on prior homes sales to check each application for FHA insurance and determine if the requested mortgage amount is consistent with the property's previous sales price history. Those cases evidencing asset flipping will be denied FHA insurance, pending further investigation. As part of this initiative, FHA also will monitor future applications for FHA insurance to prevent former FHA REO foreclosed properties from being flipped and returned to the portfolio at an inflated price.

2. Restricting Loan Points and Fees. The Baltimore Task Force identified some cases in which FHA borrowers were charged unreasonably high points and fees, as is the case with many subprime loans. Given that FHA provides 100 percent insurance coverage and that FHA loans have simple, uniform terms, the costs associated with making an FHA loan should be comparable to other conventional loans. Therefore, FHA will impose a cap on the total amount of points and fees charged FHA borrowers.

3. Tightening Use of Gifts for Downpayment. The Baltimore Task Force identified the fraudulent use of gift letters as another practice used by unscrupulous lenders to qualify borrowers for inflated mortgages. FHA will release new and clearer guidance designed to tighten controls on FHA gift letters and enhance monitoring of these provisions.

b. Initiatives to Identify and Discipline Perpetrators of Fraud and Predatory Practices

1. Using "SWAT" Teams to Identify Unscrupulous Appraisers and Predatory Lenders in Hot Zones. In Baltimore, FHA sent a SWAT team to review all foreclosures taking place from January through March of 2000. Based on this review, FHA identified a number of apparently fraudulent practices on the part of FHA appraisers and lenders. These individuals and firms will be referred to FHA's Quality Assurance Division for further action, and if appropriate, to HUD's Enforcement Center or Office of Inspector General. By immediately stopping such bad actors in their tracks, communities can begin to recover. HUD plans to

immediately extend the SWAT team approach to assess potential fraudulent activities in other cities now experiencing high numbers of FHA defaults and foreclosure

2. Implementing Credit Watch for Appraisers. The Baltimore Task Force identified fraudulent appraisals as a key contributor to subsequent default and foreclosure. FHA is currently implementing a new automated appraisal review system. To increase the effectiveness of this system, and building on the Credit Watch for Lenders, FHA will create a Credit Watch System for Appraisers that will rate appraisers on the performance of the loans linked to their appraisals. Appraisers with a consistent pattern of participating in loans that quickly move to foreclosure will be targeted for further review and, if appropriate, removed from the FHA Appraisal Roster. Like FHA's Credit Watch for Lenders, this new system will allow FHA to discipline appraisers simply based on poor performance.

Similarly, lenders associated with poorly performing appraisers will be targeted for further review and action. Finally, FHA is releasing a list of the appraisers associated with FHA foreclosed loans reviewed by the Baltimore Task Force (See Appendix B for a list of appraisers and lenders associated with loans reviewed by the Task Force). This summary shows that just five individual appraisers were responsible for the appraisals on nearly 40 percent of all FHA foreclosures in Baltimore City that occurred between January and March, 2000, and were underwritten within the last three years. Likewise, only five lenders accounted for almost 50 percent of all FHA foreclosures in the same period.

3. Tracking Mortgage Brokers. Today FHA electronically identifies the lender, the appraiser, and the non-profit entity (if any) involved in making an FHA loan. With a growing number of FHA-insured loans originating with the significant involvement of mortgage brokers, the Department believes it must also develop the capacity to monitor loan performance by individual mortgage brokers. To further enhance oversight of the underwriting process, FHA will require that the Tax Identification of any Mortgage Broker participating in the transaction be recorded as well. This new information will give FHA, for the first time, the capacity to monitor broker performance and target for disciplinary action those associated with a high loan default and claim rate.

4. Suspending Abusive Brokers. Through listing of properties on Multiple Listing Services (MLS) and the Internet, FHA's new management and marketing procedures have streamlined the sale of FHA foreclosed properties and expanded the number of participating real estate agents. Working with the Baltimore Task force, FHA will review the list of participating real estate brokers and terminate unscrupulous brokers from future participation in FHA programs.

5. Early Warning Indicators. FHA will customize data from its Neighborhood Watch system to develop early warning indicators of emerging foreclosure "Hot Zones." This data will enable local officials and HUD approved counseling organizations to better target outreach to families at risk of foreclosure. FHA will also make available summaries of the appraised values of FHA properties to help local officials better assess real estate trends and spot possible

patterns of appraisal abuse. This public information will include performance data on individual appraisers generated by the Credit Watch for Appraisers system and posted on the HUD website.

B. New Initiatives from the Public Forums

Based on the testimony heard in the five field hearings and the advice of the Task Force Members, Treasury and HUD identified two key strategies for fighting predatory lending: increase consumer education about predatory lending abuses and expand our cooperative initiatives with the industry.

1. Housing Counseling

While certainly no cure-all, expanding and strengthening available homeowner counseling will better enable consumers to make intelligent choices in the mortgage market. Without waiting for further legislation or regulatory changes, HUD can increase the counseling activities in the following ways:

a) **Expert Software System.** Working cooperatively with American Association of Retired People (AARP), HUD will develop a new "expert system" to aid housing counselors in identifying loan terms that are not in compliance with HOEPA, TILA or other applicable laws. This initiative will build on ongoing efforts to develop computer aided counseling tools for FHA's Home Equity Conversion Mortgages (HECM).

b) **Activate the Fair Housing Network.** As part of HUD's Best Practices Symposium to be held in August, 2000, HUD will convene a working session of representatives of FHIP other state and local fair housing and legal services agencies to discuss new legal approaches to confronting predatory lending, especially those aspects of predatory lending linked to racial targeting and other potential violations of applicable fair housing laws.

c) **Preventive Consumer Education.** Working with participating Task Force organizations and the NPFE, HUD and Treasury will work to mount a national public campaign to raise consumer awareness of mortgage abuses. Such an initiative could build on a similar campaign now underway in North Carolina and a newly announced campaign in the development phase in Baltimore.

2. Cooperative Initiatives with Industry

It was clear from our public hearings that many industry groups view predatory lending as a threat to their image and success. As a consequence, several private groups are now moving to establish voluntary codes of conduct, best practices, and other efforts to help protect consumers from the abuse of predatory lending. While no substitute for needed legislative and regulatory change, these initiatives are a positive step and an important acknowledgment which the Federal government should recognize and encourage. As a continuation of this Task Force process, HUD and Treasury will be working with industry groups, especially Task Force Members, to encourage them to take will pledges

about the actions they will take to help in the fight against predatory lending. The pledges could address the following topics:

a) **Registration of Mortgage Brokers.** The National Association of Mortgage Brokers proposed a national clearinghouse to register mortgage lenders and brokers. This universal registration system will enable national, state, and local regulators to better monitor and take appropriate enforcement actions against abusive loan origination practices. HUD will also take a pledge making a commitment to supporting the development of this system.

b) **Referral Pledge.** The data reveals that some, perhaps significant, number of borrowers in the subprime market, particularly minority borrowers, would actually qualify for prime loans. To expand access to the prime market for these homeowners, Task Force Members should develop a Model Best Practices Agreement that would be signed by major prime market lenders voluntarily agreeing to develop practices that require their subprime subsidiaries or affiliates to "refer up" all borrowers that could qualify for prime loans.

ATTACHMENT C



Financial Services in Distressed Communities: Issues and Answers

Financial Services in Distressed Communities: Framing the Issue, Finding Solutions
By James H. Carr and Jenny Schuetz

and

Predatory Lending: An Overview
By James H. Carr and Lopa Kolluri

August 2001

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Executive Summary *

The American financial system is arguably the most sophisticated and efficient in the world. The power of our financial services industry derives from the complexity of the nation's financial intermediaries including commercial banks, savings institutions, mortgage banks, credit unions, investment banks, securities firms, insurance companies, specialized credit intermediaries, and a variety of specialized government and government-sponsored or -regulated financial institutions.

But this sophisticated financial services infrastructure differs markedly from the world of finance in lower-income and minority communities. There, the language of finance is increasingly pawnshops, check-cashing outlets, payday lenders, and rent-to-own stores. Largely unregulated in many states, the fees charged by these alternative financial services outlets are frequently excessive and their business practices often differ greatly from the asset-building and wealth-creation services provided by mainstream financial institutions.

In addition, excessive subprime, as well as predatory, lending tend to flourish in communities saturated with check cashers, pawnshops, and related financial services outlets. The heavy concentration of these practices in lower-income and minority communities further erodes the asset-building potential of financially vulnerable households. This concentrated negative impact on households translates into increased financial distress at a community level as households already living on the margin are forced to navigate a minefield of high-cost, unscrupulous, and often fraudulent financial services providers.

The following two articles focus on the financial services infrastructure that typically serves lower-income, minority, and distressed communities. They document how the failure to ensure efficient financial services markets in those areas exposes residents to wealth-stripping financial services activities and greatly contributes to their financial marginalization. The articles offer several policy recommendations to improve the delivery of lower-cost, asset-building financial services to the nation's most financially vulnerable consumers.

The first article, titled "Financial Services in Distressed Communities: Framing the Issue, Finding Solutions," by James H. Carr and Jenny Schuetz, examines the recent explosive growth of alternative financial services outlets in distressed communities and the corresponding growth of subprime and predatory lending in those same markets. Carr and Schuetz document the high costs for households relying primarily or exclusively on those lenders. Recognizing that fringe lenders have filled an important credit gap by developing products and services to meet the unique needs of lower-income consumers, the article cautions that those services, nevertheless, often come at staggering costs. Further, the article explains that because alternative financial services providers do not offer savings products, households that rely exclusively on them to meet their financial services needs have neither the incentive nor opportunity to save.

Carr and Schuetz also highlight the substantial costs to households exploited by excessive subprime and predatory lending. The article notes that while subprime lending is a critical source

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of credit for millions of families, minority households are disproportionately steered to higher-cost subprime lending. The extreme reliance on subprime lending by minority households raises the question of whether they are steered on the basis of their race or ethnicity rather than due to legitimate creditworthiness issues. The article documents that as much as 35 to 50 percent of the borrowers in the subprime market could have qualified for lower-cost prime market loans and provides examples of the extraordinary costs to households of being unfairly steered to subprime credit. The article notes that steering of borrowers to the subprime market contributes to confusion in the policy-making community in distinguishing between legitimate subprime and predatory lending.

Carr and Schuetz conclude with three policy recommendations to improve the financial services environments of distressed communities. They are: (1) Enhance data collection on finance services transactions and increase enforcement of fair lending, equal credit opportunity, and consumer protection laws and regulations; (2) Create greater competition for financial services in distressed communities by improving the range of available financial products and services and enhancing government's role as a facilitator and supporter of financial services innovation; and (3) Enhance and expand consumer outreach and financial education and awareness.

In the area of enhancing financial innovation, the recommendations include creation of partnerships between mainstream financial services providers and alternative financial services outlets that would leverage the strengths of both sets of institutions. Such partnerships would leverage the economies of scale that could be provided by mainstream firms while leveraging the customized products and outreach techniques perfected by fringe lenders.

The second article, "Predatory Lending: An Overview," by James H. Carr and Lopa Kolluri, examines more closely the issue of predatory lending. It notes that predatory lending represents some of the most abusive lending behavior in the financial services community and highlights the fact that predatory lending is not a simple issue of high-cost lending. Rather, Carr and Kolluri note that predatory lenders structure loans to force borrowers to default for the express purpose of extracting the equity homeowners have accumulated in their properties. But the article also notes that steering households to high-cost subprime loans on the basis of race/ethnicity or other personal characteristics is also a predatory practice that should be considered in the context of debates on predatory lending. A three-part definition for predatory lending is offered to explain how lenders utilize a variety of otherwise legitimate marketing techniques and loan terms to create fraudulent and financially destructive loans. The article concludes with a series of recommendations to directly address predatory lending.

Carr and Kolluri note that because predatory lending thrives in an environment where competition for financial services is limited or lacking, effectively eliminating predatory lending requires the same three-pronged approach recommended by Carr and Schuetz to enhance the efficiency of financial services generally in distressed communities. Carr and Kolluri further point out that as few as five to seven practices constitute the bulk of the most egregious predatory lending behavior and meaningfully addressing those practices would greatly reduce the most blatant forms of predatory lending.

Financial Services in Distressed Communities: Framing the Issue, Finding Solutions*

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Introduction

The American financial system is arguably the most sophisticated and efficient in the world. The power of the U.S. financial system comes from the complexity of financial intermediaries that include commercial banks, savings institutions, mortgage banks, investment banks, securities firms, insurance companies, specialized credit intermediaries, and a variety of specialized government and government-sponsored financial institutions.

But this sophisticated financial services infrastructure differs markedly from the world of finance in lower-income and minority communities (see figure 1, Bifurcated U.S. Financial System). There, the language of finance is increasingly pawnshops, check-cashing outlets, payday lenders, and rent-to-own stores. Largely unregulated in many states, the business practices of these financial services outlets differ greatly from the asset-building and wealth-creation services accessed by the majority of Americans.

Further, excessive subprime, as well as predatory, lending tend to flourish in communities saturated with check cashers, pawnshops, and related financial services outlets. Creating greater efficiency in, and competition for, financial services in distressed communities is the key to enabling lower-income and minority residents to maximize their asset-building capabilities and limit the negative influence of excessive high-cost and predatory financial services providers.

This article discusses the recent rapid growth of the alternative or fringe financial sector and highlights how its high-cost fee structure greatly undermines the ability of individual households to accumulate assets and build wealth. The article further notes that, to the extent that fringe financial services providers concentrate in, and are the primary financial services providers for, distressed lower-income and particularly minority communities, the neighborhoods in which they locate are also seriously disadvantaged. The article concludes with a series of recommendations to promote efficient financial markets in lower-income and minority

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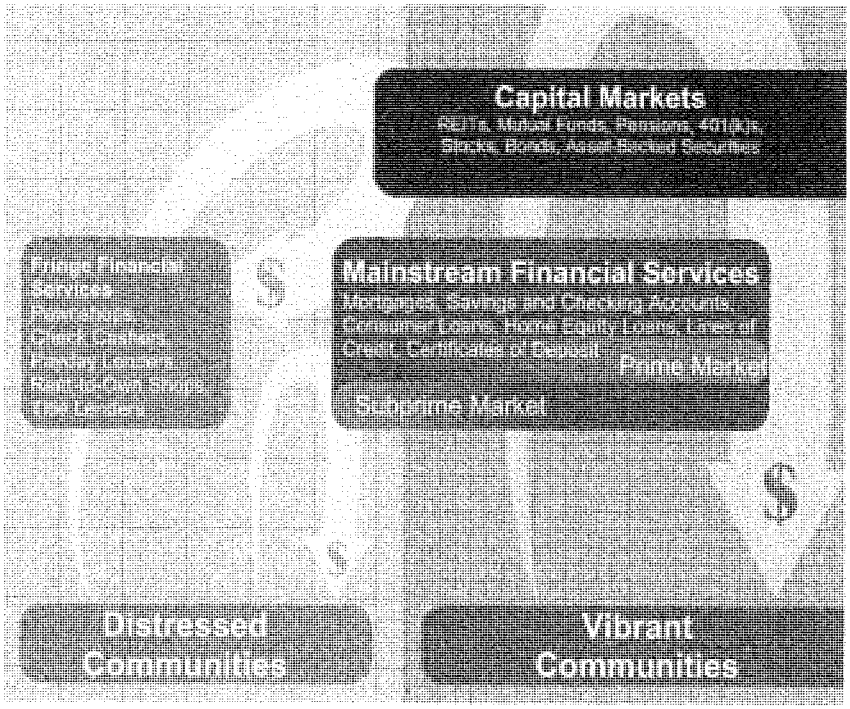
communities. A companion article focuses explicitly on predatory lending (see "Predatory Lending: An Overview").

Figure 1. **Bifurcated U.S. Financial System**



Financial Services in Distressed Communities

As many as 12 million households in the United States either have no relationship with traditional financial institutions or depend on fringe lenders for financial services. These households are disproportionately poor and minority. Among lower-income families surveyed in a 1995 Federal Reserve Survey of Consumer Finances, 25 percent were unbanked, as well as one-third of African-American households and 29 percent of Hispanic households. Without banks, these households operate largely in a cash economy or resort to fringe banking services that routinely charge significantly higher fees for services than those assessed by mainstream financial institutions. The situation is particularly daunting for African-American households, 60

percent of which have zero or negative net financial assets, according to a report by the Corporation for Enterprise Development.

Lack of physical proximity to mainstream financial institutions is perhaps the most frequently cited reason for the disparity in financial services utilization by low-income and minority populations compared with wealthier households. A 1999 *Harvard Business Review* article, for example, cites extreme disparity in financial services options available to residents of two neighborhoods in Los Angeles—one in South Central and the other in Pacific Palisades. South Central has one depository institution for every 36,000 people, while Pacific Palisades has one for every 1,250 people.

Yet while physical proximity is important, it is not the only—and often not the most significant—barrier to the use of mainstream financial services among lower-income and minority households. There are a variety of complex reasons why many lower-income and minority households do not use traditional financial services even when they have access. Those reasons include unfamiliarity with banking and savings services, a belief by consumers that they do not write enough checks to justify an account, and lack of trust of the mainstream financial services providers. In addition, mainstream financial services can also be very expensive for households that do not have a relationship with those institutions, when customers cannot fulfill minimum balance requirements, or when poor management of an account results in bounced-check or related fees.

In fact, fringe lenders attribute their rapid growth to large, unmet consumer financial services needs among many lower-income households. According to the Financial Service Centers of America (FiSCA) (formerly the National Check Cashers Association) alternative sources of credit are filling an important credit gap for "individuals with limited financial means or who may lack the tangible assets to pledge in connection with traditional types of collateralized transactions..." FiSCA further asserts that alternative financial services providers are in higher demand than banks or credit unions in many markets because they provide a wider range of services and more flexible hours of operation tailored to meet the unique needs of their clients.

There is little debate that fringe lenders provide critical services to customers whose extremely low or unreliable incomes, limited tangible assets, or inability to manage credit make them unlikely candidates for mainstream financial services. But the explosive growth of these financial services storefronts over the past decade raises many critical policy issues. First, because fringe lenders do not provide savings accounts, households that rely exclusively on them lack both the incentive and option to save. Second, the heavy concentration of fringe lenders in minority communities means that those areas are disproportionately burdened with second-class financial services options. Finally, reliance on fringe lenders, even to the extent they provide needed financial services, routinely comes at a very high cost.

Consider these examples for check cashers, payday lenders, pawnshops, auto title lenders, and various other fringe financial activity:

- Check cashers—Although the average fee at a check cashing outlet for a government or payroll check ranges from 1.5 to 3 percent of its face value, fees can run as high as 20 percent for personal checks. At least 19 states regulate some aspects of check cashing services.

- Payday lenders—institutions that offer small consumer loans of $100 to $300—routinely charge 15 percent per two-week period. In addition to annualized interest rates of more than 400 percent, such loans encourage households to spend the next paycheck before it arrives, thus encouraging a dangerous cycle that can trap a household in permanent debt.

- Pawnshops offer small, short-term loans using personal items as collateral. State-imposed interest rates are capped as high as 25 percent monthly, which, annualized, can exceed 300 percent. Loopholes in some states allow "lease back" or "roll over" agreements that add fees, sometimes doubling the already high interest rate.

- The rent-to-own industry offers purchasing credit to consumers for a variety of merchandise, such as furniture and home electronics, for weekly or monthly payments that can be applied toward ownership. Leased items are typically priced at two to three times the standard retail amount. No equity builds up in the leased items until the final payment. According to a Federal Trade Commission survey, 60 to 70 percent of customers who initiate leases eventually purchase the items. The Association of Progressive Rental Organizations estimates that the percentage of customers who complete a purchase is less than 25 percent.

- Auto title lending is a variation on traditional pawnbroking. A person with clear title to a vehicle can borrow money from a lender by giving him or her power of attorney to transfer the title should the borrower default. Title loans are typically made for about 25 percent of the car's value. Interest rates and other service charges vary between 2.5 and 25 percent per month, depending on a state's pawnshop laws. Title loans are particularly dangerous for working families because defaults can result in the loss of the car and, consequently, the job, if there is no other way to get to work.

- Robert Manning in his book, *Credit Card Nation*, also describes direct marketing campaigns for high-interest "secured" credit cards that are marketed to customers who likely would not qualify for a standard-rate bank-issued credit card. In one example, he cites an offer for a $400 line of credit for which, in return for applying for the credit card, an unsuspecting consumer agrees to pay a variety of fees totaling $369. Such "offers" may be widely distributed, but the people most likely to accept the offer are the most financially vulnerable populations with the least financial sophistication and the fewest credit options.

Compensating for Risk

While the fees charged by fringe lenders are justified on the basis of the perceived high risk of their borrowers, most of these financial services providers have devised creative ways to reduce or protect themselves against borrower default on top of the high fees they charge. Payday lenders, for example, not only require proof of employment, income, and a personal checking

account, but the borrower also must provide a postdated personal check. The rent-to-own industry allows no equity to be built up until the final payment, so a customer may meet all weekly payments and default near or at the end of the loan term, losing the item plus all previous cash payments. The retailer can then re-lease the item at the same weekly or monthly rate. Pawnshops provide cash loans in return for collateral left in the possession of the pawnbroker. And "cash leasing," a cross between payday loans and pawn loans, involves small, short-term cash advances that carry monthly interest charges of up to 30 percent, backed by an active checking account and "pledged" household items, such as a stereo, computer, or television. Some states are better than others in affording consumer protections in these types of transactions.

In fact, Progressive Policy Institute analyst Anne Kim notes that the two largest check-cashing companies in the United States cashed roughly $6.5 billion in checks last year. According to Kim, the majority of those checks were payroll or government benefit payments. The value of bad checks—that is, the checks for which the check cashers could not collect—totaled less than one-fourth of one percent of the total amount of checks cashed. The nation's two largest check cashers thus realized healthy profits charging on average 2.2 and 3.5 percent, respectively, of the face amount of the checks they cleared.

The Problem Is Growing

As table 1 illustrates, alternative financial services activity is big business. Fringe services engage in at least 280 million transactions each year for gross revenues of more than $168 billion that extract fees of at least $5.5 billion. According to Norman D'Amours, former chairman of the National Credit Union Administration, the number of unregulated and unlicensed financial services providers is growing nationwide, but the increase is exponential in low- and moderate-income and minority communities.

He notes that while the number of credit unions, banks, and thrifts has been steadily decreasing over the past five years in the United States, the number of check-cashing outlets has doubled. An April 2000 report by Dove Consulting for the U.S. Department of the Treasury reveals that about 11,000 check-cashing outlets in the United States cash more than 180 million checks annually, worth roughly $60 billion. D'Amours also estimates that there are between 12,000 and 14,000 pawnshops across the country, outnumbering credit unions and banks. Further, in 1996 there were 8,000 rent-to-own stores that served 3 million customers, according to a recent Federal Trade Commission survey. And in *Savings for the Poor*, Dr. Michael Stegman of the University of North Carolina, Chapel Hill, reported that payday lending grew nationally from 300 stores seven years ago to more than 8,000 in 1999.

Table 1. **Fringe Lending Is Real Money: Estimated Annual Transactions**

Service	Fee/Rate per Transaction	Volume of Transactions	Gross Revenues	Fee Total
Check Cashing	2–3 % payroll and government checks (can exceed 15% for personal)	180 million	$60 billion	$1.5 billion
Payday Loans	15–17% per 2 weeks 400% APR	55–69 million	$10–13.8 billion	$1.6–2.2 billion
Pawnshops	1.5–25% monthly 30-300% APR	42 million	$3.3 billion	N/A
Rent-to-Own	2–3 times retail	3 million	$4.7 billion	$2.35 billion
Auto Title Lenders	1.5–25% monthly 30–300% APR	N/A	N/A	N/A
Total	**N/A**	**280 million**	**$78 billion**	**$5.45 billion**

It Undermines Households and Communities

Even at the most modest levels, alternative financial services fees can greatly undermine the asset-building capacity of lower-income households. According to research cited by the Federal Reserve, fringe services for cash conversion and bill paying would cost an average $20,000-income household between $86 and $500 per year, while the same services at a bank would cost only $30 to $60 (assuming that low-cost banking services are available and the prospective customer is not disqualified for an account by lack of credit). Yet, $500 per year saved for a period of 10 years at a modest interest rate of only 4 percent would grow to more than $6,000. That amount would be sufficient for a down payment on a modestly priced home.

Moreover, the actual costs to many households using fringe banking would be even higher if those same households also resort to payday loans, pawnshops, rent-to-own retail, or auto title pawn loans. An example Manning offers in *Credit Card Nation* is of a $196 Magnavox TV that costs $9.99 a week for 78 weeks from a rent-to-own shop, for a total of $779. Compare it to buying the same television with a credit card at 22.8 percent interest from a national discount electronics store over the same time period for a total of $231. The difference in finance charge

would be $548. Assuming a household relied on fringe lenders for only an additional $300 worth of services per year, the new total of $800 of potential savings would grow to nearly $10,000 over a 10-year period, again assuming a modest 4 percent rate of return.

Even if these households actually were able to save some of their earnings, their failure to access mainstream financial services institutions undermines their long-term asset accumulation. To illustrate, table 2 calculates the different investment vehicles. If, in 1989, a family had $3,000 in savings, but saved the money in a shoebox, 10 years later that $3,000 would be still be worth $3,000 in nominal dollars but only $2,233 when adjusted for inflation. However, the same sum invested in a 10-year Treasury note would have grown to more than $5,000 by 1999. Investment in an S&P index fund would have yielded $9,180 over that 10-year period. And if the family had, by prophetic insight, invested their savings in Microsoft Corporation in 1990, their wealth could have grown to a staggering $211,360 by 1999.

Table 2. **The Value of Saving $3,000***

Year	Shoebox	Treasury Note	S&P 500 Index Fund	Microsoft Stock
1989	$3,000	$3,000	$3,000	$3,000
1999	$3,000	$5,072	$9,180	$211,360

* In nominal dollars.

Excessive Subprime Home Mortgage Lending

As with fringe lending, subprime mortgage lending has also experienced tremendous growth in recent years. A recent U.S. Department of Housing and Urban Development (HUD) study indicates that between 1993 and 1998, the dollar volume of subprime loans grew sevenfold, from $20 billion to $150 billion, and the number of subprime refinance loans grew tenfold, from 80,000 loans to 790,000 loans. This growth in subprime lending compares to less than a 40 percent increase in prime lending for home purchases and a 2.5 percent increase in prime refinance loans.

HUD reports that subprime loans are heavily concentrated in lower-income and minority communities—the same communities that are the target for fringe financial outlets. HUD's analysis indicates that subprime loans are three times more prevalent in lower-income neighborhoods than in high-income areas, and five times more likely in black communities than in white neighborhoods. In fact, in black neighborhoods, high-cost subprime loans accounted for 51 percent of home loans in 1998, compared with 9 percent in white areas. Moreover, homeowners in high-income black communities are six times as likely to have a subprime loan

as homeowners in high-income white neighborhoods. Estimates by Fannie Mae, Freddie Mac, and others conclude that many households in the subprime market could reasonably qualify for a prime market loan (see article on Predatory Lending in this report).

The Financial Impact of Excessive Subprime Lending

Subprime loans do not have to be predatory to seriously undermine the financial viability of households. Targeting or referring households to the subprime market in instances in which those loan applicants could reasonably have qualified for prime market loans greatly undermines the long-term asset-building potential of those households. Each additional interest point on a home mortgage totals tens of thousands of dollars on the total cost of a mortgage over the life of the loan. Subprime mortgages are routinely 3 to 4 percentage points or more higher than a comparable prime market loan. Yet, a mere 1 percentage point of additional interest can make a substantial financial impact over the life of a loan (see table 3).

Table 3. **Comparing Mortgage Payments for Different Interest Rates**

30-Year Fixed-Rate Loan				
	House Value	**$85,000**		
	Down Payment	**$4,250 (5%)**		
	Loan Amount	**$80,750**		
Annual Interest Rate	**Monthly Payment**	**Annual Payment**	**Annual Difference from 8%**	**Lifetime Difference from 8%**
8%	592.51	7,110.18	N/A	N/A
9%	649.73	7,796.79	686.61	20,598.43
10%	708.64	8,503.67	1,393.49	41,804.69
11%	769.00	9,228.01	2,117.83	63,535.05
12%	830.60	9,967.26	2,857.08	85,712.32

Take the example of a home modestly priced at $85,000. Assuming a 5 percent down payment, the mortgage is slightly under $81,000. With a base interest rate of 8 percent on a 30-year loan, a loan 1 percentage point higher results in $687 more annually. Over the lifetime of this 9 percent

loan, it would be a $21,000 difference. At 2 percentage points—a 10 percent interest rate—the difference from a prime loan of 8 percent would be $42,000, half the original loan amount. Now, take that same $687 a household could save each year by shaving off a percentage point on their mortgage and invest it at 6 percent. At the end of 30 years, that household would have $57,572 instead of having to pay $21,000 in additional interest. The 2-percentage-points savings of $1,393 per year, invested at 6 percent, would total $116,736 at the end of 30 years for the household. And if the subprime loan carried a 12 percent interest rate, the extra interest payment over the base 8 percent loan would be $85,712 over the life of the loan. Invested at 6 percent for 30 years, that $85,712 of additional payments would grow to $239,421 in savings over a 30-year period.

Reasons for Rapid Growth

Three trends in recent years appear to have strengthened the alternative financial services sector: 1) increasing consolidation into large, publicly held firms with standardized business outlets across the nation, 2) increasing involvement by mainstream financial institutions in fringe lending outlets, and 3) enhanced products and services and effective marketing schemes to capitalize on rising consumer debt and the disconnect between low-income households and the mainstream financial system.

Industry Restructuring

Restructuring within both the mainstream and fringe financial services industries are contributing to the growing significance of fringe financial storefronts in disenfranchised communities. Michael Stegman cites consolidation in the banking industry as one reason for the decline in the presence of traditional banks in neighborhoods of all income levels. In *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor,* John Caskey suggests that banking deregulation and pressure for increased profits have led banks to charge for previously free services and close unprofitable branches (often in low-income and minority areas) as well as eliminate money-losing services, such as small-balance deposit accounts.

Over the same period, several fringe financial outlets, such as pawnshops, check cashers, and payday lenders, have engaged in major consolidations. In the check-cashing industry, for example, six firms owned at least 50 outlets each in 1991. By 1999, one of the largest of these establishments had grown to more than 1,000 company-owned stores with franchises in 30 states. Further, this company has expanded its traditional in-store check-cashing business to include bill payment services as well as automated check cashing using advanced function ATMs with user-friendly touch screen menus.

Pawnshops, too, have grown into national chains. Data from *Fringe Banking* report the existence of at least five large, publicly traded nationwide pawnbroking firms. The largest of these chains went public in 1987, and by 1999 had acquired 414 stores in the United States. The rent-to-own industry has shown similar trends of consolidation. The largest firm was founded in 1986, and by 1999 owned 2,300 stores across the nation, or roughly one-fourth of all rent-to-own stores.

Convergence of Fringe and Mainstream Lenders

Wall Street has also fueled the growth in fringe and subprime activity. A recent *Business Week* article notes, for example, that through securitization—that is, the practice of issuing securities based on a pool of mortgages that can be sold to investors—leading Wall Street firms resold $60 billion of subprime mortgage loans in 1999, up from $3 billion in 1995. Between 1995 and 1998, subprime loan note sales rose from $10 billion to $87 billion. Banks now control 5 of the nation's top 10 subprime lenders and 10 of the top 25 subprime lenders.

Effective Marketing and Customized Services

While many low-income households exhibit reluctance to use traditional banks, fringe financial services providers have well-developed marketing strategies to draw in and retain customers by focusing on the relationship between customers and staff. Pawnshops and rent-to-own stores emphasize treating customers with personal attention and encourage small weekly payments made in person, allowing the retailer to market additional products to existing customers. These types of businesses rely heavily on repeat customers, which they cite as a means of increasing transactions while reducing risk, as Caskey reports in *Lower Income Americans, Higher Cost Financial Services.*

Role of Financial Markets in Community Reinvestment

Creating efficient markets in distressed communities is essential to successful revitalization of those areas. Stated otherwise, building community wealth requires the building of individual wealth. Mainstream financial institutions are the engines of wealth creation and upward financial mobility in America. Improving access to, and utilization of, the mainstream engines of wealth creation would by itself promote significant community investment.

Each dollar that is spent on overpriced financial services by a lower-income household represents potentially important savings that could lead to wealth building. For example, the more than $5.45 billion in fringe financial services fees that are collected from financially vulnerable consumers each year is slightly less than the entire asset base of the more than 460 community development financial institutions (CDFIs) operating in the United States. It is also moderately less than the fiscal year 2000 HUD budget for Community Development Block Grants plus all HOPE VI and Empowerment Zone/Enterprise Community funding.

Moreover, the fees represent an annual funding stream. If only a portion, perhaps 20 percent, of those dollars lost each year to fringe financial services could be captured and redirected to housing, that would represent more than $1 billion for home-buyer assistance or housing rehabilitation in many of the most distressed communities in the nation. And, that funding stream would not require any additional taxpayer contributions. Add to that sum the hundreds of millions of dollars unnecessarily paid each year, by households unfairly and unnecessarily steered into high-cost subprime loans, and it is immediately clear how better organizing the

financial markets in distressed communities and connecting households to the engines of wealth creation can provide a major boost to the community revitalization process.

Flowing to a broader range of consumer goods and services, that money could encourage the opening of new business based on market demand for locally desired products or services. Helping to create wealth could reduce the need for complex tax-related government subsidies that encourage businesses to relocate to distressed communities that have no economic rationale for being there other than to benefit from untargeted and questionable tax subsidies. If channeled into savings, money lost to check cashers and similar high-cost services could offer financial institutions and community residents enormous wealth-generating potential.

Fixing the Problem

Enhancing financial services options for lower-income and minority households and communities will require action in three areas:

1. Improving the availability of data on financial services transactions and aggressively enforcing fair lending, equal credit opportunity, and consumer protection laws and regulations.

2. Enhancing availability of products and services designed to meet the unique needs of lower-income and lower-wealth customers.

3. Offering consumer financial education and outreach programs.

Collecting Additional Data and Enforcing Laws

An important missing tool to address the issue of market failure in distressed communities is a robust set of data that could more easily enable policy makers, regulatory agency personnel, researchers, nonprofit community activists, and other interested parties to pinpoint critical areas and issues for examination and possible action. Enhancing data collection is always controversial. But it is simply not possible to resolve a problem that cannot be identified and examined. When the federal government first sought to include borrower race/ethnicity information in the Home Mortgage Disclosure Act database, many argued that added information would be useless because it would answer only *who* was accepted or rejected for mortgage credit but not *why*. Yet that data exposed major and critical areas for concern throughout the mortgage lending industry related to lending to traditionally underserved borrower groups. The net result has been explosive growth in affordable lending to lower-income and minority households over the past decade.

Because alternative financial services providers are regulated at the state level, with widely varying regulatory oversight, a single national reporting requirement could greatly enhance the ability of regulators, community groups, and research institutions to examine the practices of

these firms. Data elements might include fee schedules, collateral requirements, number of customers served, and revenue and earnings statements.

The goal of greater regulation with respect to fringe lenders should not be to eliminate those sources of credit. In moderation, they provide important access to credit for a variety of consumers. Rather, enhanced regulation should ensure that to the extent those services are provided, they are offered at costs that more reasonably reflect the real risks presented by consumers. Interest rates, for example, that when annualized can exceed 300 percent or more, are hard to justify under any circumstance. Further, the targeting of high-cost financial services on the basis of personal characteristics such as race or ethnicity, rather than on the basis of income or creditworthiness, should be closely monitored and effectively addressed.

For subprime loans, additional information might include key loan terms such as the inclusion of credit life insurance, balloon payments, prepayment penalties, and related major loan characteristics. Further, interest rates, points, processing fees, and closing costs would also be critical. This data could highlight areas for further investigation and allow for a more aggressive enforcement of fair housing, equal credit opportunity, and a variety of consumer protection laws.

To the greatest extent possible, reporting requirements for similar financial transactions should be the same for the greatest number of institutions possible. Dissimilar reporting requirements across institutions that perform similar services create opportunities for abuse by institutions that are not covered. At the same time, institutions that are covered may be discouraged from attempting to enter emerging markets with new or innovative products. Further, because data collection can be very costly, care should be taken to ensure that any new reporting requirements do not overwhelm financial institutions with requests for insignificant and extraneous information.

Further, an explicit focus on how equal credit opportunity and consumer protection laws are violated in distressed communities would provide financially vulnerable households with the kind of support offered to middle-income and wealthy households in vibrant communities. Each year, millions of dollars are spent on financial system regulation through agencies such as the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Department of the Treasury, and Federal Reserve System, to name a few. But federal institutions can do relatively little to protect the financial interests of households operating in a cash economy or relying on fringe financial services providers whose activities are not covered by those key federal financial regulators.

Enhancing Products to Serve Lower-Income Households

Efforts to promote a wider range of financial products and services for low-income and minority households can be divided into three categories: 1) efforts to connect households receiving government benefits to low-cost access to those funds through electronic transfer accounts (ETAs) and related initiatives; 2) enhanced utilization of technology, such as sophisticated ATMs and the Internet; and 3) innovative products and partnerships designed to meet the unique needs of lower-income, lower-wealth households.

Government Initiatives. The Debt Collection and Improvement Act of 1996 is one of several promising initiatives launched by the federal government to decrease processing costs, reduce fraud, and provide a lower-cost alternative for benefit recipients than sending them paper checks that must be cashed, usually for a fee. The law mandated that, by 1999, all federal benefit payments would be delivered electronically—a measure that is expected to save the federal government an estimated $100 million annually on processing and delivering payments. Since the legislation went into effect, Congress has mandated that states convert food stamp programs to electronic payment by 2002, using point-of-sale (POS) terminals at participating retailers. Additionally, more than 40 states have voluntarily decided to add their emergency cash assistance programs to the plastic food stamp cards so that welfare benefits will be accessible at ATMs and POS networks.

These laws create even more opportunities to link low-income families and people living in underserved areas to banks and other savings institutions. Michael Stegman, in his forthcoming article, "Banking the Unbanked," says the electronic delivery of government benefits "promotes financial inclusion" and recognizes that "economic opportunity cannot thrive where access is denied." In fact, an estimated 3 million of the roughly 12 million unbanked individuals in the United States receive federal government benefits—a large market that has gone largely untapped.

Expanding Use of Technology. A Ford Foundation white paper, "Financial Technology and the Lower-Income Consumer" by Steve Davidson et al., notes that new types of ATM and card-based technology have the potential for "turning the unbanked to the self-banked" while lowering costs and increasing access and convenience to financial services and products. The report provides several examples: Umbrella Bank in Illinois plans to put ATM-equipped kiosks in lower-income housing developments; FirstTel is gearing up for similar services in HUD housing in Florida; and Banco Popular offers an all-electronic account to customers without a traditional bank account.

Similar to the federal government's ETAs is a U.S. Treasury Department pilot initiative that uses ATMs to limit the reliance on fringe lenders and check cashers in traditionally underserved markets. Treasury is piloting a program to put ATMs in post offices to distribute Social Security payments, federal retirement payments, and other government benefits. Consumers use a debit card or credit card to access their benefits with no extra fees. The ATMs would provide safe and convenient access to banking services in traditionally underserved areas. The project, in partnership with the U.S. Postal Service and Key Bank of Cleveland, which owns and operates the ATMs, is testing the use of the free-of-charge ATMs at three urban locations in Baltimore and three rural locations outside Tallahassee, Florida.

Efforts to lower the cost of banking by using technologial advances should be encouraged among the private sector as well, since an estimated half of the country's private sector employees do not participate in direct deposit. Comptroller of the Currency John D. Hawke Jr. recently told the National Community Reinvestment Coalition that expanding the structure of the direct deposit account to make it more appealing to the unbanked is critical to bringing them into the mainstream banking system. Creating these connections—and adding functions such as transfer

of funds to other countries at a lower cost than wire transfer fees—can create links between banks and lower-income residents.

Innovative Products and Services. Mainstream financial services providers can learn from the considerable finesse demonstrated by alternative financial services providers in marketing, packaging, and bundling services. One example is bundling services such as check cashing, money orders, money wiring, utility and cable bill payment, and related services (see the summary of John Caskey's proposed solution following this article). Mainstream financial institutions can take a lesson from and form partnerships with fringe service providers, creating efficient operating structures that lower costs and then pass along savings to clients.

Innovative programs that have recently been introduced or are being test-marketed by institutions such as community development credit unions (CDCUs) and CDFIs should be encouraged and expanded. Woodstock Institute's *Reinvestment Alert No. 16* provides two examples of CDCUs that are offering alternative payday loan products to counter the often-excessive fees charged by fringe payday lenders. The Faith Community United Credit Union in Cleveland and the Louisiana-based ASI Federal Credit Union offer affordable alternatives to their members, and their experiences can show how other mainstream credit unions and financial services providers can establish similar consumer loan products. Both offer interest rates of 17 to 18 percent, with $15 to $30 processing fees and timely repayment requirements. Credit counseling is offered with the service, and a savings plan can be integrated into the loan.

Davidson et al. also provide examples of how some mainstream financial services providers are expanding their reach to lower-income consumers by lowering the cost of those services to help "transition" these customers to mainstream markets. Union Bank of California has created a division called Cash & Save that offers check-cashing services at a lower-than-average 1.0 percent to 1.5 percent fee on payroll checks issued by area employers. Customers are permitted to open Union Bank savings accounts at Cash & Save outlets. Another company, Directo Inc., is serving lower-income customers—many of whom were denied bank accounts—with a payroll debit card, allowing employees to access their pay electronically through an ATM. Directo also has an innovative wire service/ATM feature that enables customers to wire money to foreign bank accounts that can then be accessed through an ATM. The fees are much lower than those for most wire services.

New partnerships between fringe lenders and mainstream financial services providers can also prove to be highly beneficial to residents of distressed communities and the financial institutions that serve them. By moving away from an exploitative model and toward a model that lays the foundation for a long-term, mutually beneficial relationship, mainstream financial institutions can help to build the assets of lower-income consumers that can lead to more valuable and substantial relationships over time.

In *Banking the Unbanked,* Stegman cites the Chicago Community Reinvestment Act Coalition and Bank One as an example of this type of partnership. The organizations teamed up to increase lending, service, and investments in lower-income communities in the Chicago region. They are also piloting a program to promote deposit services to unbanked customers. This pilot, the "Alternative Banking Program," offers a safe, convenient, and inexpensive alternative to check-

cashing services and conducts financial literacy workshops to demonstrate the cost savings of using alternatives to check cashers.

The incentive to reform the financial services environment characterized by high-cost and inefficient financial services providers is compelling for policy experts interested in helping to promote the building of wealth among lower-income and minority households. The extraordinary sums of money involved in excessive fringe and subprime lending clearly demonstrate the fact that there is substantial potential for lower- and moderate-income households to build their financial assets. Further, recent research by Hogarth and O'Donnell in the *Journal of Consumer Policy* shows that when low- to moderate-income households are brought into institutions with a transaction account, there is a high probability of moving them "in and up" into other product lines.

Improving Financial Education and Outreach

Even if there is improved enforcement of laws, it is very important to educate consumers about the types of institutions, products, and services they should use, and ones they should avoid. Many lower-income households have limited financial savvy and do not know the most basic aspects of household budgeting. Well-conceived, -designed, and -delivered consumer education programs can be instrumental in helping households more effectively mange their finances.

In addition, consumers need to know how to identify potentially fraudulent or otherwise questionable lenders. They need to know, for example, that when they see ads that read: "No credit, no job, no problem," they should respond with "No thanks!" Financially vulnerable households need help understanding that substantial wealth can be built from relatively small amounts of money. They need support to best understand how to properly and effectively evaluate the financial services options available to them and how to select the options that best meet their needs.

Having said that, caution needs to be exercised with respect to our expectations on the ability of financial education to aid borrowers facing predatory lenders. Households with limited education are little match for sophisticated criminals intent on defrauding a household of their wealth. Loan documents are challenging and complex even for borrowers with masters degrees in business.

Mortgage loan contracts can involve 30 or more separate documents written in the legal prose and not intended to be understood by a lay person. Expecting a poorly educated borrower to defend himself or herself in this type of situation is unrealistic. For borrower education to be most effective, it will need to include education prior to selecting a lender as well as third party review at the time of closing.

Conclusion

Improving the financial services environment for lower-income and minority households is imperative to enabling them to fully benefit from the wealth-building opportunities available to

most Americans. With regard specifically to minority households, it is useful to keep in mind that discrimination has played a significant role in creating many of the distressed markets heavily populated by fringe, excessive subprime, and predatory lenders—and that for many years government policies directly supported and even enforced many of the most discriminatory actions. As a result of that history, government has an important role to play in helping eliminate the legacies of those discriminatory actions. Principal among them are the inefficient markets in distressed communities. Improving the markets can be accomplished by supporting financial institutions to reposition themselves to be more effective in meeting the financial services needs of residents of underserved communities.

Rather than acting solely as a policeman—enforcing laws and penalizing institutions that fail to perform—government should work with financial institutions to provide them with the flexibility to test programs or with the funding to pilot innovative financial services approaches that are too expensive for private financial institutions to pursue on their own.

The federal government is constantly engaged in the credit markets to ensure the efficient functioning of those markets as they pertain to middle- and upper-income households. In fact, even today, most households benefit from a substantial infrastructure of government agencies that work to perfect the operation of market mechanisms to ensure the most efficient delivery of financial services possible. But because most of the financial institutions supported or regulated by this infrastructure do not directly serve unbanked households, this elaborate infrastructure does little to promote the financial well-being of the residents of distressed communities.

Greater information and enforcement of relevant laws, combined with increased financial sophistication on the part of consumers, could go a long way toward eliminating in the near term some of the most egregious and abusive financial services practices in struggling, lower-income and minority communities. By combining the private market's innovation with publicly supported initiatives to understand and address market failure, the full range of financial services that serve the majority of Americans can be made accessible in all communities.

Strengthening Financial Services

Five Key Elements in Bridging the Banking Gap[1]

In a paper recently presented at a Federal Reserve System conference on *Changing Financial Markets and Community Development*, John P. Caskey outlined a five-point strategy to bring into the financial mainstream the "unbanked" who, without any type of deposit account, are typically customers of check-cashing outlets (CCOs). He suggests that specially bundled financial programs would help this population build savings and improve credit-risk profiles, qualifying them for lower-cost services and eliminating a common source of stress.

1. Open specialized bank branch "outlets" that provide CCO services.

Banks could provide a range of financial services to unbanked communities by creating bank "outlets" for check cashing. By locating in places convenient to large numbers of low- and moderate-income households that tend to use CCOs, these outlets could initiate banking relationships and build trust among the unbanked. Additional products and services that could be offered include money orders, stamps and envelopes, international and domestic cash wire transfers, phone cards, bus tokens and transit passes, and payment of utility and phone bills. By charging lower fees for check-cashing services than CCOs and offering discounted rates for frequent customers, bank outlets could encourage repeat business, enabling many to "graduate" to banks. The outlets could also work with customers to build savings and address credit problems.

2. Offer "starter" bank accounts with low minimum-balance requirements that cannot be overdrawn, and include access to low-cost money orders for making long-distance payments.

To encourage the unbanked to become traditional bank customers, their accounts could be tailored to their unique situations. Low-cost, low–minimum balance checking and savings accounts could be offered with nontraditional features, such as discounted money orders, stamped envelopes, convenient processing of utility bills, and electronic deposit of wages and government transfers. By blocking the account from being overdrawn, CCO customers can avoid the high costs of bouncing checks that might have dissuaded them from having traditional accounts. ATM and debit-card access could also be given, along with the service of making long-distance payments.

3. *Create accounts specifically designed to build savings.*

"Savings-building" accounts that allow individuals to pledge to save a fixed amount in small increments over a specified time period, usually a year, could also assist the unbanked. Contributions would coincide with receipt of regular income such as a paycheck and, if possible, would be automatically debited. Caskey suggests separating these accounts from a regular checking or savings account to keep a psychological distinction between the two. He also

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suggests imposing a penalty for early closure of the account and for failure to make specified deposits at regular intervals.

4. *Offer deposit-secured emergency loans to individuals whose credit histories make them ineligible for traditional mainstream credit.*

With credit-scoring and other cost-saving technologies, bank outlets could find it more feasible to make unsecured non-revolving loans of less than $1,000 to customers with good credit records. This would allow them to compete with payday lenders and pawnbrokers to offer smaller loans often not practical at larger banks because of high risk factors and administrative costs. For customers with impaired credit histories, outlets could offer deposit-secured credit cards, or loans made against the balance of a savings-building account. In addition, outlets could partner with community-based organizations (CBOs) to establish philanthropic deposit accounts to provide collateral for loans to lower-income households without financial savings.

5. Seek community-based partners and offer financial literacy programs.

Banks can benefit in many ways by forming partnerships with carefully chosen nonprofit CBOs. A well-connected CBO can help overcome distrust between community residents and banks. Also, CBOs benefit from increased financial services in the neighborhood, and can initiate and promote financial literacy initiatives.

Caskey also offered two case studies of these strategies:

"Cash & Save" Outlets of Union Bank of California

Union Bank of California began opening "Cash & Save" outlets in 1993 in Los Angeles and San Diego offering check-cashing and banking services. By 2000, there were 12 stores, the most successful of which were stand-alone outlets in large discount stores that catered to middle- and lower-middle-income shoppers. "Check-cashing" is prominently advertised and the hours of operation include evenings and weekends. In addition to traditional banking services, the Cash & Save outlets offer a full range of commercial check-cashing services. A first-time check-cashing customer pays a $3 fee to become a Cash & Save "member" with a digital photo, signature, and employment information on file.

To encourage repeat business, discounts are offered, including a $10 annual "Money Order Plan" that allows six "free" money orders a month and a discounted 1 percent check-cashing fee for the year. Other services include cashing of government checks and paychecks for nondepositors, originating domestic and international wire transfers, handling the payment of utility bills, selling prepaid phone cards, faxing and photocopying, and in some locations selling bus tokens and passes. Basic checking accounts have low minimum-balance requirements. Among nontraditional accounts is a deposit account similar to an Electronic Transfer Account that receives electronic deposits of government benefits payments with a passbook interest rate. Maintenance fees are waived, but all cash withdrawals carry a 1 percent fee. Cash & Save also offers two savings plans: The "Nest Egg" account requires a commitment to deposit at least $25 a month for one year after a $10 initial deposit, and the "Combo" account combines the Nest Egg

account with the Money Order Plan. Cash & Save outlets formed partnerships with CBOs to offer personal financial management seminars. The CBOs host the seminars and the banks publicize them. Union Bank reports that about 40 percent of its regular check-cashing customers use at least one traditional bank product within a few years.

"Over-the-Rhine" branch of Cincinnati Central Credit Union

The Cincinnati Central Credit Union (CCCU), realizing the lack of depository financial institutions in the Over-the-Rhine neighborhood, formed a partnership with a local nonprofit organization based there called SmartMoney Community Services. SmartMoney raised the capital to acquire and equip a storefront credit union branch and then provided subsidized office space. The partnership is mutually beneficial: SmartMoney provides one-on-one financial counseling sessions and helps build trust between the community and the CCCU, and the credit union provides the community with convenient, professional depository and credit services. Services include low-cost, low–minimum balance checking and savings accounts, and a small-scale individual development account program.

The branch also sells low-cost money orders, postage stamps, envelopes, and bus passes. To provide small loans to residents with impaired credit histories, the "Smart Loan" program was designed. SmartMoney collected donations from churches and individuals to use as collateral for Smart Loans, with the maximum loan amount being $3,000. SmartMoney requires that recipients enroll in its Smart Change budget counseling course to repair credit records and build savings. CCCU reports that the branch, which is largely self-supporting, has successfully met residents' needs for convenient financial services and support.

Case Study on Neighborhood Trust Federal Credit Union

Neighborhood Trust Federal Credit Union (NTFCU) in New York City is one of the fastest-growing community development credit unions in the United States. Opened in 1997, it has accumulated $5 million in assets, about double the amount in deposits in most neighborhood credit unions, according to the *New York Times*. Based in an abandoned Chemical Bank branch in the Port Authority Terminal on Fort Washington Avenue and 178th Street, the nonprofit credit union provides services to low-income residents of the Washington Heights and West Harlem communities, where check-cashing outlets and pawnshops are on nearly every corner and predatory lenders proliferate. An estimated 70 percent of NTFCU customers have never had a bank account.

Background/Structure

The idea of creating a nonprofit organization to provide financial and educational services for community development was conceived in 1994 by New York City school teachers Mark Levine and Luis De Los Santos. Recognizing the disparities of service in the Washington Heights community, Levine, a graduate of the Kennedy School at Harvard, conducted a population survey that revealed a desperate need for affordable financial services. He enlisted friends to help

him conduct research to determine how to create a community-owned and -run community credit union.

Three years later, the NTFCU was born. A daughter organization of the nonprofit Credit Where Credit is Due organization—which provides outreach, education, and training on financial management, banking services, and homeownership—NTFCU now has a staff of 12 and 3,000 members, each of whom is a shareholder.

Population Served

The two communities served by NTFCU have a total population of about 500,000 with a median household annual income of $10,000 to $12,000. In Washington Heights, 80 percent of the population is Dominican and in West Harlem it is 55 percent African American and Latino. A large proportion of the local businesses are home-based child care, beauty salons, grocery stores and convenience stores, and eateries. Most of the credit union's customers have never used mainstream financial institutions. Instead, they were typically served by pawnshops, check cashers, and predatory lenders.

Services Provided

NTFCU provides a number of financial services, including:

- Personal and business banking: Customers can open a no–minimum balance checking account with $100 and have no limit on the number of checks that can be written for a monthly service fee of $5. Savings accounts require $50 minimums. The credit union also offers ATM cards.

- Lending services in the form of personal loans, securitized credit, and mortgage lending: Personal loans ($500 to $10,000) are offered for personal needs or to start or build micro-businesses. Interest rates are higher on personal loans than for business development. Repayment periods vary by loan and borrower profiles, but generally do not exceed four years. At the time of this writing, the loan portfolio consisted of 700 loans totaling $1.9 million, with a repayment rate of 97 percent. Default rates of 3 percent are consistent with commercial banks serving higher-income populations. Securitized and partially securitized credit cards are also offered. These are basically prepaid credit cards. Mortgage lending is primarily for cooperative housing purchases, normally not exceeding $150,000. Although the majority of owner-occupied housing stock in upper Manhattan is cooperative housing, these mortgages are often viewed as risky loans for commercial banks because they are considered nontraditional.

- Education through financial literacy programs. The Credit Where Credit Is Due (CWCID) organization, the Neighborhood Trust's mother organization, conducts four different educational and outreach programs.

1. The *Personal Financial Literacy Program* focuses on developing basic accounting skills to open and use bank accounts, write checks, draft monthly budgets, save for college, and understand concepts of stock market investment. Graduates of this program can use the pro bono services of the investment company, First Investor.

2. The *Enterprise Training Program* series coaches entrepreneurs on business concepts, how to prepare business plans and budgets, access capital, handle accounting and bookkeeping, and better understand the basics of business law and employee management. After completion of the eight-class series, entrepreneurs are entitled to one hour of free consultation with the CWCID education program manager, as well as free consultations with the law firm of Chadbourn and Parke.

3. The *Youth Education Program* or *School Banking* teaches local fourth and fifth graders to use banking services and to save for their futures. Participants open bank accounts and can make deposits with as little as one cent. Withdrawals require parental consent. The program operates in local schools and includes lessons in basic math as applied to banking. More than $23,000 has been saved by the 750 participants.

4. The *Home Ownership Training Program* teaches community members how to obtain a home mortgage loan, assess one's financial capacity to repay it, calculate the terms of an affordable mortgage, and assess the value of a house. Because the majority of housing in the area is cooperative housing, the program also offers specific information about what cooperatives are and about cooperative lending.

Strategies for Success

The credit union's success is attributed to its ability to fine-tune its services to community needs, and its commitment to local economic development. The survey conducted in the beginning of CWCID's project helped identify these needs. The organization is also in a constant mode of self-evaluation and regularly asks clients to fill out evaluation questionnaires. Another strength is Neighborhood Trust's sound business practices and modeling of commercial banking operations, combined with a balance between its commercial approach and nonprofit developmental agenda. Finally, successful fund raising to cover a variety of support activities has also added to the ultimate success of Neighborhood Trust.

Individual Development Accounts

Individual development accounts (IDAs) are matched savings accounts designed to help low-wealth families or individuals build assets. Participants can use the money saved through these accounts to buy a house, develop a business, or increase job skills through education and training.

Similar to other defined contribution plans, such as 401(k)s, IDAs offer a monetary incentive for participation for every dollar saved. Individuals make regular savings deposits in their IDAs that

are then matched by funds from the sponsoring bank, foundation, other charitable organization, or local government.

IDA programs often include personal finance literacy counseling and training on such issues as homeownership, household budgeting, record keeping, and long-term economic planning.

Although the main goal of the program is to increase wealth, the accounts also provide opportunities for banks to attract new customers by increasing the comfort level of participants with financial institutions.

Several foundations, community organizations, elected representatives, and government officials have provided crucial support for IDA programs. Both the Corporation for Enterprise Development and the Center for Social Development at the University of Washington at St. Louis have played central roles in the implementation of a national IDA pilot demonstration, research on the effectiveness of IDAs, proliferation of federal and state IDA legislation, and the development and dissemination of program development materials. As a result, a proposed national IDA tax credit, called the Savings for Working Families Act, is expected to come before Congress for a vote this year.

The national demonstration has achieved the goal of proving that low-income and low-wealth individuals can save when given the proper incentives and educational tools. Over a three-year period, the 2,000-plus demonstration participants deposited more than $1.3 million. The success of the national demonstration has generated tremendous interest in and support for IDA programs at the federal, state, and local levels. In considering further initiatives, however, it is important to keep in mind that these early IDA initiatives have been relatively costly to set up. Services such as outreach and consumer education can be costly.

Community Development Financial Institutions

Definition, Structure, and Population Served	Mission	Strengths
Community Development Financial Institutions (CDFIs)		
CDFIs are private-sector financial intermediaries with community development as their primary mission. They are bridge institutions that link unconventional borrowers and conventional financial institutions. There are 6 basic types of CDFIs: 1) community development credit unions, 2) community development banks, 3) community development loan funds, 4) microenterprise funds, 5) community development corporation-based lenders and investors, and 6) community development venture funds. CDFIs target their efforts to distinct geographic	CDFIs bring private-sector capital to bear on problems that have historically required public sector solutions. They all have community development as their primary mission and carry out that mission by: 1) financing businesses and community facilities, job creation and development, and affordable housing in low- and moderate-income communities; 2) providing technical assistance to assist "unbankable" customers; 3) demonstrating that poor urban and rural areas can be profitable markets; 4) helping banks target their	The strength of CDFIs is their flexibility to adapt lending guidelines to the needs of borrowers; to accept unconventional collateral for loans; and to provide education, training, and assistance to potential borrowers. CDFIs attract private investment, they don't substitute for it. They rely on capital-led strategies to address

areas that are economically distressed and/or to distinct demographic populations that are underserved. Some CDFIs, for example, target their efforts to a particular urban, rural, or reservation community. Others lend to particular groups of people (minorities, women, low-income families) or offer specific types of credit products not readily available in the conventional market.	community reinvestment funding; and 5) bringing innovative and trailblazing products and services to disinvested areas. CDFIs make possible loans and investments in community development that conventional financial institutions would consider unbankable.	economic and social problems, and seek to establish capital relationships within their markets that seed sustainability.
CDFI Fund		
The CDFI Fund was established by the U.S. government to facilitate the creation of and capitalize a national network of financial institutions that is dedicated to community development and is committed to serving and improving low-income and low-wealth communities. CDFI Fund supports these organizations with an aim to make the most effective use of limited federal resources. It uses relatively small amounts of federal money to leverage significant amounts of private and nonfederal dollars, promotes private entrepreneurship, and encourages self-help and self-sufficiency.	The Fund bolsters economic development by investing in and assisting CDFIs. By investing in institutions, not just projects, the Fund helps CDFIs better respond to their markets by increasing their ability to manage risk, enhance capacity, and be flexible in their financing. The CDFI Fund provides the following types of assistance: equity investments, credit union shares, loans, grants, and technical assistance (directly, through grants, or by contract with organizations with expertise in community development finance). The Fund supports the following uses of financial assistance: commercial facilities that promote revitalization, community stability, or job creation or retention; businesses that provide jobs for, that are owned by, or that enhance availability of products and services to low-income people; community facilities; basic financial services; housing for low-income people; other businesses and activities deemed appropriate by the Fund; and technical assistance for capacity building, training, and development of programs, investments, or loans.	The CDFI Fund is innovative, investment-oriented, and businesslike in approaching its funding. Recognizing that there are diverse organizational levels, the Fund has established different windows for participants. In addition to the "Core CDFI Program," the Fund has implemented an "Intermediary Program" through which organizations in need of assistance can participate through CDFI intermediaries, and a "Technical Assistance Program" that offers financial support to CDFIs working to build their organizational capacity. Current Initiatives: Core Program—provides financial and technical assistance to CDFIs; Intermediary Program—provides financial assistance to CDFI intermediaries (CDFIs that finance other CDFIs); Bank Enterprise Award Program—provides financial assistance to CDFI and non-CDFI depository institutions; Certification—non-monetary classification recognizing that CDFIs meet Fund eligibility requirements; Microenterprise Awards—non-monetary award program recognizing excellence in microenterprise development; Technical Assistance Component will provide financial assistance to training and technical assistance providers that work with CDFIs; Secondary Market Initiative—financial support to enhance CDFI liquidity.

Case Study of a CDFI: First Bank of the Americas

First Bank of the Americas (FBA) in Chicago is an FDIC-insured bank designated by the U.S. Treasury as a community development financial institution. Since its founding in 1997, FBA has served the predominately Mexican-American communities of Pilsen, Back of the Yards, and Little Village. In a speech in early 2000 to the Chicago Board of Alderman, First Bank of the Americas President and CEO David Voss described the bank's mission of providing reasonably priced financial services to the surrounding community where high-cost fringe bankers do brisk business in "lifeline banking transactions" of check cashing, bill payment, and money transfer.

During a five-month period between September 1999 and February 2000, FBA refinanced more than 150 high-rate mortgages, home equity loans, and consumer loans at market interest rates. Voss estimated that FBA's refinancing will save community members more than $4 million over the next five years.

To overcome neighborhood residents' distrust of traditional financial institutions, FBA, with some outside funding, has launched a community outreach and education campaign. It conducts monthly financial literacy seminars and provides information on local Hispanic TV and radio stations. FBA also has established "school banks" at two schools, Maria Saucedo Scholastic Academy and Cristo Rey High School. The banks, staffed and managed by students, offer savings accounts to students and school staff, serving a dual function of teaching children personal financial management and introducing them to the workings of a bank.

Microfinance for Enterprise Initiatives of Low- and Moderate-Income and Other Disadvantaged Communities

Microfinance is the extension of small loans to small enterpreneurs and households that are too poor to qualify for traditional bank loans or lack assets for collateral. These loans are typically used for income generation, enterprise development, and, in some instances, for community needs such as health and education. Typically microfinance, also called microcredit, loans have a short repayment period and have terms and conditions suited to the local conditions of the community.

The concept of microfinance is not new. Informal systems of credit have existed in societies for centuries, long before modern, commercial banking came into the picture. Many of the current microfinance practices, made popular in developing countries, derive from community-based mutual credit transactions based on trust and peer-based non-collateral borrowing and repayment.

Microcredit in the United States

Microcredit can be an effective program to help empower financially disenfranchised populations, enabling those without access to lending institutions to start small businesses at bank interest rates. In the last five years a surge of interest has spread across the United States to broaden access to credit to lower-income Americans.

In the United States, microlending is centered in community-based banks, credit unions, community loan funds, and other local CDFIs. These institutions provide loans to businesses or households that have one or more of the following characteristics: (1) operate in low- and moderate-income and other disadvantaged communities, (2) are a start-up business or have annual revenues below a specific benchmark, (3) have owners who personally create their product or deliver the service, (4) have fewer than 25 employees, and (5) have a local customer base. The principal amounts of microcredit loans may be as little as $300 or as much as $25,000.

Interest rates are comparable to commercial lending rates and loan repayment rates often exceed those in the commercial sector.

Effective Strategies

According to the OCC study of microcredit practices in the United States, microlending institutions have several common strategies in small business finance. They 1) commit resources, including expert staff, and actively solicit small business customers; 2) learn about small business needs and offer tailored products and services; 3) provide small business customers with easy access; 4) establish streamlined processing for timely credit decisions; 5) offer special handling for flexible loan underwriting; 6) consider partnerships to provide options for small business finance, such as guarantees and credit enhancements, technical assistance, and gap financing; and 7) establish systems to track loan performance and profit.

Microfinance Challenges

Microlending institutions in the United States, such as CDFIs and mainstream banks, face a number of challenges and barriers in providing credit to small businesses in traditionally underserved markets. These include incompatibility of traditional credit evaluation techniques adopted in the banking sector with a need for human subjective review in the decision-making process. It also requires working effectively with government and community-based partners to provide credit enhancements, technical assistance, and other resources. In addition, microcredit providers are often working with a community with information deficits. Many would-be entrepreneurs and small-business owners are unaware of the financial and technical support available to them, and they often have social and language barriers as well. Participation in government programs and with other community development organizations also requires extra time: While banks can make decisions on microcredit loans within three days, loans that involve guarantees from the U.S. Small Business Administration or funds from government agencies often may take much longer.

Rutgers University Research on Organizations as Leaders in Expanding Homeownership

With support from the Fannie Mae Foundation, a team of researchers led by David Listokin and Elvin K. Wyly of Rutgers University conducted case studies of organizations recognized by their peers as leaders in expanding homeownership opportunities for historically underserved households and communities. The case studies describe the efforts of small and large lenders, nonprofit community-based organizations, and lending consortia. The researchers document strategies used by these organizations in the areas of institutional management, attracting and qualifying mortgage applicants, and retaining new homeowners.

The case studies reveal a diverse array of strategies designed to address market imperfections related to information, discrimination, and limited household financial resources. These strategies expand homeownership opportunities, and indicate that a broad spectrum of actors in

the housing finance system view historically underserved households and communities as viable markets, not regulatory burdens.

Challenges remain, however, in efforts to use housing finance to promote community development and household wealth accumulation. These challenges reflect inherent tensions between the industry trend toward standardized, efficient business practices and the customized, often expensive programs needed to address multiple obstacles to homeownership and community development faced by underserved households and communities. They also reflect a historically unequal distribution of risks and rewards associated with homeownership in America.

Predatory Lending: An Overview*

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Introduction

Predatory lending has become one of the most critical policy issues facing the financial services industry, particularly mortgage lending. Nearly every federal financial services regulatory agency has publicly denounced predatory lending and called for more effective regulation to address it. Legislation has been proposed in Congress and several states to combat predatory lending, and trade associations and individual financial institutions have declared their concerns. Also, the Federal Reserve Board has proposed a rule to require lenders to report annual percentage rates for all loans, a measure that could help identify predatory lenders.

Despite broad consensus to take action, efforts to end predatory lending have been modest at best. One reason for the slow response is the lack of consensus on what constitutes illegal predatory lending. While there is significant agreement on the key loan terms and lender behavior that generally constitute predatory lending, there is little political consensus at the national level within the housing finance community about how best to address the various areas of concern. Without national consensus on how most effectively to address key predatory lending practices, significant progress in this arena is not likely in the near term.

Predatory loans are characterized by excessively high interest rates or fees, and abusive or unnecessary provisions that do not benefit the borrower, including balloon payments or single-premium credit life insurance, large prepayment penalties, and underwriting that ignores a borrower's repayment ability. Yet, although high interest rates or fees are common characteristics of predatory loans, high-cost loans are not necessarily predatory. And depending on the unique characteristics of an individual loan and specific borrower, loan provisions that may be predatory in one instance, such as a prepayment penalty, may be reasonable and legitimate under others. For this reason, regulatory agencies and other institutions are cautious about instituting broad-based and sweeping regulations that could undermine legitimate sources of financing for credit-impaired households.

Further complicating efforts to stop predatory lending is the fact that there is little, if any, publicly available data regarding loan terms, such as interest rates, origination points, processing or closing fees, and special provisions such as balloon payments, credit life insurance, and

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prepayment restrictions. Without information on loan terms by borrower and neighborhood race/ethnicity and income, there is no way to effectively monitor or identify questionable lending patterns for further examination. Needless to say, a problem that cannot be identified and examined cannot be eliminated.

As mentioned in the accompanying article (see "Financial Services in Distressed Communities: Framing the Issue"), predatory lending generally does not occur in a vacuum. Rather, it breeds in an environment characterized by little competition for traditional financial services. Specifically, a community flush with "fringe lenders"—check cashing outlets, pawnshops, rent-to-own stores, title lenders, and similar operations—as well as excessive subprime lending, is the environment in which predatory lending activities often flourish.

This article provides a working definition of predatory lending and highlights some of the most common characteristics of predatory loans. It distinguishes predatory lending from subprime lending, and highlights the legitimate role that subprime lending plays for households with demonstrated credit problems. The article further points out, however, that despite a clear technical distinction between legitimate subprime lending and predatory lending, there exists a huge gray area between the two, in the form of excessive subprime lending. The article concludes with a series of recommendations and considerations for further action to limit both predatory and excessive subprime lending.

Defining the Problem

A clear definition of predatory lending is difficult due to the complexity of determining the appropriate level of fees for a given level of risk. Generally speaking, three features—alone or in combination—define predatory lending practices. Those features include targeted marketing to households on the basis of their race, ethnicity, age or gender or other personal characteristics unrelated to creditworthiness; unreasonable and unjustifiable loan terms; and outright fraudulent behavior that maximizes the destructive financial impact on consumers of inappropriate marketing strategies and loan provisions. Although a loan involving any one of these tactics might legally be considered predatory, most predatory lenders use some combination of all three to extract the greatest profit and, as a consequence, cause the greatest financial harm to the borrower.

Fraudulent Target Marketing

Predatory lenders use sophisticated technology and numerous sources of publicly available data to identify potential customers. They market their products to customers they identify as financially unsophisticated or vulnerable, and therefore most likely to accept highly unfavorable loan terms. In particular, predatory lenders look for people with limited education who are not adept in financial matters and lack the financial sophistication to scrutinize loans. Such lenders often prey on households that have limited incomes but significant equity in their homes. The elderly are a primary target for predatory lenders.

Marketing techniques include placing "cold calls" to potential borrowers, direct mailings, telephone and door-to-door solicitation, and television commercials. As with many other loan features, these practices by themselves are not predatory. Target marketing is used extensively by all types of mainstream businesses to identify potential customers and customize products to meet their particular needs. Predatory lenders use target marketing not to meet the needs of their customers, but rather to identify households most vulnerable to the lenders' aggressive or fraudulent behavior.

Predatory lenders' advertisements claim that easy and affordable home equity loans are a quick way for consumers to pay down credit card debt, take a desired vacation, or pay off other expenses, and still have lower monthly mortgage payments. Predatory lending also often involves fraudulent home improvement scams targeted to elderly homeowners because they are more likely than younger people to live in older homes that need repair, are less likely to undertake the repairs themselves, and may not have the cash to pay for someone else to perform them. Because these homeowners have built up substantial equity in their homes, they are particularly at risk of losing a major share, if not all, of their equity. Predatory lenders also make loans to homeowners who are mentally incapacitated and do not understand the nature of the mortgage transaction or papers to be signed.

Abusive Loan Terms

The second characteristic of a predatory loan is the set of abusive terms it contains. Predatory loan terms are structured to extract the greatest possible return to the lender. For equity stripping purposes, they are also routinely designed to preclude a borrower's ability to repay the loan. The loan itself may be unnecessarily large, even in excess of a 100 percent loan-to-value ratio. As long as the amount of the loan exceeds the fair market value of the home, it is difficult for the owner to refinance the mortgage or to sell the house to pay off the loan. Negative amortization loans are structured so that interest is not amortized over the life of the loan and the monthly payment is insufficient to pay off the accrued interest. The principal balance therefore increases each month and, at the end of the loan term, the borrower may owe more than the originally borrowed amount.

Aside from the loan itself—typically offered at very high interest rates—loan terms often include inflated and padded costs, such as excessive closing or appraisal charges, high origination and other administrative fees, and exorbitant prepayment penalties that trap lower-income borrowers into the subprime market. While prepayment fees are rarely charged in the prime market—some 2 percent of mortgages carry them—they are included in 80 percent of subprime mortgages, according to the Detroit Alliance for Fair Banking. And, unlike in the prime market, where prepayment fees are a tradeoff for lower interest rates, subprime mortgage holders rarely, if ever, get anything for the added fees, which can cost as much as a 6 percent penalty for early payoff. Consumers are locked into the subprime market even if they demonstrate improving creditworthiness, and are doubly hurt because they are not free to take advantage of lower interest rates as can prime market customers.

There may also be insertion of pre-dispute, mandatory, binding arbitration clauses in contractual documents. Such clauses are not necessarily offensive by themselves. When combined with other predatory loan provisions, however, they can greatly inhibit a borrower from receiving relief from highly unfavorable and unreasonable loan terms and conditions. Other typical predatory loan features include balloon payments that effectively force borrowers to refinance their loans at even higher rates later. Predatory loan terms also commonly feature single-premium credit life insurance that the lender requires as an up-front, lump-sum payment that the borrower must finance. Thus the borrower ends up paying additional interest—on top of the cost of overpriced and often unnecessary insurance. Maintenance provisions may increase the interest rate of a loan as a result of a 30- or 60-day late payment.

Fraudulent Lender Behavior

Fraudulent behavior is the third identifying characteristic of a predatory loan. It refers to illegal management by the lender of the loan transaction to extract the maximum value for the lender. Fraudulent behavior might include: 1) failing to explain the terms of the loan or providing obscure information, 2) using high-pressure tactics to force a prospective borrower to continue through the loan application process in cases in which the customer would prefer to discontinue the process, 3) omitting explanations of credit life insurance or balloon payments, and 4) discouraging borrowers from exploring lower-cost options.

One common tactic is to offer a short-term loan and quote a seemingly reasonable rate, without explaining that the "reasonable" rate becomes astronomical when translated into the annual percentage rate. "Flipping," or repeated refinancing, is another powerful tool of a predatory lender. The lender might offer to refinance a loan on the justification that the borrower can obtain a lower interest rate. But upon signing the new loan documents, the borrower finds out either that the interest rate is not lower or higher processing fees more than overwhelm any offset in interest rates. Or, a balloon payment provision in the original loan might make refinancing unavoidable.

Initiating loans without considering the borrower's ability to repay or structuring loans with payments that a borrower cannot afford can effectively strip the equity from a homeowner. And encouraging borrowers to consolidate consumer debts into a home equity loan with a higher interest rate than the underlying consumer credit debt—thereby also increasing the size of the loan—is a standard predatory lending practice. Further, predatory lenders may refuse to provide modest home equity loans and, instead, use high-pressure tactics to persuade borrowers to fully refinance their homes—again, usually at interest rates that exceed the underlying mortgage.

Other fraudulent behavior includes adding cosigners whom the lender knows have no intention of contributing to the payments, forging loan documents, and using abusive and high-pressure collection practices, such as harassing phone calls, letters, and threats. The combination of abusive loan terms and aggressive and fraudulent lender behavior that characterizes predatory lending illustrates how a loan can financially destroy an individual even in instances in which the loan's interest rate may not be alarmingly high. Because of the many tools in the arsenal of a

predatory lender, a request for a relatively modest loan can be transformed into a major financial crisis for an unsuspecting borrower.

A real-life example is useful in understanding how predatory lenders operate: ABC television's "Prime Time Live" in April 1997 featured the story of an elderly man in poor health who could not read or write. The man initially sought a small loan to buy food. Eventually the lender converted his request into a $50,000 home-equity loan. The loan was flipped just 17 days after signing, even before the first payment was due. Subsequently, in less than four years, the lender flipped the loan 11 times, attaching a 10 percent finance fee each time. The lender foreclosed on the house after the man could not make his loan payments. In this case, the man sued and his loans were forgiven. This was a very unusual ending to a predatory lending story—most victims are unable to obtain successful or satisfactory legal redress.

Finally, it is worth noting that some practices of other real estate professionals, such as mortgage brokers and home improvement contractors, could reinforce and further promote predatory lending. Home improvement contractors, for example, sometimes target inner-city neighborhoods where houses are older and often in need of renovation, and where households are cash-poor but have accumulated significant equity in their properties. In these instances, contractors may steer their customers to predatory lenders for loans to pay for the home improvements. Brokers are an important part of the infrastructure of predatory lenders. Checking property deeds and other public records and spending time in a community, brokers identify homeowners who have substantial equity in their properties and encourage those households to refinance with a predatory lender who, in turn, provides the broker with a substantial referral fee. Elderly, black, widowed women are frequent targets.

Predatory Lending as Subset of Subprime Lending

Predatory lending is a subset of subprime lending. The difference between the two is important. By definition, subprime lending is the provision of loans to households that have demonstrated an inability or unwillingness to properly manage credit. By definition, the subprime market is the credit source of last resort for households with poor credit histories, insufficient documentation of requisite financial resources or other important loan application information, and other loan application shortcomings that would limit a prospective borrower's ability to secure credit from the prime market.

Subprime loans carry higher interest rates than prime loans with the justification that borrowers with higher risk factors should pay more to offset their perceived greater risk to the financial institution advancing the loan. Subprime loan rates are also higher, according to Ken Temkin of the Urban Institute, because underwriting guidelines in the subprime market are not standardized across the industry. The lack of standardization causes variation in interest rates offered by different lenders and makes it difficult for borrowers to "shop" for the most favorable rates.

Despite this clear conceptual distinction between predatory lending and legitimate subprime lending, the reality of subprime and predatory lending is much murkier. A loan does not have to be loaded with an excessive number of egregious provisions for it to unfairly undermine the

financial solvency of a family. For example, steering minority households to the subprime market on the basis of race/ethnicity, rather than because of a demonstrated inability to properly manage credit, may be a violation of the Fair Housing Act and Equal Credit Opportunity Act—although it is not necessarily an act of "predatory lending."

In fact, even one percentage point unjustifiably added to a mortgage can add substantially to a household's financial burden and greatly undermine its asset-building capabilities. Over the 30-year life of an $81,000 home mortgage, one additional percentage point could add nearly $21,000 to the cost for the home buyer—not including the additional higher processing fees subprime loans typically carry. Note that the typical subprime loan is 300 to 400 basis points higher than a comparable prime market loan.

Concentration in Low-Income and Minority Neighborhoods

Just as fringe-lending activity is increasing, the subprime market has experienced exponential growth in lower-income minority communities. A recent study published by the U.S. Department of Housing and Urban Development (HUD) based on 1998 Home Mortgage Disclosure Act (HMDA) data uncovered striking racial disparities in the subprime market. The report finds that subprime loans are three times more likely in low-income neighborhoods than in high-income areas, and five times more likely in black neighborhoods than in white neighborhoods. In predominantly black communities, high-cost subprime lending accounted for 51 percent of home loans in 1998, compared with only 9 percent in predominantly white areas.

HUD further notes that homeowners in high-income black neighborhoods are six times as likely as homeowners in upper-income white neighborhoods, and twice as likely as homeowners in low-income white neighborhoods, to have subprime loans. Thirty-nine percent of homeowners in upper-income black neighborhoods had subprime loans, compared with 6 percent of homeowners in upper-income white neighborhoods and 18 percent for homeowners living in low-income white neighborhoods.

Does Risk Fully Explain the Size of the Subprime Market?

As noted above, the rationale for disproportionately high levels of subprime lending to lower-income and minority households is that those borrowers represent substantially greater risk than borrowers in the prime mortgage market. Unfortunately, there is little available public data on the credit quality of households that would allow for an examination of the reasonableness of the growth of subprime lending to lower-income minority households. Data that are available, however, do not support the recent explosive growth of this segment of the mortgage market.

First, several financial institutions in the past decade have confirmed that lower-income status is not synonymous with higher credit risk. Stated otherwise, lower-income consumers who receive mainstream credit perform roughly the same as middle- and upper-income households receiving similar credit. As a result, the much greater level of subprime lending to lower-income households relative to higher-income households is not immediately justified by available

information on credit quality of these two groups. Second, although black households have been shown in studies to have greater credit problems than non-Hispanic white households, the level of subprime lending to black households and communities far exceeds the measured level of credit problems experienced by those households.

According to a 1999 Freddie Mac study, black households have roughly twice the credit problems of non-Hispanic white households. Yet HUD's data show that blacks rely on subprime refinance lending roughly four times as much for their mortgage credit. Credit quality alone therefore does not fully explain the extreme reliance of black households on the subprime market. Further research by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans. Fannie Mae estimates that number closer to 50 percent.

If these estimates are accurate, it represents potentially hundreds of millions of dollars wasted each year by the very households that can least afford it.

Credit History Versus Creditworthiness

Although creditworthiness is the measure by which financial institutions determine the type of loan most appropriate for a particular borrower, there is substantial confusion between creditworthiness and credit history. Creditworthiness or credit risk is the measurement of the borrower's ability and willingness to repay a loan. Credit history is the financial transactions data on which a borrower's creditworthiness is determined. Stated otherwise, creditworthiness is the interpretation of an individual's credit history. An evaluation about creditworthiness of a borrower requires, among other things, judgments about the reliability and comparability of the underlying financial transactions data. There are a number of reasons why an individual's credit history may not accurately reflect his or her actual creditworthiness.

Confusion about credit history and creditworthiness inappropriately reinforces the idea that lower-income, and particularly minority, communities are largely bad credit risk environments. Several problems arise from interpreting creditworthiness from existing credit history data for minority households and comparing the data with that for non-Hispanic white households. First, low-income minorities are more likely to be financially unsophisticated, and thus may not attempt to correct poor credit histories before applying for a loan. Two borrowers may have similar credit behavior, but if one has taken steps to improve his or her credit records before applying for a loan, that borrower will be deemed more creditworthy. In fact, many households may be completely unaware of the need to maintain a good credit history, and the role that documentation plays in determining their access to credit.

A related issue is coaching of borrowers at the time of application for loans. Proper counseling at the time of loan application may enable a household to improve its credit score, but there may be substantial differences in the ways in which households receive such coaching along racial and ethnic lines. Third, comparing credit histories of households that have access to and use mainstream financial institutions with individuals that rely primarily on fringe banking services could result in biased assessments of creditworthiness across racial and ethnic groups.

Federal mortgage data, as well as the behavior of fringe and predatory lenders, suggest that minority households are more likely to have used finance companies and other fringe financial services whose terms and practices are more costly and harsh. In some cases, consumers may even have used predatory lending institutions that intentionally structure loans for default. In some instances, loan terms may be so oppressive and unreasonable that repayment is simply unrealistic. Or, some households may have used fringe lenders who might aggressively report even modest credit blemishes in an effort to hold onto their customers by ensuring they remain unattractive to mainstream lending institutions.

Finally, some households may default intentionally because they recognize, albeit after the fact, that the loan terms they have accepted are egregious and unfair if not outright fraudulent. In these instances, financially vulnerable households are penalized with additional credit blemishes for recognizing and acting to defend themselves from unscrupulous or fraudulent lenders.

Unfortunately for underserved households, data that might provide more accurate assessments of borrower creditworthiness are not readily available and therefore not generally used in sophisticated models of credit risk. The result is continued disparate evaluations of credit risk for lower-income, and particularly minority, households and consequently, lower homeownership rates than might be possible.

Recommendations and Solutions

Predatory lending is an outlying consequence of the inefficient financial markets that exist in many lower-income and minority communities. Predatory lending practices thrive in an environment where competition for financial services is limited or lacking, and where excessive marketing of subprime loans and fringe financial services are occurring. For this reason, effectively limiting predatory lending requires the same three-pronged approach recommended to reduce excessive fringe financial services in lower-income, minority, and distressed communities: 1) enhanced enforcement of the relevant federal and state lending and consumer protection laws, 2) increased prime market lending, and 3) improved borrower education and awareness of financial services options and opportunities (see "Financial Services in Distressed Communities").

Laws that specifically relate to predatory lending and whose greater enforcement must play a key role in eliminating predatory lending include the Fair Housing and Equal Credit Opportunities Acts, the Real Estate Settlement Procedures Act, and the Homeowner's Equity Protection Act. Some predatory lending practices also might violate various federal and state consumer protection laws, such as the Truth in Lending Act. Together, these laws provide a formidable regulatory infrastructure to make important strides in removing predatory lenders from the nation's most vulnerable and distressed communities. Together, these laws cover practically every conceivable predatory lending arrangement. (For a more detailed discussion of possible legal strategies to fight predatory lending, see Engel and McCoy 2001.)

Yet, the strength of these federal laws can, nevertheless, be a weakness. Because so many different laws could pertain to various predatory lending practices, determining which law or

laws may have been violated in any particular case can be complicated, time-consuming, and costly. Simplifying federal law to target predatory lending directly would greatly enhance the ability of lower-income households and their advocates to combat unfair and illegal lending behavior. Further, outlawing abusive practices would act as a preventive measure and would avoid the need for consumers to be harmed before there could be legal redress.

The North Carolina nonprofit Coalition for Responsible Lending, for example, points out that a handful of provisions account for the overwhelming majority of the most abusive predatory lending activities. The coalition recommends new legislation that focuses on seven loan terms and practices including: 1) credit insurance; 2) excessive fees charged to borrowers; 3) prepayment fees that do not benefit the borrower; 4) mortgage broker abuses including yield-spread premiums; 5) steering of borrowers to subprime loans on the basis of race/ethnicity, age, or gender; 6) mandatory arbitration clauses that restrict the rights of the borrower; and 7) loan flipping or repeated refinancings that do not benefit the borrower.

Many states have recently enacted or have begun to debate streamlining their state statutes to focus directly on predatory lending. The state of North Carolina enacted a comprehensive predatory lending law in July 1999. The North Carolina law defines two types of loans—"home loans" and "high-cost home loans." For all home loans, the law prohibits lending abuses such as requiring credit life, disability, or unemployment insurance, and loan flipping. With regard to high-cost home loans, it imposes expanded protections against excessive balloon payments, high interest rates and fees, negative amortization, and predatory home improvement contractors. In addition, loan counseling is required and a borrower's ability to repay must be taken into consideration.

Using the North Carolina model, the states of New York, Illinois, South Carolina, Minnesota, West Virginia, Utah, Maryland, and California are all considering predatory lending legislation. Another example of local action is Washington, DC's, new "Predatory Lending Protections and Mortgage Foreclosure Improvements Act of 2000" that provides additional protections for District residents who might find themselves at risk of losing their homes through foreclosure as a result of corrupt lending practices. Among other features, this law attacks predatory activity by defining a subset of loans that might be predatory and providing homeowners with a quick judicial review prior to a foreclosure sale. Philadelphia is another city that has recently enacted a predatory lending law.

Perhaps the most comprehensive federal examination of predatory lending performed to date was pursued jointly by the U.S. Department of the Treasury and HUD. Their report, "Curbing Predatory Home Mortgage Lending," included extensive discussion of predatory lending tactics and a wide range of recommendations to limit fraudulent lending behavior (see the full report at www.huduser.org/publications/hsgfin/curbing.html). The study highlighted and discussed practices ranging from loan flipping, targeting minority and low-income borrowers, and lending to borrowers based on the value of their home rather than the ability to repay a loan. Expanding borrowers' access to the prime market by awarding banks and thrifts Community Reinvestment Act credit and amending many existing laws were among the recommended solutions. Additionally, the study revealed that the Federal Housing Administration is developing tools to

help borrowers who have been victimized by predatory lenders to avoid foreclosure, retain their homes with a reasonable level of debt, and, if necessary, repair their credit.

The National Community Reinvestment Coalition has outlined a multipart strategy to address predatory lending. Among its recommendations are for the Federal Reserve Board to use its existing authority to prohibit unfair and deceptive mortgage lending practices, to step up its oversight of subprime lenders, and to improve data disclosure to more effectively track subprime and predatory lending.

Conclusion

The issue of predatory lending is, for good reason, an issue of national concern. Yet, while there is strong consensus to act, there is enormous inertia in taking definitive action that might impact lending of any type. Part of the failure to aggressively address predatory lending is based on a legitimate concern that price controls and blanket prohibitions of individual loan features could negatively impact market segments in unintended ways.

Moreover, as this article and the previous one on *Financial Markets in Distressed Communities* highlights, predatory lending is merely the extreme end of a spectrum of abusive, unscrupulous, and costly financial services practices that dominate lower-income and minority communities. Placing caps on certain practices and eliminating certain other behaviors would go a long way to removing some of the most destructive wealth-stripping activities from the mortgage markets in distressed communities. But limitations, restrictions, and caps on various financial services practices are not sufficient to address the broader issue of market failure that plagues these communities. That broader challenge requires positive action and initiative. Lower-income and minority communities need high-quality, low-cost financial services tailored to their low-income and low-wealth circumstances. Further, those households need access to savings vehicles that would enable them to build their assets to the greatest extent possible.

Assisting households to better understand how to make informed choices about the financial services and providers they choose is an important aspect of a comprehensive anti–predatory lending program. At the same time, however, there are real limits on the extent to which consumer financial education can help vulnerable households who are the focus of fraudulent professionals.

Mortgage loan documents can consist of dozens of provisions written in extremely complex, confusing, and technical legal language. Predatory lenders target lower-income and minority borrowers with limited education and vulnerable elderly consumers specifically because they cannot reasonably protect themselves. To expect that financially vulnerable consumers can reasonably review, understand, and challenge specific provisions in the dozens of legal documents that are routinely involved in the mortgage lending process is a highly unreasonable expectation.

Despite the inability to achieve consensus on the perfect response to predatory lending, some immediate intervention is needed and should be forthcoming at a national level. Failure to

successfully remove predatory lenders from the financial services markets could, over a relatively short time, undermine much of the success that has been achieved over the past decade in enhancing the number of historically underserved households that are now homeowners. And it could further exacerbate the tenuous financial positions of many vulnerable, lower-income, elderly homeowners, many of whom reside in older, inner-city, and distressed communities.

Principles for Responsible Lending[1]
Coalition for Responsible Lending

Homeownership not only supplies families with shelter, it also provides a way to build wealth and economic security. Unfortunately, too many American homeowners are losing their homes, as well as the wealth they spent a lifetime building, because of harmful home equity lending practices. Some lenders target elderly and poor or uneducated borrowers to strip the equity from their homes, which traps borrowers in bad loans and creates a high risk of foreclosure. Subprime lending has increased 1,000% in the last five years, and abusive lending is up commensurately.

Seven principles should govern attempts to eliminate predatory lending and protect family wealth:

- Prohibit the financing of up-front credit insurance for all loans.
- Limit fees charged borrowers, direct and indirect, to 3% of the loan amount.
- Prohibit back-end prepayment penalties on subprime loans, since they act in an anti-competitive manner by keeping lenders from remedying abusive situations.
- Take sufficient steps to address mortgage broker abuses on purchased loans, including prohibiting yield-spread premiums.
- Address steering by making sure that borrowers receive the lowest-cost loan they qualify for.
- Avoid mandatory arbitration clauses in any home loans.
- Prohibit "flipping" of borrowers through repeated fee-loaded refinancings.

1. Credit insurance premiums should not be financed into the loan up-front in a lump-sum payment. One type of credit insurance, credit life, is paid by the borrower to repay the lender should the borrower die. The product can be useful when paid for on a monthly basis. When it is paid for up-front, however, it does nothing more than strip equity from homeowners, which is why Fannie Mae and Freddie Mac have both agreed not to purchase any loan that includes financed credit insurance. Conventional loans almost never include, much less finance, credit insurance.

2. The borrower should not be charged fees greater than 3% of the loan amount (4% for FHA or VA loans). Points and fees (as defined by HOEPA) that exceed this amount (not including third party fees like appraisals or attorney fees) take more equity from borrowers than the cost or risk of subprime lending can justify. By contrast, conventional borrowers generally pay at most a 1% origination fee.

3. Subprime loans (defined as interest rates above conventional) should not include prepayment penalties, for the following reasons:

   - Prepayment penalties trap borrowers in high-rate loans, which too often leads to foreclosure. The subprime sector serves an important role for borrowers who encounter temporary credit problems that keep them from receiving low-rate conventional loans. This sector should provide borrowers a bridge to conventional financing as soon as the

[1] "Principles for Responsible Lending" are from the Coalition for Responsible Lending and are used with permission. For more information, see www.responsiblelending.org.

borrower is ready to make the transition, though prepayment penalties are designed to prevent this from happening. Why should any borrower be penalized for doing just what they are supposed to do—namely, pay off a debt?

- Prepayment penalties are hidden, deferred fees that strip significant equity from over half of subprime borrowers. Prepayment penalties of 5% are common. For a $150,000 loan, this fee is $7,500, more than the total net wealth built up over a lifetime for the median African American family. According to Lehman Brothers' prepayment assumptions, over half of subprime borrowers will be forced to prepay their loans—and pay the 4% to 5% in penalties—during the typical five-year lock-out period. And borrowers in predominantly African-American neighborhoods are five times more likely to be subject to wealth-stripping prepayment penalties than borrowers in white neighborhoods. Prepayment penalties are therefore merely deferred fees that investors fully expect to receive and borrowers never expect to pay.

- Borrower choice cannot explain the prevalence of prepayment penalties in subprime loans. Only 2% of borrowers accept prepayment penalties in the competitive conventional market, while, according to Duff and Phelps, 80% in subprime do.

4. Lenders should take sufficient steps to address mortgage broker abuses, including prohibiting yield-spread premiums. Brokers originate over half of all mortgage loans and a relatively small number of brokers are responsible for a large percentage of predatory loans. Lenders should identif—and avoid—these brokers through comprehensive due diligence. In addition, lenders should refuse to pay "yield-spread premiums"—fees lenders rebate to brokers in exchange for placing a borrower in a higher interest rate than the borrower qualifies for. These lender kickbacks violate fair lending principles since they provide brokers with a direct economic incentive to steer black borrowers into costly loans.

5. To address steering, lenders should make sure that borrowers get the lowest-cost loan they qualify for. As Fannie Mae and Freddie Mac have shown, subprime lenders charge prime borrowers who meet conventional underwriting standards higher rates than necessary. This is particularly troubling for lenders with prime affiliates–the very same "A" borrower who would receive the lender's lowest-rate loan from its prime affiliate pays substantially more from the subprime affiliate. HUD has shown that steering has a racial impact since borrowers in African-American neighborhoods are five times more likely to get a loan from a subprime lender–and therefore pay extra–than borrowers in white neighborhoods. A minority borrower with the same credit profile as a white borrower simply should not pay more for the same loan. Therefore, lenders should either:

   - offer "A" borrowers loans with "A" rates, or
   - refer such borrowers to an affiliated or outside lender that offers these rates.

6. Lenders should not impose mandatory arbitration clauses in any home loans. Increasingly, lenders are placing pre-dispute, mandatory binding arbitration clauses in their loan contracts. These clauses insulate unfair and deceptive practices from effective review and relegate consumers to a forum where they cannot obtain injunctive relief against wrongful practices, proceed on behalf of a class, or obtain punitive damages. Arbitration can also involve costly

fees, be required to take place at a distant site, or designate a pro-lender arbitrator. Arbitration will always take time the consumer may not have if they are facing foreclosure. Such clauses are unfair to borrowers, who generally do not understand what rights they are giving up; if an informed consumer thinks that arbitration is a helpful step in resolving a dispute with a lender, the consumer and lender should be permitted to agree to arbitration then.

7. Lenders should prohibit "flipping" of borrowers through repeated fee-loaded refinancings. One of the worst practices is for lenders to refinance subprime loans over and over, taking out home equity wealth in the form of high fees each time, without providing the borrower with a net tangible benefit. Some lenders originate balloon or adjustable rate mortgages only to inform the borrowers of this fact soon after closing to convince them to get a new loan that will pay off the entire balance at a fixed rate. Others require borrowers to refinance in order to catch up if the loan goes delinquent.

Combating Predatory Lending Practices

Federal Banking Regulatory Agencies Call for Greater Oversight

The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision in January issued a directive that strengthens the examination and supervision of institutions with significant subprime lending programs.

The "expanded guidance" decree specifies borrower characteristics that indicate an institution is targeting the subprime lending market, clarifies the standards to use when evaluating loss allowances, and identifies potentially predatory lending practices that safety and soundness examiners will criticize, among other features.

The expanded guidance is expected to help banks and thrifts engaging in subprime lending activities be more aware of the banking agencies' expectations regarding risk management processes.

Responses to Predatory Lending by the U.S. Department of Housing and Urban Development (HUD) and U.S. Treasury Department

A joint U.S. Department of Housing and Urban Development and U.S. Treasury Department Task Force on Predatory Lending has conducted five field forums around the country and, based on its findings, proposed a four-point plan to address predatory lending practices. The plan is detailed in the report, "Curbing Predatory Home Mortgage Lending," summarized below. The full report is available at: www.huduser.org/publications/hsgfin/curbing.html.

1. Provide improved disclosures to borrowers and enhance consumer literacy. Require creditors to recommend that high-cost loan applicants seek home mortgage counseling, disclose credit scores on request, and provide better information on loan costs and terms.

2. Prohibit damaging or unfair lending practices. Loan flipping and lending to borrowers without regard to their ability to repay should be prohibited, and brokers and lenders should be required to provide greater documentation of loan and payment history.

3. Restrict abusive terms and conditions on high-cost loans, including balloon payments, prepayment penalties, and the financing of points and fees; prohibit mandatory arbitration agreements on high-cost loans; and ban single-premium credit life insurance.

4. Use Community Reinvestment Act (CRA) credit to create a positive incentive structure for banks and thrifts. Grant CRA credit to institutions that promote borrowers from the subprime to prime mortgage market, and deny CRA credit to institutions that originate or purchase loans that violate applicable lending laws.

Proposals by the Federal Reserve Board to Strengthen Predatory Lending Prohibitions

The Federal Reserve Board has proposed amending two of its regulations to crack down on predatory lending:

The first proposal is to require additional disclosure of mortgage applications and loans under the Home Mortgage Disclosure Act (HMDA). The revision, which would mandate reporting of requests for mortgage preapprovals and home-equity lines of credit, is designed to track the level, trend, and underwriting characteristics of high-cost mortgage loans. It would help identify institutions engaged in subprime lending, make high-volume nondepository lenders subject to HMDA reporting requirements, and simplify the definition for "refinance" and "home improvement loan" to ensure more complete and consistent data.

The second proposed amendment broadens the scope of loans subject to the Home Ownership and Equity Protection Act (HOEPA) of 1994 by adjusting price triggers that determine coverage under the act. Interest rate triggers would be lowered by two percentage points (from 10 points to 8 points above current Treasury bill rates), and the fee-based triggers would include optional insurance premiums and similar credit protection products paid at closing.

The proposed amendment also prohibits certain practices, such as repeated refinancing of HOEPA-regulated loans over a short time when transactions are not in the borrower's interest, and making loans without verification of a consumer's repayment ability.

It is important to note that HOEPA still does not cover all home equity lenders and all home equity loans, and there are loopholes that allow room for abuse.

Calls for Additional Federal Action

The National Community Reinvestment Coalition (NCRC) has made several recommendations for additional federal anti–predatory lending action.

It recommends calling for federal banking regulations to increase their oversight of subprime lenders during CRA exams and accompanying fair-lending reviews. The NCRC suggests that regulatory agencies issue an interagency advisory letter saying that predatory lending will not receive credit under CRA exams and will be penalized through lower CRA ratings and fair lending referrals to the Department of Justice. It calls for the Federal Reserve Board to use its authority to conduct regular fair lending reviews of subprime affiliates of bank holding companies, as recommended by the General Accounting Office.

Secondly, the NCRC has called for Congress to pass more comprehensive anti–predatory lending legislation.

The NCRC is a national community reinvestment and fair lending trade association of more than 700 community-based organizations and local public agencies dedicated to increasing access to credit and capital for traditionally underserved urban and rural areas.

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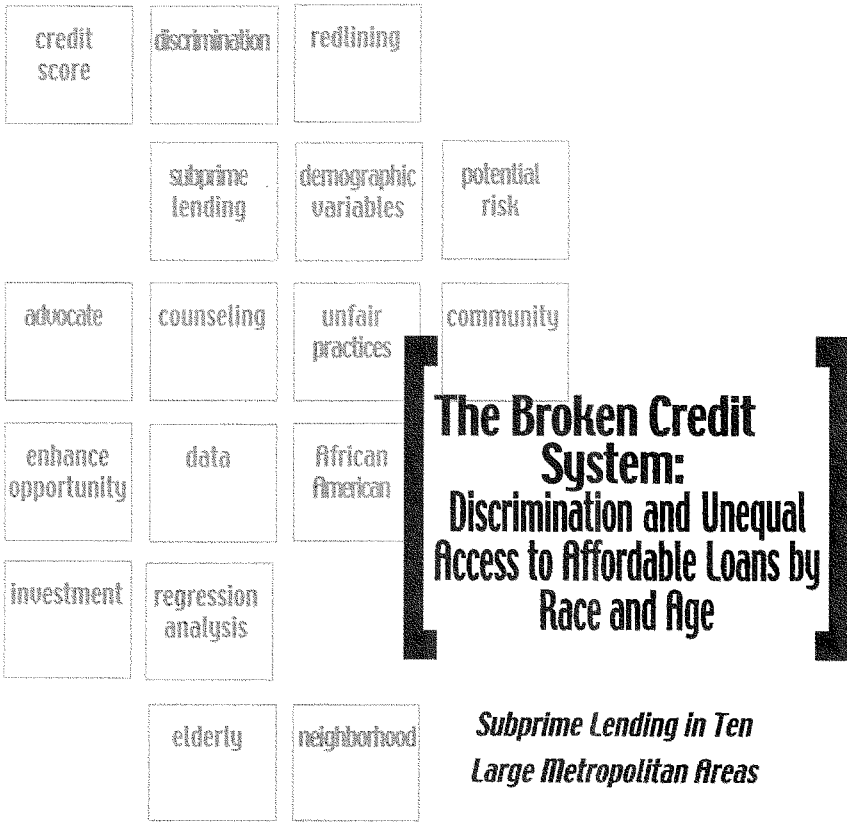
ATTACHMENT D



The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age

Subprime Lending in Ten Large Metropolitan Areas

The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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NCRC

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Executive Summary

The credit system is broken and discrimination is widespread in America. NCRC finds that African-American and predominantly elderly communities receive a considerably higher level of high cost subprime loans than is justified based on the credit risk of neighborhood residents. President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination, however, threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.

The widespread evidence of price discrimination threatens the possibility of creating sustainable and affordable homeownership opportunities . . .

A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color. Using the best available industry data on credit worthiness, NCRC uncovered a substantial amount of predatory lending involving rampant pricing discrimination and the targeting of minority and elderly communities.

Sadly, it is still the case in America that the lending marketplace is a dual

marketplace, segmented by race and age. If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community. At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower. The disproportionate amount of subprime refinance lending in predominantly elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.

Lending discrimination in the form of steering high cost loans to minorities and elderly borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[1]

This report confirms Americans' perceptions of bias in lending. In the winter of 2002, NCRC hired Republican pollster Frank Luntz and Democratic pollster Jennifer Laszlo Mizrahi to conduct a nationally representative poll of Americans' views of lending institutions. In the poll, fully 76 percent of Americans believed that steering creditworthy minorities and women to costly loan products was a significant problem. About 47

[1] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

percent of the survey respondents believed that a white man would be more likely than an African-American man with the same credit history to be approved for a loan. Only 10 percent of the respondents believed that the African-American would be more likely to be approved for a loan. Among African-American survey respondents, 74 percent thought the white man would be approved, and only 3.6 percent thought that a similarly qualified African-American would be approved over the white man. Unfortunately, this report verifies that these perceptions of discriminatory treatment are reality in too many instances.[2]

The single most utilized defense of lenders and their trade associations concerning bias is that credit scoring systems allow lenders to be color-blind in their loan decisions. This study, the largest and among the first of its kind, debunks that argument and clearly makes the case that African-American and elderly neighborhoods, regardless of the creditworthiness of their residents, receive a disproportionate amount of high cost subprime loans.

NCRC selected ten large metropolitan areas for the analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington, D.C. As expected, the amount of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. In particular:

[2] A Laszlo/Luntz Poll, conducted January 21 to February 13, 2002. Overall poll of 1,258 adults, margin of error 3.3%. Available via NCRC.

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston. For example, if 10 percent of the refinance loans in the white neighborhood were subprime, then 51 percent of the loans in an African-American neighborhood in Houston would be subprime. The portion of subprime refinance loans increased by 29, 26, and 20 percentage points in Milwaukee, Detroit, and Cleveland, respectively, from an all white to an all African-American neighborhood. Graph 1 provides details of this phenomenon across the metropolitan areas and shows a strong race factor in Atlanta, St. Louis, and Los Angeles as well.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points. Graph 2 reveals that the portion of subprime purchase loans similarly rose by 18 and 17 percentage points in Milwaukee and Detroit, respectively, in African-American neighborhoods compared to white neighborhoods.

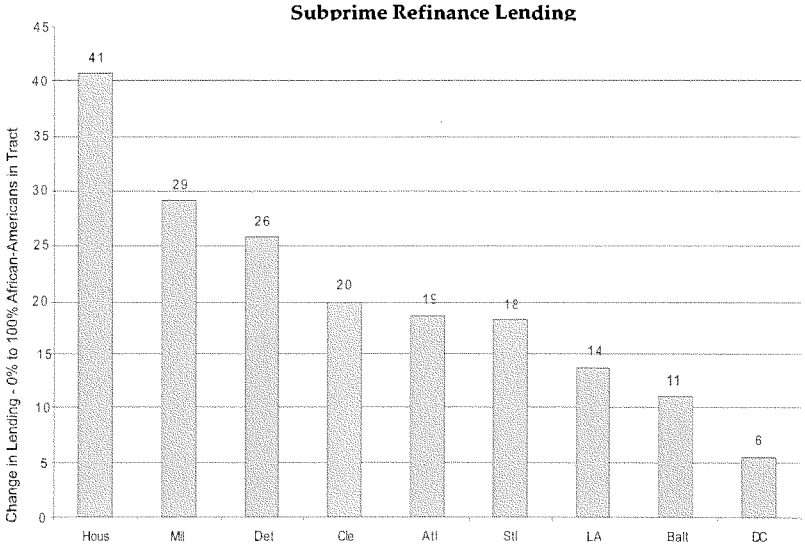
- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

- Elderly neighborhoods experienced the greatest increases in subprime refinance lending in St. Louis, Atlanta, and Houston. Even after holding income, creditworthiness, and housing market factors constant, the portion of subprime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65. Likewise, the increases were 27 and 25 percentage points in Atlanta and Houston, respectively. Although neighborhoods with such extreme age distributions (none or all residents over 65) are unusual, the regression analysis

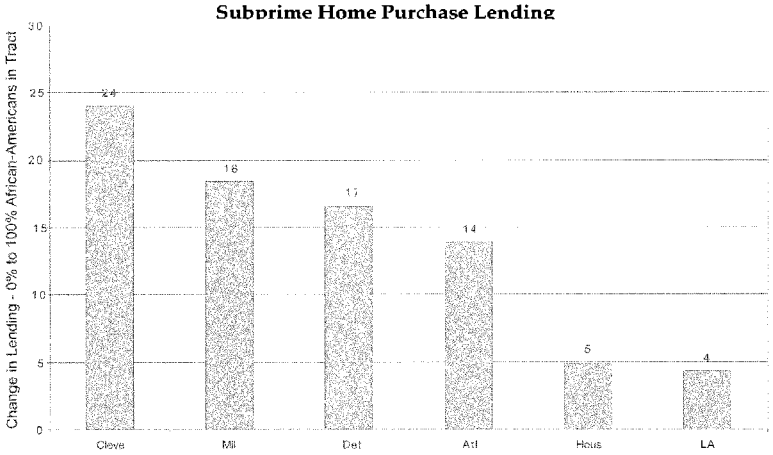
highlights and isolates the impacts of age on the level of subprime lending. Indeed, the level of subprime lending is likely to be considerably higher in neighborhoods with large concentrations of senior citizens.

- The level of subprime lending increased in a statistically significant fashion in the great majority of metropolitan areas as the percentage of neighborhood residents with no credit scores increased. Subprime refinance and home purchase lending climbed in nine and seven metropolitan areas, respectively, as the portion of neighborhood residents without credit scores increased. This is a significant issue for recent immigrants and other unbanked populations, many of whom are creditworthy for loans at prevailing interest rates, but receive high cost loans simply because they lack conventional credit histories.

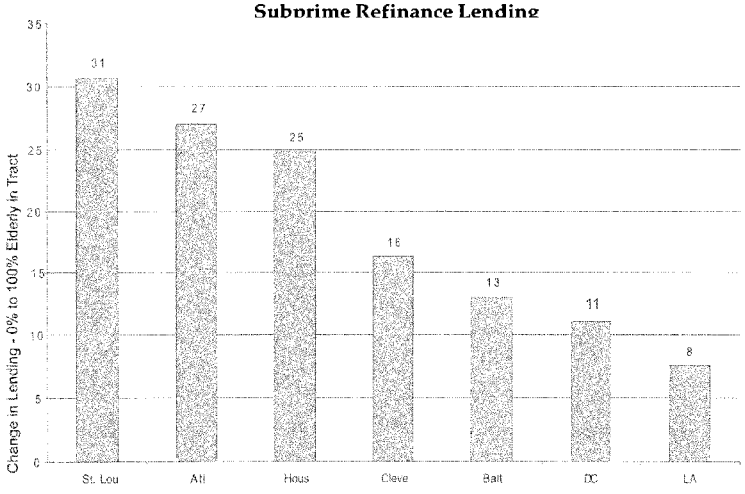
Graph 1: Index of Discrimination Against African-American Neighborhoods: Subprime Refinance Lending



Graph 2: Index of Discrimination Against African-American Neighborhoods: Subprime Home Purchase Lending



Graph 3: Index of Discrimination Against the Elderly: Subprime Refinance Lending



Recommendations

Legislative Recommendations

Reform FCRA to Mandate Complete and Accurate Credit Reports

As Congress renews the Fair Credit Reporting Act (FCRA), it must ensure that credit reports are complete and accurate. Anti-predatory lending bills introduced by members of Congress from both parties (Sarbanes and Ney) require creditors, once every three months, to provide a complete credit report and payment history to credit bureaus regarding all loans they made or serviced. A number of large subprime lenders currently withhold critical information regarding borrower on-time payments.[3] The practice of withholding information victimizes borrowers by trapping them in high cost loans and also victimizes lenders by reducing the overall reliability of the credit reporting system. A bipartisan consensus should be quickly achieved regarding this essential reform, yet the bipartisan House bill, HR 2622, does not contain this requirement. The FCRA bill proceeding in the Senate also does not require frequent reporting to the credit bureaus.

Our study also found that as the percent of neighborhood residents with no credit scores increases, so does the level of subprime lending. This is blatantly unfair since large numbers of consumers without traditional credit reports and credit scores are responsible and should qualify for loans at prevailing interest rates. One major reason why a large segment of consumers lack credit scores is that the credit reporting system does not capture non-traditional payment histories such as rental and utility

[3] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Consumers Bankers Association Conference in San Francisco on June 7, 1999, available via http://www.occ.treas.gov.

payments. Congress must require the reporting of these two essential payment history items to the credit bureaus in order to reduce pricing discrimination and make the lending system fairer.

NCRC also recommends that an FCRA renewal bill requires additional studies on credit scoring and fund and promote nationwide financial education initiatives.

Comprehensive Anti-Predatory Legislation

Congress must enact comprehensive anti-predatory lending legislation along the lines of bills introduced by Senator Sarbanes and Representative Schakowsky. Comprehensive and strong anti-predatory lending legislation would eliminate the profitability of exploitative practices by making these practices illegal. It could also reduce the amount of price discrimination since fee packing and other abusive practices would be prohibited. A comprehensive anti-predatory law would also strengthen the Community Reinvestment Act (CRA) if regulatory agencies severely penalize lenders through failing CRA ratings when the lenders violate anti-predatory law.

Congress Must Pass a CRA Modernization Bill

In the 107th Congress, Representatives Luis Gutierrez and Thomas Barrett introduced HR 865, the CRA Modernization Act. This vital bill would increase the rigor of CRA exams by requiring the federal banking agencies to scrutinize the level of lending to minorities as well as low- and moderate-income borrowers. In addition, the CRA Modernization Act would expand CRA to cover independent mortgage companies and all non-depository affiliates of banks. Since price discrimination on the basis of race is prevalent, CRA must be used to prod lenders to offer more

prime loans at prevailing interest rates to minorities. At the same time, expanding CRA to large numbers of lenders would also result in an influx of affordable loans to traditionally underserved communities.

Enhance the Quality of HMDA Data

NCRC believes that Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? While NCRC is confident in the findings of our study, we believe that more information in HMDA data is critical to fully explore the intersection of price, race, gender, and income. HMDA data must contain credit score information similar to the data used in this report. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrowers.

Using this data, regulators, researchers, the media, and the public could determine if any of the credit score systems were placing minorities and other protected classes in the higher risk categories a disproportionate amount of time. The data would facilitate more econometric analysis to assess whether the prices of loans are based on risk, race, gender, or age. In addition, other critical underwriting variables are needed in the HMDA data including information on debt-to-income ratios and loan-to-value ratios.

Financial Education Critical, Especially for Populations Lacking Credit Scores

In the metropolitan areas examined, about 15 percent of the population lacked credit scores. The percentage was even higher in minority census tracts. A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores. Increased financial education initiatives by Congress, government at all levels, the private sector, and the nonprofit sector are necessary to reach out to the segment of the population that lack credit scores and/or are "unbanked." The segment of the population without credit scores is unlikely to have a fair chance at receiving affordable loans as long as they lack credit histories and remain outside the financial mainstream. In order for financial education to be universal, NCRC recommends that the Department of Education require basic financial literacy to be part of the curriculum of all public schools.

A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores.

Regulatory Recommendations

Federal Agencies Must Step Up Enforcement of Existing Laws to Promote Full Product Choice and Prevent Product Steering

Periodically, the Federal agencies regulating financial institutions will make great fanfare announcing a settlement of a major discrimination lawsuit or the publication of new "interagency" fair lending guidelines. The sad fact, however, is that federal agency efforts to eliminate discrimination and steering creditworthy borrowers to expensive products are failing. The agencies must step up their enforcement of the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act and other fair lending laws in order to ensure full product choice for all Americans.

Halt Preemption of State Anti-Predatory and Consumer Protection Law

The Office of the Comptroller of the Currency (OCC) has preempted Georgia's anti-predatory law for large national banks and has proposed to preempt anti-predatory and consumer protection laws in all states. The OCC's proposed regulations are much weaker in combating abusive practices than state law that would be preempted. At the same time, the Office of Thrift Supervision (OTS) has been preempting anti-predatory law, one state at a time, for federally chartered thrifts. Given the evidence of widespread pricing discrimination, anti-predatory and consumer protection law at all levels need to be strengthened, not weakened. For many decades, banking laws have co-existed on a Federal and state level in many areas such as privacy and disclosures of mortgage terms. This is precisely the wrong time to wipe out critical state anti-predatory and consumer protection law. The credit system is broken, and needs more oversight, not less.

Anti-predatory and consumer protection law at all levels need to be strengthened, not weakened

Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight

The General Accounting Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board, however, continues to insist that it lacks this authority.[4] This issue must be resolved because comprehensive anti-discrimination exams of all parts of bank holding companies are critical. Most of the major banks have acquired large subprime lenders that are then considered affiliates and become off-limits to Federal Reserve examination. A pressing question is the extent to

[4] General Accounting Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

which the subprime affiliates refer creditworthy customers to the prime parts of the bank so that the customers receive loans at prevailing rates instead of higher subprime rates. Or does the subprime affiliate steer creditworthy borrowers to high cost loans? These questions remain largely unanswered. Consequently, we do not know the extent to which steering by subprime affiliates and/or their parent banks contributed to the discrimination documented by this report. Thus, it is past time for the Federal Reserve to examine affiliates as well as the parent bank.

Increase Fair Lending Enforcement of Non-Bank Lending

CRA and fair lending reviews cover depository institutions. Large non-bank lenders comprise a significant segment of subprime lenders but are not covered by regular CRA exams and fair lending reviews. As far as we know, neither the Department of Housing and Urban Development, the Department of Justice, nor the Federal Trade Commission has established a proactive program to conduct fair lending investigations of large non-bank lenders. The Department of Justice has settled lawsuits regarding price discrimination with the Long Beach Mortgage Company and other institutions.[5] These lawsuits, however, are usually reactive and in response to complaints or referrals from other regulatory agencies. In cooperation with state regulatory agencies, NCRC calls upon federal agencies to undertake a proactive and aggressive program to enforce the fair lending laws in the case of non-bank lenders.

CRA Exams Must Scrutinize Non-Prime Lending More Rigorously

Currently, CRA exams are not adequately assessing the CRA performance

[5] Department of Justice settlement with Long Beach Mortgage Company, September 5, 1996.

of subprime lenders. For example, the CRA exam of the subprime lender, Superior Bank, FSB, called its lending innovative and flexible before that thrift's spectacular collapse.[6] If CRA exams continue to mechanistically consider subprime lending, subprime lenders will earn good ratings since they usually offer a larger portion of their loans to low- and moderate-income borrowers and communities than prime lenders.

At this point, the regulatory agencies have stated in an "Interagency Question and Answer" document that banks will be downgraded if their lending violates federal anti-predatory law. NCRC has not seen rigorous action to implement this guidance. Fair lending reviews that accompany CRA exams do not usually scrutinize subprime lending for compliance with anti-predatory law, for possible pricing discrimination, or whether abusive loans are exceeding borrower ability to repay. NCRC recommends that all CRA exams of subprime lenders must be accompanied by a comprehensive fair lending and anti-predatory lending audit. In addition, CRA exams must ensure that prime lenders are not financing predatory lending through their secondary market activity or servicing abusive loans.

NCRC also recommends that any bank or thrift whose subprime lending exceeds a nominal amount such as 5 percent of its total loan amount must have a separate prime and subprime CRA lending exam. As NCRC stated in our comment letter during the Advance Notice of Proposed Rulemaking on the CRA during the fall of 2001, a bank or thrift must not pass its lending test if it does not score at least a satisfactory rating on the

[6] Office of Thrift Supervision Central Region's CRA Evaluation of Superior Bank, FSB, Docket #: 08566, September 1999. Available via http://www.ots.treas.gov, go to the CRA search engine and select "inactive" for the status of the institution being searched.

prime portion of its lending test. The lending test is currently the most important part of CRA exams for large banks and the only element of small bank exams. Prime lending must likewise be elevated as the most important part of the lending test. NCRC's study contributes to a significant amount of evidence that minority communities receive too much subprime lending due to discrimination. In order to correct for market failure and increase product choice in underserved communities, NCRC believes that prime lending must be emphasized on CRA exams.

Full Disclosure of Automated Underwriting Systems

This report focused on the impact of credit scores as well as race and age composition of neighborhoods in determining the level of subprime lending. Automated underwriting systems use credit scores and variables similar to the ones in this report in guiding financial institutions in their lending decisions. Since our report found a substantial amount of price discrimination, we believe that automated underwriting systems must be made more transparent in order to assess whether they are contributing to discrimination. Factors and the weights of factors used by the automated systems must be disclosed. The Department of Housing and Urban Development must release the results of its fair lending examination of Fannie Mae's and Freddie Mac's automated underwriting systems.

Recommendations for Lenders, Community Groups, and Consumers

Lenders Must Adopt Risk-Based, Not Race-Based or Age-Based Pricing: Best Practices Needed

This report finds that discrimination on the basis of race and age is wide-

spread in America. Too many subprime lenders disregard risk, as measured by credit scores, in pricing their loans. NCRC calls upon the lending industry to adopt comprehensive best practices so that they can avoid pricing discrimination and other predatory practices. The best practices approach must also include rigorous compliance training for loan officers as well as mystery shopping and testing initiatives to identify and eliminate discriminatory practices. NCRC is in the process of completing a mystery shopper report that documents the need for additional industry compliance efforts because the report reveals disparate treatment regarding interest rate and loan terms for white and minority testers.

Community Groups Must Advocate and Offer Financial Education and Counseling Programs

NCRC's findings reinforce the need for community group advocacy as well as program delivery. Community groups must be active in the CRA process, offering comments during CRA exams and merger applications, particularly when they believe a lender is violating fair lending law and discriminating against minorities, women, and the elderly. Each time a community group and/or coalitions of community groups change the practices of a major lender (engaged in both prime and subprime lending), the impact on the industry as a whole is profound and cannot be underestimated. At the same time, community groups should continue pursuing programmatic opportunities, including mystery shopping, financial education, and counseling programs. Community groups should increase their skill and sophistication of using data compiled from their program delivery for their advocacy and policy positions.

Consumers Must Shop for Affordable Loans and Obtain Credit Reports, Credit Scores, and Pursue Inaccuracies

NCRC recommends that consumers consult with NCRC's *Best and Worst Lenders* at http://www.ncrc.org to find a list of lenders most likely to approve minorities, women, and low- and moderate-income consumers for affordable loans. *Best and Worst Lenders* provides detailed information on lenders in 25 major metropolitan areas. Consulting with *Best and Worst Lenders* increases the chances that consumers will be approved for loans. In addition, *Best and Worst Lenders* enables consumers to identify responsible banks that reinvest consumer deposits back into minority and low- and moderate-income communities instead of redlining local communities and investing their deposits elsewhere.

Once a year, consumers should also purchase their credit reports and scores from each major credit bureau (Experian at www.experian.com, Equifax at www.equifax.com; and Trans Union at www.transunion.com). If a consumer believes that his or her credit report contains an inaccuracy, he or she should ask the credit bureaus to investigate and correct any mistakes. If the consumer believes that the credit bureaus have not fairly resolved disputes over mistakes, he or she should contact the Federal Trade Commission at www.ftc.gov.

Background and Literature Review

NCRC benefited from industry data on creditworthiness in order to produce a comprehensive study on the relationship between loan pricing and the race and age of neighborhoods. NCRC used credit scoring data provided by one of the three large credit bureaus. A credit score is a numerical score estimating the chances a consumer will be delinquent in loan payments or default altogether. The credit score is derived from statistical analysis of information contained in credit reports regarding a

consumer's past payment history and use of credit. On a census tract level, the credit scoring data indicated how many consumers were in various categories of risk. NCRC was then able to analyze the impact of credit scores on the level of subprime home lending by combining the credit scoring information with the Home Mortgage Disclosure Act (HMDA) data, and demographic and housing stock data from the Census Bureau.

NCRC employed regression analysis to predict the level of subprime lending on a census tract level in ten large metropolitan areas. The analysis allowed NCRC to determine whether increases in the African-American, Hispanic, or elderly population in a neighborhood led to increases in the amount of subprime loans after controlling for credit-worthiness (as revealed by the credit score data) and important housing stock characteristics. As stated above, the findings revealed that minority and elderly neighborhoods do, in fact, receive substantially higher levels of subprime lending than is justified based on the creditworthiness of their residents, housing values, and other measures of housing market conditions.

NCRC's findings are consistent with a body of research on subprime lending. A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers believed they received fair rates and terms.[7] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that between a third to a half of

[7] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.

borrowers who qualify for low cost loans receive subprime loans.[8] Dan Immergluck, a professor at Grand Valley State University, was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[9] Like Immergluck's work, the Department of Housing and Urban Development found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increases as the minority level of the tract increases.[10] The Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, released a controversial study in 2000 which concluded that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[11]

A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans,

NCRC's study is quite similar and builds upon important research conducted by a Federal Reserve economist and two researchers from the Wharton School at the University of Pennsylvania. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market

[8] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

[9] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.

[10] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.

[11] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?* Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.

conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[12]

Relatively few studies examine the relationship between the number of elderly residents of a neighborhood and the level of subprime lending although anecdotal evidence suggests that abusive lenders target the elderly. In one study, the South West office of Consumers Union found that every 1 percentage point increase in the portion of people over 65 in a neighborhood increased subprime refinance lending by 1.3 percentage points. The Consumers Union study examined neighborhoods in Dallas and Austin, and included demographic variables and a few underwriting variables such as loan amount to income ratios in its regression equations.[13] The AARP also conducted a national survey of elderly borrowers and found that older borrowers who were widowed, female, African-American, and less educated were more likely to receive subprime loans than their married, male, white, and more educated counterparts. The survey also found that seniors receiving subprime loans were more likely to have been approached by brokers, to have refinanced two or more times in the past three years, and to be dissatisfied with their loans.[14]

Another body of literature examines whether consumer credit reports are

[12] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

[13] Consumers Union, *Elderly in the Subprime Market*, October 2002, www.consumersunion.org.

[14] Neal Walters and Sharon Hermanson, *Older Subprime Refinance Mortgage Borrowers*, AARP Public Policy Institute, Data Digest Number 74, July 2002, http://www.aarp.org/ppi.

accurate. If consumer credit reports are incomplete and inaccurate, then the credit scores used to assess risk could be seriously flawed. Troubling evidence suggests that substantial inaccuracies exist in credit reports and could be contributing to racial disparities in lending. In the summer of 2002, the Consumer Federation of America (CFA) shed more light on how credit report flaws can disproportionately impact borrowers on the edge between prime and subprime credit. CFA's analysis of credit scores in more than 500,000 merged credit files revealed that 29 percent of consumers had scores with a range of at least 50 points when using the credit reports from each of the three major bureaus. Focusing in more detail on 1,704 at-risk mortgage purchasers with marginal scores between prime and higher cost subprime credit, CFA found that at least one-fifth would be harmed, and one-fifth would benefit from score inaccuracy if they tried to purchase mortgage loans. The upshot of this finding is that at least 8 million Americans may be erroneously placed into subprime loans and thus pay tens of thousands of dollars each in unnecessarily high mortgage interest payments.[15]

In the winter of 2003, a Federal Reserve Bulletin article revealed that almost one third of sampled credit accounts lacked information on borrower credit limits, which is a key variable for credit scores. Furthermore, subprime specialists reported credit limits 77 percent of the time for their prime customers, but only 40 percent of the time for their subprime customers.[16] Not reporting the credit limit makes borrower credit appear

[15] Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implication for Consumers*, December 2002, http://www.consumerfed.org.

[16] Robert B. Avery, Paul S. Calem, Glenn B. Canner, Raphael Bostic, *An Overview of Consumer Data and Credit Reporting*, Federal Reserve Bulletin, February 2003, http://www.federalreserve.gov.

to be much worse than it actually is. The absence of this information results in borrowers appearing to be much closer to fully utilizing their credit cards and other open ended credit than they are in reality.

The findings of NCRC, the Calem, Gillen, and Wacther study, as well as other research, are disturbing but not surprising. Predatory lenders brazenly disregard credit scores and also do not engage in other conventional and prudent underwriting techniques. They discriminate by offering minority and elderly borrowers higher interest rate loans than is justified based on credit scores. At the same time, credit scores are not accurately predicting risk due to omitted variables that are key for traditionally underserved populations. In short, the credit system is broken and discrimination will only be eliminated if the recommendations outlined above are implemented.[17]

Methodology

As stated above, the key goal of the analysis is to determine the relationship between the portion of minority and elderly persons in a census tract and the percentage of home purchase and refinance loans that are made by subprime lenders. After controlling for economic and risk factors, does the portion of subprime loans increase as the minority and elderly population in a census tract increases? In other words, this study explores the likelihood of discrimination and reverse redlining in home

[17] Given the problems with credit reports, the credit scores used here are more likely to overstate risks for minority borrowers than for white borrowers. Accordingly, the scores are more likely to overstate the percent of borrowers in high risk groups in African-American rather than white census tracts. If such bias does occur in scores, then the use of these scores means that the true impact of race on subprime lending is higher than that indicated by the results found here. That is, our estimates of discrimination or redlining are biased low. The credit report and score data needs to be improved via renewal of Fair Credit Reporting Act.

lending. NCRC chose 10 metropolitan statistical areas (MSAs) from different parts of the United States and conducted a statistical analysis in each area. In particular, the MSAs selected are: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. These areas have different demographic and economic characteristics, which will allow us to make credible and generalizable conclusions about the home lending patterns across large metropolitan areas. In the ten MSAs, the sample consists of about 7,000 census tracts (6,741 for home purchase and 7,097 for refinance). A multivariate regression approach controlled for demographic and risk factors.

NCRC conducted separate analyses for home purchase and refinance lending. We expected a higher degree of pricing disparities by race and age of neighborhood in refinance lending since subprime lenders specialize in refinance lending and make fewer home purchase loans. NCRC's previous work, including *Best and Worst Lenders*, also found more disparities in refinance lending than home purchase lending. Abusive subprime lenders are particularly active in refinance lending since their intention is to strip equity from homeowners through repeated refinancings or flipping.

Variables for the analysis belong to three categories: home lending, credit scoring, and demographics. NCRC used 2001 HMDA data for home lending, 1999 credit scoring data, and 1990 census tract demographic information. NCRC obtained the 1999 credit scoring data on a one-time basis from one of the three large credit bureaus. NCRC chose 2001 HMDA data, not 1999 data, as we believe that the distribution of credit scores on a census tract level does not vary significantly over a three year time period. NCRC ran regression equations using 1999 and 2000 home

loan data to confirm the hypothesis. The results were similar over the years. Also, 2001 was a year of lower interest rates. NCRC wanted to see if minority neighborhoods were benefiting from lower interest rates as measured by a decrease in the statistical significance of race of neighborhood on the level of subprime lending. NCRC would have preferred to use 2000 census tract data, but the HMDA data will not use 2000 census data until the 2003 release in the summer of 2004. The 2001 HMDA data uses 1990 census tract boundaries. NCRC believes the results will be similar with HMDA data using 2000 census tract boundaries, but we intend to do follow-up research.[18]

HUD Subprime and Manufactured Home Lender List

In order to classify loans as subprime, NCRC used a list of subprime and manufactured home lenders developed by HUD. Since HMDA data does not have information on the Annual Percentage Rate (APR) or other loan terms and conditions, HUD developed its list by complementing data analysis with interviews of lending institutions and a literature search. As an additional step, HUD called the lenders on its list and asked them if they considered themselves subprime and manufactured home specialists. Generally speaking, a lender was included on the list if more than 50 percent of the loans in its portfolio was subprime or manufactured home.[19]

[18] Important characteristics of the HMDA data are discussed separately in an appendix.

[19] HUD itself admits that the list is not complete. A number of institutions considered to be prime specialists make a significant number of subprime loans, even if 50 percent or more of their loans are not subprime. Also, the list may not be complete due to name changes and omissions. HUD refines its lists on an annual basis and also corrects mistakes on previous years' lists. HUD's web page (http://www.huduser.org/datasets/manu.html) has more information about the lists and has copies of the lists.

Until more information on loan terms and conditions are available in HMDA data, HUD's list is a valuable resource for conducting subprime and manufactured home loan analysis. Although the list is incomplete, it still captures significant differences in lending behavior as revealed by this report and a substantial body of research.

Data and variables

Home lending data in the analysis represents only originations of home loans, not applications for the loans. We included all types of loans: conventional, and government insured (FHA, VA, and FSA/RHS) to owner-occupants only. NCRC also separated two types of home loans: home purchase loans and refinance loans. By doing so, we aimed to see for which loan type the race and age of neighborhood residents had a stronger influence. We excluded manufactured home lenders from the analysis as initial regressions revealed that the level of manufactured home lending did not vary in a statistically significant manner with the race of neighborhood residents.[20] Future research should explore this in more detail. The study excluded census tracts in which the number of originated loans was less than 20. This was done to ensure a sufficient number of loans for meaningful characterization of each tract's lending patterns.

[20] Manufactured home lenders specialize in making loans to borrowers purchasing manufactured homes. These lenders tend to make high interest rate loans; abusive lending has been widespread in the manufactured home sector as indicated by massive foreclosures and the failures of large national manufactured home lenders. According to HUD, "A manufactured home (formerly known as a mobile home) is built to the Manufactured Home Construction and Safety Standards (HUD Code) and displays a red certification label on the exterior of each transportable section. Manufactured homes are built in the controlled environment of a manufacturing plant and are transported in one or more sections on a permanent chassis." HUD has detailed information about manufactured housing on its web page of http://www.hud.gov.

The analysis chose the following variables that would hypothetically influence subprime lending in an area.

Home lending variables (dependent variables):

%subHP – percent of home purchase loans in a census tract that were subprime.

%subREF – percent of refinance loans in a census tract that were subprime.

Demographic variables included:

%black – percent of residents in a census tract who were African-American;

%hisp – percent of residents in a census tract who were Hispanic;

%65age – percent of residents in a census tract who were over 65 years old;

medage – dummy variable. The variable revealed the median age of houses in a census tract.

0 when the median age of housing was between 0-20 years old (built in 1970-1990);
1 when the median age of housing was between 21-50 years old (built in 1969-1940);
2 when the median age of housing was 51 years and older (built before 1940);

medhhinc – 1989 median household income in a census tract;

HT – housing turnover. This variable is a ratio of all home purchase loans made in 2001 divided by owner occupied units in 1990. The literature indicates that a higher amount of housing turnover (as revealed by larger values of this variable) suggests a more vibrant market and faster home value appreciation. This should make a census tract more attractive to prime lenders and thus decrease the portion of subprime lending.

capitaliz – The "capitalization" variable is a ratio of gross median rent divided by median housing value. The literature suggests that owner-occupied units appreciate slower in neighborhoods where the median rent is higher relative to the median housing value (higher ratio values for this variable). Therefore, prime lenders may find neighborhoods less attractive with higher values for the capitalization variable, meaning that the portion of subprime loans will be higher in these neighborhoods.

Credit scoring variables included:

%vhigh – is a credit score variable that indicated the percent of people in a census tract in the very high credit risk category;

%NC – is the percent of neighborhood residents lacking credit scores;

vh+h+m – the cumulative percent of neighborhood residents in very high, high, and moderate credit risk categories added together.

The credit risk scores used in this report measure the likelihood of future delinquencies and foreclosures. The database had a credit score range from 0 to 1,000 with lower scores indicating lower risk or chance of borrower delinquency. The scores were divided into five equal categories or quintiles of risk; the specific categories are Very Low, Low, Moderate, High and Very High risk. The credit score range was separated into quintiles, not the population totals within the quintiles. In other words, each score quintile did not have equal numbers of people, but each score range was of equal length (about 200 units for each quintile since the total range is from 0 to 1,000).

For each census tract, the database contains the number and percent of neighborhood residents in each of the five risk categories, and the number and percent of neighborhood residents with no credit scores.

NCRC's analysis focuses on the "vh+h+m" credit score variable. Our regression analysis was iterative. One equation (Column 1 on Tables 1 through 10) included the combined risk variable of "vh+h+m" and the NC or no credit score variable. Column 2 is another regression in which the very high risk and no credit score variables are included as separate variables (see the tables below).

Columns 3 through 4 repeat the iterative approach for the risk variables in the same order as Columns 1 through 2. The difference between Columns 1 and 2 and Columns 3 and 4 is that the race and age variables are omitted in Columns 3 and 4. This is done in order to understand better the added explanatory power obtained by including the race and age variables (see discussion below in the Functional Form section).

The "vh+h+m" variable was statistically significant across all ten MSAs for home purchase lending and nine MSAs for refinance lending. The impact of the variable was as expected; that is, subprime lending was more prevalent as the percentage of people in a census tract with very high, high, and moderate risk increased. The regression equations including only the very high risk and no credit score variables had very similar outcomes to the equations with the "vh+h+m" combined risk and no credit score variables. Although the very high risk equations (Column 2) were similar to the "vh+h+m" equations (Column 1), we focused on the "vh+h+m" equations since subprime lenders would likely make loans to consumers with high and moderate risk as well as very high risk. The coefficients and R squares in the "vh+h+m" equations were consistent with these expectations.

In contrast to our report, the Calem, Gillen, and Wacther study focuses on the equations with the very high risk and no credit score variables. The fact that two different series of equations (those with very high risk and no credit score variables and those with the combined risk and no credit score variables) produced similar results adds to the robustness of the overall findings.

Impact of Demographic Versus Economic Factors

As stated above, we conducted multivariate regression analysis with the dependent variable represented by the percentage of subprime loans in a census tract and independent variables that control for demographic, economic and risk factors. Our variables of interest were the minority and elderly populations in a census tract. NCRC hypothesized that the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

Table 11 shows the statistical significance of variables at the 10%, 5%, and 1% precision level, sign of estimated coefficients, and adjusted R square for every regression. The adjusted R square was rather high for most MSAs and loan types (the higher the R square, the better the equation accounts for and explains patterns of subprime lending on a neighborhood level). The R square was higher for refinance than home purchase, suggesting that our model was better at predicting patterns in refinance lending. For refinance lending, the R square ranged from 0.5252 in Los Angeles to 0.8993 in Detroit. For home purchase lending, the R square fell between 0.0843 in Baltimore and 0.6865 in Cleveland. The R square was above 0.3 in five out of ten MSAs in home purchase lending. In contrast, the R square was above 0.3 in all MSAs in refinance lending. Overall, we believe our model is robust and a good predictor of lending patterns. The model's results were consistent with the Calem, Gillen, and Wachter study.

. . . the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

The African-American population in a census tract was statistically significant in six MSAs for home purchase lending and in nine MSAs for

refinance lending. As expected, after controlling for risk and housing stock characteristics, the effect of the percentage of African-American population on the portion of subprime loans in a census tract was positive in all MSAs. Lenders still associated high risk with race and thus, compensated by making a substantially higher level of subprime loans in African-American than white tracts.

The percent of Hispanic population in a census tract was significant in only one MSA for home purchase and in five MSAs for refinance lending. The sign of the coefficients was not consistent for each MSA.[21] The sign was negative in one MSA for home purchase lending and in two MSAs for refinance lending. In contrast, the sign was positive in three MSAs for refinance lending, meaning that the level of subprime refinance lending increased as the portion of Hispanics increased in a census tract. Our study results suggest no consistent relationship between the level of subprime lending and the portion of Hispanics in a neighborhood. However, the portion of Hispanics in a neighborhood was associated with an increase in subprime lending, all else equal, in a subset of the MSAs.

The portion of people over 65 was a strong factor for three out of ten MSAs for home purchase lending. For refinance lending, the age of the census tract population was significant in eight MSAs. For refinance and

[21] A coefficient expresses the effect of an independent variable on the dependent variable. In this report, the portion of subprime loans is the dependent variable. The level of subprime lending changes because of the racial composition of the neighborhood and other "independent" variables. For the racial composition of the neighborhood, the coefficient measures the impact in percentage point terms. For every percentage point increase in African-American or Hispanic residents in a census tract, the portion of subprime loans increases or decreases by a certain number of percentage points as revealed by the value and sign of the coefficient. The coefficient only has an impact if it is statistically significant (as revealed by legends in the charts capturing the regression results).

home purchase lending, the sign of the coefficients was positive in all MSAs except in two of the eleven cases. This supports the contention that abusive lenders target the elderly to take advantage of the fact that the elderly have substantial amounts of equity but are often short on cash. These results contradict those obtained by Calem, Gillen, and Wachter. They mentioned that this variable "yielded no additional insights," but their study looked at only two MSAs.

Median household income of a census tract was statistically significant in four out of ten MSAs in home purchase lending and in refinance lending. Except in one case, the sign of the coefficients was positive, which is counterintuitive. The literature, however, discusses that a segment of high income borrowers do not report income level to lenders nor do they want to undergo a lengthy application process. Hence, they receive subprime loans. It must be added that the coefficient values were very small, meaning that the income variable had a small impact on the level of subprime lending in census tracts.

Except for Detroit refinance lending, the combined risk variable in all MSAs for both loan types was statistically significant. Coefficients were positive, meaning that a larger percentage of people with higher risk factors was associated with a higher percent of subprime loans in a census tract. These findings are quite consistent with those discussed in the Calem, Gillen, and Wachter report. Also, the level of subprime home purchase and refinance lending increased in a statistically significant fashion in the great majority of MSAs as the percentage of neighborhood residents with no credit scores increased.

The other variables including housing turnover and capitalization be-

haved in the expected manner. Housing turnover was significant in most MSAs and the coefficients' signs were negative, which supported our expectations. Higher housing turnover indicates more vibrancy in the market of the neighborhood, which in turn leads to less subprime lending. The capitalization variable was significant in six MSAs for home purchase and in ten MSAs for refinance lending. Except in one case, it also had the expected effect on subprime lending. Specifically, it was positively related to the percent of subprime loans, proving that faster appreciation of the owner-occupied units (smaller capitalization ratios) leads to less subprime lending in a neighborhood.

Subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood.

In summary, after controlling for risk and housing stock characteristics, subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood. Pricing discrimination is widespread in the dual lending marketplace in America.

Metropolitan Areas Compared

Tables 12 through 14 sort MSAs by the effect of race and age factors on the level of subprime home purchase and refinance lending in a census tract. As Table 12 reveals, the percentage of African-Americans in a census tract imposed the strongest effect on subprime home purchase lending in Cleveland, Milwaukee, Detroit, and Atlanta. The African-American variable had the largest effect in Houston, Milwaukee, Detroit, and Cleveland for refinance lending. For example, in Houston a ten percentage point increase of African-Americans in a census tract, holding all other variables constant, would lead to an increase in the portion of subprime refinance loans of 4.058 percentage points. In contrast, in Baltimore a 10 percentage point increase in the portion of African-Ameri-

cans would lead to only a 1.107 percentage point increase in the portion of subprime refinance loans.

In Tables 12 through 14, the coefficients with one, two, or three asterisks are coefficients estimated at the 10%, 5%, and 1% level of statistical significance, respectively. In other words, these coefficients are valid in predicting the portion of subprime loans. In contrast, when the coefficients do not have asterisks, they cannot be used to predict the level of subprime loans.

The coefficient values for the African-American variables in this report are consistent with those in Calem, Gillen, and Wachter. The ordinary least squares regressions in the Calem, Gillen, and Wachter study estimated the African-American coefficient at about 0.2, which was approximately the median coefficient in our equations as reported in Table 12.

The portion of Hispanics in a census tract had the strongest impact in the Detroit and Houston MSAs for refinance lending, according to Table 13. In Detroit for example, a 10 percentage point increase in the Hispanic population would lead to 1.282 percentage point increase in the portion of subprime refinance lending.

The portion of people over 65 was a relatively strong variable in Detroit and Houston for home purchase lending and in St. Louis, Atlanta, and Houston for refinance lending. In particular, in the St. Louis MSA, a 10 percentage point increase of people over 65 would lead to a 3.065 percentage point increase in the portion of subprime refinance loans in a neighborhood.

In refinance and home purchase lending, the African-American portion of people in a census tract increased subprime lending regardless of the level of segregation in a MSA (see Table 12 which shows segregation levels as well as estimated coefficients for the African-American variable). For African-Americans, discrimination poses great difficulties across a wide swath of MSAs of different economic and demographic conditions. Regardless of the level of segregation, the African-American variable increased subprime refinance lending. No trends appeared regarding the level of segregation and the impact of the Hispanic variable on the amount of subprime lending.

Functional Form

Another dimension that should be discussed in this analysis is functional form: how it affects the results and what conclusions it informs. As stated above, NCRC used two forms when running the regressions: including and excluding race and age factors. The outputs are presented in the Tables 1 through 10. In most cases, the R square was lower when the race and age variables were excluded (this is observed clearly when comparing Columns 1 and 3 with the vh+h+m combined risk variable). This suggests that the equations explained a greater amount of the variation in the dependent variable when the race and age variables were included.

Calem, Gillen, and Wachter took a different iterative approach, but their findings were similar to our study. They ran some regressions with only demographic characteristics while we ran some regressions with only non-race variables. The end result of both approaches was that the R square was higher when the race variables were included.

Conclusion

After controlling for risk and housing market conditions, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas. The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood. In America today, lenders engage in widespread price discrimination, making high cost loans based on the race and age of neighborhoods, not solely based on risk.

Appendix

HMDA Data: Its Strengths and Weaknesses

Enacted by Congress in 1975, the Home Mortgage Disclosure Act (HMDA) requires banks, savings and loan associations, credit unions, and other financial institutions to publicly report detailed data on their home lending activity. Under HMDA, lenders are required to disclose annually the number of loan applications by census tract, and by the income, race, and gender of the borrower. The law also requires institutions to indicate the number and dollar amount of the loans made.

Prior to 1990, lenders were required to report the census tract containing

the property for which the applicant succeeded or failed in obtaining a home loan. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) required lenders to report the race, gender, and income of loan applicants and borrowers starting in 1990. Thus, HMDA data before 1990 reveals information only on the census tract location of the application or loan, whereas HMDA data after 1990 includes information on borrower characteristics. Also, starting in 1993, independent mortgage companies were required to report HMDA data.

HMDA requires lenders to report on a number of possible actions or "dispositions" on loan applications. Each year, the lender must report the number of loan applications it approved and denied. The lender must also indicate how many of its loan approvals were unaccepted (the bank approved the application but the applicant did not want the loan). Finally, the lender must specify how many applications were withdrawn (the applicant withdrew his application before the bank made a credit decision), and how many applications were incomplete (the application was not considered because the applicant did not provide all the necessary information).

Housing loans covered by HMDA include home purchase, home improvement, and refinance loans for single family dwellings (1 to 4 units) and loans for multi-family units. Lenders must disclose whether the loan was a conventional loan or a loan insured by a government agency such as the Federal Housing Administration (FHA), the Veterans Administration (VA), the Farm Service Agency (FSA), and the Rural Housing Service (RHS). Additional information reported includes the occupancy status of the property (owner occupied or non-owner occupied). The lender must also indicate if the loan was purchased on the secondary market and the

type of institution that bought the loan (for example, another bank or Fannie Mae or Freddie Mac).

Who is Covered by HMDA

A depository institution (bank, thrift, and credit union) must report HMDA data if it has a home office or branch in a metropolitan statistical area (MSA) and has assets above a threshold level that is adjusted upward every year by the rate of inflation. Before 1997, small depository institutions were exempt if they had assets less than $10 million. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended HMDA to adjust the exemption level to take into account annual inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. For the 1997 data, the asset level for exemption was increased from $10 million to $28 million (to take into account inflation occurring between 1975, the first year of HMDA data, through 1996). For 1998 and 1999 data collection, the Federal Reserve increased the asset level for exemption to $29 million. For the year 2000 and 2001, the Federal Reserve set the asset level for exemption to be $30 million and $31 million, respectively.

In addition, a depository institution is not required to report HMDA data if it did not make a home purchase loan on a 1-to-4 unit dwelling (or if it did not refinance a home purchase loan) during the previous calendar year.

Many non-depository institutions must also report HMDA data. An example of a non-depository institution is a mortgage company that does not accept deposits but raises funds for lending by borrowing from

investors. A non-depository institution must report HMDA data if it has more than $10 million in assets and it originated 100 or more home purchase loans (including refinances of home purchase loans) during the previous calendar year. A non-depository institution is exempt from HMDA reporting requirements if its home purchase loans (including refinances of home purchase loans) were less than 10 percent of all of its loan originations, measured in dollars, during the previous calendar year.

Gaps in HMDA Data

Small lenders and lenders with offices only in non-metropolitan areas (as noted above) are exempt from HMDA data reporting requirements. Data for rural areas is also incomplete, particularly information on the census tract location of loans. If banks and thrifts have assets under $250 million dollars (or are part of holding companies under $1 billion dollars), they do not have to report the census tract location for loans in MSAs (metropolitan statistical areas) in which they do not have any branch offices. They also do not have to report the census tract location for loans outside of MSAs.

Non-depository institutions do not have to report the census tract location of loans made in non-metropolitan areas. They have to report the census tract location of loans in those MSAs in which they received applications for, originated, or purchased five or more home purchase or home improvement loans during the preceding calendar year.

Another area of incompleteness concerns race and gender data of applications taken via the telephone. When applications are made in person, the loan officer is required to ask the applicant about his/her race. If the

applicant refuses, the loan officer is required to record race on the basis of visual observation or applicant surname. The loan officer is required to inform the applicant that federal law designed to combat discrimination requires this information. In contrast, when applications are received over the phone, the loan officer is not required to ask for the race and gender of the applicant (but this is about to change, see immediately below). When applications are received through the mail, the lending institution is required to ask for the race and gender of the applicant.

In the case of the electronic media, the official staff commentary of the Federal Reserve Board regarding the HMDA regulation states that lenders are required to ask for race and gender when applications are received over the Internet. When lenders are using electronic media with a video component, lenders are to use the same procedures as if the application is made in person.

Finally, a lender is not required to report the race, gender, and income data for loans that they purchase from another institution.

Improvements in HMDA Data

In the summer of 2002, the Federal Reserve Board made some significant changes to HMDA (the Federal Reserve Board has statutory responsibility to promulgate HMDA regulations). Lending institutions will be required to ask borrowers applying over the phone for their race and gender, starting in 2003.

In 2004, non-depository institutions making at least $25 million in home purchase loans will be required to report HMDA data. This will capture

more non-depository institutions as HMDA reporters than the thresholds described above. Lending institutions will be required to indicate in the HMDA data if the loans were for manufactured homes or traditional single family residences. The Federal Reserve Board will also require lenders to report price information if the APR on their loans exceeds the rate on Treasury securities by three percentage points for first-lien loans and five percentage points for second-lien loans.

Other changes to HMDA data beginning in 2004 include improving the definition of home improvement and refinance loans, requiring an indication if a loan is covered by the Home Ownership and Equity Protection Act, and requiring pre-approvals to be reported for home purchase loans. Finally, but importantly, lenders will be required to indicate the identity of their parent companies in the HMDA data.

Table 1: Detailed Regressions for Atlanta

Atlanta - Home Purchase					
	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0736	0.0001	-0.2301	-0.0743	Intercept
	-1.6899	0.0057	-6.9928	-3.4637	
%black [est. coeff.]	0.1393	0.1327			%black
[t-Score]	***8.4146***	***7.4253***			
%hisp [est. coeff.]	-0.2080	-0.2475			%hisp
[t-Score]	-1.3761	-1.6392			
%65age [est. coeff.]	0.0845	0.0404			%65age
[t-Score]	1.2000	0.6217			
medage [est. coeff.]	-0.0060	-0.0052	0.0114	0.0104	medage
[t-Score]	-0.9145	-0.7775	*1.7122*	1.6101	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***2.0566***	1.6146	***3.8901***	***3.1293***	
HT [est. coeff.]	-0.0007	0.0000	-0.0042	-0.0034	HT
[t-Score]	-0.3130	-0.0374	**-1.9974**	*-1.6600*	
capitaliz [est. coeff.]	2.2945	2.3405	0.3412	0.0582	capitaliz
[t-Score]	1.3955	1.4269	0.1905	0.0336	
%vhigh [est. coeff.]		0.1635		0.4289	%vhigh
[t-Score]		***2.8298***		***8.9836***	
% NC [est. coeff.]	0.0756	-0.0036	0.5576	0.2826	%NC
[t-Score]	0.8172	-0.0403	***7.3417***	***3.4278***	
vh+h+m [est. coeff.]	0.1621		0.3740		vh+h+m
[t-Score]	***2.8550***		***7.7943***		
Adj R-square	0.4566	0.4564	0.3429	0.3684	**Adj R-square**

Atlanta - Refinance					
Variable					Variable
Intercept	-0.2316	-0.0823	-0.4070	-0.1572	Intercept
	-4.9917	-3.1144	-10.8020	-6.5746	
%black [est. coeff.]	0.1886	0.1682			%black
[t-Score]	***11.1936***	***9.2579***			
%hisp [est. coeff.]	-0.2456	-0.3350			%hisp
[t-Score]	-1.5388	**-2.1166**			
%65age [est. coeff.]	0.2701	0.1899			%65age
[t-Score]	***3.6791***	***2.8195***			
medage [est. coeff.]	0.0016	0.0043	0.0325	0.0310	medage
[t-Score]	0.2257	0.6160	***4.2526***	***4.3506***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***2.7783***	**1.9990**	***4.0840***	***3.1652***	
HT [est. coeff.]	-0.0021	-0.0008	-0.0065	-0.0052	HT
[t-Score]	-0.8715	-0.3277	***-2.7204***	**-2.3121**	
capitaliz [est. coeff.]	7.9826	7.7769	5.7983	4.8837	capitaliz
[t-Score]	***4.7224***	***4.6556***	***2.9185***	***2.6230***	
%vhigh [est. coeff.]		0.3827		0.7148	%vhigh
[t-Score]		***6.2345***		***13.6511***	
%NC [est. coeff.]	0.1760	0.0061	0.8036	0.3462	%NC
[t-Score]	*1.8166*	0.0654	***9.1324***	***3.7494***	
vh+h+m [est. coeff.]	0.3458		0.6046		vh+h+m
[t-Score]	***5.6966***		***11.0804***		
Adj R-square	0.6903	0.6944	0.5654	0.6091	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 2: Detailed Regressions for Baltimore

Baltimore - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0274	0.0012	-0.0174	0.0128	Intercept
	-0.9384	0.0629	-0.9437	0.8683	
%black [est. coeff.]	0.0063	-0.0096			%black
[t-Score]	0.5582	-0.7825			
%hisp [est. coeff.]	-0.0890	-0.1080			%hisp
[t-Score]	-0.5333	-0.6547			
%65age [est. coeff.]	0.0367	0.0270			%65age
[t-Score]	0.9263	0.7600			
medage [est. coeff.]	0.0014	0.0017	0.0027	0.0026	medage
[t-Score]	0.3706	0.4567	0.7710	0.7620	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.6878	1.1145	0.4214	0.7548	
HT [est. coeff.]	-0.0209	-0.0133	-0.0267	-0.0164	HT
[t-Score]	-1.0024	-0.6474	-1.3083	-0.8145	
capitaliz [est. coeff.]	-1.5117	-2.3430	-1.4297	-2.1868	capitaliz
[t-Score]	-1.2807	*-1.9550*	-1.2171	*-1.8440*	
%vhigh [est. coeff.]		0.1912		0.1605	%vhigh
[t-Score]		***4.1024***		***5.0770***	
%NC [est. coeff.]	0.1625	0.1064	0.1432	0.0865	%NC
[t-Score]	**2.4925**	*1.6110*	**2.3639**	1.3829	
vh+h+m [est. coeff.]	0.1096		*0.1076*		vh+h+m
[t-Score]	***2.7570***		***3.9710***		
Adj R-square	0.0843	0.1028	0.0864	0.1059	**Adj R-square**

Baltimore - Refinance

Variable					**Variable**
Intercept	-0.1032	-0.0535	-0.1591	-0.0692	Intercept
	-2.7780	-2.0886	-6.0809	-3.2914	
%black [est. coeff.]	0.1107	0.1016			%black
[t-Score]	***8.0671***	***6.7403***			
%hisp [est. coeff.]	-0.4806	-0.5125			%hisp
[t-Score]	**-2.2312**	**-2.3859**			
%65age [est. coeff.]	0.1307	0.1012			%65age
[t-Score]	**2.5661**	**2.2017**			
medage [est. coeff.]	0.0041	0.0044	0.0104	0.0096	medage
[t-Score]	0.8486	0.9049	**2.0732**	**1.9929**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2127	0.1780	0.3565	0.8598	
HT [est. coeff.]	-0.1173	-0.1081	-0.1724	-0.1429	HT
[t-Score]	***-4.3461***	***-4.0315***	***-5.9525***	***-5.1085***	
capitaliz [est. coeff.]	11.4350	11.0128	12.1084	10.2778	capitaliz
[t-Score]	***7.4773***	***7.0691***	***7.2380***	***6.2013***	
%vhigh [est. coeff.]		0.1915		0.4338	%vhigh
[t-Score]		***3.2109***		***9.8300***	
%NC [est. coeff.]	0.3391	0.2854	0.3476	0.2013	%NC
[t-Score]	***3.9410***	***3.2582***	***3.9729***	**2.2663**	
vh+h+m [est. coeff.]	0.1471		0.3089		vh+h+m
[t-Score]	***2.9374***		***8.0034***		
Adj R-square	0.6306	0.6320	0.5539	0.5801	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 3: Detailed Regressions for Cleveland

Cleveland - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0968	-0.0667	-0.2787	-0.1445	Intercept
	-2.4616	-2.6279	-9.6417	-6.9277	
%black [est. coeff.]	0.2400	0.2159			%black
[t-Score]	***15.6258***	***11.9307***			
%hisp [est. coeff.]	-0.0317	-0.0693			%hisp
[t-Score]	-0.5279	-1.1269			
%65age [est. coeff.]	0.0698	0.0496			%65age
[t-Score]	1.2876	1.0664			
medage [est. coeff.]	0.0114	0.0104	0.0029	0.0008	medage
[t-Score]	**2.1543**	**1.9885**	0.4430	0.1363	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.0055	0.5456	**2.3867**	***4.2976***	
HT [est. coeff.]	-0.0425	-0.0405	-0.2003	-0.1330	HT
[t-Score]	-0.8212	-0.7884	***-3.1160***	**-2.2735**	
capitaliz [est. coeff.]	8.3768	7.5255	10.5030	6.1981	capitaliz
[t-Score]	***5.2034***	***4.5995***	***5.1443***	***3.2482***	
%vhigh [est. coeff.]		0.2395		0.8201	%vhigh
[t-Score]		***3.3621***		***15.3546***	
%NC [est. coeff.]	0.1226	0.0691	0.2533	0.0019	%NC
[t-Score]	**2.2792**	1.2988	***4.0533***	0.0307	
vh+h+m [est. coeff.]	0.1274		0.5215		vh+h+m
[t-Score]	**2.2510**		***10.6801***		
Adj R-square	0.6865	0.6904	0.4906	0.5747	**Adj R-square**

Cleveland – Refinance

Variable					**Variable**
Intercept	-0.2596	-0.1557	-0.3936	-0.1729	Intercept
	-6.1378	-5.8013	-13.4316	-8.6214	
%black [est. coeff.]	0.1988	0.1238			%black
[t-Score]	***12.4492***	***6.7255***			
%hisp [est. coeff.]	0.0693	-0.0251			%hisp
[t-Score]	1.1136	-0.4123			
%65age [est. coeff.]	0.1635	0.1104			%65age
[t-Score]	***2.8461***	**2.2404**			
medage [est. coeff.]	0.0134	0.0094	0.0028	0.0019	medage
[t-Score]	**2.1879**	1.6132	0.3966	0.3124	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.5386	1.0357	0.8153	***2.8402***	
HT [est. coeff.]	0.0142	0.0298	-0.2029	-0.0665	HT
[t-Score]	0.2246	0.4945	***-2.8433***	-1.0777	
capitaliz [est. coeff.]	16.4428	14.1417	16.9059	12.1840	capitaliz
[t-Score]	***9.4880***	***8.3802***	***8.4575***	***6.9456***	
%vhigh [est. coeff.]		0.7923		1.1672	%vhigh
[t-Score]		***10.3537***		***24.0454***	
%NC [est. coeff.]	0.3718	0.1896	0.4998	0.1288	%NC
[t-Score]	***5.9831***	***3.1951***	***7.5462***	**2.1248**	
vh+h+m [est. coeff.]	0.4403			0.8241	vh+h+m
[t-Score]	***7.0236***			***16.8755***	
Adj R-square	0.8108	0.8268	0.7400	0.8060	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 4: Detailed Regressions for Detroit

Detroit - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.1612	-0.0673	-0.2883	-0.1217	Intercept
	-6.5514	-4.5959	-15.3291	-10.5391	
%black [est. coeff.]	0.1661	0.1414			%black
[t-Score]	***17.3528***	***12.6615***			
%hisp [est. coeff.]	0.0645	0.0671			%hisp
[t-Score]	0.8549	0.8940			
%65age [est. coeff.]	0.1606	0.1108			%65age
[t-Score]	***4.5974***	***3.5032***			
medage [est. coeff.]	-0.0009	-0.0006	0.0073	0.0064	medage
[t-Score]	-0.2483	-0.1527	*1.6466*	1.5942	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***7.0185***	***7.2346***	***9.5542***	***11.2168***	
HT [est. coeff.]	-0.0487	-0.0422	-0.0668	-0.0487	HT
[t-Score]	***-2.7491***	***-2.3909***	***-3.1544***	***-2.5180***	
capitaliz [est. coeff.]	0.9817	0.2664	2.6210	-0.0667	capitaliz
[t-Score]	1.5908	0.4177	***3.6241***	-0.0964	
%vhigh [est. coeff.]		0.2817		0.5624	%vhigh
[t-Score]		***7.9450***		***21.2638***	
%NC [est. coeff.]	0.2134	0.0892	0.3806	0.0654	%NC
[t-Score]	***4.3575***	*1.7369*	***7.1284***	1.2392	
vh+h+m [est. coeff.]	0.2435		0.4483		vh+h+m
[t-Score]	***7.3623***		***15.2271***		
Adj R-square	0.6267	0.6302	0.4622	0.5494	**Adj R-square**

Detroit - Refinance

Variable					**Variable**
intercept	0.0163	0.0239	0.0160	0.0166	Intercept
	1.2207	2.3102	0.7742	1.0967	
%black [est. coeff.]	0.2577	0.2578			%black
[t-Score]	***40.0263***	***40.0004***			
%hisp [est. coeff.]	0.1282	0.1295			%hisp
[t-Score]	***2.6175***	***2.6440***			
%65age [est. coeff.]	-0.0634	-0.0633			%65age
[t-Score]	***-2.2064***	***-2.2031***			
medage [est. coeff.]	0.0059	0.0059	0.0071	0.0070	medage
[t-Score]	1.6232	1.6277	1.2371	1.2299	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***-5.1794***	***-5.1494***	***-5.6100***	***-5.5512***	
HT [est. coeff.]	-0.0940	-0.0940	-0.1672	-0.1674	HT
[t-Score]	***-4.2685***	***-4.2686***	***-4.6023***	***-4.6095***	
capitaliz [est. coeff.]	12.4840	12.4769	21.6557	21.6289	capitaliz
[t-Score]	***25.9571***	***25.9340***	***32.1928***	***32.1477***	
%vhigh [est. coeff.]		0.0088		-0.0266	%vhigh
[t-Score]		0.4675		-0.8586	
%NC [est. coeff.]	-0.0270	-0.0244	-0.0912	-0.0518	%NC
[t-Score]	-0.9466	-0.6699	*-1.9387*	-0.8615	
vh+h+m [est. coeff.]	0.0190		-0.0006		vh+h+m
[t-Score]	0.9414		-0.0181		
Adj R-square	0.8993	0.8992	0.7224	0.7226	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 5: Detailed Regressions for Houston

Houston - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0716	-0.0121	-0.0638	0.0024	Intercept
	-2.3607	-0.6369	-2.4380	0.1439	
%black [est. coeff.]	0.0492	0.0061			%black
[t-Score]	***3.5117***	0.3776			
%hisp [est. coeff.]	-0.0260	-0.0244			%hisp
[t-Score]	-1.4890	-1.4337			
%65age [est. coeff.]	0.1597	0.1507			%65age
[t-Score]	***2.5969***	***2.5793***			
medage [est. coeff.]	-0.0021	-0.0009	0.0026	0.0037	medage
[t-Score]	-0.3409	-0.1577	0.5345	0.8384	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9668	*1.6872*	1.0104	*1.9404*	
HT [est. coeff.]	-0.0030	0.0002	-0.0025	-0.0003	HT
[t-Score]	-1.0546	0.0876	-0.8813	-0.0933	
capitaliz [est. coeff.]	-0.3612	-1.4909	-1.0640	-2.2156	capitaliz
[t-Score]	-0.3971	-1.6291	-1.1510	**-2.5192**	
%vhigh [est. coeff.]		0.3416		0.3347	%vhigh
[t-Score]		***7.2297***		***9.3429***	
%NC [est. coeff.]	0.0590	-0.0969	0.0596	-0.1120	%NC
[t-Score]	1.0204	*-1.6705*	1.0468	**-1.9726**	
vh+h+m [est. coeff.]	0.2145		0.2307		vh+h+m
[t-Score]	***5.3134***		***6.4863***		
Adj R-square	0.1762	0.2121	0.1302	0.1969	**Adj R-square**

Houston - Refinance

Variable					**Variable**
Intercept	-0.2230	-0.1553	-0.4695	-0.2285	Intercept
	-4.2211	-4.7643	-8.2199	-7.2035	
%black [est. coeff.]	0.4058	0.3194			%black
[t-Score]	***17.8827***	***11.8561***			
%hisp [est. coeff.]	0.0694	0.0660			%hisp
[t-Score]	**2.2102**	**2.1770**			
%65age [est. coeff.]	0.2483	0.2632			%65age
[t-Score]	***2.2765***	***2.5762***			
medage [est. coeff.]	0.0397	0.0446	0.0859	0.0888	medage
[t-Score]	***3.7532***	***4.3637***	***8.0243***	***10.2813***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2985	1.3561	0.9242	***2.9685***	
HT [est. coeff.]	-0.0296	-0.0227	-0.0206	-0.0101	HT
[t-Score]	***-6.1039***	***-4.6654***	***-3.2921***	*-1.8924*	
capitaliz [est. coeff.]	14.4833	11.5724	10.9087	4.9465	capitaliz
[t-Score]	***9.0106***	***7.1455***	***5.1527***	***2.8008***	
%vhigh [est. coeff.]		0.6078		1.2788	%vhigh
[t-Score]		***6.9964***		***18.2973***	
%NC [est. coeff.]	0.2893	-0.0187	0.5737	-0.2016	%NC
[t-Score]	***2.6597***	-0.1652	***4.0848***	-1.5846	
vh+h+m [est. coeff.]	0.3045		0.8178		vh+h+m
[t-Score]	***4.1601***		***10.1633***		
Adj R-square	0.7364	0.7529	0.5333	0.6690	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 6: Detailed Regressions for Los Angeles

Los Angeles - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0148	0.0871	-0.0453	0.0472	Intercept
	-0.5055	4.7543	-2.0613	3.4345	
%black [est. coeff.]	0.0434	0.0278			%black
[t-Score]	***3.7431***	**2.2361**			
%hisp [est. coeff.]	-0.0738	-0.0662			%hisp
[t-Score]	***-6.5858***	***-6.0490***			
%65age [est. coeff.]	-0.0702	-0.1048			%65age
[t-Score]	*-1.6689*	**-2.5966**			
medage [est. coeff.]	0.0094	0.0088	0.0066	0.0050	medage
[t-Score]	**2.1647**	**2.0267**	1.5305	1.1809	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.4378	0.8086	*1.7249*	***3.0392***	
HT [est. coeff.]	-0.0514	-0.0332	-0.0211	-0.0031	HT
[t-Score]	*-1.9595*	-1.2885	-0.8087	-0.1218	
capitaliz [est. coeff.]	-7.2678	-8.6568	-7.7193	-11.1339	capitaliz
[t-Score]	***-3.8854***	***-4.5039***	***-4.0284***	***-5.8148***	
%vhigh [est. coeff.]		0.3435		0.4428	%vhigh
[t-Score]		***7.7136***		***11.8946***	
%NC [est. coeff.]	0.1144	-0.0043	0.0208	-0.1125	%NC
[t-Score]	**2.4322**	-0.0945	0.5577	***-2.9010***	
vh+h+m [est. coeff.]	0.2952		0.3193		vh+h+m
[t-Score]	***7.3164***		***9.0717***		
Adj R-square	0.1407	0.1441	0.0644	0.0997	**Adj R-square**

Los Angeles - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.0906	-0.0129	-0.1650	-0.0638	Intercept
	-4.3821	-1.0019	-9.8654	-6.2372	
%black [est. coeff.]	0.1378	0.1286			%black
[t-Score]	***16.9109***	***14.6106***			
%hisp [est. coeff.]	0.0280	0.0342			%hisp
[t-Score]	***3.5810***	***4.4814***			
%65age [est. coeff.]	0.0756	0.0452			%65age
[t-Score]	**2.5679**	1.6024			
medage [est. coeff.]	0.0091	0.0087	0.0194	0.0177	medage
[t-Score]	***2.9504***	***2.8080***	***5.8533***	***5.5704***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***3.0705***	***3.1206***	***3.3433***	***5.2530***	
HT [est. coeff.]	-0.0318	-0.0192	-0.0829	-0.0660	HT
[t-Score]	*-1.7193*	-1.0509	***-4.2070***	***-3.5052***	
capitaliz [est. coeff.]	5.5637	4.8410	7.4860	3.8030	capitaliz
[t-Score]	***4.2604***	***3.6001***	***5.1977***	***2.7021***	
%vhigh [est. coeff.]		0.2280		0.4768	%vhigh
[t-Score]		***7.3062***		***17.5866***	
%NC [est. coeff.]	0.1631	0.0799	0.2772	0.1393	%NC
[t-Score]	***4.9454***	**2.5321**	***9.9885***	***4.9591***	
vh+h+m [est. coeff.]	0.2113		0.3472		vh+h+m
[t-Score]	***7.4171***		***13.0532***		
Adj R-square	0.5252	0.5247	0.4009	0.4467	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 7: Detailed Regressions for Milwaukee

Milwaukee - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept [est. coeff.]	-0.0561	0.0130	-0.1595	-0.0106	Intercept
	-1.3438	0.3896	-5.7474	-0.4008	
%black [est. coeff.]	0.1844	0.1457			%black
[t-Score]	***6.8455***	***4.3336***			
%hisp [est. coeff.]	-0.0610	-0.0752			%hisp
[t-Score]	-0.6171	-0.7587			
%65age [est. coeff.]	0.0231	-0.0225			%65age
[t-Score]	0.4227	-0.4502			
medage [est. coeff.]	-0.0010	-0.0006	-0.0124	-0.0095	medage
[t-Score]	-0.1977	-0.1161	***-2.4492***	***-2.0155***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.3238	-0.6619	0.9549	0.5907	
HT [est. coeff.]	-0.1624	-0.1526	-0.1719	-0.1504	HT
[t-Score]	***-3.8946***	***-3.6747***	***-3.8059***	***-3.6134***	
capitaliz [est. coeff.]	3.8248	2.5950	7.2203	1.5137	capitaliz
[t-Score]	*1.6469*	1.0752	***2.9384***	0.6136	
%vhigh [est. coeff.]		0.2419		0.5094	%vhigh
[t-Score]		**3.3803**		***10.5301***	
%NC [est. coeff.]	0.0356	-0.0717	0.0597	-0.2022	% NC
[t-Score]	0.3727	-0.7106	0.6883	-2.2449	
vh+h+m [est. coeff.]	0.1751		0.3760		vh+h+m
[t-Score]	***3.1259***		***7.8538***		
Adj R-square	0.5929	0.5953	0.4931	0.5567	**Adj R-square**

Milwaukee - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.1289	-0.0553	-0.3075	-0.0990	Intercept
	-3.3313	-1.9004	-9.9169	-4.1451	
%black [est. coeff.]	0.2913	0.2290			%black
[t-Score]	***13.4897***	***8.8845***			
%hisp [est. coeff.]	0.0253	-0.0129			%hisp
[t-Score]	0.3411	-0.1760			
%65age [est. coeff.]	0.0682	0.0207			%65age
[t-Score]	1.2791	0.4296			
medage [est. coeff.]	-0.0010	-0.0014	-0.0226	-0.0161	medage
[t-Score]	-0.2040	-0.2998	***-3.7912***	***-3.2240***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9831	1.0871	**2.4469**	***3.0354***	
HT [est. coeff.]	-0.2229	-0.2103	-0.2733	-0.2261	HT
[t-Score]	***-5.4905***	***-5.3254***	***-5.1182***	***-5.0763***	
capitaliz [est. coeff.]	7.0170	5.3346	13.0116	5.1581	capitaliz
[t-Score]	***3.6779***	***2.7993***	***5.4563***	**2.4298**	
%vhigh [est. coeff.]		0.3505		0.7782	%vhigh
[t-Score]		***6.0860***		***18.1084***	
%NC [est. coeff.]	0.2398	0.1268	0.3423	0.0121	%NC
[t-Score]	***2.8523***	1.5293	***4.1184***	0.1611	
vh+h+m [est. coeff.]	0.2216		0.5925		vh+h+m
[t-Score]	***4.4829***		***11.8902***		
Adj R-square	0.8391	0.8470	0.7107	0.7952	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 8: Detailed Regressions for New York

New York - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0831	-0.0156	-0.0693	-0.0026	Intercept
	-3.7671	-1.1341	-5.2760	-0.2874	
%black [est. coeff.]	-0.0028	-0.0333			%black
[t-Score]	-0.2905	***-2.9956***			
%hisp [est. coeff.]	-0.0176	-0.0175			%hisp
[t-Score]	-1.1753	-1.1991			
%65age [est. coeff.]	0.0245	-0.0133			%65age
[t-Score]	0.8318	-0.4858			
medage [est. coeff.]	0.0063	-0.0049	-0.0066	-0.0052	medage
[t-Score]	***-2.2128***	*-1.7481*	***-2.3241***	*-1.8580*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.8508	1.2882	0.8606	0.9210	
HT [est. coeff.]	-0.0671	-0.0652	-0.0698	-0.0650	HT
[t-Score]	***-5.1135***	***-5.0214***	***-5.3603***	***-5.0273***	
capitaliz [est. coeff.]	4.5458	4.0967	4.5306	4.1659	capitaliz
[t-Score]	***4.6141***	***4.1908***	***4.6271***	***4.2846***	
%vhigh [est. coeff.]		0.3385		0.2506	%vhigh
[t-Score]		***8.6606***		***10.5744***	
%NC [est. coeff.]	0.1373	0.0628	0.1113	0.0342	%NC
[t-Score]	***3.1419***	1.4733	***3.0438***	0.8812	
vh+h+m [est. coeff.]	0.2211		0.2046		vh+h+m
[t-Score]	***7.0687***		***9.6398***		
Adj R-square	0.2235	0.2412	0.2237	0.2366	**Adj R-square**

New York - Refinance

Variable					Variable
Intercept	-0.3449	-0.0956	-0.3494	-0.1038	Intercept
	-15.0857	-5.5738	-16.6523	-7.0802	
%black [est. coeff.]	-0.0045	-0.0048			%black
[t-Score]	-0.5259	-0.5912			
%hisp [est. coeff.]	-0.0181	-0.0238			%hisp
[t-Score]	-1.3867	*-1.9461*			
%65age [est. coeff.]	-0.0054	-0.0127			%65age
[t-Score]	-0.1350	-0.3377			
medage [est. coeff.]	0.0244	0.0173	0.0246	0.0175	medage
[t-Score]	***4.8576***	***3.6681***	***5.0704***	***3.8485***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9236	1.1906	0.9846	1.2698	
HT [est. coeff.]	-0.2578	-0.2235	-0.2623	-0.2303	HT
[t-Score]	***-5.0285***	***-4.6395***	***-5.1396***	***-4.7978***	
capitaliz [est. coeff.]	8.2697	5.9878	8.3394	6.0702	capitaliz
[t-Score]	***3.7790***	***2.9259***	***3.8197***	***2.9704***	
%vhigh [est. coeff.]		0.8740		0.8669	%vhigh
[t-Score]		***25.6367***		***25.5495***	
%NC [est. coeff.]	0.6245	0.3339	0.6313	0.3443	%NC
[t-Score]	***9.7477***	***5.2304***	***9.8874***	***5.4100***	
vh+h+m [est. coeff.]	0.7021		0.6974		vh+h+m
[t-Score]	***21.3501***		***21.3121***		
Adj R-square	0.5878	0.6363	0.5881	0.6358	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 9: Detailed Regressions for St. Louis

St. Louis - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.3851	-0.2098	-0.3840	-0.2093	Intercept
	-10.3472	-8.2588	-10.7522	-8.4073	
%black [est. coeff.]	0.0060	0.0068			%black
[t-Score]	0.5060	0.6852			
%hisp [est. coeff.]	0.2666	0.3189			%hisp
[t-Score]	1.2764	*1.6922*			
%65age [est. coeff.]	-0.0294	-0.0279			%65age
[t-Score]	-0.4692	-0.4977			
medage [est. coeff.]	0.0287	0.0140	0.0290	0.0148	medage
[t-Score]	***3.2903***	*1.7411*	***3.9000***	**2.1538**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***5.2746***	***6.0803***	***5.2586***	***6.0563***	
HT [est. coeff.]	-0.2985	-0.2102	-0.3006	-0.2131	HT
[t-Score]	***-3.9183***	***-3.1781***	***-3.9678***	***-3.2254***	
capitaliz [est. coeff.]	10.5586	4.7064	10.6740	4.9026	capitaliz
[t-Score]	***4.6207***	**2.1910**	***4.7203***	**2.2988**	
%vhigh [est. coeff.]		0.8341		0.8276	%vhigh
[t-Score]		***12.1652***		***12.2001***	
%NC [est. coeff.]	0.5673	0.1533	0.5672	0.1557	%NC
[t-Score]	***6.4062***	*1.7063*	***6.4251***	*1.7330*	
vh+h+m	0.4893		0.4862		vh+h+m
[t-Score]	***7.3599***		***7.4763***		
Adj R-square	0.5441	0.6289	0.5453	0.6284	**Adj R-square**

St. Louis - Refinance

Variable					**Variable**
Intercept	-0.4462	-0.2706	-0.5173	-0.2867	Intercept
	-8.9409	-8.9943	-12.3150	-10.8358	
%black [est. coeff.]	0.1822	0.1405			%black
[t-Score]	***10.4092***	***8.0440***			
%hisp [est. coeff.]	0.2816	0.2517			%hisp
[t-Score]	0.7563	0.7189			
%65age [est. coeff.]	0.3065	0.2401			%65age
[t-Score]	***4.2338***	***3.7708***			
medage [est. coeff.]	0.0189	0.0192	0.0347	0.0322	medage
[t-Score]	***2.8394***	***3.0790***	***4.9275***	***5.2674***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***4.7326***	***5.0831***	***5.3023***	***5.8190***	
HT [est. coeff.]	-0.1380	-0.1004	-0.3125	-0.2252	HT
[t-Score]	*-1.8453*	-1.4468	***-3.7234***	***-3.0865***	
capitaliz [est. coeff.]	15.1680	12.6709	15.6756	11.5736	capitaliz
[t-Score]	***8.7029***	***7.5884***	***7.7473***	***6.3298***	
%vhigh [est. coeff.]		0.7636		1.0054	%vhigh
[t-Score]		***10.3399***		***14.6164***	
%NC [est. coeff.]	0.5985	0.2600	0.9368	0.3687	%NC
[t-Score]	***6.8804***	***2.9608***	***10.9743***	***4.0613***	
vh+h+m [est. coeff.]	0.5096		0.6599		vh+h+m
[t-Score]	***7.0111***		***9.2071***		
Adj R-square	0.8156	0.8368	0.7509	0.8032	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 10: Detailed Regressions for Washington, D.C.

Washington - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0921	-0.0403	-0.0839	-0.0303	Intercept
	-4.7182	-3.9111	-6.9137	-3.8307	
%black [est. coeff.]	0.0007	-0.0162			%black
[t-Score]	0.0815	*-1.9010*			
%hisp [est. coeff.]	-0.0230	-0.0117			%hisp
[t-Score]	-1.0384	-0.5382			
%65age [est. coeff.]	0.0415	0.0265			%65age
[t-Score]	1.6110	1.1546			
medage [est. coeff.]	0.0035	0.0043	0.0050	0.0034	medage
[t-Score]	1.4144	*1.7684*	**2.3703**	*1.6626*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***6.7120***	***7.7899***	***7.4649***	***7.9575***	
HT [est. coeff.]	-0.0152	-0.0083	-0.0159	-0.0082	HT
[t-Score]	**-2.5370**	-1.4396	***-2.6972***	-1.4197	
capitaliz [est. coeff.]	2.7519	1.2741	2.8480	1.7619	capitaliz
[t-Score]	***3.2323***	1.4574	***3.4670***	**2.1306**	
%vhigh [est. coeff.]		0.2455		0.1992	%vhigh
[t-Score]		***8.2219***		***11.1844***	
%NC [est. coeff.]	0.1122	0.0371	0.1043	0.0239	%NC
[t-Score]	***4.0712***	1.5746	***4.7132***	1.0587	
vh+h+m [est. coeff.]	0.1611		0.1530		vh+h+m
[t-Score]	***5.8323***		***9.3834***		
Adj R-square	0.1876	0.2180	0.1853	0.2168	**Adj R-square**

Washington - Refinance

Variable					**Variable**
Intercept	-0.0885	-0.0067	-0.1401	-0.0285	Intercept
	-4.4291	-0.6134	-10.6061	-3.3379	
%black [est. coeff.]	0.0557	0.0522			%black
[t-Score]	***6.6773***	***6.0619***			
%hisp [est. coeff.]	-0.1044	-0.0916			%hisp
[t-Score]	***-4.7428***	***-4.1683***			
%65age [est. coeff.]	0.1105	0.0694			%65age
[t-Score]	***3.9719***	***2.7602***			
medage [est. coeff.]	0.0015	0.0014	0.0126	0.0094	medage
[t-Score]	0.6225	0.5641	***5.4239***	***4.2054***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	1.5437	0.4820	***3.1343***	**2.5557**	
HT [est. coeff.]	-0.0326	-0.0234	-0.0469	-0.0296	HT
[t-Score]	***-4.9534***	***-3.6294***	***-6.7679***	***-4.4176***	
capitaliz [est. coeff.]	5.3927	4.4650	4.8013	2.8950	capitaliz
[t-Score]	***6.2500***	***4.8876***	***5.3119***	***3.2051***	
%vhigh [est. coeff.]		0.2274		0.3725	%vhigh
[t-Score]		***7.3702***		***19.4870***	
%NC [est. coeff.]	0.0900	-0.0049	0.1492	0.0014	%NC
[t-Score]	***3.1698***	-0.2003	***6.0717***	0.0573	
vh+h+m [est. coeff.]	0.2006		0.3043		vh+h+m
[t-Score]	***7.2331***		***17.2681***		
Adj R-square	0.5908	0.5917	0.5151	0.5473	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 11: Summary of Regression Results

Home Purchase Lending

	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
Variable										
%black	+++		+++	+++	+++	+++	+++			
%hisp						---				
%65age				+++	+++	-				
medage			++			++		--	+++	
medhhinc	++			+++					+++	+++
HT				---		-	---	---	---	--
capitaliz			+++			---	+	+++	+++	+++
NC		++	++	+++		++		+++	+++	+++
vh+h+m	+++	+++	++	+++	+++	+++	+++	+++	+++	+++
Adj R-square	0.4566	0.0843	0.6865	0.6267	0.1762	0.1407	0.5929	0.2235	0.5441	0.1876

Refinance Lending

	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
Variable										
%black	+++	+++	+++	+++	+++	+++	+++		+++	+++
%hisp		--		+++	++	+++				---
%65age	+++	++	+++	--	++	++			+++	+++
medage			++		+++	+++		+++	+++	
medhhinc	+++			---		+++			+++	
HT		---		---	---	-	---	---	-	---
capitaliz	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++
NC	+	+++	+++		+++	+++	+++	+++	+++	+++
vh+h+m	+++	+++	+++		+++	+++	+++	+++	+++	+++
Adj R-square	0.6903	0.6306	0.8108	0.8993	0.7364	0.5252	0.8391	0.5878	0.8156	0.5908

\+ positive relationship
\- negative relationship
\+ or - 10% significance level
++ or -- 5% significance level
+++ or --- 1% significance level

Table 12: Impact of Number of African-Americans in a Neighborhood

Percent African-Americans in a census tract

Home Purchase

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Cleveland	0.2400	***	79.7
Milwaukee	0.1844	***	84.4
Detroit	0.1661	***	86.7
Atlanta	0.1393	***	68.8
Houston	0.0492	***	71.8
Los Angeles	0.0434	***	70.5
Baltimore	0.0063		71.8
St. Louis	0.0060		78.0
Washington	0.0007		66.2
New York	-0.0028		84.3

Refinance

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Houston	0.4058	***	71.8
Milwaukee	0.2913	***	84.4
Detroit	0.2577	***	86.7
Cleveland	0.1988	***	79.7
Atlanta	0.1866	***	68.8
St. Louis	0.1822	***	78.0
Los Angeles	0.1378	***	70.5
Baltimore	0.1107	***	71.8
Washington	0.0557	***	66.2
New York	-0.0045		84.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 13: Impact of Number of Hispanics in a Neighborhood

Percent Hispanics in a census tract			
Home Purchase			
	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2666		36.7
Detroit	0.0645		48.3
New York	-0.0176		69.3
Washington	-0.0230		52.5
Houston	-0.0260		59.2
Cleveland	-0.0317		59.0
Milwaukee	-0.0610		60.6
Los Angeles	-0.0738	***	64.4
Baltimore	-0.0890		40.3
Atlanta	-0.2080		56.8
Refinance			
	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2816		36.7
Detroit	0.1282	***	48.3
Houston	0.0694	**	59.2
Cleveland	0.0693		59.0
Los Angeles	0.0280	***	64.4
Milwaukee	0.0253		60.6
New York	-0.0181		69.3
Washington	-0.1044	***	52.5
Atlanta	-0.2456		56.8
Baltimore	-0.4806	**	40.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 14: Impact of Number of Elderly Residents in a Neighborhood

Percent People over 65		
Home Purchase		
	Estimated coefficient	Level of Significance
Detroit	0.1606	***
Houston	0.1597	***
Atlanta	0.0845	
Cleveland	0.0698	
Washington	0.0415	
Baltimore	0.0367	
New York	0.0245	
Milwaukee	0.0231	
St. Louis	-0.0294	
Los Angeles	-0.0702	*
Refinance		
	Estimated coefficient	Level of Significance
St. Louis	0.3065	***
Atlanta	0.2701	***
Houston	0.2483	**
Cleveland	0.1635	***
Baltimore	0.1307	**
Washington	0.1105	***
Los Angeles	0.0756	**
Milwaukee	0.0682	
New York	-0.0054	
Detroit	-0.0634	**

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

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ATTACHMENT E

UNEQUAL BURDEN:
INCOME & RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA

This study presents a preliminary analysis of almost one million mortgages reported nationwide in calendar year 1998 under the Home Mortgage Disclosure Act (HMDA). The data clearly demonstrate the rapid growth of subprime lending during the 1990's and, further, the disproportionate concentration of such lending in the nation's minority and low-income neighborhoods. These findings are significant for the nation's policy-makers, in light of the growing evidence of widespread predatory practices in the subprime market.

AN OVERVIEW

Over the past several years, the nation has seen a veritable explosion in the subprime mortgage lending market, raising serious questions for the nation's policy makers.

In 1993, the subprime share of the overall mortgage market represented $20 billion. In five years, this volume multiplied more than seven times to $150 billion. By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending can and does serve a critical role in the Nation's economy. These borrowers may have blemishes in their credit record, insufficient credit history or non-traditional credit sources. Through the subprime loan market, they can buy a new home, improve their existing home, or refinance their mortgage to increase their cash on hand.

But there are two sides to this story. Since subprime lending often operates outside of the federal regulatory structure, it is a fertile ground for predatory lending activities, such as excessive fees, the imposition of single premium credit life insurance and prepayment penalties. The recent acceleration in predatory lending activity has accompanied the growth in subprime lending over the past decade. And predatory lending can have disastrous consequences for the unknowing borrower. At the very least, equity is stripped from the home. In more egregious cases, homeowners may lose their home altogether.

Prime lenders have made significant efforts and, indeed, significant progress in reaching historically-underserved markets and communities. However, based on disproportionate concentration, there is still much work to be done in both the primary and secondary markets.

Our analysis has led us to four fundamental conclusions:

First, there has been a monumental growth in subprime lending since 1993, suggesting that a significant number of Americans need greater access to the prime lending market.

Second, based on the disproportionate percentage of subprime loans in low and very-low income neighborhoods, there are significant potential benefits to increasing access to prime lending for these

Third, based on the disproportionate percentage of subprime loans in African-American neighborhoods, [redacted]re needs to be much greater attention focused on how to continue to increase access to prime lending markets for these communities and families.

Fourth, based on the disproportionate percentage of subprime loans held by homeowners in high income black neighborhoods, these borrowers need greater access to the prime lending market.

The first step to ensuring that subprime lending acts to enhance, and not destroy, the economic health of the families involved, is to learn more about how and where it operates in America. This analysis is the first look at the most recent nationwide data on subprime lending broken down by the income and racial characteristics of neighborhoods nationwide.

THE FINDINGS

HUD'S detailed analysis of almost 1 million mortgages reported in 1998 under HMDA reaches four critical conclusions about the state and consequences of subprime lending in America:

1. **From 1993 to 1998, the Number of Subprime Refinance Loans Increased Ten-Fold** - In 1993, there were just 80,000 subprime loans reported to HMDA. By 1998, there were more than 790,000. Over the same period, there was a seven-fold increase in the dollar volume of subprime loans, from $20 billion to $150 billion.

2. **Subprime Loans are Three Times More Likely in Low-Income Neighborhoods than in High-Income Neighborhoods** - In low-income neighborhoods, subprime loans accounted for 26 percent of total loans in 1998 - compared with only 11 percent in moderate-income neighborhoods and just 7 percent in upper-income neighborhoods. Comparable 1993 figures were 3 percent in low-income neighborhoods and 1 percent each in moderate-income and upper-income neighborhoods.

3. **Subprime Loans are Five Times More Likely in Black Neighborhoods than in White Neighborhoods** - In predominantly black neighborhoods, the high-cost subprime lending accounted for 51 percent of home loans in 1998 - compared with only 9 percent in predominately white areas. Comparable 1993 figures were 8 percent in black neighborhoods and 1 percent in white neighborhoods.

4. **Homeowners in High-Income Black Neighborhoods Are Twice as Likely as Homeowners in Low-Income White Neighborhoods to have Subprime Loans** - Only 6 percent of homeowners in upper-income white neighborhoods have subprime loans while 39 percent of homeowners in upper-income black neighborhoods have subprime loans, more than twice the rate for homeowners in low-income white neighborhoods, 18 percent.

THE ANALYSIS

HUD's detailed study of the almost 1 million mortgages reported to HMDA in 1998 focused primarily on home refinancing loans, which account for 80 percent of costly subprime loans. Subprime lending involves providing credit to borrowers with past credit problems, often at a higher cost or less favorable terms than loans available in the conventional prime market. In some cases, subprime lenders engage in abusive lending practices known as "predatory lending", which hits homebuyers with excessive mortgage fees, interest rates, penalties and insurance charges that raise the cost of homebuying by thousands of dollars for individual families.

HUD's study found that:

1. From 1993 to 1998, the number of subprime refinance loans increased ten-fold.

In 1993, there were 80,000 subprime refinance loans reported under HMDA. By 1998, this number had increased by over 900% to 790,000. (See Figure 1.) Because refinancing represents 80% of the subprime market, this analysis looks most closely at the 790,000 refinancing loans. But in the total subprime market, the number of loans increased at the same pace from 104,000 to nearly one million (997,000) in 1998.

The magnitude and speed of the increase in subprime lending alone - almost 1000% in just five years - creates a critical need for greater scrutiny and concern. While the rapid growth of subprime lending may, on the surface, appear to be good news for higher-risk borrowers, behind the numbers there is some evidence that some portion of subprime lending is occurring with borrowers whose credit would qualify them for conventional loans. Subprime lending may expose borrowers to higher up-front fees and interest rates than they would bear if they had obtained prime loans.

2. Subprime loans are three times more likely in low-income neighborhoods than in high-income neighborhoods.

HUD's analysis of almost 1 million loans reported under HMDA for 1998 also demonstrates that subprime lending is being provided increasingly to low- and very low-income families. Nationwide, 11% of refinance mortgages in 1998 were subprime, but in low-income neighborhoods, the percentage more than doubles to 26%. (See Figure 2) In upper income neighborhoods, only 7% of families have subprime refinancing debt. In 1993, only 3 percent of mortgages in low-income neighborhoods and 1 percent each in moderate- and upper-income neighborhoods were subprime.

But in the poorest communities, where families make only 50% of the median income, subprime refinances are an astounding 44%. Broken down by individuals instead of entire neighborhoods, the impact is similar. Low-income borrowers are almost 3 times as likely as upper income borrowers to rely upon subprime refinancing, (21% of low-income vs. 8% of upper-income borrowers.)

3. Subprime loans are five times more likely in black neighborhoods than in white neighborhoods.

In predominantly black neighborhoods, the high-cost subprime lending accounted for 51 percent of home loans in 1998 - compared with only 9 percent in predominately white areas. Comparable 1993 figures were 8 percent in black neighborhoods and 1 percent in white neighborhoods.

A close examination of the 1998 HMDA data broken down by neighborhood racial composition raises the need for closer scrutiny. While subprime refinance mortgages accounted for one-tenth of the refinance mortgages in predominantly white neighborhoods in 1998, in predominantly black neighborhoods, **half** of the refinance mortgages were subprime. (See Figure 3.) This means that only one in ten families in white neighborhoods pay higher fees and interest rates, but **five in ten families in African-American communities are saddled with higher rates and costs**.

Broken down by individual borrowers instead of neighborhoods, blacks are still carrying the greater proportion of subprime: 33% of all refinance mortgages in 1998, compared with only 8% for whites borrowers overall. In total, black borrowers support 13% of the subprime mortgage market, but only 5% of the mortgage market overall.

4. Homeowners in high-income black neighborhoods are twice as likely as homeowners in low-income white neighborhoods to have subprime loans.

The most dramatic view of this trend comes from comparing homeowners in upper income black and white neighborhoods. Among homeowners living in the upper income white neighborhoods, only 6% turn to subprime lenders. But 39% of homeowners living in upper-income black neighborhoods have subprime refinancing. (See Figure 4.) This is more than twice the rate - 18 percent - for homeowners living in low-income white neighborhoods.

In fact, as neighborhood income increases, the disparity between the African-American and white neighborhoods grows larger. Homeowners in low-income black communities are almost 3 times as likely as homeowners in low-income white communities to have subprime refinancing. For moderate income neighborhoods, black neighborhoods are 4 times as likely and in the upper income neighborhoods, blacks neighborhoods are six times as likely as white neighborhoods to have subprime financing.

METROPOLITAN DYNAMICS

This new analysis also presents the first recent look at subprime refinancing by metropolitan areas. A look at five cities gives a good sense that the trends identified above are consistent at the metropolitan level.

- In **Atlanta**, in about one-fifth of the 475 census tracts subprime refinancing accounts for at least 25% of all refinancing. In the vast majority of these census tracts, the population is at least 30%

- In **Philadelphia**, black neighborhoods carried about 10% of the refinancing overall, but 36% of the subprime market.

- In **New York**, subprime refinancing represents one in four loans in **more than half** of all census tracts, and black neighborhoods alone carry almost 50% of all the subprime lending in the city.

- In **Chicago**, 41% of the subprime refinancing occurs in black neighborhoods, compared to only 10% of the overall refinancing.

- In **Baltimore**, almost one-third of the census tracts (27%) have at least 25% subprime refinancing, with the greatest burden falling upon the black neighborhoods (118 our of 156 tracts).

CONCLUSION

HUD's analysis of almost one million mortgages reported to HMDA in 1998 clearly demonstrates the exponential growth in subprime lending and its disproportionate impact on low-income and, particularly, minority homeowners and communities throughout the nation. This concentration of subprime activity leaves these homeowners with significant costs of subprime loans. These borrowers may also be vulnerable to predatory lending practices.

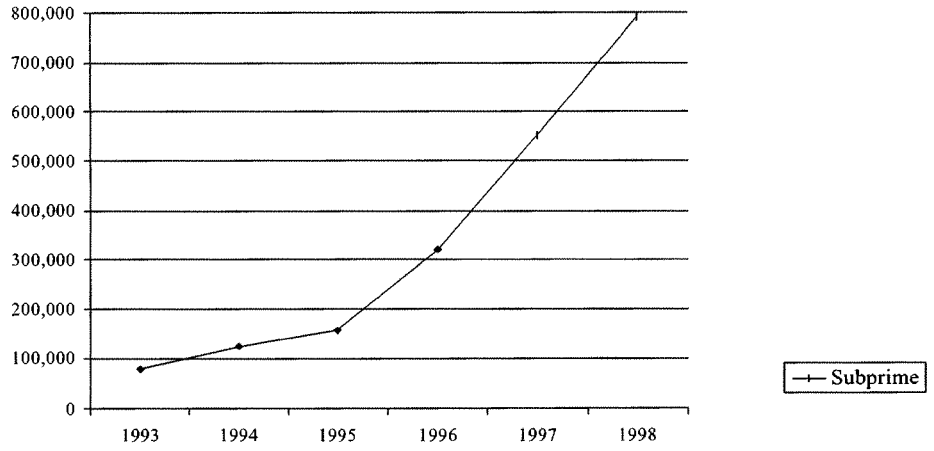
Despite the progress made by prime lenders in reaching these markets, the growing concentration of subprime loans in both low-income and minority communities, strongly suggest that much more can be done by both primary and secondary market participants to expand access to the prime lending market.

HUD's analysis clearly demonstrates the need for timely and concerted Federal action in this area - both to expand access to prime lending in these communities and to protect subprime borrowers from the dangers of predatory lending.

Figure 1

Growth in Subprime Refinance Lending

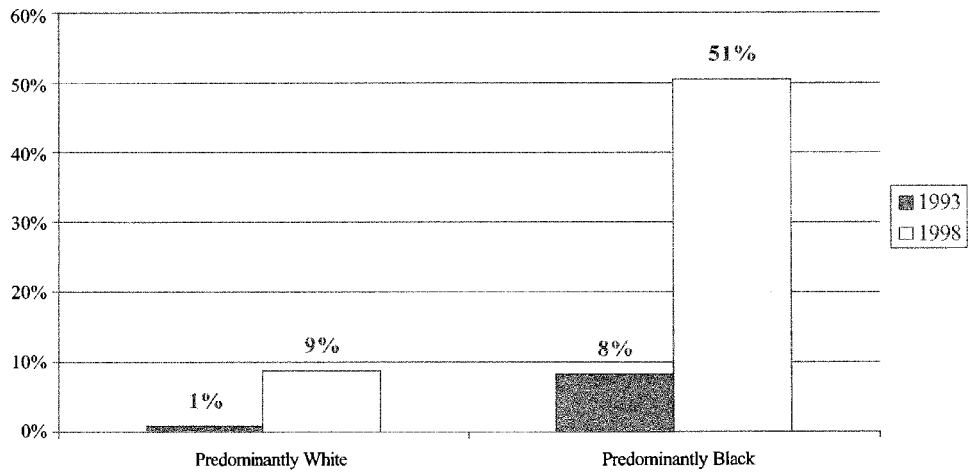
	1993	1994	1995	1996	1997	1998
Subprime	79,693	126,776	158,395	320,239	551,396	789,696



Source: 1993-1998 HMDA Data

Figure 2

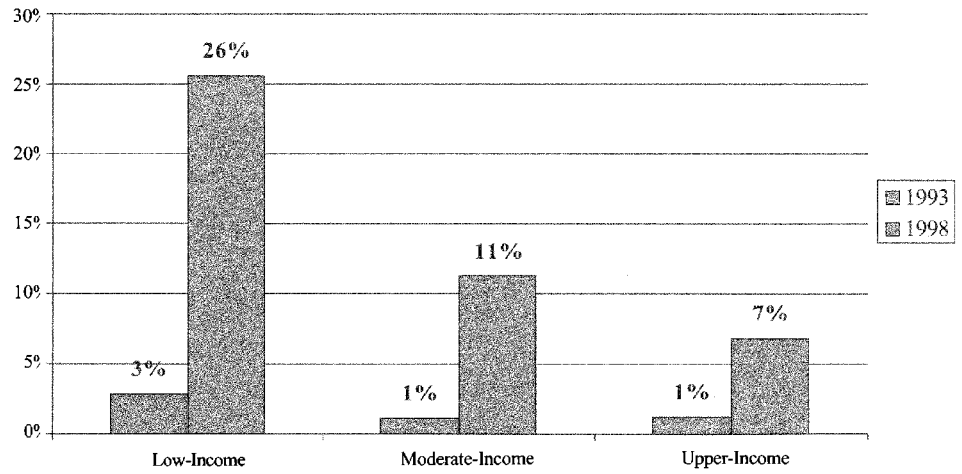
Subprime Share of Refinance Mortgages by Neighborhood Race



Note: Predominantly White: At least 85% White; Predominantly Black: At least 75% Black.

Figure 3

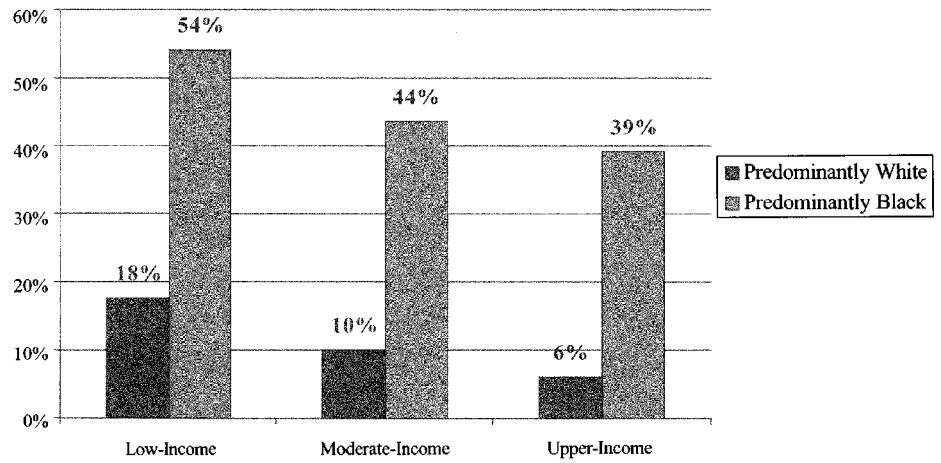
Subprime Share of Refinance Mortgages by Neighborhood Income



Note: Low-Income: Not More than 80%; Moderate-Income: 80-120%; Upper-Income: More than 120%

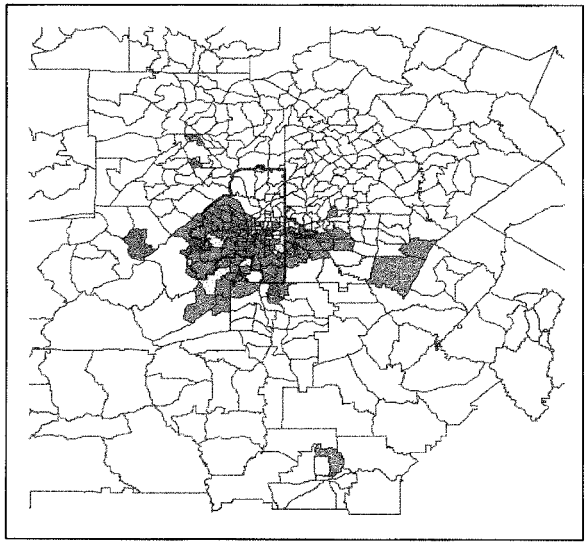
Figure 4

Subprime Share of 1998 Refinance Mortgages by Neighborhood Race and Income



Note: Predominantly White: At least 85% White; Predominantly Black: At least 75% Black.
Low-Income: Not More than 80%; Moderate-Income: 80-120%; Upper-Income: More than 120%

Atlanta Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 101 (or 21 percent) of the 475 census tracts in the Atlanta, Georgia metropolitan area refinance market.

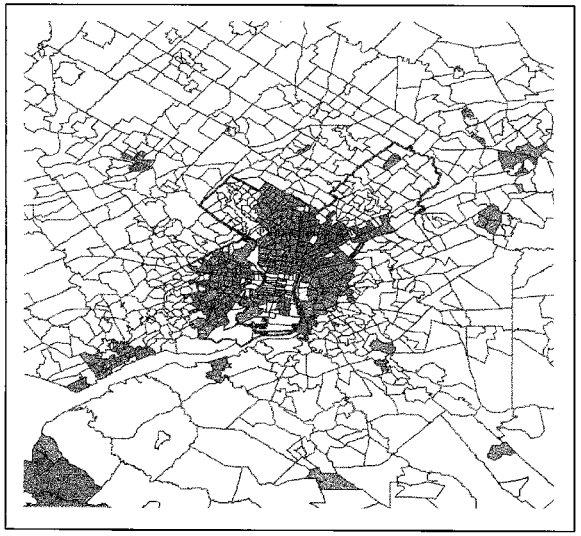
Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 94 of these 101 subprime census tracts.

Black neighborhoods accounted for 13 percent of all refinances in the Atlanta, Georgia metropolitan area but 33 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

Philadelphia Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 319 (or 25 percent) of the 1,260 census tracts in the Philadelphia metropolitan area refinance market.

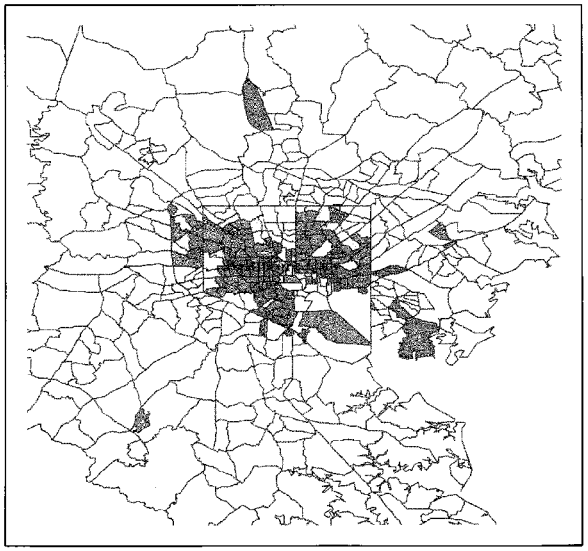
Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 201 of these 319 subprime census tracts.

Black neighborhoods accounted for 10 percent of all refinances in the Philadelphia metropolitan area but 36 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

Baltimore Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 156 (or 27 percent) of the 574 census tracts in the Baltimore metropolitan area refinance market.

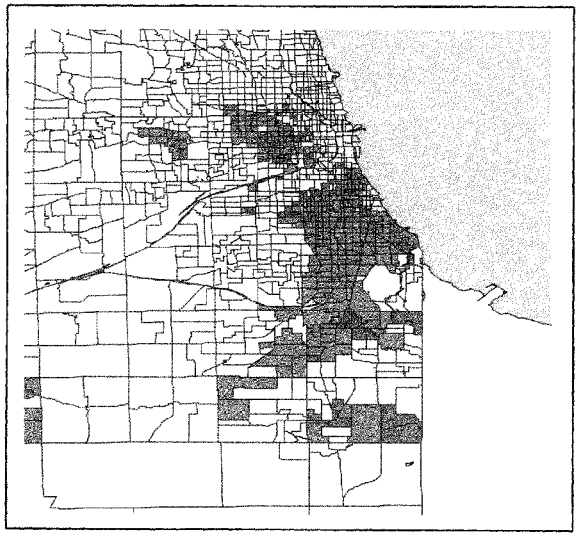
Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 118 of these 156 subprime census tracts.

Black neighborhoods accounted for 13 percent of all refinances in the Baltimore metropolitan area but 36 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

Chicago Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 438 (or 25 percent) of the 1,767 census tracts in the Chicago metropolitan area refinance market.

Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 367 of these 438 subprime census tracts.

Black neighborhoods accounted for 10 percent of all refinances in the Chicago metropolitan area but 41 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

New York Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 1,265 (or 52 percent) of the 2,420 census tracts in the New York metropolitan area refinance market.

Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 598 of these 1,265 subprime census tracts.

Black neighborhoods accounted for 23 percent of all refinances in the New York metropolitan area but 49 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

EXHIBIT BOOK

HOUSE COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

CHAIRMAN EDOLPHUS TOWNS

HEARING

"The Silent Depression: How are Minorities Faring in the Economic Downturn?"

SEPTEMBER 23, 2009

City of Baltimore 74 Motion to file first amended complaint,
Document 74-2 through Document 74-22

Attachments
F-I

ATTACHMENT F

Risk or Race?
Racial Disparities and the Subprime Refinance Market

A Report of the
Center for Community Change

Prepared by

Calvin Bradford
Calvin Bradford & Associates, Ltd.

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Co-Director

Debby Goldberg
Co-Director

Neighborhood Revitalization Project
Center for Community Change

The Neighborhood Revitalization Project (NRP) is a special project of the Center for Community, based in Washington, D.C. The Project provides training and technical assistance and also advocates for public policies on behalf of community groups and others seeking to expand the availability of responsible lending and banking services for low-income, minority, and other underserved urban and rural areas.

For additional copies of this study or for further information about the work of NRP please access the CCC website (www.communitychange.org) or contact the Project at:

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Risk or Race?
Racial Disparities and the Subprime Refinance Market

Executive Summary

African-Americans and Hispanics are disproportionately represented in the subprime home refinance mortgage market. Surprisingly, this study finds that the disparity between whites and African-Americans and other minorities actually grows at upper-income levels and is greater for higher-income African-American homeowners than for lower-income white homeowners.

High levels of subprime mortgage lending represent markets where borrowers are paying unusually high costs for credit, while often depleting their home equity. Of particular concern are the consistent and pervasive racial disparities and concentration of subprime lending in communities of color and to borrowers of color at all income levels. The persistent racial patterns found in this analysis raise questions as to whether factors other than risk alone account for them.

These patterns exist in all regions and cities of all sizes, thereby raising concerns about the absence of prime conventional mortgage loans in these geographic areas. The subprime market is fertile ground for predatory lending, a disturbing part of the explosive growth in this market. Abusive credit practices in the subprime segment of the mortgage market are stripping borrowers of home equity they may spend a lifetime building. Thousands of families end up facing foreclosure, which destabilizes communities and often shatters families.

The subprime market provides loans to borrowers who do not meet the credit standards for borrowers in the prime market. Most subprime borrowers use the collateral in their homes for debt consolidation or other consumer credit purposes. The growth in subprime lending has benefitted credit-impaired borrowers, those who may have blemishes in their credit records, insufficient credit history, or non-traditional credit sources. When undertaken responsibly, subprime lending offers the opportunity to further expand lending markets to underserved populations.

However, research by the U.S. Department of Housing and Urban Development (HUD) and others has documented the wave of foreclosures occurring in the subprime market. High foreclosure rates for subprime loans indicate that many subprime borrowers are entering into mortgage loans they cannot afford. Thus, high levels of subprime lending indicate markets where borrowers have unusually high risks of losing their homes. The sheer geographic concentration of these loans, therefore, may have asignificant negative impact not just on individual borrowers, but on entire neighborhoods. Foreclosed homes frequently remain vacant for extended periods, during

which they are neglected. These vacant homes can depress property values and lead to neighborhood deterioration and disinvestment.

This study represents some important differences from previous work. It is national in scope, analyzing lending patterns in all 331 metropolitan statistical areas (MSAs), and ranking metropolitan areas by a variety of measures of subprime lending. It also includes a regional analysis, looking at the variations in lending patterns in different geographic regions within the country. The study focuses on single-family conventional refinance loans, where subprime lending is most concentrated, using 2000 data provided by the Federal Home Mortgage Disclosure Act. In addition to looking at lending patterns based on the race and income of the borrower, the study also analyzes the way these patterns play out at the neighborhood level and identifies the types of neighborhoods in which subprime loans are most concentrated. Finally, in conjunction with this study, the Center for Community Change is making available an important new national database on subprime lending, which is posted on our website at www.communitychange.org.

Our analysis is based on two key measures. One is the percentage of home refinance loans made to any given racial or ethnic group that are subprime. The second is a comparison between this figure and the percentage of subprime refinance loans made to white borrowers in the same geographic market. This comparison is expressed as a ratio, the "racial disparity ratio." A ratio of 1.0 indicates no disparity, a ratio above 1.0 indicates that minorities are receiving a higher proportion of subprime loans than whites. The higher the ratio, the greater the disparity between white and non-white borrowers.

Key Findings

This study documents the pervasive racial disparities in subprime lending. Placed in the context of previous research, this study supports the position that risk alone does not explain these racial disparities. Our three major findings are as follows:

1. There are significant racial disparities in subprime lending, and *these disparities actually increase as income increases* (Graph 1, page 6.)

    - Lower-income African-Americans receive 2.4 times as many subprime loans as lower-income whites, while upper-income African-Americans receive 3.0 times as many subprime loans as do whites with comparable incomes.

    - Lower-income Hispanics receive 1.4 times as many subprime loans as do lower-income whites, while upper-income Hispanics receive 2.2 times as many of these loans.

    - At a level of 5.93, St. Louis has the nation's highest disparity ratio between upper-income African-Americans and upper-income whites. It was one of five metropolitan areas where this disparity ratio was greater than 4.0. In another 18 cities, this ratio was between 3.0 and 4.0. (Table 10, page 59).

2. High concentrations of subprime lending and racial disparities in subprime lending exist in all regions of the nation. (Graphs 3-8, pages 11-17.)

   - Each region contains metropolitan areas where the level of subprime lending is above the national average of 25.31%.

   - In 17 MSAs, the level of subprime lending is more than 1.5 times the national norm. Fourteen of these are in the Southeast or Southwest, 7 are in Texas. El Paso has the highest overall level of subprime loans in the nation: 47.28%.

   - For African-Americans, Hispanics and Native Americans, disparities exist in all regions of the country, reaching as high as 3.25 or more in the Midwest and Great Plains.

3. High concentrations of subprime lending and racial disparities occur in metropolitan areas of all sizes. (Graphs 9-12, pages 20-23.)

   - Twelve of the17 metropolitan areas that have concentrations of subprime lending more than 1.5 times the national norm have populations below 500,000. For example, Enid, Oklahoma, the nation's smallest metropolitan area, ranks #12 in percentage of subprime lending. On the other hand, 4 of these 17 metropolitan areas are above 1 million in population.

   - When we examined disparity ratios for cities in different size categories, we found the highest disparity ratios for African-Americans, Hispanics and Native Americans in cities under 250,000 in population. For example, the highest disparity ratio for African-Americans is found in Kankakee, Illinois, with a population of 103,833 and a disparity ratio of 6.10. For Asians, the highest disparity ratios are generally found in cities between 500,000 and 1 million in population.

Additional Racial Impacts

In examining the racial dynamics of subprime lending, our research identified three distinct dimensions to the patterns: a) high overall percentages of subprime loans made to African-Americans and Hispanics; b) high disparity ratios when these percentages are compared to white borrowers; and, c) high disparity ratios for neighborhoods with significant African-American and Hispanic residents as compared to white neighborhoods. Examples of these patterns include:

African-Americans

- In every single metropolitan area, the percentage of subprime loans made to African-American borrowers was higher than the national norm of 25.31%.

(Note: certain metropolitan areas were excluded from this calculation because they had fewer than
100 loans to African-Americans, which was the number we set as the threshold for this calculation.)

- Buffalo, New York had the highest percentage of subprime loans to African-Americans, 74.53%. (See Table 3, page 37.)

- There were no metropolitan areas where the disparity ratio for African-Americans fell below 1.64.

- The highest disparity ratio for African-Americans was Kankakee, Illinois, at 6.10. This was followed by Albany, Georgia, (5.69) and Dothan, Alabama (5.23). (See Table 6, page 47.)

- Chicago had the highest disparity ratio for African-American census tracts: 4.12. It was followed by Milwaukee (4.04) and Philadelphia (3.40). Eight metropolitan areas had disparity ratios above 3.0 for African-American census tracts; another 65 cities had disparity ratios above 2.0. (See Table 16, page 69.)

Hispanics

The highest percentages of subprime loans to Hispanic borrowers were found in El Paso, Texas, (52.36%) and San Antonio, Texas, (51.46%). (See Table 4, page 42.)

San Jose, California, had a disparity ratio for Hispanics of 2.45, the highest in the nation. Fourteen metropolitan areas had disparity ratios above 2.0. (See Table 7, page 51.)

In Corpus Christi, Texas, 75.48% of refinance loans in Hispanic census tracts were subprime, the highest percentage of subprime loans in Hispanic tracts in the nation. (See Table 15, page 68.)

Albuquerque, New Mexico, had the highest disparity ratio for Hispanic census tracts, 2.59. (See Table 17, page 73.)

Conclusion

The persistent racial disparities in levels of subprime lending found in this analysis do not, in and of themselves, constitute conclusive proof that there is widespread discrimination in the subprime lending markets. These disparities do, however, raise serious questions about the extent to which risk alone could account for such patterns. Discrimination has been a persistent problem in the home finance markets in the United States. The history of mortgage lending discrimination adds weight to the need to explore more fully the role that discrimination plays in the subprime markets through

either differential treatment of individual minority borrowers or through the effects of industry practices.

The issue of whether there is racial exploitation in the subprime markets essentially rests on two issues. First, are the disparities in subprime lending related to race? Second, can these disparities be fully explained by legitimate risk factors? Recent research suggests that risk alone does not explain the huge racial disparities that this study found across all income levels. Among the factors that influence the racial disparities in subprime lending:

- The absence of active mainstream prime lenders in minority markets has increased the chances that borrowers in these communities are paying a high cost for credit. For example, the finding that racial disparities actually increase as income increases suggests that a portion of subprime lending is occurring with borrowers whose credit histories would qualify them for lower-cost, conventional, prime loans.

- Both Fannie Mae and Freddie Mac, the publicly chartered secondary mortgage market enterprises, have questioned whether risk explains the use of subprime loans. Freddie Mac has estimated that from "10 to 30 percent of borrowers who obtained mortgages from the subprime market could have qualified for a conventional loan through Loan Prospector" (Freddie Mac's automated underwriting system). (See Freddie Mac, "*We Open Doors for America's Families*," Freddie Mac's Annual Housing Report for 1997).

- Subprime refinance lending tends to be "sold" to customers rather than "sought" by them. Subprime lenders aggressively market their loans to potential borrowers. These marketing techniques disproportionately target minority market segments, often to homeowners with considerable equity in their homes. Since mainstream prime lenders are absent from many of these same communities, homeowners are more susceptible to being persuaded that the more expensive subprime loans are all that is available to them.

- There is other evidence that risk factors do not explain racial differences in the use of subprime lending. A recent study by the Research Institute for Housing America concluded, "after controlling for borrower income, debt, and credit history, racial groups behave differently." (See Pennington-Cross, Yezer, and Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?,* Research Institute for Housing America (2000).) Specifically, the study noted that minorities are more likely to use subprime lending than whites.

Subprime lending may provide certain borrowers with access to credit they could not otherwise obtain in the prime market. However, the wide disparities in subprime lending to African-Americans and Hispanics at all income levels, suggest that factors other than risk may be at work. Further, the pervasiveness of subprime lending in

communities of color, in all regions and in metropolitan areas of all sizes, raises important public policy concerns about possible adverse implications stemming from these heavy geographic concentrations. It also suggests that minority homeowners may be particularly vulnerable to predatory lenders, which by most accounts, target communities with high levels of subprime lending.

I. Introduction

In the last decade, subprime lending has grown rapidly as a segment within the conventional mortgage market. When undertaken responsibly, subprime lending may benefit credit-impaired borrowers, and those with limited credit histories or non-traditional credit sources. Because these borrowers either pose or are perceived to pose higher risks, the interest rates and/or fees associated with the loans are higher than those found in the "prime" conventional market. In this context, subprime lending offers an opportunity to further expand the lending markets to underserved populations. However, some research suggests that a portion of subprime lending occurs to borrowers whose credit would qualify them for cheaper, conventional, prime loans.

Further, within the larger subprime market, there has been a growing public policy concern about some lenders engaging in a range of unreasonable or illegitimate lending practices. These practices are generally referred to as predatory lending. The joint HUD/Treasury report on predatory lending states that "predatory lending occurs primarily in the subprime mortgage lending market, which has grown rapidly over the past several years".[1] Generally, the practices associated with predatory lending take two forms. First, lenders may exploit borrowers by imposing credit terms that are not justified by the risk posed by the borrower. Typically this is done by charging higher interest rates and/or charging higher fees than can be justified by the risk posed by the loan. In extreme cases, lenders have made loans without regard to the ability of the borrower to repay the loan, often in schemes designed to take away the property. Second, lenders may mislead or deceive borrowers as to the costs and conditions of the loan. These practices may relate to any of the terms and conditions of the loan. This also relates to credit-related services that are sold along with the loans. One common example is the sale of various forms of credit insurance to borrowers who do not know that it is included in the loan or are not made aware of its costs and limitations. In many cases, these practices are challenged as involving fraud and misrepresentation.

Therefore, there are several reasons to be concerned about high levels of subprime lending in the mortgage markets. High levels of subprime lending indicate markets where borrowers are paying unusually high costs for credit and face unusually high risks of losing their homes. High levels of subprime lending in a market may also indicate high levels of predatory lending. For these reasons, high levels of subprime lending have become a major public policy issue in home lending.

The subprime market is not as clearly defined as the prime market. Moreover, subprime loans are not specifically delineated in such public forms of mortgage market data as the Home Mortgage Disclosure Act (HMDA). Still, we have ample evidence that subprime lending has been rapidly growing in the last decade. HUD has developed a list of subprime lenders that has

[1] U. S. Department of Housing and Urban Development and U.S. Department of Treasury, *Curbing Predatory Home Mortgage Lending: A Joint Report* (June 2000), page 2. Full citations are given the first time a document is referenced. The author, an abbreviated title, and the year are given for subsequent references.

been updated each year since 1993.[2] By using these lenders to delineate subprime loans in the HMDA data, estimates have been made of subprime lending in many metropolitan area studies. In its report on subprime lending released in April of 2000, HUD used Home Mortgage Disclosure Act data and its list of subprime lenders to calculate that the number of subprime refinance loans increased ten-fold from 1993 to 1998.[3]

A joint HUD/Treasury report on predatory lending indicated that while the total mortgage market increased about 1.7 times from 1994 through 1999, the subprime market increased about 4.7 times. The result was that the subprime share of the full mortgage market increased from 4.5% in 1994 to 12.5% in 1999.[4] The HUD/Treasury report used data from Inside Mortgage Finance, a mortgage industry publication, to estimate the size of the total subprime market. A recent draft paper on the subprime mortgage market circulated by Fannie Mae notes that between 1999 and 2000, the number of subprime loans declined, but the decline in the full mortgage market was slightly greater.[5] This would indicate an increase in the subprime share of the market. This Fannie Mae paper compares different sources of data and notes how precise estimates of the subprime market differ with the use of different sources. All of these alternative measures indicate a massive increase in subprime lending over the past several years.

The growth of subprime lending as a segment of the conventional market presents opportunities to expand the range of conventional mortgage lending to borrowers who have traditionally been excluded from the market based on factors that present risks beyond those acceptable to the normal conventional markets. But some lending practices within the subprime market - whether referred to as predatory practices or simply exploitive practices - represent a significant threat to borrowers - many of them related to populations protected by either the Fair Housing Act or the Equal Credit Opportunity Act. Some of these practices may constitute discrimination - not by excluding minorities from access to lending, but by targeting minorities or exploiting minorities by providing loans with terms and conditions not warranted by risks posed by the borrowers.[6]

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[2] See Scheessele, Randall M., *1998 HMDA Highlights*, Housing Finance - Working Paper Series - Working Paper No. HF-009, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, (October 1999).

[3] U. S. Department of Housing and Urban Development, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (April 2000), page 2.

[4] See the joint HUD/Treasury report *Curbing Predatory Lending* (2000), pages 38 and 29 - calculations from Table 3.1. (Report data taken from Inside Mortgage Finance Publications, *Mortgage Market Statistical Annual 2000*, Volume II, pages 1-2.)

[5] Barry Zigas and Paul Weech, *The Rise of Subprime Lending: Causes, Implications, and Proposals*, Draft Paper circulated by Fannie Mae (October 2001), Pages 6-10.

[6] Recent court opinions have affirmed that specifically targeting and exploiting minority markets does constitute a violation of the Fair Housing Act. See *Hargraves, et al. v. Capital City Mortgage Corporation and Thomas K. Nash* [Civ. No. 98-1021 (JHG/AK) - United States District Court for the District of Columbia] and *Honorable, et al. v. Easy Life Real Estate System, et al.* [Civ. No. 97-C-6009: United States District Court for the Northern District of Illinois, Eastern Division].

This study reviews subprime lending patterns in the mortgage refinance markets for all 331 Metropolitan Statistical Areas in the United States. We refer to these MSAs, collectively, as the "national urban" market. We were seeking to discover if the patterns of racial disparities found in selected studies of many of the larger MSAs also existed in the nation's medium and smaller MSAs and in different regions of the country. We were also seeking to discover if racial disparities in subprime lending exist for both minority neighborhoods and individual minority groups of borrowers. The study focuses on refinance loans. While the subprime market in home purchase loans is rapidly expanding, subprime lending is far greater in the refinance market. We use the Home Mortgage Disclosure Act data on refinance loans for the year 2000 as the base data, which provides information on 1,763,483 refinance loans made by 7,728 lenders in that year. Subprime loans are identified by using HUD's list of 209 subprime lenders for the year 2000.[7] We have eliminated FHA, VA, and Rural Housing program loans from the analysis, as well as loans sold to Fannie Mae or Freddie Mac. All the loans in the analysis are conventional mortgage refinance loans on single-family (1-4 unit) housing. Loans by lenders designated as manufactured housing lenders are excluded from the analysis.

II. The Major Findings

The following sections of this study review highlights of the major findings and then provide listings of the individual MSAs ranked by the levels of subprime lending or the disparity rates for selected measures. The analysis focuses on three areas where the review of all 331 MSAs confirmed the pervasiveness of racial disparities nationwide, or where patterns emerged that were not clear from the past reviews of a limited number of larger MSAs. Overall, the analysis found that:

- Racial disparities actually increase with increased borrower income;
- High levels of subprime lending and racial disparities exist in all regions in the nation; and
- High levels of subprime lending and racial disparities occur in MSAs of all sizes.

A. Racial Disparities in Subprime Lending Increase with Higher Incomes

The national urban lending totals for all 331 metropolitan areas show racial disparities in the percentage of refinance loans that are subprime. 17.42% of the conventional refinance loans made to white borrowers in 2000 were subprime loans. The comparable figures are 49.28% for African-Americans, 30.33% for Hispanics, and 27.94% for Native Americans.

[7] The list of subprime and manufactured housing lenders for 2000 was provided by Randall M. Scheessele in the Office of Policy Development and Research at the U.S. Department of Housing and Urban Development.

We calculated racial disparity ratios by comparing the subprime percentages for minority borrowers to the subprime percentage for whites. Any ratio above 1.00 indicates a disparity by race. Disparities above 2.00 indicate that the minority borrowers are at least twice as likely to have a subprime loan as are whites. Based on the figures for 2000, the disparity ratio for African-Americans is 2.83, the disparity ratio for Hispanics is 1.74, and the disparity ratio for Native-Americans is 1.60.[8]

Additionally, 16.22% of the conventional refinance loans made to Asians are subprime, creating a disparity ratio of 0.93. This indicates that Asians are slightly less likely than whites to receive a subprime loan.

The HMDA data do not contain direct measures of risk factors. They do, however, provide data on the income that borrowers used to secure loans. Therefore, we can investigate whether income differences tend to account for these racial disparities. Where other studies using HMDA data have explored this issue, racial differences have often remained when comparing borrowers within similar income ranges. Morever, some studies have indicated that higher income minorities receive higher levels of subprime loans than do lower income whites.[9]

Graph #1, below, provides data on the percentage of loans that are subprime for each minority group of borrowers within the four income ranges commonly used to present HMDA data. Income ranges are based on the comparison of the borrower's income to the HUD-estimated Median Family Income (MFI) for the Metropolitan Statistical Area (MSA) in the year of the loan. The four ranges are:

Lower-Income	Less than 80% of the MSA Median Family Income;
Moderate-Income	From 80% to less than 100% of the Median Family Income;
Middle-Income	From 100% to 120% of the Median Family Income; and,
Upper-Income	Greater than 120% of the Median Family Income.

Graph #1 has a separate bar within each of the four income ranges, representing each racial or ethnic group. The percentage of conventional refinance loans that are subprime is

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[8] Throughout this report there may be some minor discrepancies between the precise results of calculations based on data in the Detailed Table of Subprime Lending for All MSAs. These result from the fact that the detailed data in the tables and presented in the text have been rounded to two decimal places while the raw data used to calculate the measures, percentages, and disparity ratios are calculated to several more decimal places.

[9] See for example, the study by Jim Campen for the Massachusetts Community & Banking Council in Boston: *Borrowing Trouble? II - Subprime Lending in Greater Boston, 1999-2000* (2001). See also the following five studies by the U.S. Department of Housing and Urban Development: *Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending* (April 2000); *Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending* (May 2000); *Unequal Burden in Chicago: Income and Racial Disparities in Subprime Lending* (May 2000); *Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending* (April 2000); and *Unequal Burden in New York: Income and Racial Disparities in Subprime Lending* (May 2000). Most recently, see Association of Community Organizations for Reform Now (ACORN), *Separate and Unequal: Predatory Lending in America*, Washington, D.C: ACORN (November 2001).

indicated at the top of each bar. The overall national urban level of subprime loans is 25.31%.[10] The solid black line represents this level of subprime lending.

For every racial and ethnic group, the percentage of loans that are subprime declines as income increases. However, the percentage of subprime loans within each income range is always greater for minority borrowers than for white borrowers, with the single exception of Asian borrowers. Moreover, for the middle- and upper-income ranges, the percentages of subprime loans are greater for Asians as well when compared to whites. The highest percentage of subprime loans in each income range is for African-Americans. Indeed, the percentage of loans that are subprime for African-Americans never goes below the overall national level of 25.31%, even for the highest income range.

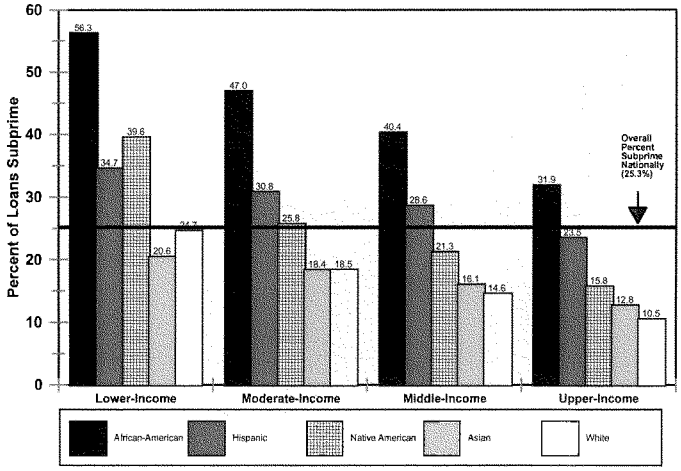
Graph #2 shows the disparity ratios within each income range when comparing each minority group of borrowers to whites. Each racial or ethnic group is represented by a different symbol. For African-Americans, Hispanics, and Asians, the disparities in subprime lending actually increase as the income ranges increase. For Native Americans, this pattern holds for all but the lowest income range. For African-Americans, this means that, while lower-income borrowers are about twice as likely as whites to receive subprime loans, upper-income African-Americans are about three times more likely to receive a subprime refinance loan. For Hispanics, the disparity ratios increase from less than 1.5 at the lower-income range to well over 2.0 in the upper-income range. For Asians, borrowers switch from having a lower share of subprime loans than whites in the lower-income range to having a larger percentage of subprime loans in the middle- and upper-income ranges. Therefore, income not only fails to explain the disparities, it indicates that the disparities increase as the income range increases.

These are overall urban figures for the nation. Not all MSAs have the 100 conventional loans in each income range for each racial or ethnic group that we set as the threshold for calculating disparities. There are, for example, no MSAs with enough Native American loans in the moderate-income to upper-income ranges to provide individual MSA disparities. Only the Chicago and Detroit MSAs have enough loans in the lower-income range to calculate disparities; here the disparities are 2.12 and 1.70, respectively. Still, when we review the patterns for all MSAs that have enough loans to calculate disparities, we see how pervasive the patterns of disparities are.

[10] The term "national urban" used in this report refers collectively to all 331 MSAs.

Graph 1 - Percent of Loans Subprime Across All MSAs

For Conventional Refinance Loans by Borrower Race and Income Group



Graph 2 - Racial Disparity in the Percent of Loans Subprime

For Conventional Refinance Loans by Borrower Race and Income Group

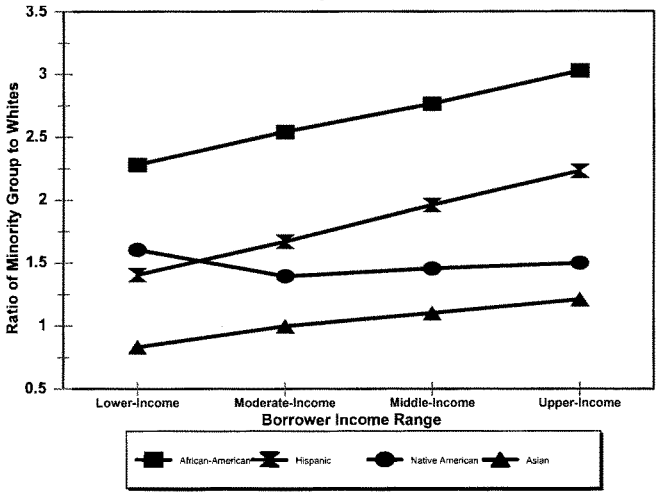


Table #1, below, shows the national urban disparity ratios within each income range for African-Americans, Hispanics and Asians, as reflected in Graph #2. The table also shows the number of MSAs within each income range that had enough loans to calculate disparity ratios for each minority group and the number of these MSAs that had disparity ratios above 1.00. The columns on the right show how many of the MSAs have ratios between 2.00 and 2.99, between 3.00 and 3.99, and 4.00 and over.

For all three racial and ethnic groups, the national urban disparity ratio increases systematically as income increases. For African-Americans, however, the lowest national urban disparity ratio is greater than the highest disparity ratio for any other minority group in any income range. Moreover, for African-Americans, racial disparities exist in every income range for every MSA where the disparity ratio could be calculated. At the national urban level, we find that upper-income African-Americans have a higher percentage of subprime loans than do lower-income whites. We call this the "upper-to-lower" racial disparity ratio for African-Americans. At the national level, this ratio is 1.29.

Table 1 - Disparity Ratios by Income Range for African-Americans, Hispanics, and Asians Compared to Whites

Income Range for Minority to White Disparity Ratios	National Urban Disparity Ratio and (Range of Ratios)	Number of MSAs with Disparity Ratios above 1.00 and the Number of MSAs with Ratios Calculated	Ratios 2.00 to 2.99	Ratios 3.00 to 3.99	Ratios 4.00 and Greater
African-Americans:					
Lower-Income	2.38 (1.35 to 3.52)	All 107 of 107	62	5	
Moderate-Income	2.54 (1.64 to 3.83)	All 71 of 71	50	12	
Middle-Income	2.76 (1.38 to 4.62)	All 29 of 29	15	9	1
Upper-Income	3.03 (1.68 to 5.93)	All 34 of 34	8	18	5
Hispanics:					
Lower-Income	1.40 (0.88 to 2.60)	51 of 55	2		
Moderate-Income	1.67 (0.92 to 2.22)	45 of 47	1		
Middle-Income	1.96 (1.17 to 2.73)	All 23 of 23	4		
Upper-Income	2.23 (0.93 to 3.06)	32 of 33	11	1	
Asians:					
Lower-Income	0.83 (0.55 to 1.34)	7 of 15			
Moderate-Income	1.00 (0.21 to 1.82)	11 of 21			
Middle-Income	1.10 (0.36 to 1.72)	5 of 13			
Upper-Income	1.21 (0.51 to 2.25)	16 of 22	2		

This review of subprime lending in the nation's urban areas shows that income itself does not explain the racial disparities in the levels of subprime lending. Indeed, these HMDA data show that the racial disparities increase with increased income.

B. Racial Disparities Exist Across All Regions of the Country

Some metropolitan areas have such small minority populations that measures of minority subprime lending and racial disparities cannot be calculated. Some regions of the nation are dominated by smaller metropolitan areas. Nonetheless, by aggregating the metropolitan areas into subtotals for regions, we can see regional patterns. We assigned each of the 331 metropolitan areas to one of the 10 HUD regions. Map #1 indicates which states fall into which region. There were 17 MSAs that overlapped more than one region. In these cases, we reviewed the 2000 Census populations of the individual counties that made up these metropolitan areas. Then, each of these 17 MSAs was assigned to the region which accounted for the majority of its population.[11]

Graphs #3 to #6 show the disparity ratios, by region, in the percent of subprime loans for the four racial and ethnic groups compared to whites. There is a separate bar on the graphs for each region, with the disparity ratio printed within each bar. Vertical lines on the graphs indicate the point at which there are no disparities (1.0), the point at which minorities have twice the level of subprime loans as whites (2.0), and the point at which minorities have three times the percentage of subprime loans as whites (3.0).

For African-Americans (Graph #3), the disparity ratio is over 2.0 in all 10 regions. Two regions, the Midwest and the Great Plains, have disparity ratios over 3.0. Even though the Great Plains region is dominated by MSAs with relatively small African-American populations, the region as a whole has the highest African-American to white disparity ratio of all regions.

For Hispanics (Graph #4), all of the regions show racial disparities (ratios greater than 1.0). While the Hispanic population is heavily concentrated in the Southwest and Western parts of the country, the New England region actually has the highest disparity ratio, at 2.0.

Native Americans generally have small numbers of borrowers in individual urban areas. When we combine metropolitan areas into regions, however, we see that Native Americans (Graph #5) have racial disparities in every region of the country. The highest disparity ratio is not, as some might expect, in a region in the Southwest, Northwest, or Great Plains. The highest disparity ratio is in the Southeast, closely followed by the Midwest, the Mid-Atlantic, and the New York/New Jersey regions.

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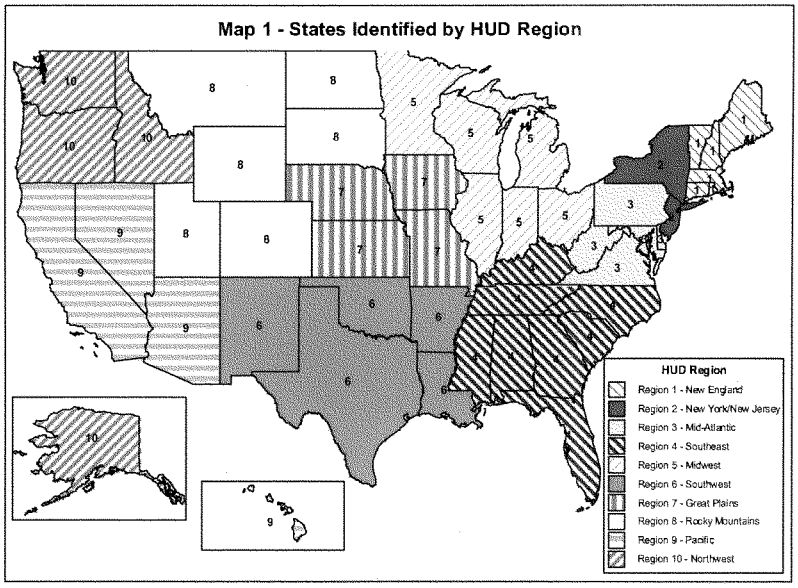
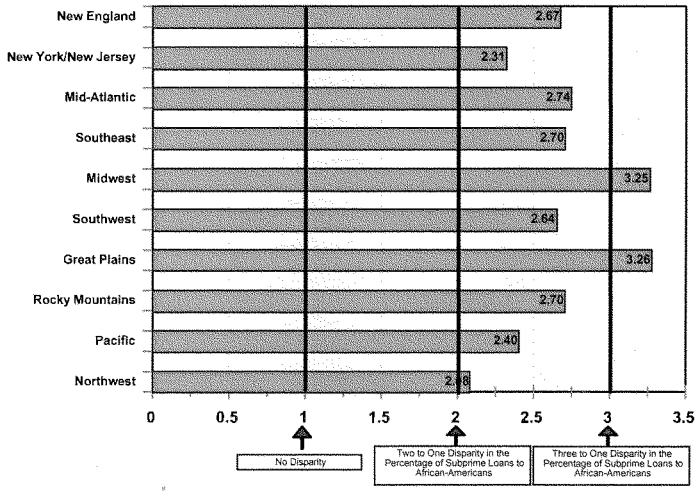
[11] The following is a list of the 17 MSAs with sections in more than one HUD region. The state with the majority of the population and the region to which it was assigned are in brackets. Flagstaff, AZ-UT [AZ, 9]; Davenport-Moline-Rock Island, IA-IL [IL, 5]; Evansville-Henderson, IN-KY [IN, 5]; Louisville, KY-IN [KY, 4]; St. Louis, MO-IL [MO, 7]; Fargo-Moorhead, ND-MN [ND, 8]; Grand Forks, ND-MN [ND, 8]; Newburgh, NY-PA [NY, 2]; Steubenville-Weirton, OH-WV [OH, 5]; Cincinnati, OH-KY-IN [OH, 5]; Philadelphia, PA-NJ [PA, 3]; Memphis, TN-AR-MS [TN, 4]; Johnson City-Kingsport-Bristol, TN-VA [TN, 4]; Norfolk-Virginia Beach-Newport News, VA-NC [VA, 3]; Wheeling, WV-OH [WV, 3]; Huntington-Ashland, WV-KY-OH [WV, 3]; Parkersburg-Marietta, WV-OH [WV, 3].


Map 1 - States Identified by HUD Region
HUD Region
Region 1 - New England
Region 2 - New York/New Jersey
Region 3 - Mid-Atlantic
Region 4 - Southeast
Region 5 - Midwest
Region 6 - Southwest
Region 7 - Great Plains
Region 8 - Rocky Mountains
Region 9 - Pacific
Region 10 - Northwest

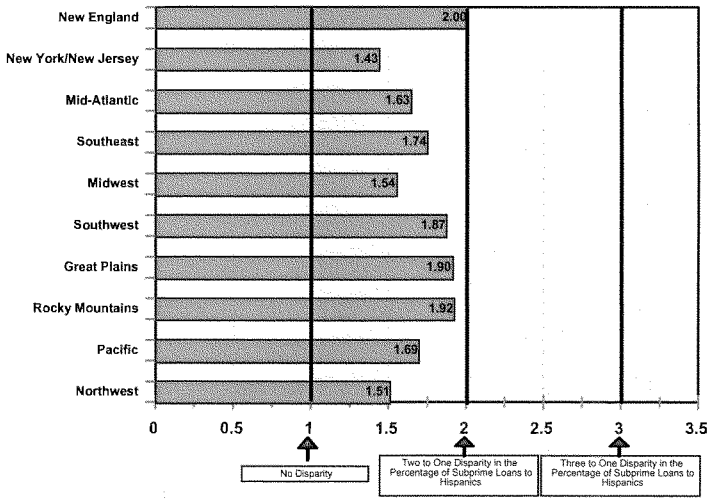
Graph 3 - African-American Subprime Disparity Ratio by Region

Ratio of the Percent Subprime for African-Americans to the Percent Subprime for Whites



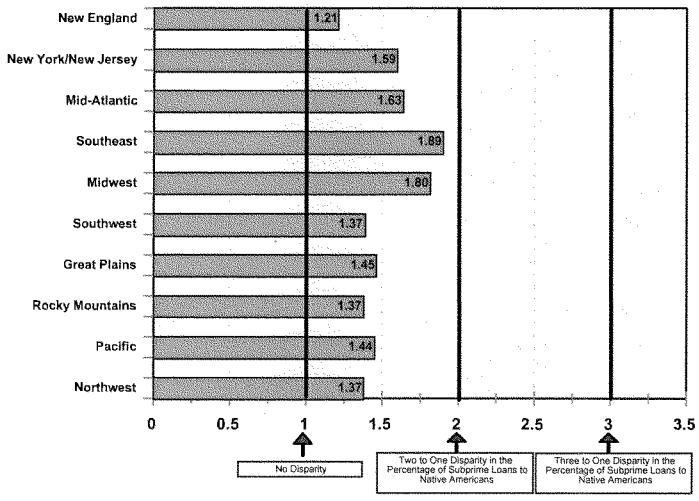
Graph 4 - Hispanic Subprime Disparity Ratio by Region

Ratio of the Percent Subprime for Hispanics to the Percent Subprime for Whites



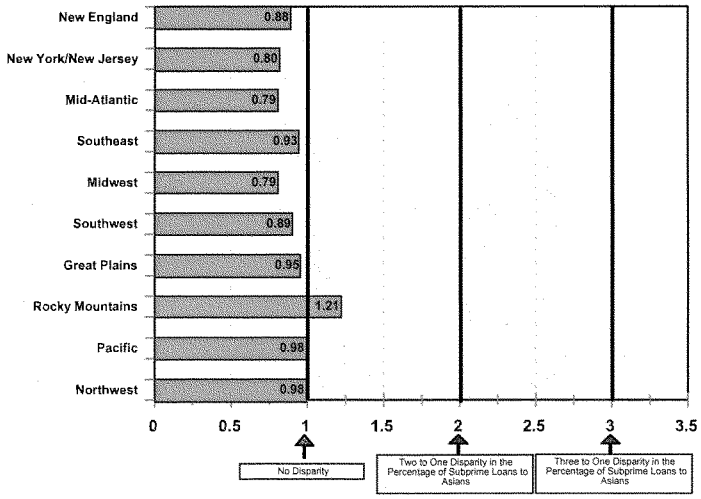
Graph 5 - Native American Subprime Disparity Ratio by Region

Ratio of the Percent Subprime for Native Americans to the Percent Subprime for Whites



Graph 6 - Asian Subprime Disparity Ratio by Region

Ratio of the Percent Subprime for Asians to the Percent Subprime for Whites



For Asians (Graph #6), overall, only one region as a whole shows racial disparities. Interestingly, this is not the Northwest or Pacific region, but the Rocky Mountains region.

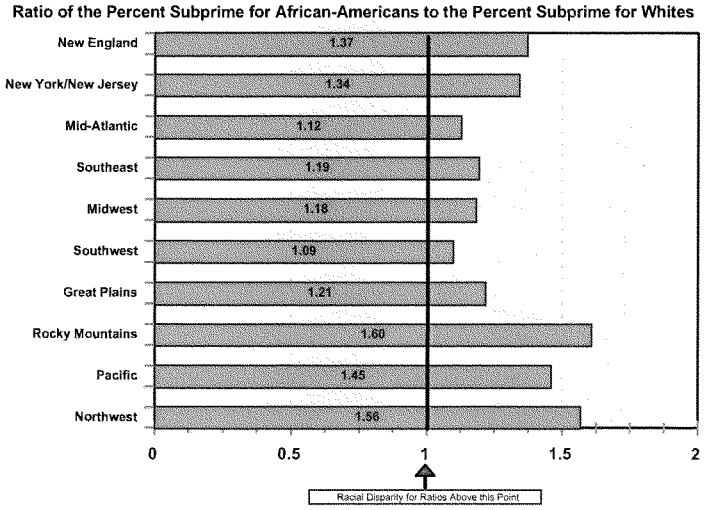
The racial disparities that we found at the national level are persistent in the regional analysis, as well. At the national urban level, for example, upper-income African-American borrowers had higher levels of subprime lending than did lower-income whites. Graph #7 shows how this upper-to-lower racial disparity ratio comes out for geographic regions. As we can see, all regions show disparities for this extreme measure of African-American disparities. These disparities range from 1.12 in the Mid-Atlantic region to 1.60 in the Rocky Mountains region.

C. High Levels of Subprime Lending Exist Across the Nation

The analysis of racial disparities in subprime mortgage lending must be seen in the context of the overall level of subprime lending at the national urban level, which has reached significant levels. For the nation's urban areas as a whole, 25.31% of all the conventional refinance loans reported under HMDA were estimated to be subprime loans. Graph #8 shows the total level of subprime lending by HUD region. The highest level of subprime lending is in the Southeast region, followed by the New York/New Jersey region and the Southwest. Previous studies have not identified these high levels of subprime lending throughout the southern part of the country. The Great Plains and Mid-Atlantic regions also have subprime lending levels above the national norm for urban areas.

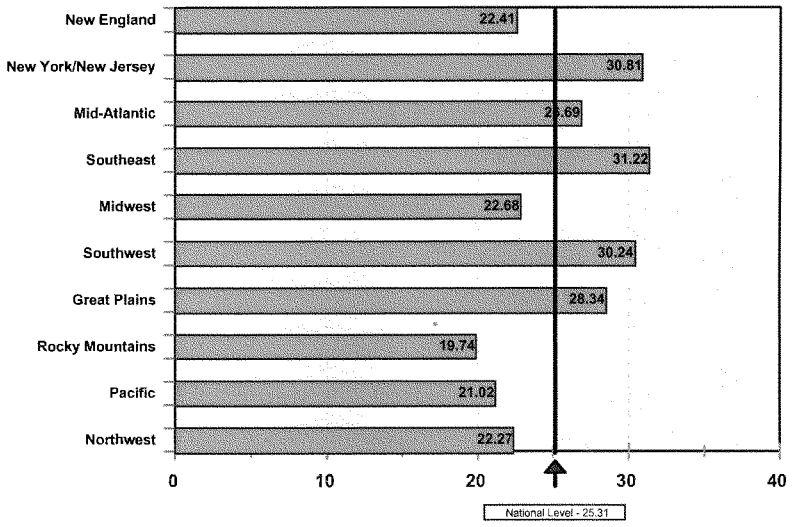
Of the 331 MSAs in the country, 156 have overall subprime lending levels above the national urban lending level, as shown in Map #2. These individual MSAs are generally spread across the country, with the exception of most of the Great Plains region. The result is that half of the regions have levels of subprime lending above the national norm. Looking at the MSAs that fall completely within a single state, we find that some states have high levels of subprime lending in all or all but one of their MSAs. This is especially true of states in the Southeast and Southwest regions. All of the MSAs that are in North Carolina are above the national level for subprime lending. All but one of the MSAs in Georgia, New York, Oklahoma, South Carolina, Tennessee, and Texas have subprime lending levels above the national norm. All but three MSAs in California have subprime lending levels above the national norm, which is particularly noteworthy because California has such a large population and represents such a large segment of the entire housing market nationwide.

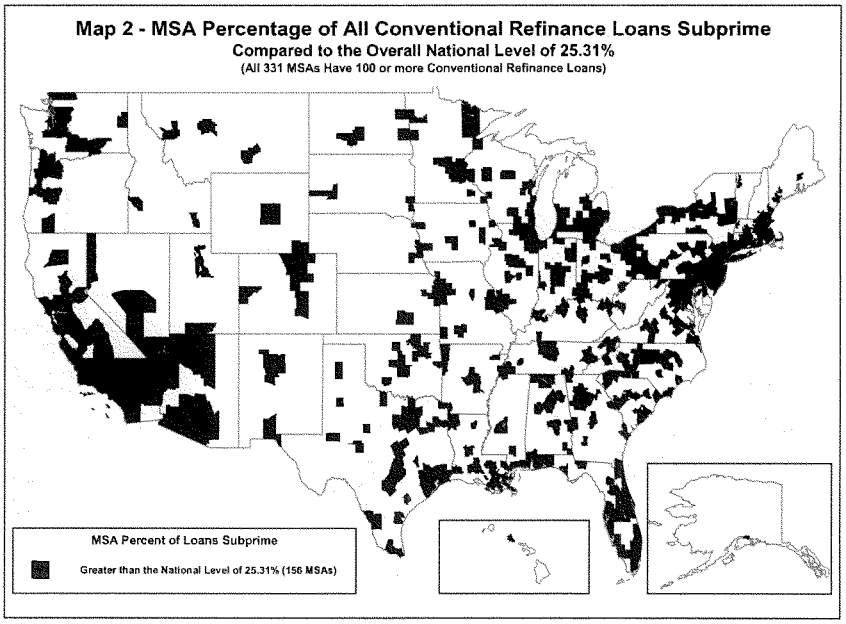
Graph 7 - Upper-Income African-American to Lower-Income White Disparity Ratio by Region



Graph 8 - Overall Percent Subprime by Region

Percent of All Conventional Refinance Loans that Are Subprime




Map 2 - MSA Percentage of All Conventional Refinance Loans Subprime
Compared to the Overall National Level of 25.31%
(All 331 MSAs Have 100 or more Conventional Refinance Loans)
MSA Percent of Loans Subprime
Greater than the National Level of 25.31% (156 MSAs)

D. Racial Disparities in Levels of Subprime Lending Occur in Urban Areas of All Sizes

Analysis of racial disparities in smaller and middle-sized MSAs is complicated by the fact that they often do not reach the threshold for the minimum number of loans to create measurements for racial disparities. This does not mean that such disparities do not exists in these MSAs. We have combined the 331 MSAs into five groups according to the size of the population as estimated from the 2000 census. The categories are:

MSAs with populations less than 250,000;
MSAs from 250,000 to 500,000 in population;
MSAs from 500,000 to 1 million in population;
MSAs from 1 million to 2 million in population; and,
MSAs with populations greater than 2 million.

Graphs #9 through #12 show the disparity ratios in the percent of subprime loans for the four racial and ethnic groups compared to whites by MSA size. There is a separate bar on the graphs for each size category, with the disparity ratio printed within each bar. Vertical lines on the graphs indicate the point where there are no disparities (1.0), the point where minorities have twice the level of subprime loans as whites (2.0), and the point where minorities have three times the percentage of subprime loans as whites (3.0).

For African-Americans (Graph #9), the disparity ratio is over 2.7 in every category. The smallest MSAs actually have the highest disparity ratio, at 3.04.

For Hispanics (Graph #10), the racial disparity ratios are about 1.7 or greater in all size categories. Again, the greatest racial disparity is in the smallest MSAs, where the disparity ratio is 1.93. The largest MSAs actually have the lowest disparity ratio.

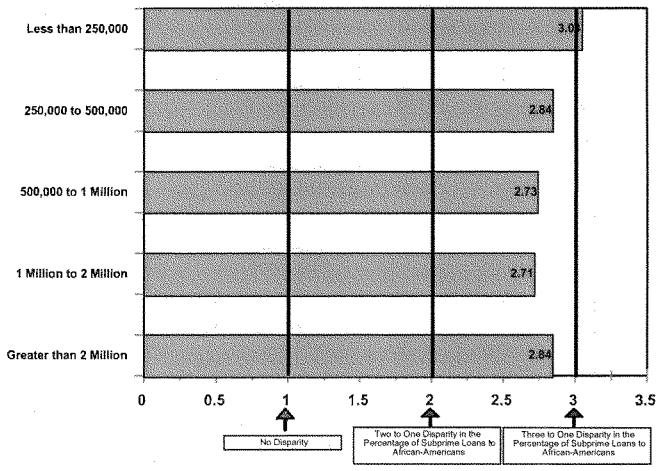
For Native Americans (Graph #11), the racial disparity ratios are at about 1.5 or greater in all of the size categories. Once again, the highest disparity ratio is for the smallest MSAs, at 1.81. The second highest disparity ratio is for the largest MSAs, at 1.64.

Asians (Graph #12), are the exception to this pattern. For Asian borrowers, disparity ratios above 1.0 occur in MSAs with population between 500,000 and 1 million. A small disparity ratio (1.01) also occurs in the smallest MSAs.

These data indicate that, generally, the highest disparity ratios are most likely in the smallest MSAs. Another pattern that is consistent across the different size categories is that African-Americans face the highest disparity ratios, followed by Hispanics and Native Americans.

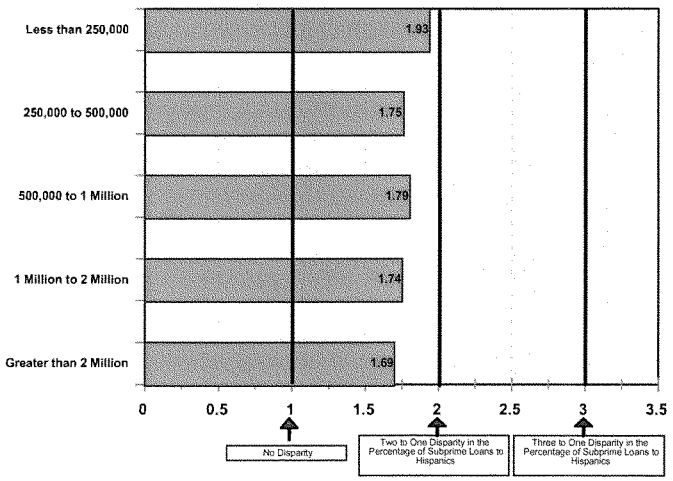
Graph 9 - African-American Subprime Disparity Ratio by MSA Size

Ratio of the Percent Subprime for African-Americans to the Percent Subprime for Whites



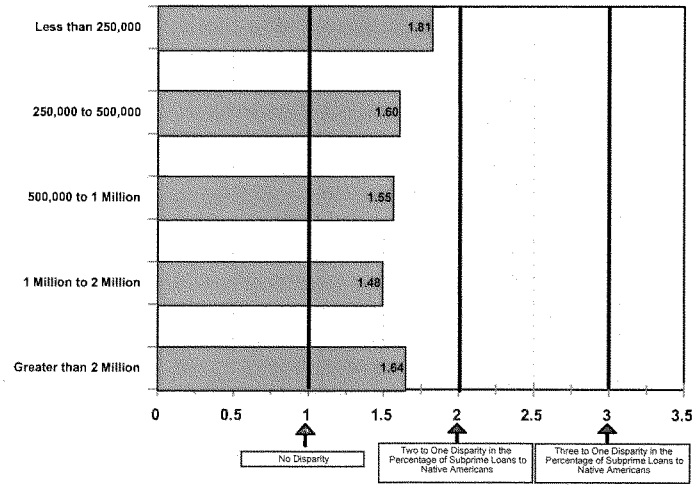
Graph 10 - Hispanic Subprime Disparity Ratio by MSA Size

Ratio of the Percent Subprime for Hispanics to the Percent Subprime for Whites

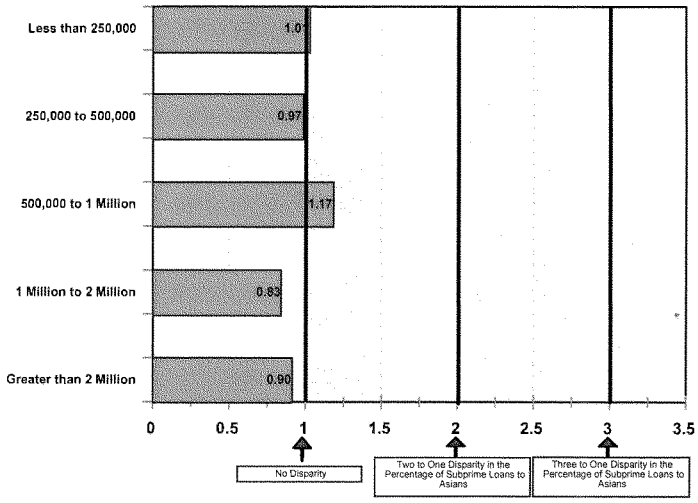


Graph 11 - Native American Subprime Disparity Ratio by MSA Size

Ratio of the Percent Subprime for Native Americans to the Percent Subprime for Whites



Ratio of the Percent Subprime for Asians to the Percent Subprime for Whites



E. Minority Lending is Concentrated in a Small Number of MSAs

Another way to look at size is to examine the extent to which lending to borrowers in particular racial or ethnic groups is concentrated in a small number of markets. Here we see different patterns for different racial or ethnic groups.

The greatest concentration is for Asian borrowers. There were 41,434 conventional refinance loans to Asians reported under HMDA in 2000. The 10 MSAs with the largest concentration of Asian refinance loans are Los Angeles-Long Beach, San Jose, Oakland, San Francisco, Chicago, Orange County (California), Honolulu, San Diego, and Seattle-Bellevue-Everett, Washington. These 10 MSAs alone account for 61.77% of all Asian conventional refinance loans and 57.40% of all Asian subprime loans. The overall percentage of subprime loans for Asians for these 10 MSAs is 15.07%, slightly below the Asian national norm of 16.22%. The Asian market is more concentrated in its top 10 MSAs for both conventional refinance loans and subprime loans than are the comparable white, Native American, African-American, or Hispanic markets.

The second greatest concentration in refinance loans was for Hispanic borrowers. There were 91,295 conventional refinance loans to Hispanic borrowers reported under HMDA in 2000. Los Angeles is the largest market, accounting for 11.7% of all these loans. The 10 MSAs with the largest Hispanic refinance markets are Los Angeles-Long Beach, Chicago, Miami, Phoenix-Mesa, Denver, Riverside-San Bernardino, Oakland, San Diego, San Jose, and Orange County (California). These 10 MSAs alone account for 48.52% of all Hispanic refinance loans and 46.13% of all Hispanic subprime refinance loans. The overall percentage of subprime refinance loans for Hispanics for these 10 MSAs is 28.84%, slightly below the national norm of 30.33% for Hispanic loans. For both conventional refinance loans and subprime loans, a larger share of the total Hispanic market is concentrated in its top 10 MSAs than is the case for the comparable white, Native American, and African-American markets.

The third most concentrated market for refinance loans was for African-American borrowers. 132,196 conventional refinance loans made to African-Americans in urban areas were reported under HMDA in 2000. The 10 MSAs with the largest market of conventional refinance loans to African-Americans are Detroit, Chicago, Atlanta, Washington, Los Angeles-Long Beach, St. Louis, New York, Cleveland-Lorain-Elyria, Philadelphia, and Oakland. These 10 MSAs account for 39.43% of all conventional refinance loans to African-Americans in urban areas and 38.79% of all estimated subprime loans to African-Americans. The overall percentage of subprime loans to African-Americans in these 10 MSAs combined is 48.48%, about at the national norm of 49.28% for African-Americans. The African-American market for refinance lending and subprime lending is more concentrated in the top 10 MSA racial markets than are the comparable white or Native American markets.

There were 6,843 conventional refinance loans made to Native Americans in urban areas reported under HMDA in 2000. The 10 MSAs with the largest concentration of conventional refinance loans to Native-Americans are Chicago, Detroit, Los Angeles-Long Beach, Tulsa, Oakland, Denver, Phoenix-Mesa, Minneapolis-St. Paul, Orange County (California), and Riverside-San Bernardino. These 10 MSAs account for 25.53% of all conventional refinance loans to Native Americans in urban areas and 22.44% of all estimated subprime loans to Native Americans. The overall percentage of subprime loans to Native Americans in these 10 MSAs combined is 24.56%, somewhat below the national norm of 27.94% for Native Americans. The Native American market for refinance lending and subprime lending is more concentrated in the top 10 MSA racial markets than is the comparable white market.

There were 1,074,626 conventional refinance loans made to whites in urban areas reported under HMDA in 2000. The 10 MSAs with the largest concentration of conventional refinance loans to whites are Chicago, Detroit, Minneapolis-St. Paul, Los Angeles-Long Beach, Boston, Phoenix-Mesa, Denver, St. Louis, Philadelphia, and Atlanta. These 10 MSAs account for 23.33% of all conventional refinance loans to whites in urban areas and 20.85% of all estimated subprime loans to whites. The overall percentage of subprime loans to whites in these 10 MSAs combined is 15.57%, below the national norm of 17.42% for whites.

F. Racial Disparities Exist Across MSAs of All Sizes

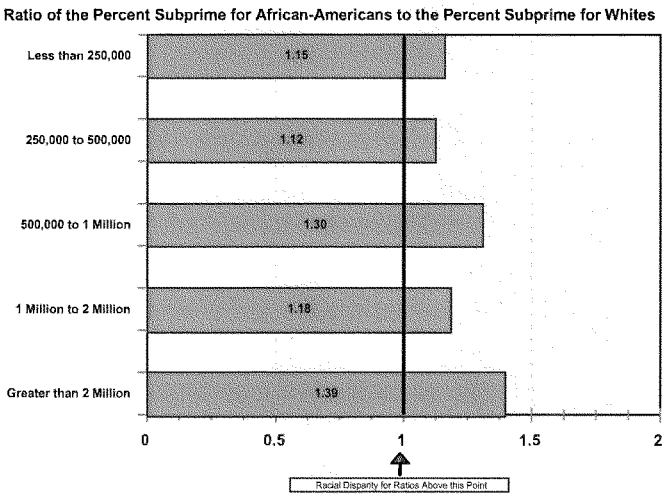
We can analyze racial disparities by comparing the level of subprime loans for upper-income African-Americans to the level of subprime loans for lower-income whites. This "upper-to-lower" ratio is an extreme measure of the racial disparities between whites and African-Americans. Graph #13 shows how this particular disparity ratio comes out for MSAs in different size categories. All categories show disparities, ranging from 1.12 for MSAs with population between 250,000 and 500,000 to 1.39 for MSAs with populations over 2 million.

III. Rankings of Individual MSAs by Subprime Lending and Racial Disparity Measures

Now we turn to a review of lending patterns at the individual MSA level. We have developed a variety of measures of subprime lending and racial disparities in subprime lending for each MSA. This enables us to rank the individual MSAs from those with the highest to lowest levels of subprime lending or racial disparities on a given measure. Keeping in mind the review of patterns by region and MSA size, each ranking indicates the region where each MSA is located and the population of the MSAs in addition to data on specific subprime lending measures.

This section is divided into four parts. First, we review overall levels of subprime lending independent of race. Second, we review subprime lending measures related to the race or ethnicity of the borrowers. Third, we review subprime lending measures by both race and income of the borrowers. Fourth, we review subprime lending measures related to the racial composition of geographic areas.

Graph 13 - Upper-Income African-American to Lower-Income White Disparity Ratio by MSA Size



We do not include in the rankings MSAs with fewer than 100 loans in any category included in the subprime lending measure under review. Therefore, there are different numbers of MSAs included in each part of this analysis.

Many MSAs did not have enough Native American borrowers to calculate our lending measures. Therefore, data for Native Americans are presented only for selected MSAs. For Asians, there were also many MSAs that did not have enough Asian refinance borrowers to provide enough data for analysis. Moreover, in most metropolitan areas where there were adequate data on Asian borrowers, Asians faired as well or better than whites. In the percentage of refinance loans that are subprime, there are only 4 MSAs where the percentage of subprime loans to Asians was above the national urban norm. These MSAs are Stockton-Lodi, California (29.75%), Salinas, California (27.78%), Vallejo-Fairfield-Napa, California (26.47%), and Fort Lauderdale, Florida (26.00%). Only 5 MSAs had Asian disparity ratios above 1.5. These are Milwaukee-Waukesha, Wisconsin (2.18), San Francisco, California (1.91), Salinas, California (1.89), Honolulu, Hawaii (1.86), and Vallejo-Fairfield-Napa, California (1.53). This analysis does not include other data on subprime lending for Asians.[12]

A. Rankings by the Total Level of Subprime Lending for Conventional Refinance Loans

We begin with a review of MSAs that have exceptionally high levels of subprime loans overall. There are 156 MSAs with overall subprime lending levels above the national urban norm of 25.31%, as shown in Map #2. Table #2, below, ranks all 331 MSAs based on the overall percentage of subprime refinance loans, from the MSA with the highest of conventional subprime refinance loans to the MSA with the lowest percentage. The table also lists the population of each MSA, the HUD region in which it is located, and the total number of conventional refinance loans reported in the 2000 HMDA data.

12 The data for Native Americans and Asians for each individual MSA are in the Detailed Table of Subprime Lending for All MSAs on the Center for Community Change web site.

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
1	El Paso, TX	679,622	6	1,767	47.82
2	Corpus Christi, TX	380,783	6	1,061	46.84
3	Laredo, TX	193,117	6	342	45.32
4	Killeen-Temple, TX	312,952	6	683	44.80
5	Beaumont-Port Arthur, TX	385,090	6	1,160	44.48
6	Miami, FL	2,253,362	4	10,701	42.67
7	Columbus, GA-AL	274,624	4	1,799	42.63
8	San Antonio, TX	1,592,383	6	5,270	41.90
9	Memphis, TN-AR-MS	1,135,614	4	7,577	41.86
10	Galveston-Texas City, TX	250,158	6	944	41.63
11	Fayetteville, NC	302,963	4	1,814	41.23
12	Enid, OK	57,813	6	427	40.75
13	Jamestown, NY	139,750	2	737	40.71
14	Rocky Mount, NC	143,026	4	872	39.68
15	Buffalo-Niagara Falls, NY	1,170,111	2	5,218	39.36
16	Daytona Beach, FL	493,175	4	3,477	38.77
17	Danville, VA	110,156	3	802	38.53
	1.5 Times the National Norm of 25.31 = 37.97				
18	McAllen-Edinburg-Mission, TX	569,463	6	1,345	37.62
19	Sumter, SC	104,646	4	734	37.33
20	Victoria, TX	84,088	6	220	37.27
21	Goldsboro, NC	113,329	4	681	37.00
22	Lakeland-Winter Haven, FL	483,924	4	3,234	36.92
23	Florence, SC	125,761	4	963	36.55
24	Pine Bluff, AR	84,278	6	364	36.54
25	New York, NY	9,314,235	2	23,104	36.50
26	Orlando, FL	1,644,561	4	10,275	36.18
27	Hickory-Morganton-Lenoir, NC	341,851	4	3,481	36.08
28	Charlotte-Gastonia-Rock Hill, NC-SC	1,499,293	4	14,789	36.07
29	Brownsville-Harlingen-San Benito, TX	335,227	6	795	35.97
30	Houston, TX	4,177,646	6	14,552	35.70
31	Jacksonville, FL	1,100,491	4	7,792	35.61
32	Jersey City, NJ	608,975	2	1,687	35.39
33	Columbia, SC	536,691	4	4,576	35.34
34	Sherman-Denison, TX	110,595	6	509	35.17
35	Richmond-Petersburg, VA	996,512	3	6,449	35.04
36	Macon, GA	322,549	4	2,381	34.86
37	Tallahassee, FL	284,539	4	1,630	34.85
38	Chattanooga, TN-GA	465,161	4	4,011	34.73
39	Vineland-Millville-Bridgeton, NJ	146,438	2	779	34.53
40	Nassau-Suffolk, NY	2,753,913	2	20,903	34.47
41	Amarillo, TX	217,858	6	961	34.13

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
42	Newburgh, NY-PA	387,669	2	2,205	34.06
43	Kansas City, MO-KS	1,776,062	7	19,011	34.02
44	Pensacola, FL	412,153	4	2,867	33.97
45	Lubbock, TX	242,628	6	711	33.90
46	Savannah, GA	293,000	4	2,140	33.83
47	Charleston-North Charleston, SC	549,033	4	4,307	33.76
48	Ocala, FL	258,916	4	1,902	33.70
49	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	17,833	33.59
50	Brazoria, TX	241,767	6	829	33.41
51	Fort Lauderdale, FL	1,623,018	4	8,804	33.41
52	Cleveland-Lorain-Elyria, OH	2,250,871	5	21,630	33.12
53	Fort Myers-Cape Coral, FL	440,888	4	3,070	33.09
54	Steubenville-Weirton, OH-WV	132,008	5	1,123	32.95
55	Greensboro--Winston-Salem--High Point, NC	1,251,509	4	10,104	32.83
56	Wilmington-Newark, DE-MD	586,216	3	4,553	32.81
57	Wichita Falls, TX	140,518	6	412	32.77
58	Norfolk-Virginia Beach-Newport News, VA-NC	1,569,541	3	8,508	32.53
59	Dayton-Springfield, OH	950,558	5	10,309	32.45
60	Mobile, AL	540,258	4	4,384	32.44
61	Binghamton, NY	252,320	2	854	32.08
62	Sharon, PA	120,293	3	1,253	32.08
63	Jackson, MS	440,801	4	2,700	32.07
64	St. Louis, MO-IL	2,603,607	7	31,741	32.02
65	Texarkana, TX-Texarkana, AR	129,749	6	463	31.97
66	Pittsburgh, PA	2,358,695	3	24,438	31.75
67	Lynchburg, VA	214,911	3	1,615	31.70
68	Canton-Massillon, OH	406,934	5	4,911	31.62
69	Atlanta, GA	4,112,198	4	34,129	31.57
70	Melbourne-Titusville-Palm Bay, FL	476,230	4	2,725	31.34
71	San Angelo, TX	104,010	6	293	31.06
72	Oklahoma City, OK	1,083,346	6	8,796	31.03
73	New Orleans, LA	1,337,726	6	10,069	30.57
74	Shreveport-Bossier City, LA	392,302	6	2,504	30.55
75	Dallas, TX	3,519,176	6	13,276	30.51
76	Akron, OH	694,960	5	7,788	30.43
77	Wheeling, WV-OH	153,172	3	1,180	30.42
78	Longview-Marshall, TX	208,780	6	651	30.41
79	Nashville, TN	1,231,311	4	11,053	30.37
80	Altoona, PA	129,144	3	998	30.36
81	Gary, IN	631,362	5	5,477	30.14
82	Albany-Schenectady-Troy, NY	875,583	2	3,805	30.12
83	Philadelphia, PA-NJ	5,100,931	3	33,093	30.11
84	Greenville-Spartanburg-Anderson, SC	962,441	4	8,621	30.09

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
85	Punta Gorda, FL	141,627	4	1,122	30.04
86	Lawton, OK	114,996	6	686	29.88
87	Clarksville-Hopkinsville, TN-KY	207,033	4	1,181	29.81
88	Syracuse, NY	732,117	2	3,068	29.69
89	Jackson, TN	107,377	4	750	29.60
90	Fitchburg-Leominster, MA	142,284	1	1,186	29.60
91	Glens Falls, NY	124,345	2	717	29.57
92	Gainesville, FL	217,955	4	1,002	29.44
93	Utica-Rome, NY	299,896	2	1,471	29.30
94	Tyler, TX	174,706	6	540	29.26
95	Albany, GA	120,822	4	656	29.12
96	Sarasota-Bradenton, FL	589,959	4	3,854	29.11
97	Visalia-Tulare-Porterville, CA	368,021	9	1,556	29.05
98	Baton Rouge, LA	602,894	6	5,491	28.97
99	New Haven-Meriden, CT	542,149	1	3,593	28.83
100	Muncie, IN	118,769	5	1,243	28.80
101	Augusta-Aiken, GA-SC	477,441	4	3,077	28.79
102	Jacksonville, NC	150,355	4	695	28.78
103	Dover, DE	126,697	3	1,075	28.74
104	Topeka, KS	169,871	7	1,166	28.73
105	Birmingham, AL	921,106	4	6,783	28.67
106	South Bend, IN	265,559	5	2,334	28.62
107	Elmira, NY	91,070	2	394	28.43
108	Pueblo, CO	141,472	8	2,087	28.41
109	Knoxville, TN	687,249	4	5,995	28.36
110	Roanoke, VA	235,932	3	1,821	28.28
111	Biloxi-Gulfport-Pascagoula, MS	363,988	4	3,225	28.25
112	West Palm Beach-Boca Raton, FL	1,131,184	4	6,038	28.20
113	Austin-San Marcos, TX	1,249,763	6	5,709	27.99
114	Springfield, MA	591,932	1	2,793	27.96
115	Newark, NJ	2,032,989	2	11,492	27.92
116	Odessa-Midland, TX	237,132	6	663	27.90
117	Waco, TX	213,517	6	564	27.84
118	Merced, CA	210,554	9	1,054	27.80
119	Yuba City, CA	139,149	9	655	27.79
120	Greenville, NC	133,798	4	658	27.66
121	Youngstown-Warren, OH	594,746	5	6,450	27.50
122	Eugene-Springfield, OR	322,959	10	2,242	27.39
123	Evansville-Henderson, IN-KY	296,195	5	2,824	27.37
124	Albuquerque, NM	712,738	6	5,804	27.33
125	Waterbury, CT	228,984	1	1,276	27.27
126	Toledo, OH	618,203	5	7,465	27.15
127	New Bedford, MA	175,198	1	1,197	27.15

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
128	Gadsden, AL	103,459	4	795	27.04
129	Wichita, KS	545,220	7	3,958	26.96
130	St. Joseph, MO	102,490	7	1,189	26.75
131	Baltimore, MD	2,552,994	3	16,749	26.74
132	Wilmington, NC	233,450	4	2,291	26.71
133	Stockton-Lodi, CA	563,598	9	4,414	26.64
134	Riverside-San Bernardino, CA	3,254,821	9	21,506	26.62
135	Mansfield, OH	175,818	5	1,996	26.60
136	Providence-Fall River-Warwick, RI-MA	1,188,613	1	9,841	26.56
137	Detroit, MI	4,441,551	5	63,592	26.55
138	Fresno, CA	922,516	9	4,100	26.41
139	Tacoma, WA	700,820	10	6,298	26.29
140	Brockton, MA	255,459	1	2,721	26.20
141	Dubuque, IA	89,143	7	546	26.19
142	Columbus, OH	1,540,157	5	15,525	26.14
143	Fort Worth-Arlington, TX	1,702,625	6	6,485	26.14
144	Abilene, TX	126,555	6	292	26.03
145	Las Vegas, NV-AZ	1,563,282	9	10,628	25.98
146	Lake Charles, LA	183,577	6	1,484	25.94
147	Rochester, NY	1,098,201	2	5,385	25.92
148	Yakima, WA	222,581	10	1,409	25.76
149	Asheville, NC	225,965	4	2,203	25.65
150	Scranton--Wilkes-Barre--Hazleton, PA	624,776	3	5,489	25.63
151	Tulsa, OK	803,235	6	5,768	25.52
152	Phoenix-Mesa, AZ	3,251,876	9	31,470	25.51
153	Trenton, NJ	350,761	2	1,837	25.42
154	Manchester, NH	198,378	1	1,539	25.41
155	Raleigh-Durham-Chapel Hill, NC	1,187,941	4	8,516	25.33
156	Atlantic-Cape May, NJ	354,878	2	2,977	25.33
	The National Norm of 25.31				
157	Little Rock-North Little Rock, AR	583,845	6	3,865	25.25
158	Parkersburg-Marietta, WV-OH	151,237	3	1,609	25.17
159	Spokane, WA	417,939	10	2,830	24.95
160	Omaha, NE-IA	716,998	7	7,332	24.88
161	Des Moines, IA	456,022	7	4,806	24.86
162	Decatur, IL	114,706	5	851	24.79
163	Hamilton-Middletown, OH	332,807	5	3,794	24.72
164	Modesto, CA	446,997	9	2,749	24.66
165	Worcester, MA-CT	511,389	1	3,921	24.66
166	Kankakee, IL	103,833	5	922	24.51
167	Medford-Ashland, OR	181,269	10	1,482	24.36
168	Yuma, AZ	160,026	9	723	24.34
169	Auburn-Opelika, AL	115,092	4	625	24.32

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
170	Monmouth-Ocean, NJ	1,126,217	2	9,149	24.32
171	Bremerton, WA	231,969	10	1,808	24.28
172	Terre Haute, IN	149,192	5	1,748	24.26
173	Tuscaloosa, AL	164,875	4	1,134	24.25
174	Hartford, CT	1,183,110	1	7,187	24.24
175	Indianapolis, IN	1,607,486	5	17,963	24.19
176	Montgomery, AL	333,055	4	2,080	24.18
177	Hagerstown, MD	131,923	3	985	24.16
178	Lima, OH	155,084	5	1,775	24.06
179	New London-Norwich, CT-RI	293,566	1	1,834	24.05
180	Salem, OR	347,214	10	2,292	24.04
181	Hattiesburg, MS	111,674	4	1,099	24.02
182	Naples, FL	251,377	4	1,793	23.98
183	Cincinnati, OH-KY-IN	1,646,395	5	18,383	23.92
184	Benton Harbor, MI	162,453	5	1,817	23.89
185	Bridgeport, CT	459,479	1	3,726	23.81
186	Bergen-Passaic, NJ	1,373,167	2	7,600	23.76
187	Charleston, WV	251,662	3	1,910	23.56
188	Anniston, AL	112,249	4	799	23.53
189	Fort Smith, AR-OK	207,290	6	1,413	23.35
190	Johnstown, PA	232,621	3	1,623	23.29
191	Lowell, MA-NH	301,686	1	2,846	23.09
192	Portland-Vancouver, OR-WA	1,918,009	10	14,674	23.07
193	Flint, MI	436,141	5	6,288	23.06
194	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	6,884	22.92
195	Monroe, LA	147,250	6	1,131	22.90
196	Olympia, WA	207,355	10	1,519	22.84
197	Erie, PA	280,843	3	2,610	22.84
198	Kokomo, IN	101,541	5	1,078	22.82
199	Decatur, AL	145,867	4	1,113	22.73
200	Jackson, MI	158,422	5	2,085	22.64
201	Bakersfield, CA	661,645	9	2,590	22.59
202	Sacramento, CA	1,628,197	9	14,053	22.34
203	Pocatello, ID	75,565	10	412	22.33
204	Dutchess County, NY	280,150	2	1,873	22.32
205	Tucson, AZ	843,746	9	6,524	22.30
206	Huntington-Ashland, WV-KY-OH	315,538	3	2,824	22.20
207	Nashua, NH	190,949	1	1,665	22.16
208	Chicago, IL	8,272,768	5	76,530	22.05
209	Myrtle Beach, SC	196,629	4	1,722	21.89
210	Fort Pierce-Port St. Lucie, FL	319,426	4	2,211	21.85
211	Rockford, IL	371,236	5	3,695	21.60
212	Redding, CA	163,256	9	1,117	21.58

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
213	Salt Lake City-Ogden, UT	1,333,914	8	14,561	21.57
214	Denver, CO	2,109,282	8	32,316	21.54
215	Huntsville, AL	342,376	4	2,138	21.52
216	Reading, PA	373,638	3	2,504	21.49
217	Colorado Springs, CO	516,929	8	5,321	21.48
218	Salinas, CA	401,762	9	3,466	21.47
219	Los Angeles-Long Beach, CA	9,519,338	9	58,756	21.41
220	Kalamazoo-Battle Creek, MI	452,851	5	4,901	21.30
221	Vallejo-Fairfield-Napa, CA	518,821	9	6,938	21.26
222	San Diego, CA	2,813,833	9	27,712	21.25
223	Elkhart-Goshen, IN	182,791	5	1,756	21.24
224	Richland-Kennewick-Pasco, WA	191,822	10	883	21.18
225	Greeley, CO	180,936	8	2,367	21.08
226	Lawrence, MA-NH	396,230	1	4,165	20.98
227	Lansing-East Lansing, MI	447,728	5	5,346	20.95
228	Charlottesville, VA	159,576	3	789	20.91
229	Williamsport, PA	120,044	3	933	20.90
230	Washington, DC-MD-VA-WV	4,923,153	3	32,067	20.88
231	Yolo, CA	168,660	9	873	20.85
232	Waterloo-Cedar Falls, IA	128,012	7	1,267	20.84
233	Boise City, ID	432,345	10	3,062	20.80
234	Houma, LA	194,477	6	1,682	20.75
235	Oakland, CA	2,392,557	9	32,139	20.67
236	Lafayette, LA	385,647	6	3,373	20.31
237	Flagstaff, AZ-UT	122,366	9	788	20.30
238	Barnstable-Yarmouth, MA	162,582	1	2,325	20.30
239	Boston, MA-NH	3,406,829	1	29,290	20.26
240	Panama City, FL	148,217	4	1,195	20.08
241	Johnson City-Kingsport-Bristol, TN-VA	480,091	4	4,289	20.07
242	Chico-Paradise, CA	203,171	9	1,342	19.90
243	Seattle-Bellevue-Everett, WA	2,414,616	10	22,516	19.85
244	Fort Walton Beach, FL	170,498	4	1,044	19.83
245	Davenport-Moline-Rock Island, IA-IL	359,062	5	3,935	19.77
246	Louisville, KY-IN	1,025,598	4	13,878	19.74
247	Casper, WY	66,533	8	512	19.73
248	Las Cruces, NM	174,682	6	988	19.53
249	Athens, GA	153,444	4	1,090	19.45
250	State College, PA	135,758	3	840	19.40
251	Milwaukee-Waukesha, WI	1,500,741	5	12,595	19.33
252	Santa Fe, NM	147,635	6	1,497	19.24
253	Portland, ME	243,537	1	1,902	19.19
254	Alexandria, LA	126,337	6	1,106	19.08
255	Racine, WI	188,831	5	1,893	19.07

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
256	Harrisburg-Lebanon-Carlisle, PA	629,401	3	5,427	18.85
257	Lafayette, IN	182,821	5	1,238	18.82
258	Cumberland, MD-WV	102,008	3	841	18.79
259	Bryan-College Station, TX	152,415	6	363	18.73
260	York, PA	381,751	3	3,174	18.65
261	Florence, AL	142,950	4	1,182	18.53
262	Sioux City, IA-NE	124,130	7	1,160	18.45
263	Fort Wayne, IN	502,141	5	6,216	18.32
264	Honolulu, HI	876,156	9	2,590	18.30
265	Allentown-Bethlehem-Easton, PA	637,958	3	5,022	18.30
266	Bellingham, WA	166,814	10	1,175	18.13
267	Lewiston-Auburn, ME	90,830	1	596	18.12
268	Reno, NV	339,486	9	2,192	18.11
269	Portsmouth-Rochester, NH-ME	240,698	1	2,001	17.99
270	Minneapolis-St. Paul, MN-WI	2,968,806	5	38,141	17.94
271	Grand Junction, CO	116,255	8	1,558	17.91
272	Lexington, KY	479,198	4	4,693	17.56
273	Cheyenne, WY	81,607	8	767	17.47
274	San Luis Obispo-Atascadero-Paso Robles, CA	246,681	9	2,252	17.45
275	Danbury, CT	217,980	1	1,763	17.36
276	Peoria-Pekin, IL	347,387	5	3,601	17.19
277	Ventura, CA	753,197	9	8,305	17.17
278	Corvallis, OR	78,153	10	350	17.14
279	Orange County, CA	2,846,289	9	25,437	17.11
280	Lancaster, PA	470,658	3	2,973	17.09
281	Lincoln, NE	250,291	7	2,183	17.09
282	Fayetteville-Springdale-Rogers, AR	311,121	6	2,814	17.06
283	Dothan, AL	137,916	4	992	16.94
284	Provo-Orem, UT	368,536	8	3,500	16.69
285	Kenosha, WI	149,577	5	1,590	16.67
286	Lawrence, KS	99,962	7	780	16.67
287	Great Falls, MT	80,357	8	646	16.56
288	Santa Rosa, CA	458,614	9	6,219	16.51
289	Bangor, ME	90,864	1	649	16.33
290	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	13,479	16.32
291	Joplin, MO	157,322	7	1,388	16.07
292	Saginaw-Bay City-Midland, MI	403,070	5	5,320	15.85
293	Billings, MT	129,352	8	934	15.85
294	Bloomington, IN	120,563	5	865	15.84
295	San Jose, CA	1,682,585	9	19,998	15.45
296	Santa Cruz-Watsonville, CA	255,602	9	2,833	15.43
297	Rapid City, SD	88,565	8	669	15.40
298	Anchorage, AK	260,283	10	865	15.03

Table 2 - Ranking by Overall Percentage of Subprime Refinance Loans

(331 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			1,763,483	25.31
299	Springfield, MO	325,721	7	3,080	14.77
300	Owensboro, KY	91,545	4	982	14.66
301	Ann Arbor, MI	578,736	5	7,526	14.40
302	Champaign-Urbana, IL	179,669	5	951	14.20
303	San Francisco, CA	1,731,183	9	16,407	14.10
304	Stamford-Norwalk, CT	353,556	1	2,984	13.40
305	Rochester, MN	124,277	5	1,208	13.33
306	Cedar Rapids, IA	191,701	7	1,862	13.32
307	Fort Collins-Loveland, CO	251,494	8	3,072	13.25
308	Pittsfield, MA	84,699	1	531	13.18
309	Burlington, VT	169,391	1	1,141	12.88
310	Grand Forks, ND-MN	97,478	8	469	12.79
311	Columbia, MO	135,454	7	1,112	12.77
	½ the National Norm of 25.31 = 12.66%				
312	Bloomington-Normal, IL	150,433	5	1,218	12.56
313	Santa Barbara-Santa Maria-Lompoc, CA	399,347	9	3,184	12.53
314	Duluth-Superior, MN-WI	243,815	5	3,166	12.41
315	Janesville-Beloit, WI	152,307	5	2,124	12.10
316	Boulder-Longmont, CO	291,288	8	3,314	12.04
317	St. Cloud, MN	167,392	5	1,462	11.22
318	Springfield, IL	201,437	5	2,067	11.08
319	Jonesboro, AR	82,148	6	722	10.80
320	Bismarck, ND	94,719	8	619	10.50
321	Missoula County, MT	95,802	8	751	10.12
322	Sheboygan, WI	112,646	5	1,220	10.00
323	Fargo-Moorhead, ND-MN	174,367	8	1,101	9.99
324	Eau Claire, WI	148,337	5	1,452	8.26
325	Sioux Falls, SD	172,412	8	1,598	7.95
326	Wausau, WI	125,834	5	1,418	7.69
327	Madison, WI	426,526	5	3,665	7.37
328	Appleton-Oshkosh-Neenah, WI	358,365	5	4,836	6.82
329	Green Bay, WI	226,778	5	3,471	5.56
330	La Crosse, WI-MN	126,838	5	1,257	5.49
331	Iowa City, IA	111,006	7	705	5.25

The highest overall percentage of subprime loans, 47.82%, is found in El Paso. The lowest level is in Iowa City (5.25%). Seventeen MSAs had subprime lending levels greater than 38%, more than 1.5 times the national norm. High levels of subprime lending can be found in MSAs of all sizes. Enid, Oklahoma, the smallest MSA, is ranked 12th highest in subprime lending (40.75%). Miami, Florida, with a population of 2.25 million, ranks # 6, and New York, with a population well over 9 million, ranks #25.

There is some concentration by region, however. Of the 17 MSAs with subprime percentages more than 1.5 times the national urban norm, 14 are from the Southeast or Southwest regions. Seven of these are from Texas alone. Therefore, we see reflections of the concentration of high levels of subprime lending in the southern parts of the country.

B. Rankings by the Subprime Measures for the Race and Ethnicity of the Borrowers

Table #2, above, ranks metropolitan areas based on the overall level of subprime lending. This measure provides us with a sense of the extent to which borrowers in those MSAs are subject to the terms and conditions of subprime lending. We see in Table #2 that these percentages vary considerably from one urban area to another – from a low of 5.25% to a high of 47.82%.

The next set of tables ranks metropolitan areas based on various racial disparity ratios. These are the percentage of conventional subprime refinance loans for particular racial or ethnic groups divided by the percentage of subprime loans for the comparable white group. These disparity ratios divide the percentage of subprime loans for the minority group by the percentage of subprime loans for the white group. This is a powerful measure, which helps to account for the variations in subprime lending from one local urban area to another.

As we rank MSAs by both the basic percentage of subprime loans for a minority group and the disparity ratio, individual MSAs may fall in quite different places in these rankings. For example, a metropolitan area may have a high level of subprime lending for Hispanics, say 40%. This may place the MSA near the top of the rankings for subprime loans to Hispanics. If the overall level of subprime lending in this MSA is also high, then 35% of the loans to whites may also be subprime. This would produce a relatively low disparity ratio of 1.14. If, on the other hand, the overall level of subprime lending in the MSA is relatively low, say 15%, and the vast majority of borrowers are white, the level of subprime lending to whites might be even lower - say 10%. This would place the MSA far down on rankings for overall subprime lending. Yet, the disparity ratio for Hispanics would be 4.0, extremely high. In another MSA, the percentage of subprime loans to Hispanics might be only 20%, well below the national norm. Yet, if the level of subprime lending to whites is only 5%, then the disparity ratio would still be 4.0. Thus, to get a clear picture of the subprime market, it is necessary to look at the overall levels of subprime lending in each MSA, as well as the percentages for specific racial and ethnic groups and the disparity ratios.

The key issue is to understand the concepts involved. High percentages of subprime lending overall, or for any racial or ethnic group, may be a concern in itself. Disparity ratios tell us whether there is a racial dimension to the subprime lending patterns.

The remainder of this section is divided into two parts. The first ranks individual MSA by the percentage of subprime loans to each racial or ethnic group of borrowers. The second section ranks individual MSA by the racial disparity ratios for each minority group.

1. Subprime Lending Levels by the Race and Ethnicity of the Borrower

For the urban lending markets as a whole, 25.31% of the conventional refinance loans in 2000 are estimated to be subprime loans. For whites, this national urban total is 17.42%. In 27 MSAs, the level of subprime lending to whites was above the national norm of 25.31. The highest level of subprime lending to whites was in Enid, Oklahoma, where 37.97% of the conventional refinance loans made to white borrowers were subprime.[13]

The levels of subprime lending are substantially higher for both African-Americans and Hispanics. Table #3 ranks MSAs by the percentage of subprime refinance loans to African-American borrowers. The total national urban percentage of subprime loans to African-Americans is just under 50% (49.28%). The highest percentage of subprime loans for African-Americans is in the Buffalo MSA (74.53%) and the lowest percentage is in the San Jose MSA (27.04%). For all 154 MSAs ranked, the percentage of subprime loans to African-Americans is above the national norm for all borrowers (25.31%).

Table 3 - Ranking by the Percentage of Subprime Refinance Loans for African-Americans

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			132,196	49.28
1	Buffalo-Niagara Falls, NY	1,170,111	2	322	74.53
2	Kankakee, IL	103,833	5	104	74.04
3	Chattanooga, TN-GA	465,161	4	324	68.21
4	Sarasota-Bradenton, FL	589,959	4	123	67.48
5	Houston, TX	4,177,646	6	1,776	64.41
6	San Antonio, TX	1,592,383	6	206	64.08
7	Evansville-Henderson, IN-KY	296,195	5	103	64.08
8	Lakeland-Winter Haven, FL	483,924	4	251	63.75
9	Austin-San Marcos, TX	1,249,763	6	261	63.22
10	Mobile, AL	540,258	4	778	62.08
11	Memphis, TN-AR-MS	1,135,614	4	2,215	61.76
12	Kansas City, MO-KS	1,776,062	7	1,632	61.70
13	Dallas, TX	3,519,176	6	1,164	61.68
14	Pensacola, FL	412,153	4	278	61.15
15	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	1,196	60.95
16	Beaumont-Port Arthur, TX	385,090	6	182	60.44
17	Oklahoma City, OK	1,083,346	6	650	60.31
18	Columbus, GA-AL	274,624	4	390	60.26
19	Omaha, NE-IA	716,998	7	313	60.06

[13] The data for all the rankings for white subprime loans is in the Detailed Table of Subprime Lending for All MSAs.

Table 3 - Ranking by the Percentage of Subprime Refinance Loans for African-Americans

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			132,196	49.28
20	Springfield, MA	591,932	1	121	59.50
21	Miami, FL	2,253,362	4	1,819	59.26
22	Daytona Beach, FL	493,175	4	206	59.22
23	Tallahassee, FL	284,539	4	319	58.93
24	Philadelphia, PA-NJ	5,100,931	3	2,853	58.92
25	Columbia, SC	536,691	4	808	58.66
26	Pittsburgh, PA	2,358,695	3	814	58.48
27	Goldsboro, NC	113,329	4	167	57.49
28	Providence-Fall River-Warwick, RI-MA	1,188,613	1	117	57.26
29	Macon, GA	322,549	4	553	56.96
30	Charleston-North Charleston, SC	549,033	4	707	56.86
31	Jacksonville, FL	1,100,491	4	1,057	56.76
32	Orlando, FL	1,644,561	4	752	56.25
33	Florence, SC	125,761	4	202	55.94
34	Cleveland-Lorain-Elyria, OH	2,250,871	5	2,997	55.49
35	Melbourne-Titusville-Palm Bay, FL	476,230	4	146	55.48
36	Jersey City, NJ	608,975	2	161	55.28
37	Wichita, KS	545,220	7	105	55.24
38	Youngstown-Warren, OH	594,746	5	290	54.83
39	Nassau-Suffolk, NY	2,753,913	2	1,056	54.64
40	Rocky Mount, NC	143,026	4	194	54.64
41	Fort Myers-Cape Coral, FL	440,888	4	119	54.62
42	Gainesville, FL	217,955	4	134	54.48
43	Canton-Massillon, OH	406,934	5	246	54.47
44	Birmingham, AL	921,106	4	1,178	54.33
45	New Haven-Meriden, CT	542,149	1	186	54.30
46	Dothan, AL	137,916	4	106	53.77
47	Fayetteville, NC	302,963	4	404	53.71
48	Huntsville, AL	342,376	4	302	53.64
49	Jackson, MS	440,801	4	609	53.37
50	West Palm Beach-Boca Raton, FL	1,131,184	4	476	53.36
51	Wilmington-Newark, DE-MD	586,216	3	362	53.31
52	Montgomery, AL	333,055	4	410	52.93
53	Danville, VA	110,156	3	157	52.87
54	Tuscaloosa, AL	164,875	4	227	52.86
55	Savannah, GA	293,000	4	343	52.77
56	Richmond-Petersburg, VA	996,512	3	1,081	52.54
57	Dayton-Springfield, OH	950,558	5	1,078	52.13
58	New Orleans, LA	1,337,726	6	2,014	52.04
59	New York, NY	9,314,235	2	3,192	51.91
60	Minneapolis-St. Paul, MN-WI	2,968,806	5	1,032	51.65
61	St. Louis, MO-IL	2,603,607	7	3,552	51.55
62	Gary, IN	631,362	5	766	51.44

Table 3 - Ranking by the Percentage of Subprime Refinance Loans for African-Americans

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			132,196	49.28
63	Lynchburg, VA	214,911	3	183	51.37
64	Toledo, OH	618,203	5	671	51.27
65	Detroit, MI	4,441,551	5	11,217	51.17
66	Fort Worth-Arlington, TX	1,702,625	6	375	50.93
67	Jackson, TN	107,377	4	163	50.92
68	Hickory-Morganton-Lenoir, NC	341,851	4	181	50.83
69	Akron, OH	694,960	5	632	50.79
70	Hattiesburg, MS	111,674	4	132	50.76
71	Chicago, IL	8,272,768	5	10,418	50.55
72	Nashville, TN	1,231,311	4	1,103	50.23
	Subtotal for the 72 MSAs with percentages over 50% (represents 59.40% of all African-American subprime loans)				54.68
73	South Bend, IN	265,559	5	170	50.00
74	Hartford, CT	1,183,110	1	255	49.41
75	Rockford, IL	371,236	5	166	49.40
76	Newark, NJ	2,032,989	2	1,177	49.19
77	Greenville, NC	133,798	4	120	49.17
78	Fort Lauderdale, FL	1,623,018	4	1,249	48.68
79	Bridgeport, CT	459,479	1	185	48.65
80	Columbus, OH	1,540,157	5	1,225	48.33
81	Greensboro--Winston-Salem--High Point, NC	1,251,509	4	1,205	48.22
82	Fresno, CA	922,516	9	112	48.21
83	Colorado Springs, CO	516,929	8	190	47.89
84	Phoenix-Mesa, AZ	3,251,876	9	700	47.86
85	Raleigh-Durham-Chapel Hill, NC	1,187,941	4	1,273	47.84
86	Sumter, SC	104,646	4	211	47.39
87	Charlotte-Gastonia-Rock Hill, NC-SC	1,499,293	4	1,335	47.34
88	Racine, WI	188,831	5	112	47.32
89	Monmouth-Ocean, NJ	1,126,217	2	244	47.13
90	Ocala, FL	258,916	4	137	46.72
91	Benton Harbor, MI	162,453	5	178	46.63
92	Las Vegas, NV-AZ	1,563,282	9	505	46.53
93	Greenville-Spartanburg-Anderson, SC	962,441	4	895	46.26
94	Biloxi-Gulfport-Pascagoula, MS	363,988	4	400	46.25
95	Indianapolis, IN	1,607,486	5	1,602	46.13
96	Kalamazoo-Battle Creek, MI	452,851	5	248	45.97
97	Milwaukee-Waukesha, WI	1,500,741	5	1,034	45.84
98	Baton Rouge, LA	602,894	6	1,003	45.76
99	Atlanta, GA	4,112,198	4	5,603	45.73
100	Baltimore, MD	2,552,994	3	2,158	45.41
101	Portland-Vancouver, OR-WA	1,918,009	10	291	45.36
102	Rochester, NY	1,098,201	2	183	45.36
103	Little Rock-North Little Rock, AR	583,845	6	462	45.24

Table 3 - Ranking by the Percentage of Subprime Refinance Loans for African-Americans

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			132,196	49.28
104	Trenton, NJ	350,761	2	191	45.03
105	Denver, CO	2,109,282	8	1,398	44.92
106	Fort Wayne, IN	502,141	5	318	44.65
107	Sacramento, CA	1,628,197	9	446	44.62
108	Bergen-Passaic, NJ	1,373,167	2	349	44.41
109	Riverside-San Bernardino, CA	3,254,821	9	876	44.41
110	Wilmington, NC	233,450	4	237	44.30
111	Albany, GA	120,822	4	181	44.20
112	Myrtle Beach, SC	196,629	4	118	44.07
113	Albuquerque, NM	712,738	6	100	44.00
114	Monroe, LA	147,250	6	166	43.98
115	Tucson, AZ	843,746	9	121	43.80
116	Cincinnati, OH-KY-IN	1,646,395	5	1,469	43.64
117	Harrisburg-Lebanon-Carlisle, PA	629,401	3	172	43.60
118	Lake Charles, LA	183,577	6	230	43.48
119	Atlantic-Cape May, NJ	354,878	2	145	43.45
120	Roanoke, VA	235,932	3	150	43.33
121	Augusta-Aiken, GA-SC	477,441	4	538	43.31
122	Norfolk-Virginia Beach-Newport News, VA-NC	1,569,541	3	1,223	43.25
123	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	579	43.01
124	Boston, MA-NH	3,406,829	1	1,032	42.93
125	Lexington, KY	479,198	4	240	42.92
126	Shreveport-Bossier City, LA	392,302	6	384	42.19
127	Flint, MI	436,141	5	752	42.15
128	Knoxville, TN	687,249	4	209	42.11
129	Oakland, CA	2,392,557	9	2,792	41.58
130	Stockton-Lodi, CA	563,598	9	195	41.54
131	Tulsa, OK	803,235	6	324	41.36
132	Los Angeles-Long Beach, CA	9,519,338	9	4,722	41.30
133	Ventura, CA	753,197	9	107	41.12
134	Peoria-Pekin, IL	347,387	5	147	40.14
135	Seattle-Bellevue-Everett, WA	2,414,616	10	725	40.00
136	Fort Pierce-Port St. Lucie, FL	319,426	4	121	38.84
137	Louisville, KY-IN	1,025,598	4	1,058	38.47
138	Davenport-Moline-Rock Island, IA-IL	359,062	5	104	38.46
139	Vallejo-Fairfield-Napa, CA	518,821	9	448	38.39
140	Lansing-East Lansing, MI	447,728	5	233	38.20
141	Ann Arbor, MI	578,736	5	298	37.92
142	Tacoma, WA	700,820	10	235	37.87
143	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	333	37.24
144	Washington, DC-MD-VA-WV	4,923,153	3	4,778	36.79
145	Athens, GA	153,444	4	120	36.67
146	San Francisco, CA	1,731,183	9	576	36.63

Table 3 - Ranking by the Percentage of Subprime Refinance Loans for African-Americans

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			132,196	49.28
147	Hamilton-Middletown, OH	332,807	5	135	36.30
148	San Diego, CA	2,813,833	9	712	36.24
149	Alexandria, LA	126,337	6	186	36.02
150	Orange County, CA	2,846,289	9	273	33.70
151	Lafayette, LA	385,647	6	633	29.86
152	Saginaw-Bay City-Midland, MI	403,070	5	345	29.86
153	Stamford-Norwalk, CT	353,556	1	121	28.93
154	San Jose, CA	1,682,585	9	466	27.04

High levels of subprime lending for African-Americans exist across MSAs of all sizes. Number one-ranked Buffalo has a population of 1,170,111. The Kankakee, Illinois MSA (74.04%), which has a population of just under 104,000, ranks second. The Houston MSA ranks 5th (64.41%), with a population over 4 million.

High levels of subprime lending to African-Americans exist in MSAs in many regions, though there many of the MSAs with the very highest rankings are found in the South. Of the 10 top-ranked MSAs, 7 are in the Southeast or Southwest region, and 3 are in Texas alone.

There are 72 MSAs where more than 50% of the refinance loans to African-Americans are estimated to be subprime: essentially 2 or more times the national norm for all borrowers. These 72 MSAs account for 59.40% of all the subprime loans to African-Americans. The total percentage of subprime loans for African-Americans for these 72 MSAs combined is 54.68%.

Table #4 provides comparable rankings for the percentage of subprime loans to Hispanic borrowers. Subprime lending levels are generally much lower for Hispanics than for African-Americans. El Paso ranks highest in the percentage of subprime loans for Hispanics (52.36%) and San Antonio, at 51.46%, is also above the 50% level. Boulder, Colorado ranks lowest, at 17.12%. Actually, 23 of these 99 MSAs have subprime lending levels for Hispanics that are below the national norm of 25.31%. Also, 2 MSAs (Santa Cruz-Watsonville, California, and Boulder-Longmont, Colorado) have Hispanic subprime lending levels about equal to or below the national norm of 17.42% for whites.

Table 4 - Ranking by the Percentage of Subprime Refinance Loans for Hispanics

(99 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			91,295	30.33
1	El Paso, TX	679,622	6	976	52.36
2	San Antonio, TX	1,592,383	6	1,745	51.46
3	Corpus Christi, TX	380,783	6	388	47.42
4	Providence-Fall River-Warwick, RI-MA	1,188,613	1	134	44.03
5	Fresno, CA	922,516	9	875	44.00
6	Austin-San Marcos, TX	1,249,763	6	625	42.40
7	Phoenix-Mesa, AZ	3,251,876	9	4,051	40.36
8	Visalia-Tulare-Porterville, CA	368,021	9	360	40.00
9	Fort Myers-Cape Coral, FL	440,888	4	140	40.00
10	Daytona Beach, FL	493,175	4	119	39.50
11	Kansas City, MO-KS	1,776,062	7	279	39.07
12	Naples, FL	251,377	4	130	38.46
13	Philadelphia, PA-NJ	5,100,931	3	475	38.11
14	Laredo, TX	193,117	6	249	37.75
15	Jacksonville, FL	1,100,491	4	104	37.50
16	Omaha, NE-IA	716,998	7	161	37.27
17	Orlando, FL	1,644,561	4	940	37.23
18	Merced, CA	210,554	9	252	36.90
19	Hartford, CT	1,183,110	1	121	36.36
20	Cleveland-Lorain-Elyria, OH	2,250,871	5	369	36.04
21	Lakeland-Winter Haven, FL	483,924	4	156	35.90
22	Houston, TX	4,177,646	6	2,285	35.75
23	Lawrence, MA-NH	396,230	1	181	35.36
24	New York, NY	9,314,235	2	1,236	35.11
25	Miami, FL	2,253,362	4	4,484	34.95
26	McAllen-Edinburg-Mission, TX	569,463	6	936	34.94
27	Indianapolis, IN	1,607,486	5	112	34.82
28	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	910	34.51
29	Salem, OR	347,214	10	131	34.35
30	Lansing-East Lansing, MI	447,728	5	102	34.31
31	Denver, CO	2,109,282	8	3,321	34.18
32	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	223	34.08
33	Riverside-San Bernardino, CA	3,254,821	9	3,295	33.14
34	Monmouth-Ocean, NJ	1,126,217	2	148	33.11
35	Tucson, AZ	843,746	9	1,382	32.92
36	Nassau-Suffolk, NY	2,753,913	2	673	32.54
37	Fort Lauderdale, FL	1,623,018	4	913	31.98
38	Brownsville-Harlingen-San Benito, TX	335,227	6	485	31.96
39	Albuquerque, NM	712,738	6	2,114	31.84
40	Yakima, WA	222,581	10	296	31.76
41	Greeley, CO	180,936	8	287	31.71
42	Sacramento, CA	1,628,197	9	766	31.46
43	Las Vegas, NV-AZ	1,563,282	9	764	30.76

Table 4 - Ranking by the Percentage of Subprime Refinance Loans for Hispanics

(99 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			91,295	30.33
44	Dallas, TX	3,519,176	6	1,197	30.66
45	Fort Worth-Arlington, TX	1,702,625	6	491	30.14
46	Boston, MA-NH	3,406,829	1	509	29.67
47	West Palm Beach-Boca Raton, FL	1,131,184	4	351	29.63
48	San Diego, CA	2,813,833	9	2,795	29.59
49	Salinas, CA	401,762	9	725	29.52
50	Yuma, AZ	160,026	9	312	29.49
51	Pueblo, CO	141,472	8	575	29.39
52	Vallejo-Fairfield-Napa, CA	518,821	9	499	29.26
53	Gary, IN	631,362	5	318	29.25
54	New Orleans, LA	1,337,726	6	231	29.00
55	Detroit, MI	4,441,551	5	570	28.95
56	Toledo, OH	618,203	5	148	28.38
57	Jersey City, NJ	608,975	2	289	28.37
58	Portland-Vancouver, OR-WA	1,918,009	10	275	28.36
59	Bridgeport, CT	459,479	1	124	28.23
60	Stockton-Lodi, CA	563,598	9	584	28.08
61	Baltimore, MD	2,552,994	3	119	27.73
62	Seattle-Bellevue-Everett, WA	2,414,616	10	344	27.62
63	Salt Lake City-Ogden, UT	1,333,914	8	692	27.60
64	Bakersfield, CA	661,645	9	473	27.48
65	San Jose, CA	1,682,585	9	2,788	27.47
66	Oklahoma City, OK	1,083,346	6	153	27.45
67	Colorado Springs, CO	516,929	8	282	27.30
68	Bergen-Passaic, NJ	1,373,167	2	539	27.27
69	Tacoma, WA	700,820	10	107	27.10
70	Modesto, CA	446,997	9	448	27.01
71	Provo-Orem, UT	368,536	8	103	26.21
72	Boise City, ID	432,345	10	123	26.02
73	Oakland, CA	2,392,557	9	2,805	25.99
74	Fort Collins-Loveland, CO	251,494	8	116	25.86
75	Newark, NJ	2,032,989	2	460	25.65
76	Los Angeles-Long Beach, CA	9,519,338	9	10,716	25.42
77	Yolo, CA	168,660	9	101	24.75
78	Orange County, CA	2,846,289	9	2,513	24.67
79	Odessa-Midland, TX	237,132	6	132	24.24
80	Santa Fe, NM	147,635	6	477	23.69
81	St. Louis, MO-IL	2,603,607	7	132	23.48
82	Atlanta, GA	4,112,198	4	371	23.45
83	Ventura, CA	753,197	9	1,071	23.06
84	Santa Rosa, CA	458,614	9	350	22.57
85	Chicago, IL	8,272,768	5	7,525	22.33
86	San Luis Obispo-Atascadero-Paso Robles, CA	246,681	9	130	22.31
87	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	340	21.18

Table 4 - Ranking by the Percentage of Subprime Refinance Loans for Hispanics

(99 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			91,295	30.33
88	Minneapolis-St. Paul, MN-WI	2,968,806	5	383	20.63
89	San Francisco, CA	1,731,183	9	1,364	20.60
90	Milwaukee-Waukesha, WI	1,500,741	5	288	20.49
91	Saginaw-Bay City-Midland, MI	403,070	5	157	20.38
92	Stamford-Norwalk, CT	353,556	1	103	19.42
93	Las Cruces, NM	174,682	6	403	19.35
94	Reno, NV	339,486	9	104	19.23
95	Rockford, IL	371,236	5	120	19.17
96	Washington, DC-MD-VA-WV	4,923,153	3	784	18.88
97	Santa Barbara-Santa Maria-Lompoc, CA	399,347	9	477	18.24
98	Santa Cruz-Watsonville, CA	255,602	9	321	17.76
99	Boulder-Longmont, CO	291,288	8	146	17.12

High levels of subprime lending to Hispanics can be found in cities of different sizes. El Paso, the top ranked MSA for Hispanic subprime refinance lending, has a population just under 680,000. Laredo, ranked 14th (37.75%), has a population under 200,000. Providence, Rhode Island is ranked #3 in Hispanic subprime lending and has a population of 1.18 million. Philadelphia is the 4th largest MSA in the nation and ranks 13th highest in subprime lending to Hispanics (38.11%). At the low end, Los Angeles is the largest MSA, but ranks 76th in subprime lending to Hispanics (25.42%) at about the national norm for all borrowers. Chicago, the 3rd largest MSA ranks 85th (22.33%) at a rate below the national norm.

Once again, a number of Southern cities are high in the rankings. Of the top 10 MSAs for subprime lending to Hispanics, 2 are in the Southeast and 4 are in the Southwest regions. All of Southwestern MSAs are in Texas.

For the nation's urban areas as a whole, the percentage of conventional subprime refinance loans to Asians is 16.22%, lower than the comparable percentage for whites. The percentage of subprime loans to Asians is below 30% for all MSAs ranked. There are only 4 MSAs where the percentage of subprime loans to Asians was above the national urban norm. These MSAs are Stockton-Lodi, California (29.75%), Salinas, California (27.78%), Vallejo-Fairfield-Napa, California (26.47%), and Fort Lauderdale, Florida (26.00%).[14]

Table 5 ranks MSAs by the level of subprime refinance loans made to Native Americans. Two MSAs, Phoenix (35.17%), and Atlanta (30.00) have subprime percentages at or above 30%. Nine of the 16 MSAs have subprime levels above the national norm of 25.31% for all borrowers. Of these 9 MSAs, Atlanta, Washington, Chicago, and Detroit are metropolitan areas in which lending to Native Americans has not been the focus of much research. These 4 MSAs actually

[14] The data for these 43 MSAs are in the Detailed Table of Subprime Lending for All MSAs.

account for 10.65% of all conventional refinance loans to Native Americans and 10.56% of all the estimated subprime refinance loans to Native Americans. Collectively, 27.71% of the conventional refinance loans to Native Americans in these 4 metropolitan areas are estimated to be subprime, about at the national urban norm of 27.94% for Native Americans.

Seven of the 10 HUD regions contain MSAs with levels of subprime lending to Native Americans above the national norm for all borrowers, consistent with the other patterns we have highlighted. The pattern for the size of MSAs is quite different. All but one of the 16 of the MSAs with more than 100 conventional refinance loans to Native Americans have populations of over 1 million people.

The review of the basic percentage of conventional refinance loans that are subprime shows that the raw percentages of subprime loans are highest for African-Americans and lowest for Asians. Indeed, Asians often have subprime lending levels lower than those for whites. For African-Americans and Hispanics, high levels of subprime lending relative to the norm for each of these groups occur in MSAs of many different size ranges. For these two groups, however, the highest levels of subprime lending occur more often in areas in the Southeast and Southwest regions of the country, and especially in Texas. For Native Americans all but one of the MSAs ranked are large MSAs, with populations of over 1 million people. These MSAs cut across many regions of the nation.

Table 5 - Ranking by the Percentage of Subprime Refinance Loans for Native Americans

(16 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total (All 331 MSAs Combined)			6,843	27.94
1	Phoenix-Mesa, AZ	3,251,876	9	145	35.17
2	Atlanta, GA	4,112,198	4	100	30.00
3	Washington, DC-MD-VA-WV	4,923,153	3	102	29.41
4	Oklahoma City, OK	1,083,346	6	120	27.50
5	Chicago, IL	8,272,768	5	289	27.34
6	Riverside-San Bernardino, CA	3,254,821	9	124	26.61
7	Detroit, MI	4,441,551	5	238	26.47
8	Los Angeles-Long Beach, CA	9,519,338	9	199	26.13
9	Seattle-Bellevue-Everett, WA	2,414,616	10	120	25.83
10	Minneapolis-St. Paul, MN-WI	2,968,806	5	141	24.82
11	Oakland, CA	2,392,557	9	147	24.49
12	Philadelphia, PA-NJ	5,100,931	3	114	21.05
13	Denver, CO	2,109,282	8	146	20.55
14	Tulsa, OK	803,235	6	178	19.66
15	San Diego, CA	2,813,833	9	108	15.74
16	Orange County, CA	2,846,289	9	140	10.71

2. Disparity Ratios by the Race and Ethnicity of the Borrower

The clearest evidence of racial differences in subprime lending in the urban refinance markets is found in the disparity ratios, comparing minority group borrowers to white borrowers. We begin directly with reviews of the patterns for individual racial and ethnic groups of borrowers.

Table #6 ranks MSAs by disparity ratios for African-Americans. The table also provides data for the MSA population, the region, the number of conventional refinance loans to African-Americans, and the percentage of conventional refinance loans to African-Americans that are subprime.

The 154 MSAs that are ranked, all of which show racial disparities, account for 96.22% of all conventional refinance loans to African-Americans and 96.75% of all estimated subprime loans to African-Americans. The overall national disparity ratio for African-Americans is 2.83. The highest disparity ratio is 6.10, for Kankakee, Illinois. This means that African-Americans in that city are more than 6 times as likely as whites to receive subprime loans. Two MSAs have disparity ratios over 5.0 - Albany, Georgia (5.69%) and Dothan, Alabama (5.23%). No MSA has a disparity ratio below 1.64. Thus, in the MSA with the lowest disparity ratio (Hamilton-Middletown, Ohio), African-Americans are 1.6 times more likely than whites to have a subprime loan.

Forty-six MSAs have disparity ratios over 3.0. These 46 MSAs represent 39.84% of all conventional refinance loans to African-Americans and 41.13% of all subprime refinance loans to African-Americans. The overall disparity ratio for these 46 MSAs is 3.56. The combined percentage of subprime loans to African-Americans for these 46 MSAs is 50.87% - over half.

Altogether, 142 MSAs have disparity ratios above 2.0. This represents 92.56% of all conventional refinance loans to African-Americans and 93.45% of all subprime loans to African-Americans. The overall disparity ratio for these 142 MSAs is 2.85. The combined percentage of subprime refinance loans to African-Americans for these 142 MSAs is 49.75%.

Generally, extremely high disparity ratios are related to high levels of subprime lending to African Americans. But this is not always the case. The Ann Arbor, Michigan MSA, for example, has a disparity ratio of 3.83. Here the percentage of subprime loans to African Americans is 37.92%, well below the national norm of 49.28% for African Americans. This is the result of the low level of subprime lending to whites: 9.89%, which is well below the national norm for whites.

Table 6 - Ranking by the Disparity in the Percentage of Subprime Lending for African-Americans Compared to Whites

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			132,196	49.28	2.83
1	Kankakee, IL	103,833	5	104	74.04	6.10
2	Albany, GA	120,822	4	181	44.20	5.69
3	Dothan, AL	137,916	4	106	53.77	5.23
4	Montgomery, AL	333,055	4	410	52.93	4.58
5	Monroe, LA	147,250	6	166	43.98	4.37
6	Milwaukee-Waukesha, WI	1,500,741	5	1,034	45.84	4.31
7	Jackson, MS	440,801	4	609	53.37	4.27
8	San Francisco, CA	1,731,183	9	576	36.63	4.12
9	Jackson, TN	107,377	4	163	50.92	4.09
10	Raleigh-Durham-Chapel Hill, NC	1,187,941	4	1,273	47.84	4.03
11	Tuscaloosa, AL	164,875	4	227	52.86	3.88
12	Racine, WI	188,831	5	112	47.32	3.88
13	Huntsville, AL	342,376	4	302	53.64	3.88
14	Chicago, IL	8,272,768	5	10,418	50.55	3.84
15	Ann Arbor, MI	578,736	5	298	37.92	3.83
16	St. Louis, MO-IL	2,603,607	7	3,552	51.55	3.64
17	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	579	43.01	3.60
18	Harrisburg-Lebanon-Carlisle, PA	629,401	3	172	43.60	3.48
19	New Orleans, LA	1,337,726	6	2,014	52.04	3.44
20	Minneapolis-St. Paul, MN-WI	2,968,806	5	1,032	51.65	3.42
21	Philadelphia, PA-NJ	5,100,931	3	2,853	58.92	3.40
22	Hattiesburg, MS	111,674	4	132	50.76	3.38
23	Detroit, MI	4,441,551	5	11,217	51.17	3.37
24	Savannah, GA	293,000	4	343	52.77	3.37
25	Fort Wayne, IN	502,141	5	318	44.65	3.35
26	Alexandria, LA	126,337	6	186	36.02	3.32
27	Peoria-Pekin, IL	347,387	5	147	40.14	3.32
28	Sarasota-Bradenton, FL	589,959	4	123	67.48	3.30
29	Memphis, TN-AR-MS	1,135,614	4	2,215	61.76	3.28
30	Augusta-Aiken, GA-SC	477,441	4	538	43.31	3.26
31	Benton Harbor, MI	162,453	5	178	46.63	3.25
32	Omaha, NE-IA	716,998	7	313	60.06	3.23
33	Lexington, KY	479,198	4	240	42.92	3.21
34	Athens, GA	153,444	4	120	36.67	3.19
35	Gainesville, FL	217,955	4	134	54.48	3.18
36	Little Rock-North Little Rock, AR	583,845	6	462	45.24	3.12
37	Macon, GA	322,549	4	553	56.96	3.12
38	Shreveport-Bossier City, LA	392,302	6	384	42.19	3.09
39	Atlanta, GA	4,112,198	4	5,603	45.73	3.09
40	Goldsboro, NC	113,329	4	167	57.49	3.07
41	Tucson, AZ	843,746	9	121	43.80	3.07
42	Tallahassee, FL	284,539	4	319	58.93	3.06

Table 6 - Ranking by the Disparity in the Percentage of Subprime Lending for African-Americans Compared to Whites

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			132,196	49.28	2.83
43	Birmingham, AL	921,106	4	1,178	54.33	3.05
44	Youngstown-Warren, OH	594,746	5	290	54.83	3.04
45	Richmond-Petersburg, VA	996,512	3	1,081	52.54	3.04
46	Springfield, MA	591,932	1	121	59.50	3.02
	Subtotal for the 46 MSAs with disparity ratios above 3.0 (represents 39.84% of all African-American refinance loans and 41.13% of all subprime loans)				50.87	3.56
47	Kalamazoo-Battle Creek, MI	452,851	5	248	45.97	3.00
48	Austin-San Marcos, TX	1,249,763	6	261	63.22	2.99
49	Kansas City, MO-KS	1,776,062	7	1,632	61.70	2.99
50	Charleston-North Charleston, SC	549,033	4	707	56.86	2.98
51	Columbia, SC	536,691	4	808	58.66	2.96
52	Washington, DC-MD-VA-WV	4,923,153	3	4,778	36.79	2.95
53	Florence, SC	125,761	4	202	55.94	2.94
54	Stamford-Norwalk, CT	353,556	1	121	28.93	2.93
55	Saginaw-Bay City-Midland, MI	403,070	5	345	29.86	2.91
56	Baton Rouge, LA	602,894	6	1,003	45.76	2.91
57	Evansville-Henderson, IN-KY	296,195	5	103	64.08	2.89
58	Lake Charles, LA	183,577	6	230	43.48	2.89
59	Rockford, IL	371,236	5	166	49.40	2.88
60	Colorado Springs, CO	516,929	8	190	47.89	2.88
61	Wichita, KS	545,220	7	105	55.24	2.88
62	Hartford, CT	1,183,110	1	255	49.41	2.87
63	Mobile, AL	540,258	4	778	62.08	2.85
64	Dallas, TX	3,519,176	6	1,164	61.68	2.85
65	Pensacola, FL	412,153	4	278	61.15	2.85
66	Bridgeport, CT	459,479	1	185	48.65	2.82
67	Boston, MA-NH	3,406,829	1	1,032	42.93	2.81
68	Greenville, NC	133,798	4	120	49.17	2.80
69	Myrtle Beach, SC	196,629	4	118	44.07	2.79
70	Ventura, CA	753,197	9	107	41.12	2.79
71	Lafayette, LA	385,647	6	633	29.86	2.79
72	Providence-Fall River-Warwick, RI-MA	1,188,613	1	117	57.26	2.78
73	Toledo, OH	618,203	5	671	51.27	2.77
74	Trenton, NJ	350,761	2	191	45.03	2.73
75	Oakland, CA	2,392,557	9	2,792	41.58	2.70
76	Atlantic-Cape May, NJ	354,878	2	145	43.45	2.70
77	Louisville, KY-IN	1,025,598	4	1,058	38.47	2.69
78	Flint, MI	436,141	5	752	42.15	2.69
79	Fayetteville, NC	302,963	4	404	53.71	2.65
80	Charlotte-Gastonia-Rock Hill, NC-SC	1,499,293	4	1,335	47.34	2.63
81	Baltimore, MD	2,552,994	3	2,158	45.41	2.63
82	Wilmington, NC	233,450	4	237	44.30	2.62
83	Columbus, OH	1,540,157	5	1,225	48.33	2.61

Table 6 - Ranking by the Disparity in the Percentage of Subprime Lending for African-Americans Compared to Whites

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			132,196	49.28	2.83
84	Columbus, GA-AL	274,624	4	390	60.26	2.61
85	Chattanooga, TN-GA	465,161	4	324	68.21	2.61
86	Norfolk-Virginia Beach-Newport News, VA-NC	1,569,541	3	1,223	43.25	2.61
87	Fresno, CA	922,516	9	112	48.21	2.61
88	Denver, CO	2,109,282	8	1,398	44.92	2.60
89	Gary, IN	631,362	5	766	51.44	2.60
90	Fort Pierce-Port St. Lucie, FL	319,426	4	121	38.84	2.59
91	Pittsburgh, PA	2,358,695	3	814	58.48	2.58
92	Lynchburg, VA	214,911	3	183	51.37	2.58
93	Oklahoma City, OK	1,083,346	6	650	60.31	2.54
94	Roanoke, VA	235,932	3	150	43.33	2.54
95	West Palm Beach-Boca Raton, FL	1,131,184	4	476	53.36	2.51
96	Buffalo-Niagara Falls, NY	1,170,111	2	322	74.53	2.49
97	Indianapolis, IN	1,607,486	5	1,602	46.13	2.48
98	Lansing-East Lansing, MI	447,728	5	233	38.20	2.48
99	Cleveland-Lorain-Elyria, OH	2,250,871	5	2,997	55.49	2.48
100	Los Angeles-Long Beach, CA	9,519,338	9	4,722	41.30	2.47
101	Greensboro--Winston-Salem--High Point, NC	1,251,509	4	1,205	48.22	2.47
102	New Haven-Meriden, CT	542,149	1	186	54.30	2.45
103	Houston, TX	4,177,646	6	1,776	64.41	2.43
104	Phoenix-Mesa, AZ	3,251,876	9	700	47.86	2.42
105	San Jose, CA	1,682,585	9	466	27.04	2.41
106	New York, NY	9,314,235	2	3,192	51.91	2.40
107	Fort Worth-Arlington, TX	1,702,625	6	375	50.93	2.40
108	Bergen-Passaic, NJ	1,373,167	2	349	44.41	2.39
109	Sacramento, CA	1,628,197	9	446	44.62	2.37
110	Rochester, NY	1,098,201	2	183	45.36	2.37
111	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	1,196	60.95	2.37
112	Newark, NJ	2,032,989	2	1,177	49.19	2.36
113	Cincinnati, OH-KY-IN	1,646,395	5	1,469	43.64	2.35
114	Seattle-Bellevue-Everett, WA	2,414,616	10	725	40.00	2.35
115	Miami, FL	2,253,362	4	1,819	59.26	2.33
116	Nashville, TN	1,231,311	4	1,103	50.23	2.33
117	South Bend, IN	265,559	5	170	50.00	2.31
118	Jacksonville, FL	1,100,491	4	1,057	56.76	2.31
119	Biloxi-Gulfport-Pascagoula, MS	363,988	4	400	46.25	2.28
120	Canton-Massillon, OH	406,934	5	246	54.47	2.28
121	Monmouth-Ocean, NJ	1,126,217	2	244	47.13	2.26
122	Albuquerque, NM	712,738	6	100	44.00	2.26
123	Greenville-Spartanburg-Anderson, SC	962,441	4	895	46.26	2.25
124	Melbourne-Titusville-Palm Bay, FL	476,230	4	146	55.48	2.25
125	Orlando, FL	1,644,561	4	752	56.25	2.25
126	Danville, VA	110,156	3	157	52.87	2.24

Table 6 - Ranking by the Disparity in the Percentage of Subprime Lending for African-Americans Compared to Whites

(154 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			132,196	49.28	2.83
127	Akron, OH	694,960	5	632	50.79	2.24
128	Lakeland-Winter Haven, FL	483,924	4	251	63.75	2.23
129	Wilmington-Newark, DE-MD	586,216	3	362	53.31	2.23
130	Vallejo-Fairfield-Napa, CA	518,821	9	448	38.39	2.22
131	Rocky Mount, NC	143,026	4	194	54.64	2.19
132	Orange County, CA	2,846,289	9	273	33.70	2.18
133	Dayton-Springfield, OH	950,558	5	1,078	52.13	2.18
134	Portland-Vancouver, OR-WA	1,918,009	10	291	45.36	2.18
135	San Antonio, TX	1,592,383	6	206	64.08	2.16
136	Las Vegas, NV-AZ	1,563,282	9	505	46.53	2.15
137	Fort Myers-Cape Coral, FL	440,888	4	119	54.62	2.15
138	Jersey City, NJ	608,975	2	161	55.28	2.14
139	Nassau-Suffolk, NY	2,753,913	2	1,056	54.64	2.13
140	Sumter, SC	104,646	4	211	47.39	2.10
141	Davenport-Moline-Rock Island, IA-IL	359,062	5	104	38.46	2.07
142	Ocala, FL	258,916	4	137	46.72	2.03
	Subtotal for the 142 MSAs with disparity ratios above 2.0 (represents 92.56% of all African-American refinance loans and 93.45% of all subprime loans)				49.75	2.85
143	Hickory-Morganton-Lenoir, NC	341,851	4	181	50.83	2.00
144	Fort Lauderdale, FL	1,623,018	4	1,249	48.68	1.99
145	Tulsa, OK	803,235	6	324	41.36	1.99
146	Daytona Beach, FL	493,175	4	206	59.22	1.96
147	San Diego, CA	2,813,833	9	712	36.24	1.90
148	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	333	37.24	1.89
149	Riverside-San Bernardino, CA	3,254,821	9	876	44.41	1.85
150	Knoxville, TN	687,249	4	209	42.11	1.85
151	Tacoma, WA	700,820	10	235	37.87	1.76
152	Stockton-Lodi, CA	563,598	9	195	41.54	1.75
153	Beaumont-Port Arthur, TX	385,090	6	182	60.44	1.71
154	Hamilton-Middletown, OH	332,807	5	135	36.30	1.64

Disparity ratios above 2.0 are in every region of the country. Seven of the 10 MSAs with the highest disparity ratios, are in the Southeast or Southwest. This reflects the same bias for the Southern part of the country that we saw in basic levels of subprime lending for African-Americans. The one difference is that none of the top 10 MSAs in disparity ratios for African-Americans is in Texas.

As with the basic subprime percentages, MSAs of many different sizes have high rankings. Several of the largest MSAs have high rankings: Chicago is ranked 14th, Philadelphia is ranked 21st and Detroit is ranked 23rd. On the other hand, 5 of the top 10-ranked MSAs have populations under 150,000.

Table #7 ranks MSAs by disparity ratios for Hispanic borrowers as compared to whites.[15] The overall disparity ratio is 1.74. The highest disparity ratio is 2.45, for San Jose, California and 13 additional MSAs have disparity ratios above 2.0. These 14 MSAs account for 14.32% of all conventional refinance loans and 16.12% of all Hispanic subprime loans. The overall disparity ratio for these 14 MSAs is 2.08. The percentage of subprime refinance loans for these 14 MSAs combined is 34.16%, about 4% over the national norm for Hispanics.

Table 7 - Ranking by the Disparity in the Percentage of Subprime Lending for Hispanics Compared to Whites

(98 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			91,295	30.33	1.74
1	San Jose, CA	1,682,585	9	2,788	27.47	2.45
2	Naples, FL	251,377	4	130	38.46	2.40
3	Fresno, CA	922,516	9	875	44.00	2.38
4	San Francisco, CA	1,731,183	9	1,364	20.60	2.32
5	Tucson, AZ	843,746	9	1,382	32.92	2.30
6	Fort Collins-Loveland, CO	251,494	8	116	25.86	2.27
7	Lansing-East Lansing, MI	447,728	5	102	34.31	2.23
8	Philadelphia, PA-NJ	5,100,931	3	475	38.11	2.20
9	Lawrence, MA-NH	396,230	1	181	35.36	2.15
10	Providence-Fall River-Warwick, RI-MA	1,188,613	1	134	44.03	2.14
11	Hartford, CT	1,183,110	1	121	36.36	2.11
12	Phoenix-Mesa, AZ	3,251,876	9	4,051	40.36	2.04
13	Salinas, CA	401,762	9	725	29.52	2.01
14	Austin-San Marcos, TX	1,249,763	6	625	42.40	2.01
	Subtotal for the 14 MSAs with disparity ratios above 2.0 (represents 14.32% of all Hispanic refinance loans and 16.12% of all subprime loans)				34.16	2.08
15	Omaha, NE-IA	716,998	7	161	37.27	2.00
16	Saginaw-Bay City-Midland, MI	403,070	5	157	20.38	1.99
17	Denver, CO	2,109,282	8	3,321	34.18	1.98
18	Stamford-Norwalk, CT	353,556	1	103	19.42	1.97
19	Santa Barbara-Santa Maria-Lompoc, CA	399,347	9	477	18.24	1.97
20	Yuma, AZ	160,026	9	312	29.49	1.97
21	Boston, MA-NH	3,406,829	1	509	29.67	1.94
22	Milwaukee-Waukesha, WI	1,500,741	5	288	20.49	1.93
23	New Orleans, LA	1,337,726	6	231	29.00	1.92
24	Detroit, MI	4,441,551	5	570	28.95	1.91
25	Kansas City, MO-KS	1,776,062	7	279	39.07	1.89
26	Visalia-Tulare-Porterville, CA	368,021	9	360	40.00	1.89
27	Indianapolis, IN	1,607,486	5	112	34.82	1.88
28	Greeley, CO	180,936	8	287	31.71	1.80
29	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	340	21.18	1.77

[15] Laredo, Texas, is an MSA with a majority population of Hispanics. It did not have enough white loans to calculate a disparity ratio.

Table 7 - Ranking by the Disparity in the Percentage of Subprime Lending for Hispanics Compared to Whites

(98 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			91,295	30.33	1.74
30	San Antonio, TX	1,592,383	6	1,745	51.46	1.74
31	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	223	34.08	1.73
32	Las Cruces, NM	174,682	6	403	19.35	1.73
33	Merced, CA	210,554	9	252	36.90	1.71
34	Provo-Orem, UT	368,536	8	103	26.21	1.70
35	Chicago, IL	8,272,768	5	7,525	22.33	1.70
36	Vallejo-Fairfield-Napa, CA	518,821	9	499	29.26	1.70
37	Oakland, CA	2,392,557	9	2,805	25.99	1.69
38	Sacramento, CA	1,628,197	9	766	31.46	1.67
39	El Paso, TX	679,622	6	976	52.36	1.66
40	St. Louis, MO-IL	2,603,607	7	132	23.48	1.66
41	Santa Fe, NM	147,635	6	477	23.69	1.65
42	Colorado Springs, CO	516,929	8	282	27.30	1.64
43	Bakersfield, CA	661,645	9	473	27.48	1.64
44	Bridgeport, CT	459,479	1	124	28.23	1.64
45	Boulder-Longmont, CO	291,288	8	146	17.12	1.63
46	Brownsville-Harlingen-San Benito, TX	335,227	6	485	31.96	1.63
47	Albuquerque, NM	712,738	6	2,114	31.84	1.63
48	New York, NY	9,314,235	2	1,236	35.11	1.62
49	Seattle-Bellevue-Everett, WA	2,414,616	10	344	27.62	1.62
50	Cleveland-Lorain-Elyria, OH	2,250,871	5	369	36.04	1.61
51	Baltimore, MD	2,552,994	3	119	27.73	1.61
52	Corpus Christi, TX	380,783	6	388	47.42	1.60
53	Orange County, CA	2,846,289	9	2,513	24.67	1.60
54	Salem, OR	347,214	10	131	34.35	1.59
55	Monmouth-Ocean, NJ	1,126,217	2	148	33.11	1.59
56	Atlanta, GA	4,112,198	4	371	23.45	1.59
57	Fort Myers-Cape Coral, FL	440,888	4	140	40.00	1.57
58	Yakima, WA	222,581	10	296	31.76	1.57
59	Ventura, CA	753,197	9	1,071	23.06	1.56
60	McAllen-Edinburg-Mission, TX	569,463	6	936	34.94	1.56
61	San Diego, CA	2,813,833	9	2,795	29.59	1.55
62	Toledo, OH	618,203	5	148	28.38	1.54
63	Santa Rosa, CA	458,614	9	350	22.57	1.53
64	Jacksonville, FL	1,100,491	4	104	37.50	1.52
65	Los Angeles-Long Beach, CA	9,519,338	9	10,716	25.42	1.52
66	Washington, DC-MD-VA-WV	4,923,153	3	784	18.88	1.51
67	Orlando, FL	1,644,561	4	940	37.23	1.49
68	Gary, IN	631,362	5	318	29.25	1.48
69	Bergen-Passaic, NJ	1,373,167	2	539	27.27	1.47
70	Las Vegas, NV-AZ	1,563,282	9	764	30.76	1.42
71	Fort Worth-Arlington, TX	1,702,625	6	491	30.14	1.42
72	Dallas, TX	3,519,176	6	1,197	30.66	1.42

Table 7 - Ranking by the Disparity in the Percentage of Subprime Lending for Hispanics Compared to Whites

(98 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			91,295	30.33	1.74
73	West Palm Beach-Boca Raton, FL	1,131,184	4	351	29.63	1.39
74	Salt Lake City-Ogden, UT	1,333,914	8	692	27.60	1.39
75	Riverside-San Bernardino, CA	3,254,821	9	3,295	33.14	1.38
76	Yolo, CA	168,660	9	101	24.75	1.38
77	Miami, FL	2,253,362	4	4,484	34.95	1.38
78	Boise City, ID	432,345	10	123	26.02	1.37
79	San Luis Obispo-Atascadero-Paso Robles, CA	246,681	9	130	22.31	1.37
80	Minneapolis-St. Paul, MN-WI	2,968,806	5	383	20.63	1.37
81	Portland-Vancouver, OR-WA	1,918,009	10	275	28.36	1.36
82	Houston, TX	4,177,646	6	2,285	35.75	1.35
83	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	910	34.51	1.34
84	Fort Lauderdale, FL	1,623,018	4	913	31.98	1.31
85	Daytona Beach, FL	493,175	4	119	39.50	1.31
86	Santa Cruz-Watsonville, CA	255,602	9	321	17.76	1.29
87	Pueblo, CO	141,472	8	575	29.39	1.29
88	Nassau-Suffolk, NY	2,753,913	2	673	32.54	1.27
89	Odessa-Midland, TX	237,132	6	132	24.24	1.27
90	Lakeland-Winter Haven, FL	483,924	4	156	35.90	1.26
91	Tacoma, WA	700,820	10	107	27.10	1.26
92	Newark, NJ	2,032,989	2	460	25.65	1.23
93	Modesto, CA	446,997	9	448	27.01	1.23
94	Reno, NV	339,486	9	104	19.23	1.18
95	Stockton-Lodi, CA	563,598	9	584	28.08	1.18
96	Oklahoma City, OK	1,083,346	6	153	27.45	1.16
97	Rockford, IL	371,236	5	120	19.17	1.12
98	Jersey City, NJ	608,975	2	289	28.37	1.10

In contrast to the regional pattern for African-Americans, only one of the 10 MSAs with the highest Hispanic disparity ratios is in the Southeast or Southwest (Naples, Florida). For Hispanics, 4 of the top 10 and 8 of the top 20 ranked MSAs are in the Pacific region (in particular, California and Arizona). Also, several of the top-ranked MSAs are in the New England region. For example, Lawrence (Maine-New Hampshire), Providence-Fall River-Warwick (Rhode Island-Massachusetts), and Hartford (Connecticut) are ranked 9th through 11th, respectively.

By size, MSAs with high disparities for Hispanics tend to be middle and larger MSAs. For example, while 5 of the top 10 MSAs for African-American disparity ratios had populations less than 150,000, we have to go down to the MSA ranked #41 (Santa Fe) in the Hispanic ranking to find a metropolitan area this small.

Table #8 ranks MSAs by the disparity ratio for Asians. The highest disparity ratio is for the Milwaukee MSA (2.18). The lowest is for Detroit (0.55). There are 21 MSAs where Asians have higher levels of subprime loans than do whites. These 21 MSAs account for 37.89% of all conventional refinance loans to Asians and 46.12% (almost half) of the subprime loans to Asians. For these 21 MSAs combined, the overall disparity ratio for Asians is 1.15, higher than the national ratio of 0.93, and the percentage of subprime loans to Asians is 19.75%, compared to the national average of 16.22%.

Table 8 - Ranking by the Percentage of Subprime Lending for Asians Compared to Whites

(43 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			41,434	16.22	0.93
1	Milwaukee-Waukesha, WI	1,500,741	5	108	23.15	2.18
2	San Francisco, CA	1,731,183	9	2,792	16.98	1.91
3	Salinas, CA	401,762	9	252	27.78	1.89
4	Honolulu, HI	876,156	9	1,595	22.01	1.86
5	Vallejo-Fairfield-Napa, CA	518,821	9	578	26.47	1.53
6	San Diego, CA	2,813,833	9	1,384	24.93	1.30
7	Minneapolis-St. Paul, MN-WI	2,968,806	5	564	19.15	1.27
8	Salt Lake City-Ogden, UT	1,333,914	8	219	25.11	1.27
9	Stockton-Lodi, CA	563,598	9	242	29.75	1.25
10	Sacramento, CA	1,628,197	9	512	21.88	1.16
11	Philadelphia, PA-NJ	5,100,931	3	312	19.87	1.15
12	Portland-Vancouver, OR-WA	1,918,009	10	347	23.63	1.13
13	Santa Rosa, CA	458,614	9	114	16.67	1.13
14	Ventura, CA	753,197	9	253	16.60	1.12
15	Phoenix-Mesa, AZ	3,251,876	9	344	21.22	1.07
16	Denver, CO	2,109,282	8	471	18.47	1.07
17	Las Vegas, NV-AZ	1,563,282	9	404	23.02	1.07
18	Fort Lauderdale, FL	1,623,018	4	100	26.00	1.06
19	Oakland, CA	2,392,557	9	3,773	16.25	1.05
20	Fresno, CA	922,516	9	108	19.44	1.05
21	Seattle-Bellevue-Everett, WA	2,414,616	10	1,228	17.67	1.04
	Subtotal for the 21 MSAs with disparity ratios above 1.0 (represents 37.89% of all Asian refinance loans and 46.12% of all subprime loans)				19.75	1.15
22	Orlando, FL	1,644,561	4	118	24.58	0.98
23	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	157	24.84	0.96
24	Nassau-Suffolk, NY	2,753,913	2	228	24.12	0.94
25	San Jose, CA	1,682,585	9	4,203	10.37	0.92
26	Bergen-Passaic, NJ	1,373,167	2	308	16.88	0.91
27	Orange County, CA	2,846,289	9	1,942	14.01	0.91
28	Los Angeles-Long Beach, CA	9,519,338	9	5,106	15.02	0.90
29	Tacoma, WA	700,820	10	150	18.67	0.87
30	Houston, TX	4,177,646	6	442	22.17	0.84
31	Chicago, IL	8,272,768	5	2,483	10.99	0.84
32	Riverside-San Bernardino, CA	3,254,821	9	698	20.06	0.84

Table 8 - Ranking by the Percentage of Subprime Lending for Asians Compared to Whites

(43 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			41,434	16.22	0.93
33	Baltimore, MD	2,552,994	3	176	14.20	0.82
34	Boston, MA-NH	3,406,829	1	502	12.55	0.82
35	Washington, DC-MD-VA-WV	4,923,153	3	1,088	10.11	0.81
36	New York, NY	9,314,235	2	691	17.51	0.81
37	St. Louis, MO-IL	2,603,607	7	176	11.36	0.80
38	Dallas, TX	3,519,176	6	262	15.65	0.72
39	Oklahoma City, OK	1,083,346	6	100	17.00	0.72
40	Newark, NJ	2,032,989	2	187	13.90	0.67
41	Middlesex-Somerset-Hunterdon, NJ	1,169,641	2	231	12.12	0.62
42	Atlanta, GA	4,112,198	4	334	8.98	0.61
43	Detroit, MI	4,441,551	5	892	8.41	0.55

Of the top 10 ranked MSAs for disparities in subprime lending to Asians, 7 are in the Pacific region. One other, Salt Lake City-Ogden (ranked 8th), is in the Rocky Mountains region. The other 2 MSAs in the top 10 are Milwaukee (ranked 1st) and Minneapolis-St. Paul (ranked 7th). Therefore, there is a strong bias toward the West and West Coast areas in MSAs with racial disparities for Asians. Fifteen of the 21 MSAs with Asian disparity ratios above 1.0 are in the Pacific or Northwest regions.

Fourteen of the 21 MSAs with disparity ratios over 1.0 have populations of more than 1 million people. None of these 21 MSAs has a population less than 400,000. This would be expected, as the Asian population is relatively small when compared to the African-American and Hispanic populations and few MSAs in the smaller ranges have a large enough population of Asian homeowners to create a market over the 100 loans necessary for our calculations.

Table #9 ranks MSAs by the disparity ratio for Native Americans. Thirteen MSAs have disparity ratios greater than 1.0. These 13 MSAs account for 29.01% of all conventional refinance loans to Native Americans and 27.56% of the conventional subprime refinance loans to Native Americans. The disparity ratio for these 13 MSAs combined is 1.65, compared to the overall national urban disparity ratio for Native Americans of 1.60.

The highest disparity ratio is for the Washington, DC-MD-VA-WV MSA (2.36). Two other MSAs have disparity ratios above 2.0. These are Chicago (2.08) and Atlanta (2.03). The lowest disparity ratio is for Orange County, California (0.69).

Table 9 - Ranking by the Disparity in the Percentage of Subprime Lending for Native Americans Compared to Whites

(16 MSAs)

	MSA Name	Popnlation	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)			6,843	27.94	1.60
1	Washington, DC-MD-VA-WV	4,923,153	3	102	29.41	2.36
2	Chicago, IL	8,272,768	5	289	27.34	2.08
3	Atlanta, GA	4,112,198	4	100	30.00	2.03
4	Phoenix-Mesa, AZ	3,251,876	9	145	35.17	1.78
5	Detroit, MI	4,441,551	5	238	26.47	1.75
6	Minneapolis-St. Paul, MN-WI	2,968,806	5	141	24.82	1.64
7	Oakland, CA	2,392,557	9	147	24.49	1.59
8	Los Angeles-Long Beach, CA	9,519,338	9	199	26.13	1.57
9	Seattle-Bellevue-Everett, WA	2,414,616	10	120	25.83	1.52
10	Philadelphia, PA-NJ	5,100,931	3	114	21.05	1.22
11	Denver, CO	2,109,282	8	146	20.55	1.19
12	Oklahoma City, OK	1,083,346	6	120	27.50	1.16
13	Riverside-San Bernardino, CA	3,254,821	9	124	26.61	1.11
	Subtotal for the 13 MSAs with disparity ratios above 1.0 (represents 29.01% of all Native American refinance loans and 27.56% of all subprime loans)				26.55	1.65
14	Tulsa, OK	803,235	6	178	19.66	0.95
15	San Diego, CA	2,813,833	9	108	15.74	0.82
16	Orange County, CA	2,846,289	9	140	10.71	0.69

Five of the 13 MSAs with a disparity ratio above 1.0 are in the Pacific or Northwest regions. Another 5 are in either the Midwest or Mid-Atlantic regions. This regional distribution may be partly the result of the fact that the Native American population in metropolitan lending markets is quite small. Only very large metropolitan areas have 100 or more loans reported to Native Americans. Twelve of the 13 MSAs with disparity ratios above 1.0 have populations above 2 million people. These regional and size patterns might change with the use of multi-year data, in which many more metropolitan areas would have enough loans to Native Americans to calculate disparity ratios.

With the measures we have used for the 2000 HMDA data, we have shown a pervasive pattern of racial disparities for African-Americans and Hispanics. Thirteen of the 16 MSAs with enough Native American loans to calculate disparity ratios indicated that Native Americans had higher levels of subprime lending than did whites. About half of the MSAs that had adequate data for Asians also show racial disparities. Many MSAs were excluded from our review because they did not have enough minority loans in the single year of HMDA data to calculate disparity ratios. Over the course of several years' data, many more MSAs would have enough loans to calculate disparity ratios at the thresholds we have set. Because we consider the thresholds we have used to be conservative, we can lower the threshold to get some idea of what the disparity ratios would be if more MSAs had enough minority loans to qualify. Also, we can combine all the individual racial and ethnic groups into a single minority category.

If we set the threshold required for calculating minority disparity ratios at 20 conventional refinance loans, then 311 of the 331 MSAs have enough data to calculate an overall minority disparity ratio. In this case, 160 would have disparity ratios over 2.0. One hundred and forty-three (143) MSAs would have a disparity ratio between 1.00 and 2.00. In all, 303 MSAs would have a minority disparity ratio greater than 1.0. This would be over 90% of all the 331 metropolitan areas in the nation. Map #3 shows that these 303 metropolitan areas would be spread across the entire country. Every state would have at least one MSA with a minority disparity ratio over 1.0, except Vermont and North Dakota.

C. Ranking of MSAs by Racial Disparities in Subprime Lending Across Different Income Ranges

The patterns of disparity ratios for upper-income borrowers is particularly troubling, since one would expect few upper-income borrowers, of any race or ethnicity, to receive subprime loans. Thirty-one MSAs had disparity ratios for upper-income African-Americans that were above 2.00. Of these MSAs, 5 had disparity ratios greater than 4.00, and 18 had disparity ratios between 3.00 and 4.00. Table #10, below, ranks MSAs by upper-income disparity ratios for African-Americans.

For upper-income Hispanics, 12 MSAs had disparity ratios above 2.00, and 1 of these had a disparity ratio above 3.00. Table #11, ranks MSAs by upper-income disparity ratios for Hispanics.

For Asians, who had lower levels of subprime lending than whites in the lower-income range, 2 MSAs had disparity ratios above 2.00 in the upper-income range. These MSAs were Salinas, California (at 2.25), and Philadelphia (at 2.04). San Francisco fell just below this level at 1.96.

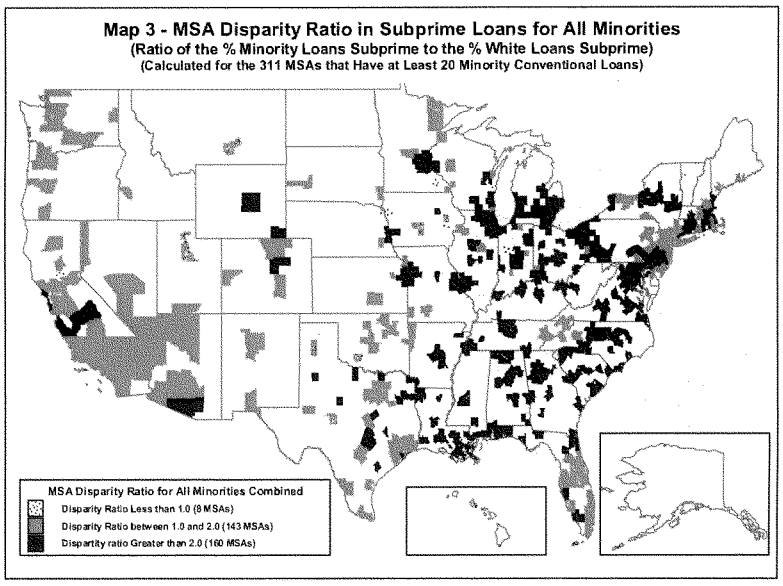

Map 3 - MSA Disparity Ratio in Subprime Loans for All Minorities
(Ratio of the % Minority Loans Subprime to the % White Loans Subprime)
(Calculated for the 311 MSAs that Have at Least 20 Minority Conventional Loans)
MSA Disparity Ratio for All Minorities Combined
Disparity Ratio Less than 1.0 (8 MSAs)
Disparity Ratio between 1.0 and 2.0 (143 MSAs)
Disparity ratio Greater than 2.0 (160 MSAs)

Table 10 - Ranking by African-American to White Upper-Income Disparity Ratios

(34 MSAs - The Data for White and African-American Percent Subprime Are for Upper-Income Borrowers Only)

	MSA Name	White Percent Subprime	African-American Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)	10.54	31.94	3.03
1	St. Louis, MO-IL	5.16	30.58	5.93
2	Chicago, IL	5.94	29.62	4.99
3	San Francisco, CA	6.29	29.36	4.66
4	New Orleans, LA	8.56	37.50	4.38
5	Indianapolis, IN	6.00	25.60	4.27
6	Washington, DC-MD-VA-WV	6.08	24.02	3.95
7	Greensboro--Winston-Salem--High Point, NC	7.31	28.81	3.94
8	Baton Rouge, LA	9.22	36.26	3.93
9	Detroit, MI	7.86	29.41	3.74
10	Lafayette, LA	6.27	23.42	3.73
11	Memphis, TN-AR-MS	9.62	35.57	3.70
12	Kansas City, MO-KS	10.08	36.84	3.66
13	Boston, MA-NH	9.07	33.04	3.64
14	Cincinnati, OH-KY-IN	6.86	25.00	3.64
15	Philadelphia, PA-NJ	9.31	32.02	3.44
16	Baltimore, MD	10.25	34.93	3.41
17	Denver, CO	10.42	35.37	3.39
18	Houston, TX	14.38	48.00	3.34
19	Norfolk-Virginia Beach-Newport News, VA-NC	8.39	27.61	3.29
20	Miami, FL	15.43	49.29	3.19
21	Dallas, TX	11.27	35.96	3.19
22	Cleveland-Lorain-Elyria, OH	11.79	37.30	3.16
23	Atlanta, GA	8.45	25.73	3.05
	Subtotal for the 23 MSAs with disparity ratios above 3.0 (represents 40.12% of all African-American upper-income subprime loans)			3.90
24	Newark, NJ	13.93	41.07	2.95
25	Oakland, CA	10.58	30.27	2.86
26	New York, NY	15.23	43.25	2.84
27	Tampa-St. Petersburg-Clearwater, FL	14.43	38.84	2.69
28	Los Angeles-Long Beach, CA	13.20	33.84	2.56
29	Vallejo-Fairfield-Napa, CA	13.07	31.61	2.42
30	San Diego, CA	17.00	34.39	2.02
31	Phoenix-Mesa, AZ	12.36	24.79	2.01
	Subtotal for the 31 MSAs with disparity ratios above 2.0 (represents 61.82% of all African-American upper-income subprime loans)			3.25
32	Riverside-San Bernardino, CA	19.92	38.61	1.94
33	Fort Lauderdale, FL	17.04	30.37	1.78
34	Las Vegas, NV-AZ	17.46	29.31	1.68

Table 11 - Ranking by Hispanic to White Upper-Income Disparity Ratios

(33 MSAs - The Data for White and Hispanic Percent Subprime Are for Upper-Income Borrowers Only)

	MSA Name	White Percent Subprime	Hispanic Percent Subprime	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)	10.54	23.52	2.23
1	Salinas, CA	10.47	32.02	3.06
2	Tucson, AZ	8.61	24.55	2.85
3	San Francisco, CA	6.29	16.81	2.67
4	San Jose, CA	7.23	18.73	2.59
5	Santa Barbara-Santa Maria-Lompoc, CA	8.45	20.15	2.38
6	Denver, CO	10.42	24.18	2.32
7	Chicago, IL	5.94	13.77	2.32
8	Oakland, CA	10.58	23.42	2.21
9	El Paso, TX	19.87	40.99	2.06
10	Fresno, CA	13.89	28.57	2.06
11	Dallas, TX	11.27	23.08	2.05
12	Vallejo-Fairfield-Napa, CA	13.07	26.21	2.01
	Subtotal for the 12 MSAs with disparity ratios above 2.0 (represents 18.72% of all African-American upper-income subprime loans)			2.80
13	New York, NY	15.23	29.00	1.90
14	Los Angeles-Long Beach, CA	13.20	23.97	1.82
15	Houston, TX	14.38	26.07	1.81
16	Tampa-St. Petersburg-Clearwater, FL	14.43	25.98	1.80
17	Las Cruces, NM	8.59	14.66	1.71
18	Miami, FL	15.43	25.42	1.65
19	Phoenix-Mesa, AZ	12.36	20.34	1.65
20	San Antonio, TX	20.93	33.14	1.58
21	Stockton-Lodi, CA	16.67	26.32	1.58
22	Brownsville-Harlingen-San Benito, TX	17.31	26.91	1.55
23	San Diego, CA	17.00	25.37	1.49
24	Washington, DC-MD-VA-WV	6.08	8.93	1.47
25	Albuquerque, NM	11.56	16.67	1.44
26	Orange County, CA	12.77	17.59	1.38
27	Orlando, FL	14.52	19.38	1.33
28	Las Vegas, NV-AZ	17.46	22.86	1.31
29	Ventura, CA	11.76	15.18	1.29
30	Riverside-San Bernardino, CA	19.92	25.66	1.29
31	Fort Lauderdale, FL	17.04	20.30	1.19
32	Sacramento, CA	13.99	15.33	1.10
33	Pueblo, CO	18.91	17.50	0.93

The racial disparities for upper-income African-Americans are so pervasive that none of the 34 MSAs had a disparity ratio of less than 1.68. The 23 MSAs with disparity ratios over 3.00 for upper-income African-Americans account for 40.12% of all subprime loans to this group of borrowers. These 23 MSAs have a combined upper-income disparity ratio of 3.90. The 31 MSAs

that have disparity ratios over 2.00 actually account for 61.82% of all subprime loans to upper-income African-Americans. These MSAs have a combined upper-income disparity ratio of 3.25.

For Hispanics, the 12 MSAs with upper-income disparity ratios over 2.00 account for 18.72% of all subprime loans to upper-income Hispanics. These 12 MSAs have a combined disparity ratio of 2.80.

One commonly used measure of extreme racial disparities is to compare the treatment of upper-income minorities, who would be expected to represent the lowest risk of all minority borrowers, to lower-income whites, who would be expected to represent the highest risk among white borrowers. Where these "upper to lower" disparity ratios are over 1.00, we have the strongest evidence from the HMDA data challenging the idea that the disparities between minorities and whites could be explained purely by risk factors. Table #12 ranks MSAs by disparity ratios for upper-income minorities to lower income whites. The highest of these disparity ratios is in San Francisco, with an upper-to-lower-income disparity ratio of 2.34. In other words, in San Francisco, upper-income African-Americans are 2.34 times more likely to receive a subprime refinance loan than lower-income whites. Twenty-nine MSAs have disparity ratios above 1.00, indicating that upper-income African-Americans in these MSAs receive more subprime loans than do lower-income whites. These 29 MSAs represent over 57% of all the conventional refinance loans to African-Americans in urban areas. The overall disparity ratio for these 29 MSAs combined is 1.41, compared to 1.29 for urban areas as a whole.

For Hispanics, there are 30 MSAs where "upper to lower" disparity ratios can be calculated. Of these MSAs, there were 2 MSAs where this disparity ratio was greater than 2.0. They were Salinas (2.21) and Santa Barbara-Santa Maria-Lompoc (2.03) - both in California. Ten MSAs have disparity ratios over 1.00. These 10 MSAs account for just under 27% of all subprime lending to Hispanics. The disparity ratio for these 10 MSAs combined is 1.17, while the comparable national urban disparity ratio for Hispanics is 0.95. These data are presented in Table #13, below.

Table 12 - Ranking by Upper-Income African-American to Lower-Income White Disparity Ratios

(34 MSAs - Data on Conventional Loans and Percent Subprime Are for All African-American Borrowers Only)

	MSA Name	All African-American Conventional Loans	Percent Subprime for All African-Americans	Disparity Ratio
	National Urban Total for all 331 MSAs	132,196	49.28	1.29
1	San Francisco, CA	576	36.63	2.34
2	Boston, MA-NH	1,032	42.93	1.66
3	San Diego, CA	712	36.24	1.64
4	Denver, CO	1,398	44.92	1.60
5	Lafayette, LA	633	29.86	1.53
6	St. Louis, MO-IL	3,552	51.55	1.51
7	Baltimore, MD	2,158	45.41	1.50

Table 12 - Ranking by Upper-Income African-American to Lower-Income White Disparity Ratios

(34 MSAs - Data on Conventional Loans and Percent Subprime Are for All African-American Borrowers Only)

	MSA Name	All African-American Conventional Loans	Percent Subprime for All African-Americans	Disparity Ratio
8	Vallejo-Fairfield-Napa, CA	448	38.39	1.50
9	Oakland, CA	2,792	41.58	1.46
10	Newark, NJ	1,177	49.19	1.45
11	Baton Rouge, LA	1,003	45.76	1.45
12	Los Angeles-Long Beach, CA	4,722	41.30	1.45
13	New Orleans, LA	2,014	52.04	1.44
14	Chicago, IL	10,418	50.55	1.42
15	New York, NY	3,192	51.91	1.38
16	Washington, DC-MD-VA-WV	4,778	36.79	1.34
17	Detroit, MI	11,217	51.17	1.32
18	Miami, FL	1,819	59.26	1.29
19	Atlanta, GA	5,603	45.73	1.27
20	Riverside-San Bernardino, CA	876	44.41	1.27
21	Kansas City, MO-KS	1,632	61.70	1.26
22	Las Vegas, NV-AZ	505	46.53	1.20
23	Cleveland-Lorain-Elyria, OH	2,997	55.49	1.19
24	Tampa-St. Petersburg-Clearwater, FL	1,196	60.95	1.17
25	Philadelphia, PA-NJ	2,853	58.92	1.17
26	Norfolk-Virginia Beach-Newport News, VA-NC	1,223	43.25	1.15
27	Memphis, TN-AR-MS	2,215	61.76	1.14
28	Houston, TX	1,776	64.41	1.07
29	Greensboro--Winston-Salem--High Point, NC	1,205	48.22	1.01
	Subtotal for the 29 MSAs with disparity ratios above 1.0 (represents 57.25% of all African-American subprime loans)			1.41
30	Dallas, TX	1,164	61.68	0.99
31	Fort Lauderdale, FL	1,249	48.68	0.97
32	Cincinnati, OH-KY-IN	1,469	43.64	0.92
33	Indianapolis, IN	1,602	46.13	0.90
34	Phoenix-Mesa, AZ	700	47.86	0.87

Table 13 - Ranking by Upper-Income Hispanic to Lower-Income White Disparity Ratios

(30 MSAs - Data on Conventional Loans and Percent Subprime Are All Hispanic Borrowers)

	MSA Name	All Hispanic Conventional Loans	Percent Subprime for All Hispanics	Disparity Ratio
	National Urban Total (All 331 MSAs Combined)	91,295	30.33	0.95
1	Salinas, CA	725	29.52	2.21
2	Santa Barbara-Santa Maria-Lompoc, CA	477	18.24	2.03
3	San Francisco, CA	1,364	20.60	1.34

Table 13 - Ranking by Upper-Income Hispanic to Lower-Income White Disparity Ratios

(30 MSAs - Data on Conventional Loans and Percent Subprime Are All Hispanic Borrowers)

	MSA Name	All Hispanic Conventional Loans	Percent Subprime for All Hispanics	Disparity Ratio
4	San Jose, CA	2,788	27.47	1.33
5	Vallejo-Fairfield-Napa, CA	499	29.26	1.24
6	San Diego, CA	2,795	29.59	1.21
7	Tucson, AZ	1,382	32.92	1.13
8	Oakland, CA	2,805	25.99	1.13
9	Denver, CO	3,321	34.18	1.09
10	Los Angeles-Long Beach, CA	10,716	25.42	1.02
	Subtotal for the 10 MSAs with disparity ratios above 1.0 (represents 26.59% of all Hispanic subprime loans)			1.17
11	Fresno, CA	875	44.00	1.00
12	Orange County, CA	2,513	24.67	0.98
13	Las Vegas, NV-AZ	764	30.76	0.94
14	New York, NY	1,236	35.11	0.92
15	Ventura, CA	1,071	23.06	0.91
16	Riverside-San Bernardino, CA	3,295	33.14	0.84
17	Stockton-Lodi, CA	584	28.08	0.78
18	Tampa-St. Petersburg-Clearwater, FL	910	34.51	0.78
19	Phoenix-Mesa, AZ	4,051	40.36	0.71
20	Miami, FL	4,484	34.95	0.67
21	Chicago, IL	7,525	22.33	0.66
22	San Antonio, TX	1,745	51.46	0.66
23	Fort Lauderdale, FL	913	31.98	0.65
24	Albuquerque, NM	2,114	31.84	0.64
25	Dallas, TX	1,197	30.66	0.63
26	Pueblo, CO	575	29.39	0.62
27	Sacramento, CA	766	31.46	0.60
28	Houston, TX	2,285	35.75	0.58
29	Orlando, FL	940	37.23	0.56
30	Washington, DC-MD-VA-WV	784	18.88	0.50

D. Rankings of MSAs with High Levels of Subprime Lending and High Racial Disparity Ratios for Minority Neighborhoods

In addition to the problems of racial disparities for minority borrowers, discrimination in lending has been characterized by neighborhood disparities as well. The racial or ethnic composition of a neighborhood has been used to "redline" minority or racially changing areas so that they are denied access to homes sales and lending. At one time, these practices were enforced through restrictive covenants on the sale of properties. For subprime lending, the issue here is not excluding minority areas but infusing lending that carries higher costs and higher risks for the borrower into minority communities where it is not justified by the risks to the lender. The high levels of subprime lending in a neighborhood may be precursors to eventual high levels of foreclosures as well. (For a more detailed discussion about the relationship between subprime

lending and foreclosures, see p. 78.) Therefore, this section will review subprime lending by the racial and ethnic composition of neighborhoods.

The HMDA data provide information on the census tract location of each loan. Census tracts are relatively small geographic areas defined by the Bureau of the Census and are commonly used as surrogate measures for local neighborhoods. We have coded all the census tracts in the MSAs in the United States by the racial composition of the population. The HMDA data use the 1990 census tracts as the reporting base. We used three years of HMDA data on the reported race of home purchase borrowers to update the racial composition of census tracts as reported in 1990 to account for subsequent racial change.[16]

Our definition of a minority census tract is a tract where at least 75% of the population is minority. We will focus our analysis on comparing African-American census tracts and Hispanic census tracts to white census tracts.[17] That is, we shall be using only those tracts that were at least 75% white, 75% African-American, or 75% Hispanic.[18]

1. Levels of Subprime Loans by the Race and Ethnicity of Census Tracts

There are 329 MSAs with white census tract data.[19] Roughly half of these 329 MSAs fall above and half fall below the overall national percentage of 21.09% conventional subprime refinance loans for the white census tracts in the nation's urban areas. This is lower than the overall national urban norm for the percentage of all loans that are subprime (25.31%). The individual percentage of subprime loans in white tracts ranges from a high of 41.11% (Killeen-Temple, Texas) to a low of 5.25% (Iowa City).[20] Only 10 MSAs have white subprime lending rates above 35% and only 36 have rates above 30%.

Table #14 provides the data for the 72 MSAs that have adequate data for African-American census tracts. The percentage of conventional subprime refinance loans in African-American census tracts is 56.92%. The 72 MSAs ranked account for 95.09% of all the refinance loans in all African-American census tracts and 95.14% of all the subprime loans in these tracts. The subprime levels in these 72 MSAs range from a high of 75.50% in Buffalo-Niagra Falls to a low of 38.17% in Sumter, South Carolina. Comparing the data for individual MSAs, the lowest

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[16] See the Methodological Notes at the end of this report for the detailed description of the process of updating census tracts for racial change.

[17] For those interested in minority areas as a whole, the Detailed Table of Subprime Lending for All MSAs does provide data for minority census tracts where all minority populations were combined to define the racial composition of the tracts.

[18] While the census tracts defined as diverse are not included in the analysis sections of this report, the subprime lending data for these tracts are found in the Detailed Table of Subprime Lending for All MSAs.

[19] There are 4 MSAs for which we did not calculate ranking data for whites tracts. All of these are in Texas. Two of these had fewer than 100 loans from white tracts (El Paso and Brownsville-Harlingen-San Benito). Two others do not have any white census tracts (Laredo and McAllen-Edinburg-Mission).

[20] The rankings for white census tracts are found in the Detailed Table of Subprime Lending for All MSAs.

levels of subprime lending in African-American census tracts begin roughly at the highest level for white census tracts. That is, in only two of these 72 MSAs (Sumter and Denver) is the percentage of subprime loans in African-American census tracts lower than the highest level for white census tracts in any MSA.

There are 57 MSAs in which the percentage of subprime loans in African-American census tracts is above 50%, roughly twice the nation urban norm for all subprime lending. These 57 MSAs account for 81.02% of all the conventional refinance loans in African-American census tracts and 84.49% of all the subprime loans in these tracts. The overall percentage of subprime loans for the African-American census tracts in these 57 MSAs is 59.36%. That is, collectively, over 84% of the subprime loans in African-American neighborhoods are in MSAs where the level of subprime refinance loans in African-American neighborhoods is over 50%. In terms of all African-American borrowers, these 57 MSAs account for 66.6% of all the conventional refinance loans to African-Americans and 70.33% of all the subprime loans to African-Americans.

Table 14 - Ranking by the Percentage of Subprime Refinance Loans for African-American Census Tracts

(72 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total for All African-American Census Tracts			70,145	56.92
1	Buffalo-Niagara Falls, NY	1,170,111	2	302	75.50
2	Dallas, TX	3,519,176	6	549	71.95
3	Philadelphia, PA-NJ	5,100,931	3	3,498	71.81
4	Wilmington-Newark, DE-MD	586,216	3	117	71.79
5	Kansas City, MO-KS	1,776,062	7	1,221	71.01
6	Orlando, FL	1,644,561	4	257	70.43
7	Memphis, TN-AR-MS	1,135,614	4	1,503	69.66
8	Houston, TX	4,177,646	6	989	68.45
9	Chattanooga, TN-GA	465,161	4	137	66.42
10	Charlotte-Gastonia-Rock Hill, NC-SC	1,499,293	4	585	65.64
11	Hartford, CT	1,183,110	1	122	65.57
12	Miami, FL	2,253,362	4	900	65.56
13	Oklahoma City, OK	1,083,346	6	273	65.20
14	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	534	64.98
15	Las Vegas, NV-AZ	1,563,282	9	121	64.46
16	Richmond-Petersburg, VA	996,512	3	554	64.08
17	Nassau-Suffolk, NY	2,753,913	2	634	64.04
18	Fort Lauderdale, FL	1,623,018	4	468	63.89
19	Pittsburgh, PA	2,358,695	3	485	63.09
20	Shreveport-Bossier City, LA	392,302	6	225	62.67
21	Cleveland-Lorain-Elyria, OH	2,250,871	5	2,891	61.81
22	Fayetteville, NC	302,963	4	133	61.65
23	Columbus, GA-AL	274,624	4	211	61.61
24	Jacksonville, FL	1,100,491	4	600	61.33

Table 14 - Ranking by the Percentage of Subprime Refinance Loans for African-American Census Tracts

(72 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total for All African-American Census Tracts			70,145	56.92
25	West Palm Beach-Boca Raton, FL	1,131,184	4	184	60.87
26	Savannah, GA	293,000	4	250	60.40
27	Little Rock-North Little Rock, AR	583,845	6	160	60.00
28	New York, NY	9,314,235	2	3,748	59.90
29	Mobile, AL	540,258	4	353	58.92
30	Jackson, MS	440,801	4	365	58.63
31	Greenville-Spartanburg-Anderson, SC	962,441	4	106	58.49
32	New Orleans, LA	1,337,726	6	1,047	58.17
33	Birmingham, AL	921,106	4	744	58.06
34	Baltimore, MD	2,552,994	3	1,217	57.52
35	Baton Rouge, LA	602,894	6	499	57.52
36	Dayton-Springfield, OH	950,558	5	879	57.34
37	Columbia, SC	536,691	4	403	57.32
38	Greensboro--Winston-Salem--High Point, NC	1,251,509	4	525	56.95
39	St. Louis, MO-IL	2,603,607	7	2,359	56.72
40	Akron, OH	694,960	5	399	56.64
41	Norfolk-Virginia Beach-Newport News, VA-NC	1,569,541	3	741	56.14
42	Detroit, MI	4,441,551	5	8,545	55.80
43	Macon, GA	322,549	4	110	55.45
44	Gary, IN	631,362	5	521	55.28
45	Toledo, OH	618,203	5	268	55.22
46	Indianapolis, IN	1,607,486	5	895	55.20
47	Raleigh-Durham-Chapel Hill, NC	1,187,941	4	435	55.17
48	Atlanta, GA	4,112,198	4	2,855	55.03
49	Fort Worth-Arlington, TX	1,702,625	6	115	54.78
50	Chicago, IL	8,272,768	5	7,928	54.78
51	Milwaukee-Waukesha, WI	1,500,741	5	456	54.39
52	Newark, NJ	2,032,989	2	917	52.56
53	Tulsa, OK	803,235	6	215	52.56
54	Nashville, TN	1,231,311	4	519	51.83
55	Boston, MA-NH	3,406,829	1	519	51.45
56	Columbus, OH	1,540,157	5	643	51.17
57	Cincinnati, OH-KY-IN	1,646,395	5	600	51.00
	Subtotal for the 57 MSAs where the African-American census tracts have a subprime lending rate greater than 50% (represents 81.02% of all African-American census tract refinance loans and 84.49% of all such subprime loans)				59.36
58	Flint, MI	436,141	5	469	48.83
59	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	255	48.24
60	Charleston-North Charleston, SC	549,033	4	127	48.03
61	Minneapolis-St. Paul, MN-WI	2,968,806	5	110	47.27
62	Biloxi-Gulfport-Pascagoula, MS	363,988	4	110	47.27
63	Albany, GA	120,822	4	103	46.60
64	Montgomery, AL	333,055	4	221	46.15

Table 14 - Ranking by the Percentage of Subprime Refinance Loans for African-American Census Tracts

(72 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total for All African-American Census Tracts			70,145	56.92
65	Oakland, CA	2,392,557	9	1,048	44.94
66	Fort Wayne, IN	502,141	5	111	44.14
67	Benton Harbor, MI	162,453	5	143	44.06
68	Louisville, KY-IN	1,025,598	4	942	43.63
69	Washington, DC-MD-VA-WV	4,923,153	3	2,744	42.27
70	Los Angeles-Long Beach, CA	9,519,338	9	2,919	41.32
71	Denver, CO	2,109,282	8	440	40.00
72	Sumter, SC	104,646	4	131	38.17

There is at least one MSA in each region except the Northwest. This fits the general distribution pattern of concentrated populations of African-Americans. Of the top 10 ranked MSAs, 6 are in the Southeast and Southwest, including the two largest MSAs in Texas (Dallas and Houston).

Smaller MSAs are not as likely to have census tracts that are at least 75% African-American and have 100 conventional refinance loans in 2000. It is not surprising that the MSAs for which we have data are generally the medium and larger sized MSAs. Only 3 of the 72 MSAs (Albany, Georgia; Benton Harbor, Michigan; and Sumter, South Carolina) have populations less than 250,000 people, and all of these have subprime percentages under 50%.

The African-American population is the most highly segregated minority population. The Hispanic population is much less concentrated in purely Hispanic areas. Therefore, there are only 12 MSAs with at least 100 conventional refinance loans in census tracts that are at least 75% Hispanic. Table #15 provides the data for these 12 MSAs. Still, the 12 MSAs where there are at least 100 conventional refinance loans in the Hispanic tracts account for 90.37% of all the refinance loans in all Hispanic census tracts and 89.99% of all the subprime loans in these tracts. The overall percentage of subprime loans for all Hispanic census tracts is 42.63%. This means that almost 90% of the subprime loans in Hispanic neighborhoods are in MSAs where the collective level of subprime refinance loans in Hispanic neighborhoods is over 40%. The highest ranked MSA (Corpus Christi) has a subprime lending level of 74.58% (about equal to the highest ranked MSAs for African-American tracts). The lowest ranking MSA is Los Angeles, at 27.24%.

There are 4 MSAs in which the percentage of subprime loans in Hispanic census tracts is above 50%. Just these 4 MSAs account for 21.07% of all the conventional refinance loans in Hispanic census tracts and 29.56% of all the subprime loans in these tracts. The overall percentage of subprime loans for the Hispanic census tracts in these 4 MSAs is 59.81%. Therefore, collectively, almost 30% of the subprime loans in Hispanic neighborhoods are in MSAs where the level of subprime refinance loans in Hispanic neighborhoods is over 50%.

Table 15 - Ranking by the Percentage of Subprime Refinance Loans for Hispanic Census Tracts

(12 MSAs)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime
	National Urban Total for All Hispanic Census Tracts			7,309	42.63
1	Corpus Christi, TX	380,783	6	118	74.58
2	San Antonio, TX	1,592,383	6	678	60.03
3	El Paso, TX	679,622	6	534	59.36
4	Albuquerque, NM	712,738	6	210	51.90
	Subtotal for the 4 MSAs where the Hispanic census tracts have a subprime lending rate greater than 50% (represents 21.07% of all Hispanic census tract refinance loans and 29.56% of all such subprime loans)				59.81
5	Laredo, TX	193,117	6	267	48.31
6	Brownsville-Harlingen-San Benito, TX	335,227	6	229	43.23
7	McAllen-Edinburg-Mission, TX	569,463	6	649	42.37
8	Tucson, AZ	843,746	9	225	41.33
9	Miami, FL	2,253,362	4	1,929	41.06
10	Orange County, CA	2,846,289	9	101	37.62
11	Chicago, IL	8,272,768	5	391	28.13
12	Los Angeles-Long Beach, CA	9,519,338	9	1,274	27.24

The 7 highest ranked MSAs are all in the Southwest region, and 6 of these are in Texas. Three of the other ranked MSAs are in the Pacific region.

With only 12 MSAs, not too much can be read into the distribution by size, except that one would expect that these 12 MSAs would generally be the larger ones. There is 1 MSA with less than 250,000 in population (Laredo). Four of the MSAs have over 2 million in population, and all of these are at the bottom of the rankings, with the largest MSA (Los Angeles) having the lowest ranking of all 12 MSAs.

Both African-American and Hispanic neighborhoods have exceptionally high levels of subprime lending. The high levels of subprime lending are, however, more pervasive for African-American neighborhoods. Almost 85% of all the subprime loans in African-American neighborhoods are in MSAs where the percentage of subprime loans in these neighborhoods is over 50%. These rates of subprime lending in African-American neighborhoods go as high as 75% for an individual MSA. For Hispanics, almost 30% of all the subprime loans in heavily Hispanic neighborhoods are in MSAs where the percentage of subprime loans in these neighborhoods is over 50%. These rates of subprime lending in Hispanic neighborhoods also go as high as 75% for an individual MSA. There are no MSAs where the level of subprime lending in white neighborhoods is over 50%.

2. Disparity Ratios by the Race and Ethnicity of Census Tracts

Table #16 provides the data for the 72 MSAs that have adequate data for African-American census tracts and for the urban areas of the nation as a whole. The national urban disparity ratio is 2.70 - meaning that African-American census tracts, as a whole, have levels of subprime lending that are 2.7 times the levels in white census tracts. These are the same 72 MSAs that qualified for rankings on the level of subprime loans in African-American census tracts. Thus, they account for 95.09% of all the refinance loans in all African-American census tracts and 95.14% of all the subprime loans in these tracts.

The disparity ratios in these 72 MSAs range from a high of 4.12 (Chicago) to a low of 1.13 (Sumter, South Carolina). Therefore, there are racial disparities for all of the MSAs where this ratio could be calculated. One other MSA also had a ratio above 4.00. This is Milwaukee (4.04).

There are 65 of these MSAs that have disparity ratios above 2.0. These 65 MSAs account for 92.76% of all the refinance loans in all African-American census tracts and 92.95% of all the subprime loans in these tracts. This means that about 93% of the subprime loans in African-American neighborhoods are in MSAs where the levels of subprime lending in African-American census tracts are more than twice what they are in white census tracts. There are 8 MSAs that have disparity ratios above 3.0. These MSAs account for 30.67% of all the refinance loans in all African-American census tracts and 31.47% of all the subprime loans in these tracts. Thus, almost a third of the subprime loans in African-American neighborhoods are in MSAs where the levels of subprime lending in African-American neighborhoods are more than 3 times the levels in white neighborhoods.

Table 16 – Ranking by the Percentage of Subprime Lending for African-American Tracts Compared to White Tracts

(72 MSAs - Conventional Refinance Loans and Percent Subprime Are for African-American Census Tracts)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total for All African-American Tracts			70,145	56.92	2.70
1	Chicago, IL	8,272,768	5	7,928	54.78	4.12
2	Milwaukee-Waukesha, WI	1,500,741	5	456	54.39	4.04
3	Philadelphia, PA-NJ	5,100,931	3	3,498	71.81	3.40
4	Grand Rapids-Muskegon-Holland, MI	1,088,514	5	255	48.24	3.40
5	Detroit, MI	4,441,551	5	8,545	55.80	3.17
6	Dallas, TX	3,519,176	6	549	71.95	3.16
7	Hartford, CT	1,183,110	1	122	65.57	3.09
8	Little Rock-North Little Rock, AR	583,845	6	160	60.00	3.08
	Subtotal for the 8 MSAs where the African-American census tracts have a disparity ratio greater than 3.0 (represents 30.67% of all African-American census tract refinance loans and 31.47% of all such subprime loans)				58.41	3.47
9	Minneapolis-St. Paul, MN-WI	2,968,806	5	110	47.27	2.98
10	Birmingham, AL	921,106	4	744	58.06	2.97
11	Memphis, TN-AR-MS	1,135,614	4	1,503	69.66	2.94
12	Oakland, CA	2,392,557	9	1,048	44.94	2.93
13	Miami, FL	2,253,362	4	900	65.56	2.91

Table 16 – Ranking by the Percentage of Subprime Lending for African-American Tracts Compared to White Tracts

(72 MSAs - Conventional Refinance Loans and Percent Subprime Are for African-American Census Tracts)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total for All African-American Tracts			70,145	56.92	2.70
14	Montgomery, AL	333,055	4	221	46.15	2.89
15	Jackson, MS	440,801	4	365	58.63	2.87
16	Boston, MA-NH	3,406,829	1	519	51.45	2.85
17	Fort Wayne, IN	502,141	5	111	44.14	2.80
18	Las Vegas, NV-AZ	1,563,282	9	121	64.46	2.80
19	Shreveport-Bossier City, LA	392,302	6	225	62.67	2.73
20	Raleigh-Durham-Chapel Hill, NC	1,187,941	4	435	55.17	2.72
21	New Orleans, LA	1,337,726	6	1,047	58.17	2.71
22	Indianapolis, IN	1,607,486	5	895	55.20	2.68
23	Los Angeles-Long Beach, CA	9,519,338	9	2,919	41.32	2.68
24	Baltimore, MD	2,552,994	3	1,217	57.52	2.66
25	Baton Rouge, LA	602,894	6	499	57.52	2.65
26	Houston, TX	4,177,646	6	989	68.45	2.64
27	Washington, DC-MD-VA-WV	4,923,153	3	2,744	42.27	2.63
28	Flint, MI	436,141	5	469	48.83	2.59
29	West Palm Beach-Boca Raton, FL	1,131,184	4	184	60.87	2.58
30	Fort Lauderdale, FL	1,623,018	4	468	63.89	2.57
31	Louisville, KY-IN	1,025,598	4	942	43.63	2.55
32	Newark, NJ	2,032,989	2	917	52.56	2.54
33	Wilmington-Newark, DE-MD	586,216	3	117	71.79	2.54
34	Gary, IN	631,362	5	521	55.28	2.51
35	Kansas City, MO-KS	1,776,062	7	1,221	71.01	2.48
36	Cleveland-Lorain-Elyria, OH	2,250,871	5	2,891	61.81	2.45
37	Toledo, OH	618,203	5	268	55.22	2.43
38	Fort Worth-Arlington, TX	1,702,625	6	115	54.78	2.43
39	Richmond-Petersburg, VA	996,512	3	554	64.08	2.41
40	Albany, GA	120,822	4	103	46.60	2.41
41	Cincinnati, OH-KY-IN	1,646,395	5	600	51.00	2.41
42	New York, NY	9,314,235	2	3,748	59.90	2.39
43	Atlanta, GA	4,112,198	4	2,855	55.03	2.35
44	Oklahoma City, OK	1,083,346	6	273	65.20	2.33
45	Mobile, AL	540,258	4	353	58.92	2.30
46	Orlando, FL	1,644,561	4	257	70.43	2.27
47	Denver, CO	2,109,282	8	440	40.00	2.26
48	Columbus, OH	1,540,157	5	643	51.17	2.26
49	Savannah, GA	293,000	4	250	60.40	2.25
50	Tulsa, OK	803,235	6	215	52.56	2.23
51	Buffalo-Niagara Falls, NY	1,170,111	2	302	75.50	2.23
52	Macon, GA	322,549	4	110	55.45	2.18
53	Benton Harbor, MI	162,453	5	143	44.06	2.16
54	Chattanooga, TN-GA	465,161	4	137	66.42	2.15
55	Tampa-St. Petersburg-Clearwater, FL	2,395,997	4	534	64.98	2.14
56	St. Louis, MO-IL	2,603,607	7	2,359	56.72	2.14

Table 16 – Ranking by the Percentage of Subprime Lending for African-American Tracts Compared to White Tracts

(72 MSAs - Conventional Refinance Loans and Percent Subprime Are for African-American Census Tracts)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total for All African-American Tracts			70,145	56.92	2.70
57	Norfolk-Virginia Beach-Newport News, VA-NC	1,569,541	3	741	56.14	2.13
58	Jacksonville, FL	1,100,491	4	600	61.33	2.12
59	Pittsburgh, PA	2,358,695	3	485	63.09	2.11
60	Akron, OH	694,960	5	399	56.64	2.10
61	Dayton-Springfield, OH	950,558	5	879	57.34	2.08
62	Nassau-Suffolk, NY	2,753,913	2	634	64.04	2.07
63	Charlotte-Gastonia-Rock Hill, NC-SC	1,499,293	4	585	65.64	2.06
64	Greenville-Spartanburg-Anderson, SC	962,441	4	106	58.49	2.06
65	Greensboro--Winston-Salem--High Point, NC	1,251,509	4	525	56.95	2.02
	Subtotal for the 65 MSAs where the African-American census tracts have a disparity ratio greater than 2.0 (represents 92.76% of all African-American census tract refinance loans and 92.95% of all such subprime loans)				57.03	2.65
66	Columbus, GA-AL	274,624	4	211	61.61	1.95
67	Nashville, TN	1,231,311	4	519	51.83	1.91
68	Columbia, SC	536,691	4	403	57.32	1.89
69	Biloxi-Gulfport-Pascagoula, MS	363,988	4	110	47.27	1.82
70	Fayetteville, NC	302,963	4	133	61.65	1.64
71	Charleston-North Charleston, SC	549,033	4	127	48.03	1.57
72	Sumter, SC	104,646	4	131	38.17	1.13

Five of the top 10 ranked MSAs are in the Midwest region. Another 3 of the top 10 ranked MSAs are in the Southeast or Southwest regions. If we look at the 5 MSAs ranked just below the top 10, however, we see that 4 of these are in the Southeast. MSAs in the Southeast also include all 10 of the 72 MSAs with the lowest ranking on disparity rates, though all the MSAs show racial disparities. All of the MSAs, except Sumter, South Carolina, have disparity ratios above 1.5.

As we noted previously, smaller MSAs are not as likely to have census tracts that are at least 75% African-American and have 100 conventional refinance loans in 2000. Since the same 72 MSAs that qualified for rankings on the basic percent of subprime loans to African-American tracts also qualified for these rankings, the overall range of sizes remains the same - generally in the medium and larger sized MSAs. Eight of the 10 top ranked MSAs have populations over 1 million people. This includes 4 of the 10 largest MSAs in the country (Chicago, Philadelphia, Detroit, and Dallas), all with populations over 3 million people. Looked at from another view, 44 of the 61 MSAs with populations over 1 million people are included in Table #16. All but one of these MSAs has a disparity ratio greater than 2.0. The 2 smaller MSAs in the top 10 are Little Rock and Birmingham. Six of the 10 lowest ranked MSAs have populations under 550,000.

There were 12 MSAs that had adequate data to calculate the percentage of subprime loans in Hispanic census tracts. There are only 8 MSAs with adequate data to calculate racial

disparities comparing Hispanic and white census tracts. Table #17 shows the disparity ratios and related data for these 8 MSAs. There were 4 MSAs that had large Hispanic populations, but did not have 100 loans in their white tracts or did not have any white census tracts.[21]

The overall disparity ratio for Hispanic census tracts is 2.02. Even though there are just 8 MSAs for which these disparity ratios could be calculated, as a group, they account for 67.40% of all conventional refinance loans in Hispanic census tracts and 63.67% of all subprime loans in these tracts. That is, roughly two-thirds of the market for conventional refinance loans in heavily Hispanic neighborhoods were in census tracts where, collectively, over 40% of these loans are subprime and where the overall level of subprime loans was more than twice the level in white neighborhoods.

Individually, the disparity ratios for these 8 MSAs range from a high of 2.59 (Albuquerque) to a low of 1.77 (Los Angeles). There were 6 of these MSAs that had individual disparity ratios above 2.0. Taken as a group, these 6 MSAs represented about one-fourth of the market for conventional refinance loans (23.57%) in heavily Hispanic neighborhoods and about one-fourth of the share of the subprime market in these neighborhoods (27.12%). Overall, the percentage of subprime loans for this group is 49.04%. It is possible for a group of MSAs to have a collective disparity ratio greater than the ratio for any individual group. This is due to combination effects of the size of the Hispanic populations in different MSAs combined with the different levels of subprime lending for Hispanic and white census tracts in different MSAs. In the case of these 6 MSAs, the overall disparity ratio is actually 3.31, higher than for any individual MSA in the group.

With only 8 MSAs, it is not even possible for there to be MSAs in all 10 regions. On the other hand, 6 of the 8 MSAs are in the Southwest or Pacific region. Aside from Chicago, all of the MSAs are in the south or west.

All but one of these 8 MSAs in Table #17 have more than 700,000 people. As with the data for the basic percentage of subprime loans in Hispanic census tracts, only the larger MSAs are likely to meet the thresholds for the definition of a Hispanic tract and the number of loans in each census tract. Two of the 5 largest MSAs in the nation fall in this set of MSAs (Los Angeles and Chicago). Still, the top ranking MSA has slightly more than 700,000 people, and Corpus Christi, with less than 400,000 people, ranks 5th.

[21] All of these are in Texas. Two of these had fewer than 100 loans in white tracts (El Paso and Brownsville-Harlingen-San Benito). Two others do not have any white census tracts (Laredo and McAllen-Edinburg-Mission).

Table 17 - Ranking by the Percentage of Subprime Lending for Hispanic Tracts Compared to White Tracts

(8 MSAs - Conventional Refinance Loans and Percent Subprime Are for Hispanic Census Tracts)

	MSA Name	Population	HUD Region	Conventional Refinance Loans	Percent Subprime	Disparity Ratio
	National Urban Total for All Hispanic Tracts			7,309	42.63	2.02
1	Albuquerque, NM	712,738	6	210	51.90	2.59
2	Orange County, CA	2,846,289	9	101	37.62	2.41
3	San Antonio, TX	1,592,383	6	678	60.03	2.35
4	Tucson, AZ	843,746	9	225	41.33	2.29
5	Corpus Christi, TX	380,783	6	118	74.58	2.17
6	Chicago, IL	8,272,768	5	391	28.13	2.11
	Subtotal for the 6 MSAs where the Hispanic census tracts have a disparity ratio greater than 2.0 (represents 23.57% of all Hispanic census tract refinance loans and 27.12% of all such subprime loans)				49.04	3.31
7	Miami, FL	2,253,362	4	1,929	41.06	1.82
8	Los Angeles-Long Beach, CA	9,519,338	9	1,274	27.24	1.77

In sum, the review of the limited number of MSAs with adequate data for heavily African-American and Hispanic census tracts is compatible with the analysis for individual borrowers by race. African-American and Hispanic neighborhoods have high levels of subprime lending when compared to the norm for all borrowers in the urban parts of the country. Moreover, there are significant racial disparities in the levels of subprime lending when African-American and Hispanic census tracts are compared to white census tracts. These disparities exist for every MSA where these data could be calculated.

While these disparities exist for both African-American and Hispanic neighborhoods, the disparities are much greater and encompass a much larger share of all minority neighborhoods for African-Americans than for Hispanics. Over 90% of the subprime loans in African-American neighborhoods are in MSAs where the level of subprime lending in African-American neighborhoods is more than twice the level in the white neighborhoods. For Hispanics, over two-thirds of the subprime loans are in MSAs where the level of subprime lending in Hispanic neighborhoods is more than 1.75 times level in the white neighborhoods.

IV. Conclusion

A. Historical Discrimination in the Mortgage Markets

Discrimination has been a persistent problem in the home finance markets in the United States. This study reviews racial and ethnic differences in the patterns of subprime lending in the home refinance markets in all 331 Metropolitan Statistical Areas (MSAs) in the United States for loans originated in 2000. The persistent disparities in levels of subprime lending found in this

analysis do not constitute proof that there is widespread discrimination in the subprime lending markets. These disparities do, however, raise serious questions about the extent to which risk alone could account for such patterns. The history of discrimination in mortgage lending and several current analyses of the rapidly growing subprime markets add weight to the need to explore more fully the role that discrimination plays in the subprime markets through either treatment or through the effects of industry practices.

Redlining of racially-changing and minority communities before the 1970s was the product of prejudices written into the very standards of the real estate and lending industries.[22] The Federal Housing Administration (FHA) was one of the major redlining institutions, building discrimination into its underwriting standards.[23] When minorities could gain access to home loans, they were often through non-traditional lending, such as contracts for deed. These arrangements typically charged interest rates that were far above those charged by traditional lenders to white borrowers.[24] Moreover, these contracts often denied the borrower the right to build up equity prior to the final payment.

After the urban riots of the 1960s, there was an increased awareness of this historical discrimination. The passage of the Equal Credit Opportunity Act and the Fair Housing Act prohibited many past discriminatory practices and provided potential protections for the members of minority racial groups, ethnic groups, and religious groups that had been the targets of past discrimination. Subsequent revisions of these laws have increased these protections.

Still, some of the reforms led to additional types of exploitation. Traditionally, discrimination had taken place by exclusion of minorities from access to the mainstream of conventional and institutional forms of credit. By reversing its redlining practices without imposing any monitoring of the lenders using its loan products, the FHA contributed to lending practices that inundated minority and racially changing communities with FHA loans. Where FHA lending was concentrated in minority communities, FHA foreclosures and the resulting concentration of vacant and boarded up homes were also concentrated in minority communities. While many minority borrowers gained their first chance at homeownership, the rampant fraud and mismanagement in the use of the programs not only harmed tens of thousands of individual

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[22] See The National Commission on Neighborhoods, "Neighborhood Reinvestment," Chapter 1 in *People Building Neighborhoods: Final Report to the President and the Congress of the United States,* Washington, D.C.: U.S. Government Printing Office (1979), for a brief history of discrimination in FHA lending. Full citations are given the first time a document is referenced. The author, an abbreviated title, and the year are given for subsequent references.

[23] For example, Federal Housing Administration (1936) *Underwriting Manual*, Washington, D.C., U.S. Government Printing Office and Federal Housing Administration (1938) *Underwriting Manual*, Washington, D.C., U.S. Government Printing Office.

[24] See The National Commission on Neighborhoods, "Neighborhood Reinvestment," Chapter 1 in *People Building Neighborhoods* (1979) and U.S. Department of Housing and Urban Development, Office of Fair Housing and Equal Opportunity, *Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Lending,* Washington, D.C.: U.S. Government Printing Office (1977).

homeowners, but destroyed whole communities.[25] Moreover, the exploitation of minorities through continued use of contract sales and other forms of exploitation continued.[26] These forms of discrimination were defined by patterns of infusion - the infusion of minority markets with mortgage products that carried onerous terms and conditions or that were marked by fraud and abuses in underwriting and servicing.

All of this became the basis for additional national efforts to strengthen fair lending laws. Part of this effort has been to expand conventional lending to underserved populations - both lower-income populations and racial and ethnic minorities at all income levels. During the 1980s and early 1990s, progress was made in expanding conventional markets through setting purchasing goals for Fannie Mae and Freddie Mac - thus encouraging lenders to originate more loans to lower-income borrowers and minority borrowers. Community-based organizations initiated the basic loan programs that have now become the basis of many products by Fannie Mae and Freddie Mac. Progress was also made through the implementation of the Community Reinvestment Act, especially through reinvestment programs initiated by community-based organizations. Increased litigation against lending discrimination during this period and strengthened fair lending laws and regulations created pressures that discouraged lenders from engaging in the practices that had historically supported discriminatory lending markets.

B. Risk Alone Does Not Explain the Racial Disparities in Subprime Lending

The issue of whether there is racial exploitation in the subprime markets essentially rests on two situations. First, are there disparities in subprime lending related to race? Second, is it unlikely that these disparities can be fully explained by legitimate risk factors? We have several studies showing racial disparities and some evidence that risk alone does not explain the differences.

In addition to some studies with national level data[27], there have been individual cities or metropolitan areas where the disparities in subprime lending have been associated with race. In Baltimore, for example, the Public Justice Center published a study of the metropolitan mortgage lending markets that reviewed conventional lending, FHA lending, and subprime lending, including a review of GSE purchases controlling for subprime lending.[28] In Boston there has been a continuing series of mortgage lending studies from the Massachusetts Community & Banking Council. These studies were originally confined to general lending patterns, but in

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[25] See Brian Boyer, *Cities Destroyed for Cash: The FHA Scandal at HUD,* Chicago: Follett Publishing Company (1973).

[26] See Leonard Downie, Jr., *Mortgage on America: The Real Cost of Real Estate Speculation,* New York: Praeger Publishers (1974).

[27] See, for example, Barry Zigas and Paul Weech, *The Rise of Subprime Lending* (2001), pages 10-12 and U.S. Department of Housing and Urban Development, *Subprime Lending Report - Unequal Burden* (2000), pages 2-3.

[28] Calvin Bradford, *Crisis in Deja Vu: A Profile of the Racial Patterns in Home Purchase Lending in the Baltimore Area Market from 1995-1997,* Baltimore, Maryland: The Public Justice Center (2000).

recent years they have included the analyses of subprime lending as well.[29] In other places, like Chicago, there have been multiple studies of subprime lending done independently by different organizations.[30]

Some of the studies that have found racial disparities in subprime lending included more than one metropolitan area. For example, as background for its report on subprime lending, HUD engaged in detailed studies of five metropolitan areas.[31] Most recently, the Association of Community Organizations for Reform Now (ACORN) reviewed subprime lending in 60 of the larger metropolitan areas.[32]

Almost all of these studies that show large disparities in subprime lending related to race have been based on Home Mortgage Disclosure Act data. These data do not provide information on the credit profiles, loan-to-value (LTV) ratios, debt ratios, and some other factors generally associated with risk. Yet, there is reason to question whether large racial disparities can be explained away by risk factors alone. This is especially true when the racial disparities are within similar borrower income ranges.

Several factors indicate the need to question the ability of risk to explain these racial disparities in subprime lending. First, industry publications, such as *Inside B&C Lending*, indicate that almost two-thirds of subprime lending is comprised of A- loans.[33] These are loans on the margin between prime loan risk standards and the subprime market. Discrimination often occurs on the margins of eligibility.

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[29] See, for example, the following three studies by Jim Campen for the Massachusetts Community & Banking Council in Boston: *Borrowing Trouble? - Subprime Mortgage Lending in Greater Boston, 1999* (2001); *Borrowing Trouble? II - Subprime Lending in Greater Boston, 1999-2000* (2001); and *Changing Patterns VIII - Mortgage Lending to Traditionally Underserved Borrowers & Neighborhoods in Greater Boston, 1990-2000* (2001).

[30] See, for example, Daniel Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development,* Chicago: The Woodstock Institute (1999) and National Training and Information Center, *Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures,* Chicago: The National Training and Information Center (1999).

[31] See the following five studies by the U.S. Department of Housing and Urban Development: *Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending* (April 2000); *Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending* (May 2000); *Unequal Burden in Chicago: Income and Racial Disparities in Subprime Lending* (May 2000); *Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending* (April 2000); and *Unequal Burden in New York: Income and Racial Disparities in Subprime Lending* (May 2000).

[32] Association of Community Organizations for Reform Now (ACORN), *Separate and Unequal: Predatory Lending in America* (2001).

[33] "Retail Retains Momentum During First Half of 2001" in *Inside B&C Lending*, Bethesda, Maryland: Inside Mortgage Finance Publications (September 17, 2001), page 3.

Second, both Fannie Mae and Freddie Mac have questioned whether risk explains the use of subprime loans. Freddie Mac has estimated that from "10 to 30 percent of borrowers who obtained mortgages in the subprime market could have qualified for a conventional loan through Loan Prospector" (Freddie Mac's automated underwriting system).[34] In its discussion paper on subprime lending, Fannie Mae expresses the same confidence that a significant share of the subprime market actually could be served under prime risk underwriting standards. The draft reads, "evidence suggests that the competition in this market is limited and many borrowers are paying higher costs for their mortgage than they should." Another section reads, "research commissioned by Fannie Mae suggests that there are real opportunities for conventional prime market lenders to bring their low-cost financing options to markets now dominated by high-cost providers". Speaking specifically about minority communities and the growth of subprime lending there, the paper states that "the growth in subprime lending in these communities indicates that there are opportunities for prime credit lenders to serve more consumers and deliver value in some of these markets."[35]

Third, subprime refinance lending, in particular, is often "sold" to customers rather than "sought" by the borrower. Subprime lenders often engage in marketing designed to sell the advantages of loan consolidation or cash-back refinancing that allegedly lowers a borrower's monthly payments. Moreover, marketing techniques may disproportionately target minority market segments. For example, sophisticated marketing can target people who have loans that have not been refinanced in many years, creating the prospect of considerable equity against which to market a refinance loan. Also, sophisticated marketing can target persons with substantial reliance on credit card debt that can be consolidated into mortgage refinancing. In many urban areas where discrimination in past prime mortgage markets causes minorities to rely more heavily on credit card and finance company debt, such marketing is likely to disproportionately target minorities. At its recent conference on predatory lending, Fannie Mae officials highlighted recent research on market segments that indicated that minority borrowers were more likely than white borrowers to focus on whether they would be accepted for a loan. White borrowers were more likely than minority borrowers to focus on the costs of the loan.[36] This is consistent with the past history of discrimination. It would also make minorities more susceptible to the subprime marketing techniques which tend to minimize loan qualification issues and focus on the alleged advantages of refinancing.

Fourth, there is evidence that when risk factors are analyzed, racial differences in the use of subprime lending remains. Broad-scale subprime lending studies that analyze both race and individual risk are extremely rare and limited in scope. One recent study by the Research Institute for Housing America does attempt to control for risk factors in accounting for an analysis of

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[34] Freddie Mac, "We Open Doors for America's Families", *Freddie Mac's Annual Housing Activities Report for 1997*. McLean, Virginia: Freddie Mac (1998), pages 23-24.

[35] Barry Zigas and Paul Weech, *The Rise of Subprime Lending* (2001), pages 27, 24 and 6, respectively.

[36] The findings were presented at the Fannie Mae Predatory Lending Conference "Lending to Borrowers with Blemished Credit: Challenges and Opportunities", in the session "Blemished Credit Borrowers & the Non-Traditional Market", October 10, 2001. See also a review of this research and additional related information in Barry Zigas and Paul Weech, *The Rise of Subprime Lending* (2001), pages 26-27.

which borrowers receive subprime loans. The authors conclude that "after controlling for borrower income, debt, and credit history, racial groups behave differently". Specifically, the authors note that Blacks, Indians, Hispanics, and Asians are more likely to use subprime lending than are whites.[37] Collectively, the persistent historical patterns of discrimination in the mortgage markets, the marginal nature of the majority of the subprime market, the assessment by the GSEs that more of the market could be served by prime lenders, the marketing practices of subprime lenders, the perceptions of minorities concerning their treatment in the market, and the analysis of risk factors all lead to doubts that risk can adequately explain racial differences in the use of subprime loans.

C. Discriminatory Subprime Lending Harms both Individual Borrowers and Communities

When a borrower receives a subprime loan when they could have qualified for a conventional prime loan, that person suffers losses due to the higher costs and other onerous terms associated with subprime loans. These may be related to higher interest rates, higher loan fees, and costs typically not found in the prime market, such as prepayment penalties or single-premium credit insurance.[38] Subprime borrowers also suffer from foreclosure rates that are higher than comparable rates both FHA loans and for the prime market.[39]

In addition to the harm done to individuals who receive subprime loans when they could have received less onerous terms and conditions from a prime loan, there may be neighborhood impacts as well. Because of racial segregation patterns in this country, when subprime loans, and subprime foreclosures, are concentrated among minority populations, they also tend to be concentrated in minority neighborhoods as well. This has been a well-documented condition for FHA foreclosures and minority communities.[40] Concentrated foreclosures undermine property values and contribute to neighborhood decline and blight. One study of subprime foreclosures in Chicago found that "subprime lenders and servicers were responsible for 30 foreclosures in 1993.

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[37] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?*, Arlington, Virginia: Research Institute for Housing America (2000), page 13.

[38] See Barry Zigas and Paul Weech, *The Rise of Subprime Lending* (2001) for a review of many of these impacts.

[39] See the joint HUD/Treasury report *Curbing Predatory Lending* (2000), pages 34-35.

[40] Early studies documenting the neighborhood effects of FHA foreclosures are documented in The National Commission on Neighborhoods, "Neighborhood Reinvestment," Chapter 1 in *People Building Neighborhoods* (1979) and in U.S. Department of Housing and Urban Development, *Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Lending*, (1977). Contemporary studies include, for example, National Training and Information Center, *The Devil's in the Details: An Analysis of FHA Default Concentration and Lender Performance in 20 U.S. Cities*, Chicago: National Training and Information Center (1997) and Calvin Bradford, *Crisis in Deja Vu* (2000).

The number skyrocketed to 1,417 in 1998, a 4,623% increase.[41] Maps in this study show the areas in the Chicago metropolitan market where the foreclosures are located. The areas of heaviest foreclosures coincide with minority areas and areas of high FHA foreclosures identified in earlier studies. A study done by Abt Associates for HUD in Atlanta indicated that subprime foreclosures had increased 232% between 1996 and 1999 while prime lender foreclosures had decreased by 15%. The study indicates that the share of subprime foreclosures was higher in minority areas than in white areas.[42] HUD's review of foreclosure filings in the Baltimore area concludes, "In predominantly black tracts, subprime lenders accounted for 57 percent of mortgages being foreclosed (compared with a subprime market share of 42 percent [of the originations]). The data show that subprime loans were much quicker to foreclose than were conventional or FHA loans".[43]

In many different measures, this analysis of HMDA data for 2000 shows that racial disparities exist in MSAs all across the nation. At the national level for urban refinance loans, racial disparity ratios are 1.6 for Native Americans, over 1.7 for Hispanics, and over 2.8 for African-Americans. To the extent that income might explain racial differences, the data show that these disparities are actually greater for upper-income minorities than for lower-income whites.

These disparities are greatest for African-Americans. Racial disparities for African-Americans are greater than 3.0 for borrowers in the upper-income range. For refinance loans, 67% of all African-American borrowers live in neighborhoods where more than half the refinance loans are subprime. Racial disparities for African-Americans are as high as 6.04 in individual MSAs. Racial disparities for African-Americans are greater than 2.0 in every region, and greater than 2.7 in all MSA size ranges.

As we noted above, the pattern would be even worse if we had selected a less conservative threshold for calculating subprime measures. If we had set the threshold required for calculating minority disparity ratios at 20 conventional refinance loans rather than the 100 used in the analysis, then 311 of the 331 MSAs would have enough data to calculate an overall minority disparity ratio. In this case, 303 MSAs would have a minority disparity ratio greater than 1.0.

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[41] National Training and Information Center, *Preying on Neighborhoods* (1999), page 17.

[42] U.S. Department of Housing and Urban Development: *Unequal Burden in Atlanta* (2000), Figure 8 and pages 7-8.

[43] U.S. Department of Housing and Urban Development: *Unequal Burden in Baltimore* (2000), page 4 - see also Figure 8 and Figure 11.

This would be over 90% of all the 331 metropolitan areas in the nation. In addition, 160 MSAs - or 48% - would have minority disparity ratios over 2.0.

V. Methodological Notes

This study is based on the HMDA data. There are, of course, limitations on the completeness and accuracy of these data sets.[44] While HMDA data do not include all lenders, especially some subprime lenders, the HMDA data are the most complete set of publicly available mortgage data that include data on the race of the borrowers and the geographic locations of the loans. There are also limitations on the use of HUD's list of subprime lenders. Lenders that do not report HMDA data are not included. Some lenders not identified as subprime lenders make significant numbers of subprime loans. Some lenders identified as subprime lenders also make significant numbers of conventional prime loans. We have modified our analysis to screen each loan made by a HUD-designated subprime lender and to count any loan sold to Fannie Mae or Freddie Mac as a prime loan. Generally, this should reduce the miscounting of prime loans as subprime loans even though these GSEs do purchase small shares of subprime loans.

Subprime lenders have a relatively high incidence of non-reporting of racial data. For the HMDA data we have used in this analysis of refinance loans, more than 50% of the subprime loans are missing race data in 21 MSAs. Missing data for subprime loans runs as high at 66.67% in individual MSAs. Overall, 34.45% of all subprime loans had missing race data while only 18.87% of all prime conventional refinance loans are missing race data. In a discussion of issues related to HMDA data, Randall Scheessele notes that when the racial composition of census tracts is defined for loans that do not have data on the borrower's individual race, the loans with missing data are more likely to be in minority census tracts than in white census tracts.[45] Presumably, if full racial data were reported, the level of subprime loans in the minority population would increase. Therefore, the limitations of the data sources for loans and subprime lenders and even the screening process tend to create conservative estimates of the numbers of subprime loans in the market as well as the numbers of subprime loans to minorities.

In addition to identifying the race of the borrowers, we have also allocated all the loans in the analysis to census tracts that are identified by racial composition. Because the HMDA data are coded for 1990 census tracts, 1990 census data on race were used to code the census tracts. Using the definition of minority tracts employed by HUD in its *Subprime Lending Report*, census tracts are defined as minority or majority when more than 75% of the population is of a single racial or ethnic group. All other census tracts are defined as racially diverse. This is a conservative definition of minority census tracts compared to the more common practice of defining tracts as majority or minority based on 51% or more of the population.

To take account of racial change in the homeownership markets within the last decade, we have applied a technique of comparing the percentages of homeownership by racial group in 1990 to the percentages of home purchase loans reported for that racial group in the most recent three years of HMDA data. Where the percentage of a minority racial group's home purchase

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[44] See the discussion of these limitations by Randall Scheessele, *1998 HMDA Highlights* (1999), Appendix D, pages 7-10.

[45] Randall Scheessele, *1998 HMDA Highlights* (1999), pages 35-36.

loans are more than 25% greater than the percentage of homeownership by the group in 1990, these census tracts are defined as racially diverse. These calculations are only made for census tracts that had at least 50 home purchase loans with race reported during the three years of HMDA data. For example, assume that 15% of the homeowners in a census tract were reported as African-American in 1990 and 50% of the home purchase borrowers in the 1998-2000 HMDA data for that tract were reported as African-American. The difference in the percentage of African-American home purchase borrowers and the percentage of African-American homeowners in 1990 would be 35%. This is greater than 25%, so the tract would be defined as diverse. Comparable calculations would be made for each individual racial group and for minorities as a whole.

Income levels for individual borrowers are provided in the HMDA data. The analysis of subprime lending by income compares specific borrower income ranges for white and minority borrowers. These ranges are defined by comparing the borrower's reported income to HUD's estimated median family income for that MSA for the year 2000. Census tract incomes are based on the median family income of the census tracts in 1990. Census tract income ranges are defined by comparing the median family income of the census tract in 1990 to the 1990 median family income for the MSA in which the census tract was located in 1990.

Using these data and techniques, the analysis calculates the percentage of all conventional refinance loans that are subprime for various income and racial groups. Disparities in the percentage of subprime loans are created by comparing the percentage of subprime loans for one specific group to the percentage for another group. Because percentages have little meaning when very small numbers of loans are involved, the analysis focuses on subprime percentages only when there are at least 100 conventional loans in the specific category being reviewed. In all, the analysis incorporated 89 specific measures of subprime lending and racial disparities. The last section of the study provides a multi-part table with detailed data on each of these measures for all MSAs with adequate data to calculate measures. Each part of this table provides a total figure for all 331 MSAs combined, which we shall refer to as the national urban total. In each part of the table, MSAs are presented in rank order for a particular measure.[46] Technical notes on the methodology and the formats and notations in the tables precede the actual table data.

It is important to note that this analysis is confined to metropolitan areas. Partly, this is a result of the HMDA data not covering all areas of the nation. Nothing in this report should be taken to suggest that subprime lending and racial disparities in subprime lending are not prevalent in rural areas. Second, while Native Americans are included in the analysis, most concentrations of Native American populations are in lands outside of metropolitan areas. Moreover, Native American populations may be disproportionately served by manufactured housing lenders that have been excluded from this analysis. Therefore, the data on racial disparities for Native Americans in this study is severely limited.

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[46] MSAs that did not have at least 100 loans in a category necessary for a ranking were eliminated from the rankings. As a result, most rankings do not include all 331 MSAs. In the Detailed Table of Subprime Lending for All MSAs, the field headings for the rankings indicate how many MSAs are included in the rankings.

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VII. Supplemental Tables of Subprime Lending and Rankings for All MSAs

As background for this report, we calculated a total of 80 different measures of subprime lending for each of the 331 MSAs in the country. We developed rankings based on 64 of these measures. The table with this full set of measures and rankings can be downloaded from the Center for Community Change Web site (http://www.communitychange.org).

As a supplement to this report, we have included the following table which contains the base data on the numbers of conventional refinance loans and the percentages of these loans that are estimated to be subprime for selected borrower and census tract racial characteristics for all 331 MSAs. In addition, the table contains data on the overall percentage of conventional refinance loans that are estimated to be subprime for each MSA and the ratio relating this percentage to the overall national urban percentage of loans that are subprime. For each of these measures, the table also provides the ranking for that MSA, based on an order from the highest level of subprime lending to the lowest for each measure.

Calculations of the percentage of loans estimated to be subprime were made for each category in each MSA if there were at least 10 conventional refinance loans in that category. In order to be included in the rankings, however, there had to be at least 100 loans in each critical category. Therefore, some MSAs have subprime lending percentages for certain measures but no ranking. MSAs that did not have enough loans to meet our thresholds for calculations have blank fields for those subprime measures and rankings. The table headings indicate how many MSAs had enough loans for each ranking.

The racial definitions for census tract were designed to be conservative. That is, tracts needed to have high levels of racial concentration in order to qualify as white or minority tracts. In order to be defined as a white (non-Hispanic), African-American, or Hispanic census tract, the 1990 population had to be greater than 75% white (non-Hispanic), African-American, or Hispanic, respectively. Census tracts were defined as diverse if they met one of two conditions. First, the total minority population had to be equal to or less than 75% in 1990. Second, a tract that was initially defined as white would be redefined as diverse if our review of HMDA lending indicated that this was a tract that had experienced racial change. Census tracts were defined as having experienced racial change if there were at least 50 home purchase loans in that census tract reported for the 1998-2000 HMDA data and the percentage of minority home purchase borrowers in that tract was more than 25% greater than the percentage of minority home owners reported for that tract in the 1990 census. For these calculations, only the HMDA loans with racial data were used.

The Supplemental Table of Subprime Lending and Rankings is split into two parts. Part 1 contains data by the race or ethnicity of the borrower and Part 2 contains data by the racial composition of census tracts. Both parts include a row for the data for the national urban totals as a whole and a row for each individual MSA. The MSAs are listed alphabetically in the table.

Part 1 contains base data on the total levels of subprime lending for each MSA and data and rankings for the percentage of subprime loans to white, African-American, and Hispanic borrowers. For each MSA, Part 1 includes the following data:

The total number of conventional refinance loans for the 2000 HMDA Data;

The total percentage of conventional refinance loans estimated to be subprime and the MSA ranking for this percentage;

The ratio of the MSA percentage of loans estimated to be subprime to the national urban percentage of loans estimated to be subprime (the ranking for this measure is the same as the ranking for the percentage of loans estimated to be subprime in the measure above);

The percentage of loans estimated to be subprime for white borrowers and the MSA ranking for this percentage;

The percentage of loans estimated to be subprime for African-American borrowers and the MSA ranking for this percentage; and,

The percentage of loans estimated to be subprime for Hispanic borrowers and the MSA ranking for this percentage.

Part 2 contains subprime percentages and rankings based on the racial composition of census tracts. For reference purposes, Part 2 of the Supplemental Table repeats the data for the total percentage of loans in each MSA that are estimated to be subprime. For each MSA, Part 2 contains the following data:

The percentage of loans estimated to be subprime for white census tracts and the MSA ranking for this percentage;

The percentage of loans estimated to be subprime for diverse census tracts and the MSA ranking for this percentage;

The percentage of loans estimated to be subprime for African-American census tracts and the MSA ranking for this percentage; and,

The percentage of loans estimated to be subprime for Hispanic census tracts and the MSA ranking for this percentage.

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
1	Abilene, TX	292	26.03	144	1.03	20.20	102			35.00	
2	Akron, OH	7,788	30.43	76	1.20	22.66	51	50.79	69	30.00	
3	Albany, GA	656	29.12	95	1.15	7.77	317	44.20	111		
4	Albany-Schenectady-Troy, NY	3,805	30.12	82	1.19	22.56	55	47.06		55.56	
5	Albuquerque, NM	5,804	27.33	124	1.08	19.50	116	44.00	113	31.84	39
6	Alexandria, LA	1,106	19.08	254	0.75	10.84	293	36.02	149		
7	Allentown-Bethlehem-Easton, PA	5,022	18.30	265	0.72	13.13	258	34.62		16.28	
8	Altoona, PA	998	30.36	80	1.20	20.06	104				
9	Amarillo, TX	961	34.13	41	1.35	29.22	11	71.79		41.11	
10	Anchorage, AK	865	15.03	298	0.59	12.75	262	39.13		26.67	
11	Ann Arbor, MI	7,526	14.40	301	0.57	9.89	304	37.92	141	15.25	
12	Anniston, AL	799	23.53	188	0.93	17.07	174	44.30			
13	Appleton-Oshkosh-Neenah, WI	4,836	6.82	328	0.27	5.66	326			20.00	
14	Asheville, NC	2,203	25.65	149	1.01	20.31	98	38.82			
15	Athens, GA	1,090	19.45	249	0.77	11.50	287	36.67	145		
16	Atlanta, GA	34,129	31.57	69	1.25	14.78	229	45.73	99	23.45	82
17	Atlantic-Cape May, NJ	2,977	25.33	156	1.00	16.12	193	43.45	119	15.94	
18	Auburn-Opelika, AL	625	24.32	169	0.96	14.67	232	46.32			
19	Augusta-Aiken, GA-SC	3,077	28.79	101	1.14	13.29	255	43.31	121	31.58	
20	Austin-San Marcos, TX	5,709	27.99	113	1.11	21.15	82	63.22	9	42.40	6
21	Bakersfield, CA	2,590	22.59	201	0.89	16.75	182	43.04		27.48	64
22	Baltimore, MD	16,749	26.74	131	1.06	17.27	167	45.41	100	27.73	61
23	Bangor, ME	649	16.33	289	0.65	12.72	263				
24	Barnstable-Yarmouth, MA	2,325	20.30	238	0.80	14.83	228	18.18		16.67	
25	Baton Rouge, LA	5,491	28.97	98	1.14	15.74	199	45.76	98	26.67	
26	Beaumont-Port Arthur, TX	1,160	44.48	5	1.76	35.42	3	60.44	16	32.35	
27	Bellingham, WA	1,175	18.13	266	0.72	15.79	197			43.75	
28	Benton Harbor, MI	1,817	23.89	184	0.94	14.33	236	46.63	91	17.65	
29	Bergen-Passaic, NJ	7,600	23.76	186	0.94	18.55	141	44.41	108	27.27	68
30	Billings, MT	934	15.85	293	0.63	14.27	240			26.67	
31	Biloxi-Gulfport-Pascagoula, MS	3,225	28.25	111	1.12	20.28	100	46.25	94	43.48	
32	Binghamton, NY	854	32.08	61	1.27	23.30	46				
33	Birmingham, AL	6,783	28.67	105	1.13	17.83	157	54.33	44	29.41	
34	Bismarck, ND	619	10.50	320	0.41	5.87	323				

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
35	Bloomington, IN	865	15.84	294	0.63	12.63	264	18.18			
36	Bloomington-Normal, IL	1,218	12.56	312	0.50	10.46	298	23.33			
37	Boise City, ID	3,062	20.80	233	0.82	19.02	128			26.02	72
38	Boston, MA-NH	29,290	20.26	239	0.80	15.26	214	42.93	124	29.67	46
39	Boulder-Longmont, CO	3,314	12.04	316	0.48	10.48	297	13.64		17.12	99
40	Brazoria, TX	829	33.41	50	1.32	25.10	29	34.04		42.22	
41	Bremerton, WA	1,808	24.28	171	0.96	19.20	122	46.67		44.44	
42	Bridgeport, CT	3,726	23.81	185	0.94	17.22	171	48.65	79	28.23	59
43	Brockton, MA	2,721	26.20	140	1.04	20.12	103	40.45		32.26	
44	Brownsville-Harlingen-San Benito, TX	795	35.97	29	1.42	19.58	113			31.96	38
45	Bryan-College Station, TX	363	18.73	259	0.74	12.02	277	21.43		42.86	
46	Buffalo-Niagara Falls, NY	5,218	39.36	15	1.56	29.96	8	74.53	1	48.57	
47	Burlington, VT	1,141	12.88	309	0.51	7.41	318				
48	Canton-Massillon, OH	4,911	31.62	68	1.25	23.92	39	54.47	43	57.14	
49	Casper, WY	512	19.73	247	0.78	13.71	249			33.33	
50	Cedar Rapids, IA	1,862	13.32	306	0.53	11.96	279	41.67			
51	Champaign-Urbana, IL	951	14.20	302	0.56	8.90	311	28.00			
52	Charleston, WV	1,910	23.56	187	0.93	17.48	162	47.27			
53	Charleston-North Charleston, SC	4,307	33.76	47	1.33	19.10	127	56.86	30	35.29	
54	Charlotte-Gastonia-Rock Hill, NC-SC	14,789	36.07	28	1.42	17.97	154	47.34	87	15.46	
55	Charlottesville, VA	789	20.91	228	0.83	14.92	225	35.59			
56	Chattanooga, TN-GA	4,011	34.73	38	1.37	26.14	18	68.21	3	40.00	
57	Cheyenne, WY	767	17.47	273	0.69	14.90	226			32.50	
58	Chicago, IL	76,530	22.05	208	0.87	13.15	257	50.55	71	22.33	85
59	Chico-Paradise, CA	1,342	19.90	242	0.79	15.65	203			23.08	
60	Cincinnati, OH-KY-IN	18,383	23.92	183	0.95	18.53	142	43.64	116	20.00	
61	Clarksville-Hopkinsville, TN-KY	1,181	29.81	87	1.18	19.56	114	48.94		43.75	
62	Cleveland-Lorain-Elyria, OH	21,630	33.12	52	1.31	22.41	57	55.49	34	36.04	20
63	Colorado Springs, CO	5,321	21.48	217	0.85	16.64	184	47.89	83	27.30	67
64	Columbia, MO	1,112	12.77	311	0.50	8.91	310	35.00			
65	Columbia, SC	4,576	35.34	33	1.40	19.79	107	58.66	25	36.84	
66	Columbus, GA-AL	1,799	42.63	7	1.68	23.08	47	60.26	18	40.00	
67	Columbus, OH	15,525	26.14	142	1.03	18.49	144	48.33	80	24.39	
68	Corpus Christi, TX	1,061	46.84	2	1.85	29.64	10	68.18		47.42	3

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
69	Corvallis, OR	350	17.14	278	0.68	16.10	194				
70	Cumberland, MD-WV	841	18.79	258	0.74	11.63	285	10.34			
71	Dallas, TX	13,276	30.51	75	1.21	21.65	68	61.68	13	30.66	44
72	Danbury, CT	1,763	17.36	275	0.69	13.19	256	34.29		20.00	
73	Danville, VA	802	38.53	17	1.52	23.58	45	52.87	53		
74	Davenport-Moline-Rock Island, IA-IL	3,935	19.77	245	0.78	18.56	140	38.46	138	22.99	
75	Daytona Beach, FL	3,477	38.77	16	1.53	30.22	7	59.22	22	39.50	10
76	Dayton-Springfield, OH	10,309	32.45	59	1.28	23.91	41	52.13	57	26.32	
77	Decatur, AL	1,113	22.73	199	0.90	17.59	159	64.71			
78	Decatur, IL	851	24.79	162	0.98	18.39	147	58.18			
79	Denver, CO	32,316	21.54	214	0.85	17.26	169	44.92	105	34.18	31
80	Des Moines, IA	4,806	24.86	161	0.98	22.31	58	37.50		30.36	
81	Detroit, MI	63,592	26.55	137	1.05	15.17	215	51.17	65	28.95	55
82	Dothan, AL	992	16.94	283	0.67	10.29	301	53.77	46		
83	Dover, DE	1,075	28.74	103	1.14	21.13	83	43.37			
84	Dubuque, IA	546	26.19	141	1.03	25.90	20				
85	Duluth-Superior, MN-WI	3,166	12.41	314	0.49	10.74	294				
86	Dutchess County, NY	1,873	22.32	204	0.88	15.11	219	41.07		21.21	
87	Eau Claire, WI	1,452	8.26	324	0.33	6.13	322				
88	El Paso, TX	1,767	47.82	1	1.89	31.46	5	56.25		52.36	1
89	Elkhart-Goshen, IN	1,756	21.24	223	0.84	17.75	158	40.74		17.95	
90	Elmira, NY	394	28.43	107	1.12	18.32	149	30.00			
91	Enid, OK	427	40.75	12	1.61	37.97	1	66.67			
92	Erie, PA	2,610	22.84	197	0.90	15.71	200	60.78		27.27	
93	Eugene-Springfield, OR	2,242	27.39	122	1.08	26.20	17			41.94	
94	Evansville-Henderson, IN-KY	2,824	27.37	123	1.08	22.14	61	64.08	7	40.00	
95	Fargo-Moorhead, ND-MN	1,101	9.99	323	0.39	7.31	319				
96	Fayetteville, NC	1,814	41.23	11	1.63	20.29	99	53.71	47	27.59	
97	Fayetteville-Springdale-Rogers, AR	2,814	17.06	282	0.67	12.97	260			22.22	
98	Fitchburg-Leominster, MA	1,186	29.60	90	1.17	26.01	19			50.00	
99	Flagstaff, AZ-UT	788	20.30	237	0.80	18.80	133			12.07	
100	Flint, MI	6,288	23.06	193	0.91	15.70	201	42.15	127	30.14	
101	Florence, AL	1,182	18.53	261	0.73	14.21	242	44.83			
102	Florence, SC	963	36.55	23	1.44	19.02	129	55.94	33		

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
103	Fort Collins-Loveland, CO	3,072	13.25	307	0.52	11.37	288	14.29		25.86	74
104	Fort Lauderdale, FL	8,804	33.41	51	1.32	24.44	36	48.68	78	31.98	37
105	Fort Myers-Cape Coral, FL	3,070	33.09	53	1.31	25.44	26	54.62	41	40.00	9
106	Fort Pierce-Port St. Lucie, FL	2,211	21.85	210	0.86	14.97	224	38.84	136	23.08	
107	Fort Smith, AR-OK	1,413	23.35	189	0.92	16.43	189	64.52			
108	Fort Walton Beach, FL	1,044	19.83	244	0.78	11.76	284	31.71		18.75	
109	Fort Wayne, IN	6,216	18.32	263	0.72	13.33	254	44.65	106	25.00	
110	Fort Worth-Arlington, TX	6,485	26.14	143	1.03	21.26	77	50.93	66	30.14	45
111	Fresno, CA	4,100	26.41	138	1.04	18.50	143	48.21	82	44.00	5
112	Gadsden, AL	795	27.04	128	1.07	21.53	75	48.84			
113	Gainesville, FL	1,002	29.44	92	1.16	17.11	173	54.48	42	6.67	
114	Galveston-Texas City, TX	944	41.63	10	1.64	30.33	6	81.08		57.33	
115	Gary, IN	5,477	30.14	81	1.19	19.77	108	51.44	62	29.25	53
116	Glens Falls, NY	717	29.57	91	1.17	20.62	93				
117	Goldsboro, NC	681	37.00	21	1.46	18.69	136	57.49	27		
118	Grand Forks, ND-MN	469	12.79	310	0.51	8.54	314				
119	Grand Junction, CO	1,558	17.91	271	0.71	16.98	178			26.74	
120	Grand Rapids-Muskegon-Holland, MI	13,479	16.32	290	0.64	11.94	280	43.01	123	21.18	87
121	Great Falls, MT	646	16.56	287	0.65	14.87	227				
122	Greeley, CO	2,367	21.08	225	0.83	17.57	161	30.00		31.71	41
123	Green Bay, WI	3,471	5.56	329	0.22	5.26	327				
124	Greensboro--Winston-Salem--High Point, NC	10,104	32.83	55	1.30	19.55	115	48.22	81	30.30	
125	Greenville, NC	658	27.66	120	1.09	17.58	160	49.17	77		
126	Greenville-Spartanburg-Anderson, SC	8,621	30.09	84	1.19	20.53	95	46.26	93	27.27	
127	Hagerstown, MD	985	24.16	177	0.95	15.79	198				
128	Hamilton-Middletown, OH	3,794	24.72	163	0.98	22.10	63	36.30	147	33.33	
129	Harrisburg-Lebanon-Carlisle, PA	5,427	18.85	256	0.74	12.54	266	43.60	117	19.61	
130	Hartford, CT	7,187	24.24	174	0.96	17.25	170	49.41	74	36.36	19
131	Hattiesburg, MS	1,099	24.02	181	0.95	15.01	222	50.76	70		
132	Hickory-Morganton-Lenoir, NC	3,481	36.08	27	1.43	25.46	25	50.83	68	50.00	
133	Honolulu, HI	2,590	18.30	264	0.72	11.83	283	23.81		26.09	
134	Houma, LA	1,682	20.75	234	0.82	11.97	278	44.68			
135	Houston, TX	14,552	35.70	30	1.41	26.47	15	64.41	5	35.75	22
136	Huntington-Ashland, WV-KY-OH	2,824	22.20	206	0.88	16.80	181	37.50			

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
137	Huntsville, AL	2,138	21.52	215	0.85	13.84	246	53.64	48	33.33	
138	Indianapolis, IN	17,963	24.19	175	0.96	18.56	139	46.13	95	34.82	27
139	Iowa City, IA	705	5.25	331	0.21	4.67	330	10.00			
140	Jackson, MI	2,085	22.64	200	0.89	15.36	211	51.52		28.57	
141	Jackson, MS	2,700	32.07	63	1.27	12.49	267	53.37	49		
142	Jackson, TN	750	29.60	89	1.17	12.44	271	50.92	67		
143	Jacksonville, FL	7,792	35.61	31	1.41	24.63	34	56.76	31	37.50	15
144	Jacksonville, NC	695	28.78	102	1.14	17.07	175	72.41			
145	Jamestown, NY	737	40.71	13	1.61	34.52	4				
146	Janesville-Beloit, WI	2,124	12.10	315	0.48	9.33	306	32.14		12.12	
147	Jersey City, NJ	1,687	35.39	32	1.40	25.83	21	55.28	36	28.37	57
148	Johnson City-Kingsport-Bristol, TN-VA	4,289	20.07	241	0.79	13.12	259	25.93		23.08	
149	Johnstown, PA	1,623	23.29	190	0.92	12.88	261	33.33			
150	Jonesboro, AR	722	10.80	319	0.43	5.69	325	25.00			
151	Joplin, MO	1,388	16.07	291	0.63	10.43	299	20.00			
152	Kalamazoo-Battle Creek, MI	4,901	21.30	220	0.84	15.31	212	45.97	96	28.07	
153	Kankakee, IL	922	24.51	166	0.97	12.14	274	74.04	2	41.38	
154	Kansas City, MO-KS	19,011	34.02	43	1.34	20.66	91	61.70	12	39.07	11
155	Kenosha, WI	1,590	16.67	285	0.66	13.40	252	33.33		21.74	
156	Killeen-Temple, TX	683	44.80	4	1.77	37.41	2	77.19		68.75	
157	Knoxville, TN	5,995	28.36	109	1.12	22.79	50	42.11	128		
158	Kokomo, IN	1,078	22.82	198	0.90	18.15	152	41.03			
159	La Crosse, WI-MN	1,257	5.49	330	0.22	4.69	329				
160	Lafayette, IN	1,238	18.82	257	0.74	15.55	204	14.29		4.76	
161	Lafayette, LA	3,373	20.31	236	0.80	10.72	295	29.86	151	22.22	
162	Lake Charles, LA	1,484	25.94	146	1.02	15.06	221	43.48	118		
163	Lakeland-Winter Haven, FL	3,234	36.92	22	1.46	28.52	12	63.75	8	35.90	21
164	Lancaster, PA	2,973	17.09	280	0.68	11.93	281	34.48		31.58	
165	Lansing-East Lansing, MI	5,346	20.95	227	0.83	15.38	210	38.20	140	34.31	30
166	Laredo, TX	342	45.32	3	1.79	28.57				37.75	14
167	Las Cruces, NM	988	19.53	248	0.77	11.20	290			19.35	93
168	Las Vegas, NV-AZ	10,628	25.98	145	1.03	21.60	70	46.53	92	30.76	43
169	Lawrence, KS	780	16.67	286	0.66	10.93	292	22.22			
170	Lawrence, MA-NH	4,165	20.98	226	0.83	16.47	188	38.71		35.36	23

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
171	Lawton, OK	686	29.88	86	1.18	24.25	37	43.42		56.25	
172	Lewiston-Auburn, ME	596	18.12	267	0.72	9.21	308				
173	Lexington, KY	4,693	17.56	272	0.69	13.37	253	42.92	125	13.04	
174	Lima, OH	1,775	24.06	178	0.95	16.18	192	42.11			
175	Lincoln, NE	2,183	17.09	281	0.68	12.48	268	18.18		13.04	
176	Little Rock-North Little Rock, AR	3,865	25.25	157	1.00	14.49	235	45.24	103	18.75	
177	Longview-Marshall, TX	651	30.41	78	1.20	14.56	234	34.55			
178	Los Angeles-Long Beach, CA	58,756	21.41	219	0.85	16.69	183	41.30	132	25.42	76
179	Louisville, KY-IN	13,878	19.74	246	0.78	14.28	239	38.47	137	14.58	
180	Lowell, MA-NH	2,846	23.09	191	0.91	17.95	156	35.71		35.71	
181	Lubbock, TX	711	33.90	45	1.34	22.65	52	54.84		63.27	
182	Lynchburg, VA	1,615	31.70	67	1.25	19.92	105	51.37	63		
183	Macon, GA	2,381	34.86	36	1.38	18.28	150	56.96	29	27.27	
184	Madison, WI	3,665	7.37	327	0.29	5.85	324	14.29		13.95	
185	Manchester, NH	1,539	25.41	154	1.00	19.48	117			36.36	
186	Mansfield, OH	1,996	26.60	135	1.05	18.45	146	40.54		20.00	
187	McAllen-Edinburg-Mission, TX	1,345	37.62	18	1.49	22.46	56			34.94	26
188	Medford-Ashland, OR	1,482	24.36	167	0.96	23.90	42			26.32	
189	Melbourne-Titusville-Palm Bay, FL	2,725	31.34	70	1.24	24.63	33	55.48	35	46.38	
190	Memphis, TN-AR-MS	7,577	41.86	9	1.65	18.85	131	61.76	11	48.28	
191	Merced, CA	1,054	27.80	118	1.10	21.57	72	45.83		36.90	18
192	Miami, FL	10,701	42.67	6	1.69	25.38	27	59.26	21	34.95	25
193	Middlesex-Somerset-Hunterdon, NJ	6,884	22.92	194	0.91	19.69	110	37.24	143	34.08	32
194	Milwaukee-Waukesha, WI	12,595	19.33	251	0.76	10.64	296	45.84	97	20.49	90
195	Minneapolis-St. Paul, MN-WI	38,141	17.94	270	0.71	15.11	220	51.65	60	20.63	88
196	Missoula County, MT	751	10.12	321	0.40	10.40	300				
197	Mobile, AL	4,384	32.44	60	1.28	21.79	65	62.08	10	14.29	
198	Modesto, CA	2,749	24.66	164	0.97	22.01	64	33.33		27.01	70
199	Monmouth-Ocean, NJ	9,149	24.32	170	0.96	20.84	87	47.13	89	33.11	34
200	Monroe, LA	1,131	22.90	195	0.90	10.07	303	43.98	114		
201	Montgomery, AL	2,080	24.18	176	0.96	11.55	286	52.93	52		
202	Muncie, IN	1,243	28.80	100	1.14	24.53	35	44.83			
203	Myrtle Beach, SC	1,722	21.89	209	0.86	15.81	196	44.07	112		
204	Naples, FL	1,793	23.98	182	0.95	15.99	195	57.58		38.46	12

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
205	Nashua, NH	1,665	22.16	207	0.88	16.87	180			53.33	
206	Nashville, TN	11,053	30.37	79	1.20	21.55	73	50.23	72	29.41	
207	Nassau-Suffolk, NY	20,903	34.47	40	1.36	25.65	23	54.64	39	32.54	36
208	New Bedford, MA	1,197	27.15	127	1.07	21.23	79	44.00		73.33	
209	New Haven-Meriden, CT	3,593	28.83	99	1.14	22.21	59	54.30	45	40.58	
210	New London-Norwich, CT-RI	1,834	24.05	179	0.95	21.06	84	39.29		34.78	
211	New Orleans, LA	10,069	30.57	73	1.21	15.14	218	52.04	58	29.00	54
212	New York, NY	23,104	36.50	25	1.44	21.63	69	51.91	59	35.11	24
213	Newark, NJ	11,492	27.92	115	1.10	20.88	86	49.19	76	25.65	75
214	Newburgh, NY-PA	2,205	34.06	42	1.35	27.91	13	50.00		40.79	
215	Norfolk-Virginia Beach-Newport News, VA-NC	8,508	32.53	58	1.29	16.59	185	43.25	122	30.00	
216	Oakland, CA	32,139	20.67	235	0.82	15.40	209	41.58	129	25.99	73
217	Ocala, FL	1,902	33.70	48	1.33	23.04	48	46.72	90	16.16	
218	Odessa-Midland, TX	663	27.90	116	1.10	19.12	125	46.67		24.24	79
219	Oklahoma City, OK	8,796	31.03	72	1.23	23.70	44	60.31	17	27.45	66
220	Olympia, WA	1,519	22.84	196	0.90	18.99	130	47.06		24.00	
221	Omaha, NE-IA	7,332	24.88	160	0.98	18.61	138	60.06	19	37.27	16
222	Orange County, CA	25,437	17.11	279	0.68	15.45	205	33.70	150	24.67	78
223	Orlando, FL	10,275	36.18	26	1.43	25.02	30	56.25	32	37.23	17
224	Owensboro, KY	982	14.66	300	0.58	12.09	275	58.33			
225	Panama City, FL	1,195	20.08	240	0.79	8.07	316	45.45			
226	Parkersburg-Marietta, WV-OH	1,609	25.17	158	0.99	18.20	151	46.15			
227	Pensacola, FL	2,867	33.97	44	1.34	21.48	76	61.15	14	14.29	
228	Peoria-Pekin, IL	3,601	17.19	276	0.68	12.08	276	40.14	134	25.00	
229	Philadelphia, PA-NJ	33,093	30.11	83	1.19	17.33	165	58.92	24	38.11	13
230	Phoenix-Mesa, AZ	31,470	25.51	152	1.01	19.74	109	47.86	84	40.36	7
231	Pine Bluff, AR	364	36.54	24	1.44	15.43	206	43.21			
232	Pittsburgh, PA	24,438	31.75	66	1.25	22.62	53	58.48	26	55.38	
233	Pittsfield, MA	531	13.18	308	0.52	8.72	313				
234	Pocatello, ID	412	22.33	203	0.88	19.35	118				
235	Portland, ME	1,902	19.19	253	0.76	14.27	241				
236	Portland-Vancouver, OR-WA	14,674	23.07	192	0.91	20.83	88	45.36	101	28.36	58
237	Portsmouth-Rochester, NH-ME	2,001	17.99	269	0.71	12.45	270	35.71			
238	Providence-Fall River-Warwick, RI-MA	9,841	26.56	136	1.05	20.57	94	57.26	28	44.03	4

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
239	Provo-Orem, UT	3,500	16.69	284	0.66	15.41	208			26.21	71
240	Pueblo, CO	2,087	28.41	108	1.12	22.86	49	51.72		29.39	51
241	Punta Gorda, FL	1,122	30.04	85	1.19	22.12	62	20.63		42.42	
242	Racine, WI	1,893	19.07	255	0.75	12.21	273	47.32	88	35.14	
243	Raleigh-Durham-Chapel Hill, NC	8,516	25.33	155	1.00	11.87	282	47.84	85	20.63	
244	Rapid City, SD	669	15.40	297	0.61	15.43	207				
245	Reading, PA	2,504	21.49	216	0.85	15.17	216	36.84		30.30	
246	Redding, CA	1,117	21.58	212	0.85	18.74	134			33.33	
247	Reno, NV	2,192	18.11	268	0.72	16.27	191	33.33		19.23	94
248	Richland-Kennewick-Pasco, WA	883	21.18	224	0.84	15.27	213			25.76	
249	Richmond-Petersburg, VA	6,449	35.04	35	1.38	17.31	166	52.54	56	33.33	
250	Riverside-San Bernardino, CA	21,506	26.62	134	1.05	24.02	38	44.41	109	33.14	33
251	Roanoke, VA	1,821	28.28	110	1.12	17.06	176	43.33	120		
252	Rochester, MN	1,208	13.33	305	0.53	12.24	272	18.18			
253	Rochester, NY	5,385	25.92	147	1.02	19.14	124	45.36	102	28.07	
254	Rockford, IL	3,695	21.60	211	0.85	17.12	172	49.40	75	19.17	95
255	Rocky Mount, NC	872	39.68	14	1.57	25.00	31	54.64	40		
256	Sacramento, CA	14,053	22.34	202	0.88	18.81	132	44.62	107	31.46	42
257	Saginaw-Bay City-Midland, MI	5,320	15.85	292	0.63	10.25	302	29.86	152	20.38	91
258	Salem, OR	2,292	24.04	180	0.95	21.58	71			34.35	29
259	Salinas, CA	3,466	21.47	218	0.85	14.66	233	38.54		29.52	49
260	Salt Lake City-Ogden, UT	14,561	21.57	213	0.85	19.83	106	42.86		27.60	63
261	San Angelo, TX	293	31.06	71	1.23	21.18	81			25.64	
262	San Antonio, TX	5,270	41.90	8	1.66	29.64	9	64.08	6	51.46	2
263	San Diego, CA	27,712	21.25	222	0.84	19.12	126	36.24	148	29.59	48
264	San Francisco, CA	16,407	14.10	303	0.56	8.89	312	36.63	146	20.60	89
265	San Jose, CA	19,998	15.45	295	0.61	11.23	289	27.04	154	27.47	65
266	San Luis Obispo-Atascadero-Paso Robles, CA	2,252	17.45	274	0.69	16.33	190	20.00		22.31	86
267	Santa Barbara-Santa Maria-Lompoc, CA	3,184	12.53	313	0.50	9.28	307	25.64		18.24	97
268	Santa Cruz-Watsonville, CA	2,833	15.43	296	0.61	13.75	248	43.75		17.76	98
269	Santa Fe, NM	1,497	19.24	252	0.76	14.32	237			23.69	80
270	Santa Rosa, CA	6,219	16.51	288	0.65	14.71	231	24.14		22.57	84
271	Sarasota-Bradenton, FL	3,854	29.11	96	1.15	20.48	97	67.48	4	40.00	
272	Savannah, GA	2,140	33.83	46	1.34	15.67	202	52.77	55		

Part 1 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Borrower Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	Ranking by Total Percent Subprime (331 MSAs)	Ratio of MSA % Subprime to Total National Urban % Subprime	White Borrower Percent Subprime	Ranking by Percent White Borrower Subprime (330 MSAs)	African-American Borrower Percent Subprime	Ranking by Percent African-American Borrower Subprime (154 MSAs)	Hispanic Borrower Percent Subprime	Ranking by Percent Hispanic Borrower Subprime (99 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
273	Scranton--Wilkes-Barre--Hazleton, PA	5,489	25.63	150	1.01	18.72	135	42.11		47.62	
274	Seattle-Bellevue-Everett, WA	22,516	19.85	243	0.78	17.04	177	40.00	135	27.62	62
275	Sharon, PA	1,253	32.08	62	1.27	26.20	16	54.55			
276	Sheboygan, WI	1,220	10.00	322	0.40	8.20	315			4.35	
277	Sherman-Denison, TX	509	35.17	34	1.39	18.34	148	36.36			
278	Shreveport-Bossier City, LA	2,504	30.55	74	1.21	13.63	250	42.19	126	25.00	
279	Sioux City, IA-NE	1,160	18.45	262	0.73	17.35	163			10.00	
280	Sioux Falls, SD	1,598	7.95	325	0.31	6.91	321				
281	South Bend, IN	2,334	28.62	106	1.13	21.69	66	50.00	73	36.36	
282	Spokane, WA	2,830	24.95	159	0.99	20.69	90	20.00		23.08	
283	Springfield, IL	2,067	11.08	318	0.44	7.11	320	35.37			
284	Springfield, MA	2,793	27.96	114	1.10	19.67	111	59.50	20	50.65	
285	Springfield, MO	3,080	14.77	299	0.58	10.99	291	16.67		7.69	
286	St. Cloud, MN	1,462	11.22	317	0.44	9.06	309				
287	St. Joseph, MO	1,189	26.75	130	1.06	19.22	121				
288	St. Louis, MO-IL	31,741	32.02	64	1.27	14.15	243	51.55	61	23.48	81
289	Stamford-Norwalk, CT	2,984	13.40	304	0.53	9.86	305	28.93	153	19.42	92
290	State College, PA	840	19.40	250	0.77	16.59	186				
291	Steubenville-Weirton, OH-WV	1,123	32.95	54	1.30	25.58	24	52.63			
292	Stockton-Lodi, CA	4,414	26.64	133	1.05	23.77	43	41.54	130	28.08	60
293	Sumter, SC	734	37.33	19	1.47	22.56	54	47.39	86		
294	Syracuse, NY	3,068	29.69	88	1.17	22.18	60	65.08		33.33	
295	Tacoma, WA	6,298	26.29	139	1.04	21.54	74	37.87	142	27.10	69
296	Tallahassee, FL	1,630	34.85	37	1.38	19.25	120	58.93	23	33.33	
297	Tampa-St. Petersburg-Clearwater, FL	17,833	33.59	49	1.33	25.74	22	60.95	15	34.51	28
298	Terre Haute, IN	1,748	24.26	172	0.96	18.68	137	59.38			
299	Texarkana, TX-Texarkana, AR	463	31.97	65	1.26	12.54	265	34.21			
300	Toledo, OH	7,465	27.15	126	1.07	18.49	145	51.27	64	28.38	56
301	Topeka, KS	1,166	28.73	104	1.14	21.68	67	36.00		26.92	
302	Trenton, NJ	1,837	25.42	153	1.00	16.52	187	45.03	104	25.00	
303	Tucson, AZ	6,524	22.30	205	0.88	14.29	238	43.80	115	32.92	35
304	Tulsa, OK	5,768	25.52	151	1.01	20.80	89	41.36	131	25.64	
305	Tuscaloosa, AL	1,134	24.25	173	0.96	13.63	251	52.86	54		
306	Tyler, TX	540	29.26	94	1.16	15.15	217	59.02		15.38	

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31			17.42		49.28		30.33	
307	Utica-Rome, NY	1,471	29.30	93	1.16	19.64	112	53.85			
308	Vallejo-Fairfield-Napa, CA	6,938	21.26	221	0.84	17.26	168	38.39	139	29.26	52
309	Ventura, CA	8,305	17.17	277	0.68	14.76	230	41.12	133	23.06	83
310	Victoria, TX	220	37.27	20	1.47	20.91	85			57.14	
311	Vineland-Millville-Bridgeton, NJ	779	34.53	39	1.36	26.88	14	44.19		46.94	
312	Visalia-Tulare-Porterville, CA	1,556	29.05	97	1.15	21.20	80	35.29		40.00	8
313	Waco, TX	564	27.84	117	1.10	19.25	119	65.62		46.15	
314	Washington, DC-MD-VA-WV	32,067	20.88	230	0.82	12.46	269	36.79	144	18.88	96
315	Waterbury, CT	1,276	27.27	125	1.08	17.35	164	43.33		35.71	
316	Waterloo-Cedar Falls, IA	1,267	20.84	232	0.82	14.10	245	50.72			
317	Wausau, WI	1,418	7.69	326	0.30	5.15	328				
318	West Palm Beach-Boca Raton, FL	6,038	28.20	112	1.11	21.24	78	53.36	50	29.63	47
319	Wheeling, WV-OH	1,180	30.42	77	1.20	20.49	96	61.54			
320	Wichita Falls, TX	412	32.77	57	1.29	25.27	28	61.54		52.38	
321	Wichita, KS	3,958	26.96	129	1.06	19.20	123	55.24	37	30.00	
322	Williamsport, PA	933	20.90	229	0.83	13.79	247				
323	Wilmington, NC	2,291	26.71	132	1.06	16.89	179	44.30	110		
324	Wilmington-Newark, DE-MD	4,553	32.81	56	1.30	23.91	40	53.31	51	52.38	
325	Worcester, MA-CT	3,921	24.66	165	0.97	20.66	92	47.06		32.00	
326	Yakima, WA	1,409	25.76	148	1.02	20.24	101	26.67		31.76	40
327	Yolo, CA	873	20.85	231	0.82	17.96	155			24.75	77
328	York, PA	3,174	18.65	260	0.74	14.13	244	35.48		6.67	
329	Youngstown-Warren, OH	6,450	27.50	121	1.09	18.05	153	54.83	38	35.14	
330	Yuba City, CA	655	27.79	119	1.10	24.88	32			21.95	
331	Yuma, AZ	723	24.34	168	0.96	15.00	223			29.49	50

Part 2 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Census Tract Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	White Tract Percent Subprime	Ranking by Percent White Tracts Subprime (329 MSAs)	Diverse Tract Percent Subprime	Ranking by Percent Diverse Tracts Subprime (204 MSAs)	African-American Tract Percent Subprime	Ranking by Percent African-American Tracts Subprime (72 MSAs)	Hispanic Tract Percent Subprime	Ranking by Percent Hispanic Tracts Subprime (12 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
1	Abilene, TX	292	26.03	24.14	110	41.94					
2	Akron, OH	7,788	30.43	26.97	72	54.97	16	56.64	40		
3	Albany, GA	656	29.12	19.35	212	38.71	119	46.60	63		
4	Albany-Schenectady-Troy, NY	3,805	30.12	29.55	41	51.52					
5	Albuquerque, NM	5,804	27.33	20.05	198	30.12	171			51.90	4
6	Alexandria, LA	1,106	19.08	13.95	290	32.22	162	43.75			
7	Allentown-Bethlehem-Easton, PA	5,022	18.30	17.46	243	26.30	183				
8	Altoona, PA	998	30.36	30.36	32						
9	Amarillo, TX	961	34.13	29.25	45	52.12	26				
10	Anchorage, AK	865	15.03	14.92	283	21.43					
11	Ann Arbor, MI	7,526	14.40	13.68	292	30.30	167	46.00			
12	Anniston, AL	799	23.53	21.07	175	45.45		69.23			
13	Appleton-Oshkosh-Neenah, WI	4,836	6.82	6.84	326	4.55					
14	Asheville, NC	2,203	25.65	24.54	103	37.17	135	52.78			
15	Athens, GA	1,090	19.45	16.92	253	30.25	169	66.67			
16	Atlanta, GA	34,129	31.57	23.42	131	42.04	91	55.03	48		
17	Atlantic-Cape May, NJ	2,977	25.33	23.26	135	37.46	128	44.00			
18	Auburn-Opelika, AL	625	24.32	24.89	97	23.26	193	20.00			
19	Augusta-Aiken, GA-SC	3,077	28.79	23.29	133	37.37	130	43.24			
20	Austin-San Marcos, TX	5,709	27.99	22.71	145	44.64	70	80.60		59.18	
21	Bakersfield, CA	2,590	22.59	19.31	213	26.08	186				
22	Baltimore, MD	16,749	26.74	21.62	166	37.18	134	57.52	34		
23	Bangor, ME	649	16.33	16.33	264						
24	Barnstable-Yarmouth, MA	2,325	20.30	20.30	190						
25	Baton Rouge, LA	5,491	28.97	21.72	163	38.35	121	57.52	35		
26	Beaumont-Port Arthur, TX	1,160	44.48	39.19	5	57.71	10	60.00			
27	Bellingham, WA	1,175	18.13	18.36	228	7.69					
28	Benton Harbor, MI	1,817	23.89	20.41	186	46.85	52	44.06	67		
29	Bergen-Passaic, NJ	7,600	23.76	20.24	194	28.55	177	50.67			
30	Billings, MT	934	15.85	15.85	273						
31	Biloxi-Gulfport-Pascagoula, MS	3,225	28.25	25.99	81	38.90	117	47.27	62		
32	Binghamton, NY	854	32.08	32.00	23						
33	Birmingham, AL	6,783	28.67	19.58	205	42.78	85	58.06	33		
34	Bismarck, ND	619	10.50	10.50	314						

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	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	White Tract Percent Subprime	Ranking by Percent White Tracts Subprime (329 MSAs)	Diverse Tract Percent Subprime	Ranking by Percent Diverse Tracts Subprime (204 MSAs)	African-American Tract Percent Subprime	Ranking by Percent African-American Tracts Subprime (72 MSAs)	Hispanic Tract Percent Subprime	Ranking by Percent Hispanic Tracts Subprime (12 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
35	Bloomington, IN	865	15.84	15.84	274						
36	Bloomington-Normal, IL	1,218	12.56	12.56	304						
37	Boise City, ID	3,062	20.80	20.63	181	36.36					
38	Boston, MA-NH	29,290	20.26	18.08	231	33.16	156	51.45	55		
39	Boulder-Longmont, CO	3,314	12.04	11.84	308	24.53					
40	Brazoria, TX	829	33.41	32.65	18	39.36					
41	Bremerton, WA	1,808	24.28	24.28	108						
42	Bridgeport, CT	3,726	23.81	18.30	229	42.24	87	57.69			
43	Brockton, MA	2,721	26.20	24.66	100	33.62	153				
44	Brownsville-Harlingen-San Benito, TX	795	35.97	8.33	321	34.13	147			43.23	6
45	Bryan-College Station, TX	363	18.73	16.51	262	31.25					
46	Buffalo-Niagara Falls, NY	5,218	39.36	33.87	15	70.55	1	75.50	1		
47	Burlington, VT	1,141	12.88	12.88	300						
48	Canton-Massillon, OH	4,911	31.62	29.91	38	58.50	9				
49	Casper, WY	512	19.73	19.73	201						
50	Cedar Rapids, IA	1,862	13.32	13.12	298	33.33					
51	Champaign-Urbana, IL	951	14.20	12.85	301	32.43		63.64			
52	Charleston, WV	1,910	23.56	23.26	136	43.33		20.00			
53	Charleston-North Charleston, SC	4,307	33.76	30.59	31	37.35	131	48.03	60		
54	Charlotte-Gastonia-Rock Hill, NC-SC	14,789	36.07	31.80	24	52.24	25	65.64	10		
55	Charlottesville, VA	789	20.91	20.05	197	33.96					
56	Chattanooga, TN-GA	4,011	34.73	30.85	30	56.80	12	66.42	9		
57	Cheyenne, WY	767	17.47	15.71	276	35.82					
58	Chicago, IL	76,530	22.05	13.31	295	28.49	178	54.78	50	28.13	11
59	Chico-Paradise, CA	1,342	19.90	19.90	199						
60	Cincinnati, OH-KY-IN	18,383	23.92	21.17	173	39.56	111	51.00	57		
61	Clarksville-Hopkinsville, TN-KY	1,181	29.81	25.89	83	45.89	59				
62	Cleveland-Lorain-Elyria, OH	21,630	33.12	25.24	91	45.62	61	61.81	21		
63	Colorado Springs, CO	5,321	21.48	19.56	208	40.70	101				
64	Columbia, MO	1,112	12.77	12.60	303						
65	Columbia, SC	4,576	35.34	30.25	34	44.60	71	57.32	37		
66	Columbus, GA-AL	1,799	42.63	31.62	25	51.56	28	61.61	23		
67	Columbus, OH	15,525	26.14	22.64	147	43.44	77	51.17	56		
68	Corpus Christi, TX	1,061	46.84	34.38	13	48.08	42			74.58	1

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
69	Corvallis, OR	350	17.14	17.14	249						
70	Cumberland, MD-WV	841	18.79	18.79	221						
71	Dallas, TX	13,276	30.51	22.77	143	42.94	83	71.95	2	61.90	
72	Danbury, CT	1,763	17.36	17.21	248	24.32					
73	Danville, VA	802	38.53	35.63	10	44.87	66				
74	Davenport-Moline-Rock Island, IA-IL	3,935	19.77	18.38	227	42.17	90				
75	Daytona Beach, FL	3,477	38.77	37.07	7	64.71	3	58.93			
76	Dayton-Springfield, OH	10,309	32.45	27.51	66	46.66	55	57.34	36		
77	Decatur, AL	1,113	22.73	20.39	188	40.80	100				
78	Decatur, IL	851	24.79	21.82	162	58.21					
79	Denver, CO	32,316	21.54	17.67	238	35.65	140	40.00	71		
80	Des Moines, IA	4,806	24.86	24.32	107	37.10	136				
81	Detroit, MI	63,592	26.55	17.59	239	45.03	63	55.80	42		
82	Dothan, AL	992	16.94	14.38	287	32.69	159	47.37			
83	Dover, DE	1,075	28.74	28.00	62	39.71					
84	Dubuque, IA	546	26.19	26.19	80						
85	Duluth-Superior, MN-WI	3,166	12.41	12.41	305						
86	Dutchess County, NY	1,873	22.32	21.82	161	51.61					
87	Eau Claire, WI	1,452	8.26	8.26	322						
88	El Paso, TX	1,767	47.82	17.24	246	43.69	76			59.36	3
89	Elkhart-Goshen, IN	1,756	21.24	20.82	178	39.02					
90	Elmira, NY	394	28.43	28.06	60						
91	Enid, OK	427	40.75	40.75	2						
92	Erie, PA	2,610	22.84	21.69	165	70.49					
93	Eugene-Springfield, OR	2,242	27.39	27.39	69						
94	Evansville-Henderson, IN-KY	2,824	27.37	25.58	85	62.90	4				
95	Fargo-Moorhead, ND-MN	1,101	9.99	9.99	317						
96	Fayetteville, NC	1,814	41.23	37.68	6	41.43	94	61.65	22		
97	Fayetteville-Springdale-Rogers, AR	2,814	17.06	16.62	259	25.95	187				
98	Fitchburg-Leominster, MA	1,186	29.60	29.38	43	37.50					
99	Flagstaff, AZ-UT	788	20.30	19.69	202	25.64					
100	Flint, MI	6,288	23.06	18.83	219	43.05	80	48.83	58		
101	Florence, AL	1,182	18.53	17.47	242	35.19					
102	Florence, SC	963	36.55	29.59	39	40.33	104	57.89			

Part 2 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Census Tract Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	White Tract Percent Subprime	Ranking by Percent White Tracts Subprime (329 MSAs)	Diverse Tract Percent Subprime	Ranking by Percent Diverse Tracts Subprime (204 MSAs)	African-American Tract Percent Subprime	Ranking by Percent African-American Tracts Subprime (72 MSAs)	Hispanic Tract Percent Subprime	Ranking by Percent Hispanic Tracts Subprime (12 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
103	Fort Collins-Loveland, CO	3,072	13.25	13.25	296						
104	Fort Lauderdale, FL	8,804	33.41	24.82	98	39.47	114	63.89	18		
105	Fort Myers-Cape Coral, FL	3,070	33.09	31.10	27	60.53	6	65.96			
106	Fort Pierce-Port St. Lucie, FL	2,211	21.85	19.52	209	37.02	137	52.17			
107	Fort Smith, AR-OK	1,413	23.35	20.60	183	42.22	88				
108	Fort Walton Beach, FL	1,044	19.83	19.29	214	39.29					
109	Fort Wayne, IN	6,216	18.32	15.74	275	43.98	74	44.14	66		
110	Fort Worth-Arlington, TX	6,485	26.14	22.52	149	39.58	110	54.78	49		
111	Fresno, CA	4,100	26.41	18.90	218	32.73	158	81.48		50.67	
112	Gadsden, AL	795	27.04	24.47	104	38.18	123	47.83			
113	Gainesville, FL	1,002	29.44	24.45	105	62.16	5	65.00			
114	Galveston-Texas City, TX	944	41.63	39.42	4	49.09	37	66.67			
115	Gary, IN	5,477	30.14	22.04	158	47.03	48	55.28	44		
116	Glens Falls, NY	717	29.57	29.57	40						
117	Goldsboro, NC	681	37.00	29.47	42	44.80	67	67.65			
118	Grand Forks, ND-MN	469	12.79	12.79	302						
119	Grand Junction, CO	1,558	17.91	17.88	236	20.00					
120	Grand Rapids-Muskegon-Holland, MI	13,479	16.32	14.21	289	37.96	124	48.24	59		
121	Great Falls, MT	646	16.56	16.56	261						
122	Greeley, CO	2,367	21.08	20.31	189	25.13	189				
123	Green Bay, WI	3,471	5.56	5.56	327						
124	Greensboro--Winston-Salem--High Point, NC	10,104	32.83	28.19	57	46.64	56	56.95	38		
125	Greenville, NC	658	27.66	22.78	142	37.20	132	48.48			
126	Greenville-Spartanburg-Anderson, SC	8,621	30.09	28.43	54	39.92	108	58.49	31		
127	Hagerstown, MD	985	24.16	23.98	113						
128	Hamilton-Middletown, OH	3,794	24.72	23.46	129	56.25	13	54.05			
129	Harrisburg-Lebanon-Carlisle, PA	5,427	18.85	16.60	260	42.90	84	51.95			
130	Hartford, CT	7,187	24.24	21.21	172	40.33	103	65.57	11		
131	Hattiesburg, MS	1,099	24.02	20.50	185	33.80	150	64.44			
132	Hickory-Morganton-Lenoir, NC	3,481	36.08	35.96	9	48.48					
133	Honolulu, HI	2,590	18.30	8.70	320	14.94	204				
134	Houma, LA	1,682	20.75	19.14	216	30.20	170				
135	Houston, TX	14,552	35.70	25.95	82	43.03	81	68.45	8	53.33	
136	Huntington-Ashland, WV-KY-OH	2,824	22.20	21.70	164	40.26					

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
137	Huntsville, AL	2,138	21.52	17.23	247	41.03	99	41.18			
138	Indianapolis, IN	17,963	24.19	20.61	182	37.79	125	55.20	46		
139	Iowa City, IA	705	5.25	5.25	329						
140	Jackson, MI	2,085	22.64	22.16	155	32.79		40.00			
141	Jackson, MS	2,700	32.07	20.40	187	38.29	122	58.63	30		
142	Jackson, TN	750	29.60	23.53	127	44.87	65	60.61			
143	Jacksonville, FL	7,792	35.61	28.95	49	50.75	29	61.33	24		
144	Jacksonville, NC	695	28.78	27.74	64	50.00					
145	Jamestown, NY	737	40.71	40.25	3						
146	Janesville-Beloit, WI	2,124	12.10	11.80	309	28.21					
147	Jersey City, NJ	1,687	35.39	23.98	114	35.61	141	66.67			
148	Johnson City-Kingsport-Bristol, TN-VA	4,289	20.07	19.83	200	40.38					
149	Johnstown, PA	1,623	23.29	23.17	137	38.46					
150	Jonesboro, AR	722	10.80	10.80	313						
151	Joplin, MO	1,388	16.07	16.07	268						
152	Kalamazoo-Battle Creek, MI	4,901	21.30	19.56	207	44.54	72	50.55			
153	Kankakee, IL	922	24.51	15.39	281	65.00	2	73.81			
154	Kansas City, MO-KS	19,011	34.02	28.64	50	59.15	7	71.01	5		
155	Kenosha, WI	1,590	16.67	16.40	263	41.18					
156	Killeen-Temple, TX	683	44.80	41.11	1	53.99	22				
157	Knoxville, TN	5,995	28.36	27.41	68	49.73	34	52.54			
158	Kokomo, IN	1,078	22.82	20.80	179	61.11					
159	La Crosse, WI-MN	1,257	5.49	5.49	328						
160	Lafayette, IN	1,238	18.82	18.82	220						
161	Lafayette, LA	3,373	20.31	17.10	251	24.19	191	49.30			
162	Lake Charles, LA	1,484	25.94	21.62	167	44.79	68	42.62			
163	Lakeland-Winter Haven, FL	3,234	36.92	34.88	11	48.70	38	70.59			
164	Lancaster, PA	2,973	17.09	15.85	272	31.95	163				
165	Lansing-East Lansing, MI	5,346	20.95	19.58	204	40.52	102	21.21			
166	Laredo, TX	342	45.32							48.31	5
167	Las Cruces, NM	988	19.53	11.28	311	19.55	199			31.18	
168	Las Vegas, NV-AZ	10,628	25.98	23.01	139	37.19	133	64.46	15		
169	Lawrence, KS	780	16.67	16.67	258						
170	Lawrence, MA-NH	4,165	20.98	19.06	217	41.27	95				

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Part 2 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Census Tract Race/Ethnicity

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
171	Lawton, OK	686	29.88	28.98	48	30.00					
172	Lewiston-Auburn, ME	596	18.12	18.12	230						
173	Lexington, KY	4,693	17.56	16.83	255	34.97	144	48.15			
174	Lima, OH	1,775	24.06	22.09	157	52.33		60.87			
175	Lincoln, NE	2,183	17.09	17.06	252						
176	Little Rock-North Little Rock, AR	3,865	25.25	19.46	210	47.13	46	60.00	27		
177	Longview-Marshall, TX	651	30.41	28.17	58	35.43	142	55.00			
178	Los Angeles-Long Beach, CA	58,756	21.41	15.43	278	22.96	195	41.32	70	27.24	12
179	Louisville, KY-IN	13,878	19.74	17.12	250	34.84	145	43.63	68		
180	Lowell, MA-NH	2,846	23.09	22.50	150	33.78	151				
181	Lubbock, TX	711	33.90	27.58	65	47.75	43			61.11	
182	Lynchburg, VA	1,615	31.70	29.03	47	54.07	21	69.57			
183	Macon, GA	2,381	34.86	25.40	90	55.01	15	55.45	43		
184	Madison, WI	3,665	7.37	7.33	325	13.04					
185	Manchester, NH	1,539	25.41	25.41	89						
186	Mansfield, OH	1,996	26.60	24.62	101	54.55	18				
187	McAllen-Edinburg-Mission, TX	1,345	37.62			33.74	152			42.37	7
188	Medford-Ashland, OR	1,482	24.36	24.36	106						
189	Melbourne-Titusville-Palm Bay, FL	2,725	31.34	29.31	44	58.82	8				
190	Memphis, TN-AR-MS	7,577	41.86	23.70	123	53.35	23	69.66	7		
191	Merced, CA	1,054	27.80	22.73	144	30.45	165				
192	Miami, FL	10,701	42.67	22.55	148	37.55	126	65.56	12	41.06	9
193	Middlesex-Somerset-Hunterdon, NJ	6,884	22.92	20.08	196	27.68	179				
194	Milwaukee-Waukesha, WI	12,595	19.33	13.46	293	38.84	118	54.39	51		
195	Minneapolis-St. Paul, MN-WI	38,141	17.94	15.88	271	40.03	106	47.27	61		
196	Missoula County, MT	751	10.12	10.12	315						
197	Mobile, AL	4,384	32.44	25.57	86	50.13	31	58.92	29		
198	Modesto, CA	2,749	24.66	22.47	151	28.56	176				
199	Monmouth-Ocean, NJ	9,149	24.32	23.29	134	43.43	78	70.59			
200	Monroe, LA	1,131	22.90	14.35	288	48.57	40	54.35			
201	Montgomery, AL	2,080	24.18	15.99	269	34.15	146	46.15	64		
202	Muncie, IN	1,243	28.80	27.04	71			55.13			
203	Myrtle Beach, SC	1,722	21.89	20.52	184	25.06	190	41.38			
204	Naples, FL	1,793	23.98	23.42	130	55.17					

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
205	Nashua, NH	1,665	22.16	22.16	154						
206	Nashville, TN	11,053	30.37	27.07	70	47.45	45	51.83	54		
207	Nassau-Suffolk, NY	20,903	34.47	30.90	29	46.63	57	64.04	17		
208	New Bedford, MA	1,197	27.15	26.39	79	46.67					
209	New Haven-Meriden, CT	3,593	28.83	24.15	109	46.94	49	63.83			
210	New London-Norwich, CT-RI	1,834	24.05	23.71	122	35.19					
211	New Orleans, LA	10,069	30.57	21.47	170	39.08	116	58.17	32		
212	New York, NY	23,104	36.50	25.03	94	39.86	109	59.90	28	54.29	
213	Newark, NJ	11,492	27.92	20.68	180	37.54	127	52.56	52		
214	Newburgh, NY-PA	2,205	34.06	33.29	17	46.83	53				
215	Norfolk-Virginia Beach-Newport News, VA-NC	8,508	32.53	26.41	78	41.18	96	56.14	41		
216	Oakland, CA	32,139	20.67	15.36	282	23.23	194	44.94	65	28.57	
217	Ocala, FL	1,902	33.70	32.49	20	41.59	93	63.41			
218	Odessa-Midland, TX	663	27.90	21.32	171	39.50	112				
219	Oklahoma City, OK	8,796	31.03	28.03	61	46.92	50	65.20	13		
220	Olympia, WA	1,519	22.84	22.84	141						
221	Omaha, NE-IA	7,332	24.88	21.51	169	46.87	51	64.95			
222	Orange County, CA	25,437	17.11	15.59	277	21.02	197			37.62	10
223	Orlando, FL	10,275	36.18	31.01	28	45.90	58	70.43	6		
224	Owensboro, KY	982	14.66	14.66	286						
225	Panama City, FL	1,195	20.08	18.49	226	48.57		54.17			
226	Parkersburg-Marietta, WV-OH	1,609	25.17	25.17	92						
227	Pensacola, FL	2,867	33.97	28.52	52	54.84	17	81.82			
228	Peoria-Pekin, IL	3,601	17.19	16.28	265	45.36					
229	Philadelphia, PA-NJ	33,093	30.11	21.10	174	45.77	60	71.81	3		
230	Phoenix-Mesa, AZ	31,470	25.51	20.97	176	42.45	86			57.58	
231	Pine Bluff, AR	364	36.54	21.89	160	52.50	24	60.47			
232	Pittsburgh, PA	24,438	31.75	29.96	37	52.07	27	63.09	19		
233	Pittsfield, MA	531	13.18	13.18	297						
234	Pocatello, ID	412	22.33	22.25	153						
235	Portland, ME	1,902	19.19	19.19	215						
236	Portland-Vancouver, OR-WA	14,674	23.07	22.32	152	40.29	105	44.44			
237	Portsmouth-Rochester, NH-ME	2,001	17.99	17.99	234						
238	Providence-Fall River-Warwick, RI-MA	9,841	26.56	25.13	93	43.08	79				

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
239	Provo-Orem, UT	3,500	16.69	16.69	257						
240	Pueblo, CO	2,087	28.41	23.74	120	33.96	149				
241	Punta Gorda, FL	1,122	30.04	30.04	36						
242	Racine, WI	1,893	19.07	17.39	245	47.89					
243	Raleigh-Durham-Chapel Hill, NC	8,516	25.33	20.26	192	36.99	138	55.17	47		
244	Rapid City, SD	669	15.40	15.40	280						
245	Reading, PA	2,504	21.49	19.57	206	35.81	139				
246	Redding, CA	1,117	21.58	21.58	168						
247	Reno, NV	2,192	18.11	17.74	237	23.57	192				
248	Richland-Kennewick-Pasco, WA	883	21.18	19.67	203	32.38	161				
249	Richmond-Petersburg, VA	6,449	35.04	26.56	76	47.09	47	64.08	16		
250	Riverside-San Bernardino, CA	21,506	26.62	23.77	119	30.35	166			48.81	
251	Roanoke, VA	1,821	28.28	23.97	115	54.17	20	58.75			
252	Rochester, MN	1,208	13.33	13.33	294						
253	Rochester, NY	5,385	25.92	23.99	112	49.22	36	65.79			
254	Rockford, IL	3,695	21.60	17.88	235	41.71	92				
255	Rocky Mount, NC	872	39.68	36.01	8	42.22	89	51.35			
256	Sacramento, CA	14,053	22.34	20.12	195	30.30	168				
257	Saginaw-Bay City-Midland, MI	5,320	15.85	13.76	291	37.43	129	42.35			
258	Salem, OR	2,292	24.04	23.86	117	27.27	180				
259	Salinas, CA	3,466	21.47	12.95	299	28.67	175				
260	Salt Lake City-Ogden, UT	14,561	21.57	20.25	193	33.47	154				
261	San Angelo, TX	293	31.06	28.35	55	37.23					
262	San Antonio, TX	5,270	41.90	25.52	88	50.35	30	58.33		60.03	2
263	San Diego, CA	27,712	21.25	18.70	222	27.17	181	41.38			
264	San Francisco, CA	16,407	14.10	9.31	319	17.75	200	36.67			
265	San Jose, CA	19,998	15.45	12.07	307	16.98	201				
266	San Luis Obispo-Atascadero-Paso Robles, CA	2,252	17.45	17.45	244						
267	Santa Barbara-Santa Maria-Lompoc, CA	3,184	12.53	11.58	310	16.01	202				
268	Santa Cruz-Watsonville, CA	2,833	15.43	15.43	279	15.38	203				
269	Santa Fe, NM	1,497	19.24	14.83	284	20.90	198			30.00	
270	Santa Rosa, CA	6,219	16.51	16.20	266	29.33	172				
271	Sarasota-Bradenton, FL	3,854	29.11	26.70	75	55.83	14	73.91			
272	Savannah, GA	2,140	33.83	26.88	73	44.88	64	60.40	26		

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	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
273	Scranton--Wilkes-Barre--Hazleton, PA	5,489	25.63	25.63	84						
274	Seattle-Bellevue-Everett, WA	22,516	19.85	18.67	223	28.76	174				
275	Sharon, PA	1,253	32.08	31.58	26	48.65					
276	Sheboygan, WI	1,220	10.00	10.00	316						
277	Sherman-Denison, TX	509	35.17	34.56	12	50.00					
278	Shreveport-Bossier City, LA	2,504	30.55	22.98	140	39.47	113	62.67	20		
279	Sioux City, IA-NE	1,160	18.45	16.77	256	26.21	184				
280	Sioux Falls, SD	1,598	7.95	7.95	323						
281	South Bend, IN	2,334	28.62	24.77	99	50.00	32	64.29			
282	Spokane, WA	2,830	24.95	24.94	95						
283	Springfield, IL	2,067	11.08	9.95	318	44.62					
284	Springfield, MA	2,793	27.96	23.38	132	45.09	62	72.22			
285	Springfield, MO	3,080	14.77	14.77	285						
286	St. Cloud, MN	1,462	11.22	11.22	312						
287	St. Joseph, MO	1,189	26.75	26.75	74						
288	St. Louis, MO-IL	31,741	32.02	26.53	77	48.28	41	56.72	39		
289	Stamford-Norwalk, CT	2,984	13.40	12.38	306	35.34	143				
290	State College, PA	840	19.40	19.40	211						
291	Steubenville-Weirton, OH-WV	1,123	32.95	32.49	21	61.11					
292	Stockton-Lodi, CA	4,414	26.64	23.52	128	28.87	173				
293	Sumter, SC	734	37.33	33.75	16	41.07	97	38.17	72		
294	Syracuse, NY	3,068	29.69	28.47	53	54.21	19				
295	Tacoma, WA	6,298	26.29	25.54	87	38.67	120				
296	Tallahassee, FL	1,630	34.85	27.89	63	43.96	75	63.16			
297	Tampa-St. Petersburg-Clearwater, FL	17,833	33.59	30.34	33	48.61	39	64.98	14		
298	Terre Haute, IN	1,748	24.26	23.55	125	44.83					
299	Texarkana, TX-Texarkana, AR	463	31.97	28.60	51	79.17					
300	Toledo, OH	7,465	27.15	22.68	146	49.43	35	55.22	45		
301	Topeka, KS	1,166	28.73	27.42	67	48.61					
302	Trenton, NJ	1,837	25.42	18.51	225	41.07	98	52.38			
303	Tucson, AZ	6,524	22.30	18.07	232	33.22	155			41.33	8
304	Tulsa, OK	5,768	25.52	23.54	126	49.75	33	52.56	53		
305	Tuscaloosa, AL	1,134	24.25	17.59	240	32.48	160	60.49			
306	Tyler, TX	540	29.26	23.16	138	52.24		79.17			

Part 2 - Supplemental Table of Subprime Lending and Rankings for All MSAs by Census Tract Race/Ethnicity

	MSA Name	Total Conv. Refinance Loans	Total Percent Subprime	White Tract Percent Subprime	Ranking by Percent White Tracts Subprime (329 MSAs)	Diverse Tract Percent Subprime	Ranking by Percent Diverse Tracts Subprime (204 MSAs)	African-American Tract Percent Subprime	Ranking by Percent African-American Tracts Subprime (72 MSAs)	Hispanic Tract Percent Subprime	Ranking by Percent Hispanic Tracts Subprime (12 MSAs)
	National Urban Total (All 331 MSAs Combined)	1,763,483	25.31	21.09		34.79		56.92		42.63	
307	Utica-Rome, NY	1,471	29.30	29.17	46						
308	Vallejo-Fairfield-Napa, CA	6,938	21.26	16.86	254	26.31	182				
309	Ventura, CA	8,305	17.17	15.98	270	21.70	196			27.66	
310	Victoria, TX	220	37.27	34.03	14	42.47					
311	Vineland-Millville-Bridgeton, NJ	779	34.53	32.44	22	39.08	115	80.00			
312	Visalia-Tulare-Porterville, CA	1,556	29.05	23.80	118	34.11	148				
313	Waco, TX	564	27.84	23.96	116	47.14		60.00			
314	Washington, DC-MD-VA-WV	32,067	20.88	16.09	267	25.56	188	42.27	69		
315	Waterbury, CT	1,276	27.27	24.09	111	47.67	44				
316	Waterloo-Cedar Falls, IA	1,267	20.84	17.55	241	50.55		64.00			
317	Wausau, WI	1,418	7.69	7.69	324						
318	West Palm Beach-Boca Raton, FL	6,038	28.20	23.60	124	39.92	107	60.87	25		
319	Wheeling, WV-OH	1,180	30.42	30.09	35						
320	Wichita Falls, TX	412	32.77	32.63	19	40.74					
321	Wichita, KS	3,958	26.96	24.93	96	43.03	82	70.13			
322	Williamsport, PA	933	20.90	20.90	177						
323	Wilmington, NC	2,291	26.71	22.13	156	44.77	69	48.10			
324	Wilmington-Newark, DE-MD	4,553	32.81	28.30	56	46.77	54	71.79	4		
325	Worcester, MA-CT	3,921	24.66	23.74	121	44.32	73				
326	Yakima, WA	1,409	25.76	20.30	191	32.90	157				
327	Yolo, CA	873	20.85	18.65	224	30.62	164				
328	York, PA	3,174	18.65	18.00	233	41.11					
329	Youngstown-Warren, OH	6,450	27.50	24.57	102	57.46	11	62.67			
330	Yuba City, CA	655	27.79	28.17	59	22.92					
331	Yuma, AZ	723	24.34	21.90	159	26.13	185			26.19	

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Center for Community Change

The heart of the Center's work is helping grassroots leaders build strong community-based organizations, which it believes are the building blocks of change in low-income communities.

These organizations tap a community's capacity for self-help, nurture leaders, improve businesses, give residents a say in their community's future perhaps most important, give low-income people a sense of hope.

Every year, the Center provides an array of hands-on assistance for hundreds of organizations that work in low-income communities, helping them to get started, develop effective boards, raise money, organize their communities, set objectives, devise strategies, win issue campaigns, build housing and develop a stronger local economy.

The Center also works to give low-income people and organizations a voice on public policies that affect their communities. It has helped lead campaigns to increase lending in low income and minority communities, preserve and improve public housing, increase job opportunities, strengthen community involvement in federal funding programs, make foundations and other funders more responsive to low-income communities, and much more.

In addition, the Center publishes a variety of reports, studies, guidebooks and newsletters. It has sponsored dozens of special projects that work on a variety of poverty-related issues.

The Center, a national nonprofit organization, has offices in Washington, DC, and San Francisco as well as staff in several other cities.

ATTACHMENT G



Unfair Lending:

The Effect of Race and Ethnicity on the Price of Subprime Mortgages

Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li
Center for Responsible Lending

May 31, 2006

CENTER FOR RESPONSIBLE LENDING

www.responsiblelending.org



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Brief Synopsis

This study extends previous analyses of home loan pricing disparities by supplementing HMDA data with additional loan-level information from a large, proprietary subprime database. By merging the datasets, we were able to evaluate whether race and ethnicity affect subprime loan pricing after controlling for key risk factors, including credit scores and loan-to-value ratios. The results show that African-American and Latino borrowers are more likely to receive higher-rate subprime home loans than white borrowers, even when we control for legitimate risk factors.

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I. EXECUTIVE SUMMARY

Last year, for the first time, lenders were required to report details on the costs of subprime home loans—mortgages intended to serve borrowers with blemished credit or other high-risk characteristics. Lenders disclosed pricing information related to the most expensive subprime loans (referred to here as "higher-rate" loans), while lower-rate loans in the subprime market and virtually all prime loans were exempt from this reporting requirement. Several analyses of this information, collected under the Home Mortgage Disclosure Act (HMDA), have shown that African-American and Latino borrowers received a disproportionate share of higher-rate home loans, even when controlling for factors such as borrower income and property location.

A number of concerned groups have pointed to these disparities as evidence of discrimination that slows economic progress among groups who already lag far behind in homeownership and wealth. Others contend, however, that the pricing disparities are not meaningful, since they do not fully account for legitimate differences in credit risks. In this report, we attempt to move the debate forward by providing a more detailed examination of pricing patterns in the subprime home loan market. Our study analyzed subprime home loan prices charged to different racial and ethnic groups while controlling for the effects of credit scores, loan-to-value ratios, and other underwriting factors. To our knowledge, this is the first full research report that examines 2004 HMDA data to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices.

Our findings show that, for most types of subprime home loans, African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. The disparities we find are large and statistically significant: For many types of loans, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.

This analysis was possible because we supplemented the 2004 HMDA data with information from a large, proprietary subprime loan dataset. Individually, both databases lack certain pieces of data that would be helpful for an in-depth comparison of subprime loan pricing. By combining loan information from both sources, however, we obtain more complete information on a large set of loans. Using a combined dataset of over 177,000 subprime loans, we analyzed whether borrowers of color are at greater risk of receiving higher-rate subprime loans than similarly-situated white borrowers.

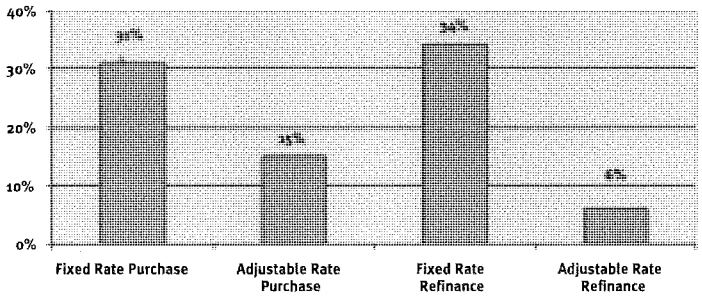
Our basic findings are outlined here:

1) **African-Americans were more likely to receive higher-rate home purchase and refinance loans than similarly-situated white borrowers, particularly for loans with prepayment penalties.**

- The effect of being an African-American borrower on the cost of credit was greatest for loans containing penalties for early payoff, which comprised over 60 percent of the loans we examined.

- As shown in the chart below, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than if they had been white borrowers with similar qualifications. Results varied depending on the type of interest rate (i.e., fixed or adjustable) and the purpose (refinance or purchase) of the loan.

Increased Likelihood that African-American Borrowers Received a Higher-Rate Subprime Loan with a Prepayment Penalty* versus Similarly-Situated White Borrowers

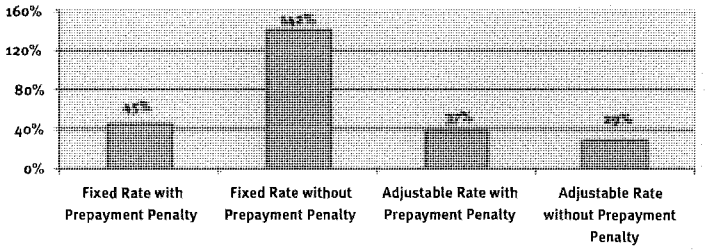


* During 2004, approximately two-thirds of all home loans in the subprime market had prepayment penalties.

2) Latino borrowers were more likely to receive higher-rate loans than similarly-situated non-Latino white borrowers for mortgages used to purchase homes. Differences for refinance loans were not significant at a 95 percent confidence level.

- Latino borrowers purchasing homes were 29 to 142 percent more likely to receive a higher-rate loan than if they had been non-Latino and white, depending on the type of interest rate and whether the loan contained a prepayment penalty.
- Pricing disparities between Latinos and non-Latino white borrowers for refinance loans were not significant at the 95 percent confidence level in our dataset.

Increased Likelihood that Latino Borrowers Received a Higher-Rate Subprime Purchase Loan versus Similarly-Situated White Borrowers



This analysis does not allow us to estimate precisely how much race and ethnicity increase the prices charged to borrowers. It is also beyond the scope of this paper to determine definitively why these disparities exist. However, we do posit several possible causes, including the considerable leeway mortgage originators have to impose charges beyond those justified by risk-based pricing.

A notable and pervasive example of discretionary pricing occurs through "yield-spread premiums," which are monetary incentives for mortgage brokers to inflate rates on subprime loans. Other causes of pricing disparities may include the inconsistent application of objective pricing criteria, targeting of families of color by higher-rate lenders or brokers, and lack of investment by lower-cost lenders in these communities. It is likely that all of these factors contribute to making subprime home loans more costly than necessary.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone.

For African-Americans, the most striking disparities that emerged in our research were associated with prepayment penalties; for Latinos, the greatest disparities related to loan type (purchase versus refinance). Examining these differences, we discuss several hypotheses. First, we believe the larger disparities observed for African-Americans in subprime loans with prepayment penalties may be related to yield-spread premiums, since lenders are often more willing to pay these premiums on loans that include prepayment penalties. Mortgage originators routinely make exceptions to guidelines, but it may be that African-Americans receive fewer favorable exceptions than white borrowers. Second, we believe that the disparities evidenced for Latinos on purchase mortgages might arise from a greater concentration of recent immigrants among this borrower pool. If so, the higher disparities in the purchase market may be a result of higher-cost lenders targeting recent immigrants.

While these results are particularly disturbing for borrowers of color, the results have negative implications for all borrowers in the subprime market, since common business practices such as discretionary pricing can affect anyone. The cost of mortgages matters more than the cost of typical consumer goods. Whether or not families receive fairly priced home loans is a major factor in their fundamental financial security. Higher loan costs will both dissuade some potential borrowers from investing in homeownership and increase the risk of foreclosure for those who do.

Lenders and policymakers can take a number of constructive actions to help ensure more equitable pricing for all borrowers. These include:

- Curtailing steering by requiring objective pricing standards;
- Holding lenders and brokers responsible for providing loans that are suitable for their customers;
- Amending HMDA to expand the disclosure requirements for risk and pricing information;
- Ensuring that adequate resources are dedicated to fully enforcing fair lending laws; and
- Creating incentives and supporting a policy framework that lead the market to better serve African-American and Latino communities.

II. BACKGROUND

A. HMDA

In 1975, Congress enacted the Home Mortgage Disclosure Act (HMDA). HMDA was a legislative response to the widespread practice of mortgage "redlining," that is, the systematic exclusion of neighborhoods of color when marketing or originating home loans.[1] Shortly thereafter, Congress passed the Community Reinvestment Act (CRA) to encourage lending in previously neglected communities,[2] and amended the Equal Credit Opportunity Act (ECOA), to prohibit discrimination based on race and national origin, among other criteria.[3] While CRA mandated that financial institutions help meet the credit needs of their entire communities and ECOA outlawed discrimination in the extension of financial credit, the original HMDA aided in the implementation of both laws by requiring regulated institutions to disclose summaries of their mortgage lending by census tracts.

These laws focused on access to credit, and they were enacted during a time when there was less concern about discriminatory disparities in mortgage pricing, partly because nearly all states had regulatory limits on interest rates and points charged for mortgages. That situation changed in 1980 with the passage of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which preempted state laws governing interest rates and points on first-lien loans unless states explicitly chose to opt out of the law.[4] By deregulating most mortgage lending, DIDMCA laid the groundwork for a high-priced subprime mortgage refinance market, and resulted in a market segment with a much wider range of loan prices than was found in the prime market.[5]

Meanwhile, disclosure requirements under HMDA have evolved over time to reflect the changing nature of mortgage lending and discriminatory practices, broadening both the range of lenders under its purview and the information those lenders are required to disclose.[6] Specifically, HMDA's scope has expanded to encompass non-depository institutions, such as mortgage companies, which have significantly increased their share of the mortgage market over the past three decades. In addition, the disclosure requirements of lenders have evolved to include a wide range of loan application data on loan approval decisions, borrower demographics, and property characteristics.[7]

One of the most important changes to HMDA is the recent inclusion of limited pricing information related to the annual percentage rate (APR) of certain loans.[8] For loans originated in 2004, lenders were required to report the spread between the APR of designated loans and the yield on a U.S. Treasury security of comparable maturity. Specifically, lenders submitted this information on first-lien loans if the spread was at or above three percentage points, and they submitted this information on subordinate liens if the spread was at least five points. Throughout this paper, we refer to loans with APRs high enough to require the disclosure of this spread as "higher-rate" loans.

This information on higher-rate loans makes it possible for the first time to use HMDA not just to detect disparities in loan dispositions (i.e., the proportion of loans that were approved or denied) between demographic groups, but also differences in loan pricing.[9] Since borrowers can be vulnerable to discrimination at both the underwriting and pricing stages of the loan process, the ability to detect discriminatory patterns in both areas is critical for ensuring that all racial and ethnic communities have an equal opportunity to build home equity.

Select HMDA Studies on Racial and Ethnic Disparities in Mortgage Lending

Though analyses of mortgage pricing based on HMDA data have not been possible prior to the release of the 2004 data, many studies have examined HMDA data to evaluate other issues related to possible inequities in the mortgage market. Such studies have tended to focus on differences in loan disposition (i.e., whether loan applications have been approved or denied) by race and ethnicity or on whether certain groups are disproportionately served by subprime lenders.

1) Impact of Race and Ethnicity on Loan Decisions

Because HMDA has long been the primary source of public information on loan applications and underwriting decisions, it has been used extensively to analyze whether certain groups of borrowers are more or less likely to have their application for a home loan denied. The most famous research of this kind was published in 1996 by the Federal Reserve Bank of Boston, "Mortgage Lending in Boston: Interpreting HMDA Data," often referred to simply as the "Boston Fed Study."[1] This study combined publicly-available HMDA data from the Boston area with a number of additional variables, including information on credit history collected from area lenders. The study found that the risk of loan denial for African-Americans and Latinos was about 80 percent greater than that of white applicants, controlling for a host of applicant, loan, property, and neighborhood characteristics.[2]

2) Impact of Race and Ethnicity on Loan Originations

Several studies have used HMDA data to analyze whether specific racial and ethnic groups receive a disproportionate share of subprime loans. Because HMDA data does not specifically identify subprime loans, most of these studies have approximated which loans were subprime by using annual lists of predominantly subprime lenders published by the U.S. Department of Housing and Urban Development (HUD).

A 2000 joint report by HUD and the U.S. Department of Treasury explored the relationship between subprime lending and neighborhood racial composition.[3] Relying on HMDA data, the study reported that subprime lending accounted for 51 percent of all refinance loans in predominantly African-American communities in 1998, compared to only nine percent in predominantly white neighborhoods. The study also found that these disparities persisted even when controlling for neighborhood income.

A 2002 national study by the Center for Community Change analyzed the proportion of borrowers receiving subprime refinance loans by race and ethnicity and found pervasive disparities among African-American, Latino and white borrowers.[4] In addition, the authors found that disparities persisted within income categories and actually increased as income went up. Specifically, while lower-income African-American borrowers were 2.4 times as likely to receive a loan from a subprime lender as lower-income white borrowers, upper-income African-American borrowers were 3.2 times as likely to receive such loans as upper-income white borrowers. At the same time, lower-income Latino borrowers were 1.4 times as likely to receive a subprime loan as lower-income white borrowers, and upper-income Latinos were 2.1 times as likely to receive such loans as upper-income whites.

In "The Neighborhood Distribution of Subprime Mortgage Lending," Paul Calem, Kevin Gillen and Susan Wachter controlled for variables included in HMDA data as well as census tract-level risk information to evaluate the effect of borrower race and neighborhood racial composition on receiving subprime loans in Chicago and Philadelphia.[5] Specifically, the authors combined HMDA data with variables such as foreclosure rates and information on the credit scores of the tracts' populations and found that both the race of individual borrowers and neighborhood racial composition have statistically-significant impacts on the likelihood of receiving a loan from a subprime lender, even after controlling for the borrower information available in HMDA and tract-level risk factors.

B. The 2004 HMDA Data: Pricing Disparities Surface

In September 2005, the Federal Financial Institutions Examination Council (FFIEC) released the 2004 data for all HMDA reporters in electronic form, making it possible to analyze the entire U.S. mortgage market.[15] The release of this data has contributed valuable information to the debate on whether the mortgage market extends credit equally and fairly to borrowers of all races and ethnicities. Organizations such as the National Community Reinvestment Coalition (NCRC), the Association of Community Organizations for Reform Now (ACORN), and the Consumer Federation of America (CFA) have pointed to the existence of large disparity ratios (i.e., the ratios between the proportion of borrowers of color that received higher-rate loans to the proportion of whites receiving such loans) as potential evidence of unfair pricing.[16] Others have dismissed such claims, asserting that raw disparity ratios are meaningless since they do not control for differences in legitimate risk factors, such as credit histories and loan-to-value ratios, among different racial and ethnic groups.[17]

The most comprehensive analysis of the 2004 HMDA data to date, conducted by staff to the Board of Governors of the Federal Reserve System (Fed), found that pricing disparities persist even after controlling for borrower-specific information such as income, origination amount, gender, property location and presence of a co-applicant.[18] In "New Information Reported Under HMDA and Its Implication for Fair Lending Enforcement," the Fed authors first confirmed the existence of large raw disparities between the proportion of African-American and Hispanic white borrowers receiving higher-rate loans to that of non-Hispanic white borrowers in both the home purchase and refinance markets.[19]

The Fed authors next made a series of adjustments to account for differences between white borrowers and borrowers of color by controlling for the following demographic information contained in HMDA data: borrower income, loan amount, location (MSA) of the property, presence of a co-applicant, and gender. Essentially, these adjustments estimated the portion of loans to African-American and Hispanic borrowers that would be expected to be higher-rate if, on average, the observed borrower traits were the same for these borrowers as for non-Hispanic white borrowers. These adjustments lowered observed disparity ratios between borrowers of color and whites by seven to 17 percent, but large disparities still existed.[20] The authors also adjusted for differences in lender composition between the groups. This second set of adjustments estimated the proportion of loans to African-Americans and Hispanic white borrowers that would be expected to be higher rate if the distribution of these loans among individual lenders were the same as the distribution of loans for non-Hispanic white borrowers. Interestingly, these "lender adjustments" reduced the disparity ratios considerably, though significant differences remained.[21]

Table 1. Federal Reserve Evaluation of the Disparities in the Incidence of Higher-Rate Loans* for Site-Built Properties: Black and White Hispanic Borrowers vs. Non-Hispanic White Borrowers

Borrower Race/ Ethnicity	Loan Purpose	Raw Disparity Ratio	Disparity Ratio Controlling for HMDA Borrower Characteristics	Disparity Ratio Controlling for HMDA Borrower Characteristics Plus Originating Lender
Black/African-American	Purchase	3.7	3.1	1.4
Black/African-American	Refinance	2.7	2.3	1.8
Hispanic or Latino	Purchase	2.3	1.9	1.3
Hispanic or Latino	Refinance	1.5	1.4	1.1

* Here we summarize findings only for conventional, owner-occupied, first-lien mortgages.
Source: Avery et al. (see note 18), Table 10.

However, the Fed's analysis of HMDA data did not control for several important risk factors, such as credit scores or loan-to-value ratios (LTVs), since these variables are not part of HMDA's disclosure requirements. The paper does, however, present partial results from an analysis conducted by the Credit Research Center (CRC). CRC analyzed data, including FICO scores and LTVs, from eight subprime lenders and found little disparity between the proportions of borrowers of different races and ethnicities getting higher-rate loans, seemingly in contrast with findings presented later in this paper. However, the Fed's paper does not fully explain CRC's methodology, and the data is likely limited in ways that make it of questionable value in understanding the disparity ratios in HMDA data and broader patterns in the subprime market. For more information about the CRC study, see Appendix 1.

Our analysis adds significantly to this body of research by supplementing HMDA data with information from a proprietary database. By combining information from each of these two datasets, we were able to incorporate important risk factors into a multivariate analysis of mortgage pricing.

III. A MORE IN-DEPTH LOOK AT PRICING DISPARITIES

A. Data

To include additional information on risk factors that might account for higher prices charged to African-American and Latino borrowers, we combined the 2004 HMDA data with a large, proprietary database of subprime loans. Like HMDA data, the other database contains specific information on individual loans, including borrower and property characteristics. Several types of information can be found in both datasets, including data on the location of the property, the originating lender, lien status, loan purpose, property type, and loan amount.

However, each dataset contains some information that the other does not. For example, the proprietary database includes critical pieces of information on loan risk at origination that are not included in HMDA, such as the LTV, credit score (FICO), and whether the loan was covered by private mortgage insurance. On the other hand, HMDA contains information on the race and ethnicity of borrowers. In addition, while HMDA contains information on APR spreads (which incorporates information on certain fees), the proprietary database has information on the mortgage note rate and whether the loan includes a prepayment penalty, but no information on APRs or up-front fees. (See Appendix 5 for information about the limitations of APR.) Finally, while the proprietary database we use is among the largest subprime home loan datasets available, accounting for an estimated 87 percent of U.S. subprime originations in 2004,[22] it only contains securitized subprime loans. For its part, the HMDA dataset is the single largest publicly-available dataset on U.S. mortgage originations, and it includes both prime and subprime loans for covered lenders.

Using information common to both HMDA and the proprietary database, we were able to match loans from the two databases, creating a new dataset of 177,487 subprime loans originated in 2004.[23] This merged dataset includes individual loan information on borrower characteristics (race, ethnicity, income, FICO credit score, income documentation level); loan characteristics (LTV, loan amount, purpose, existence and duration of prepayment penalties); property characteristics (location, property type); and pricing (APR spread for higher-rate loans).[24] To complement this loan-level data, we added publicly-available information on prevailing interest rates and state-specific information on housing prices, demographics and state judicial foreclosure and deficiency judgment laws.[25]

Using this combined dataset, we first examined the distribution of first-lien subprime loans that carried APRs above the three-percentage-point HMDA rate-reporting threshold ("higher-rate" loans). More specifically, we tabulated raw disparity ratios by categories of LTV and credit score. ("Disparity ratios" are the proportions of higher-rate loans received by borrowers of color divided by those of white borrowers.) This allowed for a simple analysis of whether overall disparity ratios might be attributable to differences in the LTV and credit scores between racial and ethnic groups.

A note on racial and ethnic designation:

The HMDA data allows borrowers to report both an ethnicity designation (either "Hispanic or Latino" or "Not Hispanic or Latino") and up to five racial designations (including both "white" and "African-American or Black"). To simplify notation and serve our research purposes, we coded and refer to any borrower who was identified as "Hispanic or Latino" as "Latino," and any borrower who was identified as "African-American or Black" in any of the race fields as "African-American." We coded borrowers and refer to them as "white" if they were associated with "Not Hispanic or Latino" and only identified as "white" in the race fields. The remaining loans were not coded into racial or ethnic categories and were excluded from the analysis. In practice, the Latino and African-American categories are not mutually exclusive, but the overlap in our merged dataset is small (about two percent), and using this method ensures maximum inclusion for members of each group.

Tables 2 and 3 show disparity ratios for African-American and Latino borrowers versus white borrowers. For African-Americans, disparity ratios in every LTV/FICO category exceeded one, while for Latinos disparity ratios exceeded one in the majority of categories. For example, for home purchasers with credit scores of 680 or higher and loan-to-value ratios of 90 percent or higher, disparity ratios for Latinos and African-Americans were 1.28 and 1.37, respectively. In other words, Latinos and African-Americans were 28 percent and 37 percent more likely, respectively, to receive a higher-rate subprime loan than whites.

We note that the disparities listed in Tables 2 and 3 differ from the Fed's results listed in Table 1 for at least two reasons. First, we are making a somewhat different comparison. While the Fed calculations use the proportion of higher-rate loans to all other loans for each group, Figures 2 and 3 use the proportion of higher-rate loans to all other subprime loans. In other words, while the Fed was able to look at pricing disparities across the entire market, data limitations require us to focus on disparities within the subprime sector. Second, Tables 2 and 3 group loans into combinations of FICO credit score and LTV, which effectively introduces a measure of control for risk.

Table 2. Subprime Purchase Loan Disparity Ratios by LTV/FICO Combination

LTV Percent	FICO Range	Borrower Race/Ethnicity	Number of Observations	Proportion of Loans that are High Cost	Disparity Ratio (vs. White Borrowers)
Less than 80	Less than620	African-American	326	64.4	1.20
		Latino	339	54.9	1.03
		White	1,279	53.1	NA
	620-679	African-American	152	30.9	1.53
		Latino	289	27.0	1.34
		White	847	20.2	NA
	680+	African-American	101	8.9	1.65
		Latino	358	13.4	2.50
		White	1,515	5.4	NA
80-89	Less than 620	African-American	1,700	62.6	1.26
		Latino	1,309	46.5	0.94
		White	4,223	49.7	NA
	620-679	African-American	1,351	35.7	1.60
		Latino	2,783	25.7	1.12
		White	5,483	22.9	NA
	680+	African-American	731	21.34	2.85
		Latino	2,615	14.5	1.93
		White	5,900	7.5	NA
90+	Less than 620	African-American	2,351	83.7	1.06
		Latino	1,709	75.7	0.96
		White	5,001	79.0	NA
	620-679	African-American	2,004	67.4	1.15
		Latino	3,115	59.8	1.02
		White	6,382	58.5	NA
	680+	African-American	931	46.8	1.37
		Latino	2,372	43.8	1.28
		White	3,936	34.1	NA

Table 3. Subprime Refinance Loan Disparity Ratios by LTV/FICO Combination

LTV Percent	FICO Range	Borrower Race/Ethnicity	Number of Observations	Proportion of Loans that are High Cost	Disparity Ratio (vs. White Borrowers)
Less than 80	Less than 620	African-American	2,904	62.8	1.05
		Latino	2,973	56.8	0.95
		White	12,314	59.6	NA
	620-679	African-American	731	20.0	1.18
		Latino	1,303	16.0	0.94
		White	4,957	17.0	NA
	680+	African-American	316	8.5	2.24
		Latino	976	5.3	1.39
		White	4,055	3.8	NA
80-89	Less than 620	African-American	2,496	68.4	1.11
		Latino	2,021	58.2	0.95
		White	9,365	61.5	NA
	620-679	African-American	818	27.5	1.22
		Latino	1,205	22.3	0.99
		White	4,808	22.6	NA
	680+	African-American	252	14.3	1.70
		Latino	586	8.5	1.01
		White	2,007	8.4	NA
90+	Less than 620	African-American	1,481	71.8	1.05
		Latino	977	63.2	0.93
		White	5,319	68.1	NA
	620-679	African-American	1,159	51.9	1.17
		Latino	1,219	45.1	1.02
		White	4,858	44.2	NA
	680+	African-American	264	29.6	1.21
		Latino	455	31.7	1.30
		White	1,557	24.4	NA

Because disparities between racial and ethnic groups persisted within a majority of LTV-FICO combinations, the results suggested the need for a more in-depth approach to determine how much conventional risk factors explain pricing variations between groups.

B. Statistical Analysis

Our statistical analysis adapts a mortgage pricing model created by Brent Ambrose, Michael LaCour-Little and Anthony Sanders in their study, "The Effect of Conforming Loan Status on Mortgage yield-spreads: A Loan Level Analysis."[26] In that study, the authors examined whether conforming to the conventional loan guidelines set by Fannie Mae and Freddie Mac had an impact on mortgage prices. Although our purpose is different and, consequently, the specific variables that we analyze are not identical to those included in their study, we adapted their general analytical approach.

Like Ambrose et al., we used multiple regression analysis to estimate the impact of different borrower, property, loan and geographic factors on the APR spread of a loan. Multiple regression allows the effect of individual factors (the "independent variables") on an outcome of interest (the "dependent variable") to be isolated from the effect of all other independent variables included in the models. In our case, we were interested in separating the effect of race and ethnicity on APR spreads from the effect of genuine risk factors such as LTVs and credit scores. However, whereas Ambrose et al. had the actual APR spread for all of the loans in their database, we only have the spread for those loans that exceeded HMDA's APR spread-reporting threshold. As a result, while the Ambrose study was able to use regression analysis to estimate the actual APR spread, our analysis allowed us to compare

the odds and likelihoods of different racial and ethnic groups receiving higher-rate loans, but did not allow us to estimate the magnitude of differences in APR spreads themselves.

To examine the effects of race and ethnicity, we conducted two distinct analyses. First, we used an initial "base" logistical regression model to estimate how much borrowers' race or ethnicity affected whether their loans were higher-rate, holding constant a host of borrower, property, loan, and geographic independent variables. However, logisric regression procedures assume that there is no "reverse-causation" between the dependent and independent variables. In other words, this method assumes that, while the independent variables may affect the dependent variable, the reverse is not true. We recognize that this assumption may not be valid in our case since a loan's APR may affect some of the variables we hold constant, namely LTV, loan amount, and whether the loan carried a prepayment penalty. For example, a borrower's decision to borrow a certain dollar amount might be, in part, based on the rate quoted. Therefore, like the Ambrose study, our final analysis includes statistical adjustments to account for the possible interdependence of these variables, providing a more reliable estimate of the effect of race and ethnicity on the risk of receiving a higher-rate loan.

1. The Base Model

As mentioned above, we first conducted logistic regressions to estimate whether race and ethnicity affected the risk of receiving a higher-rate loan. Table 4, below, lists the specific variables that were included in this base model.

Table 4. Logistical Specification for Base Model

Dependent Variable	Variable Description
HMDA_Threshold	Dummy variable=1 if APR spread is reported in HMDA, else=0
Independent Variables	
Borrower Characteristics	
BLACK	Dummy variable =1 if the borrower is African-American, else=0
LATINO	Dummy variable =1 if the borrower is Latino, else=0
MONTHLY INCOME	Monthly income, in dollars
FICO[27]	FICO credit score
FULL_DOC	Dummy variable=1 if the borrower provided full documentation of income, else=0
Loan/Property Characteristics	
LTV	Loan-to-value ratio at origination
ORIG_AMT	Loan origination amount, in dollars
PREPAY	Dummy variable=1 if the loan carries a prepayment penalty, else=0
MULTI	Dummy variable=1 if the loan is secured by a property with 2-4 units, else=0
CONDO	Dummy variable=1 if the loan is secured by a condominium, else=0
AGENCY CODES[28]	Categorical dummy variables representing the regulatory agency of the originating lender
Economic Variables:	
CREDIT_SPREAD	Monthly difference between AAA and Baa bond yields
YIELD_CURVE	Monthly difference between 10-year and 1-year Treasury yields
HPI_VOL	8 quarter standard deviation in the OFHEO state Housing Price Index
RATE_VOL	15 month standard deviation in 1-year Treasury yield
Q2-Q4	Categorical dummy variables for the second, third and fourth quarters of 2004
Geographic Variables:	
CDIV2-CDIV9	Categorical dummy variables for the Census division in which the property is located
STATELAW2-STATELAW4	Categorical dummy variables for state laws created by Ambrose et al. based on rules pertaining to judicial foreclosure and deficiency judgment
N_CCITY	Dummy variable=1 if the property is located in an MSA but outside of a central city, else=0
RURAL	Dummy variable=1 if the property is located outside an MSA, else=0
BLACK_STATE	Proportion of state population that is African-American
LATINO_STATE	Proportion of state population that is Latino

2. Expanded Model: Final Analysis

Our final model used more sophisticated techniques to analyze the same variables while accounting for potential interdependence of APR and some of the independent variables. Appendix 4 explains our methodology in more detail, but in the simplest terms, this model removed statistical problems that might be caused by reverse causation (i.e., two-way effects) between a loan's price and LTV, origination amount, and the existence of a prepayment penalty.

3. Analyses for Different Loan Categories

Recognizing that loan prices may depend in part on the type of interest rate (adjustable or fixed) and/or the loan purpose (purchase or refinance), we performed all analyses separately for each of the following four loan categories: 1) Purchase fixed-rate mortgages (FRMs); 2) Purchase adjustable-rate mortgages (ARMs); 3) Refinance FRMs; and 4) Refinance ARMs. In addition, to limit variations in loan products within each category, we included only the dominant types of ARM and fixed-rate loans.[29]

Specifically, our analysis of ARM loans included only 2/28 hybrid ARMs (loans with a fixed interest rate for two years followed by a 28-year term with semi-annual interest rate adjustments calculated by adding a margin to an index based on six-month LIBOR rates), with either no prepayment penalty or a prepayment penalty of two years. Our analysis of fixed-rate mortgages included all 30-year loans, with either no prepayment penalty or a prepayment penalty with a term of three years.[30] All analyses were further restricted to loans secured by first-liens on owner-occupied, single-family properties. Finally, we also excluded loans secured by manufactured housing units, those backed by private mortgage insurance, those with non-standard amortization schedules, and those with origination amounts exceeding the jumbo loan thresholds.[31]

4. Presentation of Findings: Odds and Likelihoods

When using logistic regressions to predict whether an event will happen or not, it is conventional to express the results in terms of "odds ratios." In this case, we are essentially trying to understand whether race or ethnicity help explain whether a borrower receives a higher-rate home loan, even after controlling for conventionally accepted risk factors. Odds ratios are simply the odds of one group receiving a higher-rate loan divided by the odds of a reference group. (In our case, the reference group is similarly-situated white borrowers.)

Odds ratios include two important features: magnitude and significance. The magnitude is simply the value of the ratio. An odds ratio of 1.0 indicates there is no disparity. A ratio above 1.0 indicates that, for instance, the odds of getting a higher-rate loan were greater for African-American and Latino borrowers than the odds for similar white borrowers, while a ratio under 1.0 indicates that the odds for these groups was lower than for white borrowers. For example, if the odds ratio between African-American borrowers and white borrowers is 1.3, it means that the odds of an African-American borrower receiving a higher-rate loan is 30 percent greater than the odds for a similarly-situated white borrower. If, however, the odds ratio were 0.7, the odds of an African-American borrower receiving a higher-rate loan would be 30 percent lower than that of a similarly-situated white borrower. The significance shows whether an odds ratio was different from 1.0 by a statistically-significant amount. Statistical significance is the conventional method in social science research for judging whether observed differences represent meaningful disparities or are the result of random variation.

While odds ratios are conventionally used when presenting information from logistic regressions,[32] it is often more intuitive to think in terms of probabilities or likelihoods. Therefore, we used the information from our models to predict the likelihoods that the African-American and Latino borrowers in our dataset received a higher-rate loan and compared that to the expected likelihood if those same borrowers had been white. By comparing these two predicted probabilities, which are estimated based on identical risk factors between groups, we were able to isolate the effect of race and ethnicity on the likelihood of receiving a higher-rate loan for borrowers in our dataset. See Appendix 7 for a more detailed explanation of odds and likelihoods.

5. Limitations

Like all statistical analyses, the study presented here has limitations. First, APR spread is an imperfect measure for examining pricing data, since it essentially blends interest rates with points and fees in a way that assumes that borrowers will keep the loan for its entire term and, consequently, it rends to underemphasize costs arising from fees.[33] However, in the context of this study, it is unlikely this limitation would undercut our basic findings, since it is unlikely that preferences for fee-rare tradeoffs systematically vary by race or ethnicity in ways that are uncorrelated with credit score, income, LTV, or other factors already included in our analysis. Moreover, to the extent that borrowers of color are targeted for high-fee predatory lending,[34] such patterns would tend to lead to underestimated pricing disparities between these borrowers and white borrowers since, again, APR rends to minimize the costs of fees.[35]

Second, because HMDA only provides APR-spread information for higher-rate loans, our analysis is limited to comparing the relative odds and likelihoods of receiving these higher-rate loans. Unlike Ambrose et al., we did not estimate the magnitude of the differences in APRs between loans.

Third, unlike the Fed study, our darabase was not large enough to control for metropolitan statistical area or for individual lenders. However, our analysis does account for general correlations between APR, on the one hand, and location, race, and ethnicity on the other by controlling for state housing prices, census regions, state laws regarding judicial foreclosure and deficiency judgment and state racial and ethnic compositions. In addirion, by including regulating agencies as independent variables, we essentially control for lender type.

Fourth, since our merged data only contains subprime loans, this analysis neither allows for an evaluation of pricing disparities that includes the prime market, nor provides any insight into how different borrowers end up with prime rather than subprime lenders.

Finally, our models may omit information that is correlated with both APR and the race and ethnicity of borrowers (e.g., employment tenure). Though we were able to control for the majority of risk-based characteristics that lenders generally use to price loans, at least according to rate sheets, it is nevertheless possible that omitted variables could influence our results. This limitation applies to virtually all empirical social science research.

IV. FINDINGS

First, we note that—apart from the findings for race and ethnicity—the results for our explanatory variables were consistent with rational risk-based pricing practices in the mortgage industry. For example, coefficients on LTV were consistently positive and significant, showing that higher LTVs increase the likelihood of receiving a higher-rate loan. Also, estimates on credit scores were negative and significant, showing that borrowers with lower credit scores were also more likely to receive higher-rate loans. We also note that our models did a good job overall of predicting whether borrowers would receive a higher-rate loan. Appendix 6 presents the full results, including model-fit statistics for all models.

African-American borrowers were 31 percent more likely to receive a higher-rate loan on fixed-rate purchases.

In general, our analyses show that race and ethnicity were significant factors in determining whether borrowers received higher-rate home loans. That is, African-American and Latino borrowers were more likely to receive higher-rate loans than white borrowers with similar risk factors for many categories of subprime loans. The significance of race was particularly consistent for loans with prepayment penalties, while the impact of ethnicity was concentrated in loans for home purchases.

A. Effect of Race on Subprime Loan Pricing

1. Purchase Loans: Our estimates show that race had a significant effect on the risk of receiving a higher-rate loan for most fixed-rate and all adjustable-rate subprime purchase mortgages. Specifically:

• Fixed-Rate Purchase Loans:
Our base model estimated that the odds of receiving a higher-rate, fixed-rate purchase loan for African Americans were 71 percent greater than for whites. In our final model, the increase in the odds for African-American borrowers on loans without prepayment penalties continued to be positive, but was no longer significant at a 95 percent confidence level. However, for the more than 60 percent of fixed-rate purchase loans that did contain prepayment penalties, the increase in odds for African-American borrowers rose to 84 percent and was statistically-significant. Based on our likelihood simulation, we estimated that these African-American borrowers were 31 percent more likely to receive a higher-rate loan than if they had been white borrowers.*

Table 5. Effect of Race on Risk of Receiving a Higher-Rate Subprime Purchase Loan (African-American vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	3,679	**1.71**	**28.7%**	17,978	**1.24**	**9.0%**
Final Model	**Loans without Prepayment Penalties**	1,444	1.64	30.9%	4,657	**1.40**	**16.3%**
	Loans with Prepayment Penalties	2,235	**1.84**	**30.8%**	13,321	**1.41**	**15.3%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Purchase Loans: Both the base and final models estimated that African-Americans were more likely to receive a higher-rate adjustable rate purchase loan than similarly-situated whites. The base model estimated that the odds for African-Americans were 24 percent higher than for whites. In our final model, the increase in odds rose to 40 percent for loans without prepayment penalties and 41 percent for loans with prepayment penalties, both of which were statistically significant. Translated into likelihoods, African-Americans in our sample were 15 to 16 percent more likely to receive a higher-rate ARM purchase loan than if they had been white.

2. Refinance Loans: Our base model estimated that race had a positive and significant effect on the likelihood of receiving a higher-rate loan for all fixed-rate and adjustable-rate subprime refinance loans. In our final model, the increased odds persisted for loans with prepayment penalties.

• Fixed-Rate Refinance Loans: Our base model estimated that the odds of an African-American borrower receiving a higher-rate fixed-rate refinance loan were 44 percent greater than for a similarly-situated white borrower. Our final model showed that, for fixed-rate refinance loans without prepayment penalties, the impact of race was not detectable at a 95 percent confidence level. However, over two-thirds of fixed-rate refinance loans did have prepayment penalties, and our final model estimated that the odds of African-American borrowers with these loans receiving a higher-rate were 62 percent higher than for white borrowers. Translated into relative likelihoods, these African-American borrowers were 34 percent more likely to receive a higher-rate loan than if they had been white.

Table 6. Effect of Race on Risk of Receiving a Higher-Rate Subprime Refinance Loan (African-American vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	8,799	**1.44**	**22.9%**	18,470	**1.16**	**5.6%**
Final Model	**Loans without Prepayment Penalties**	2,881	1.24	11.2%	6,520	1.04	1.2%
	Loans with Prepayment Penalties	5,918	**1.62**	**34.3%**	11,950	**1.17**	**6.1%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Refinance Loans: Our base model estimated that the odds of an African-American borrower receiving a higher-rate adjustable-rate refinance loan were 16 percent greater than for a similarly-situated white borrower. Again, our final model showed different results for loans with and without prepayment penalties. Specifically, the final model showed a small and positive difference between African-Americans and whites in loans without prepayment penalties (only 35 percent of adjustable-rate subprime refinance loans in our analysis), though one that is not significant at a 95 percent confidence level. However, for the 65 percent of ARM refinance loans that do have prepayment penalties, the final model estimated that the odds of an African-American borrower receiving a higher-rate loan were 17 percent higher than the odds for a white borrower with similar risk features. Our likelihood simulation estimated that these borrowers were six percent more likely to receive higher-rate loans than if they had been white.

B. Effect of Ethnicity on Subprime Loan Pricing

1. Purchase Loans: All final model results showed that Latino borrowers were more likely to receive higher-rate subprime purchase loans than white borrowers.

• Fixed-Rate Purchase Loans: The base model estimated that the odds of a Latino borrower receiving a higher-rate, fixed-rate purchase loan were 60 percent greater than a similarly-situated white borrower. In our final model, the increase in odds rose to 189 percent for loans without prepayment penalties and 71 percent for those with prepayment penalties. Translated into relative likelihoods, the final model suggested that Latino borrowers of fixed-rate purchase loans without prepayment penalties in our sample were 142 percent more likely to receive higher-rate loans than if they had been white. Latino borrowers of fixed-rate purchase loans with prepayment penalties in our sample were 45 percent more likely to receive higher-rate loans than if they had been white.

Latino borrowers of fixed-rate purchase loans with prepayment penalties in our sample were 45 percent more likely to receive higher-rate loans than if they had been white.

Table 7. Effect of Ethnicity on Receiving a Higher-Rate Subprime Purchase Loan (Latino vs. White)

Models		FRMs			ARMs		
		Number of Observations	Odds Ratio	Increased Likelihood	Number of Observations	Odds Ratio	Increased Likelihood
Base Model	**All Loans**	3,679	**1.60**	**39.6%**	17,978	1.06	3.6%
Final Model	**Loans without Prepayment Penalties**	1,444	**2.89**	**141.9%**	4,657	**1.52**	**28.6%**
	Loans with Prepayment Penalties	2,235	**1.71**	**44.6%**	13,321	**1.66**	**37.4%**

*Bolded results are statistically significant at a 95 percent confidence level.

• Adjustable-Rate Purchase Loans: The base model estimated that the odds of a Latino borrower receiving a higher-rate adjustable-rate purchase loan were not different at a 95 percent confidence interval from a similarly-situated white borrower. However, the final model indicated that the increased risk for Latino borrowers was, in fact, statistically significant. Specifically, the odds of Latino borrowers receiving a higher-rate on adjustable-rate purchase loans were 52 percent greater for loans with prepayment penalties and 66 percent greater for those without prepayment penalties than for similarly-situated whites. For our sample, Latino borrowers of ARM purchase loans with and without prepayment penalties were, respectively, 37 percent and 29 percent more likely to receive higher-rate loans than if they had been white.

2. Refinance Loans: Our models did not find evidence of an impact of ethnicity on loan prices in the refinance market at a 95 percent confidence level.

• Fixed-Rate and Adjustable-Rate Refinance Loans: Neither the base nor the final model found a difference in the odds of Latinos receiving a higher-rate subprime refinance loan compared to white non-Latino borrowers that was significant at a 95 percent confidence level. This was true both for fixed-rate and adjustable-rare subprime refinance loans.

V. DISCUSSION

The pricing disparities revealed by our results point to underlying market inefficiencies that have implications for all borrowers. While disparities highlight disadvantages faced by borrowers of color, this by no means suggests that the subprime market is delivering uniformly desirable or good outcomes for white borrowers. To the contrary, we believe that evidence of disparate pricing for borrowers of color is likely a symptom of a larger set of issues in a market that has gained notoriety as a magnet for predatory lenders. The point is further underscored by the scale of legal settlements related to widespread predatory lending by subprime lenders. For example, Household Finance entered a settlement agreement in 2002 for $484 million that stands as the largest consumer restitution agreement in U.S. history.[36] Sizeable settlements also have been entered into by Citigroup and, most recently, Ameriquest.[37]

We believe that evidence of disparate pricing for borrowers of color is likely a symptom of a larger set of issues in a market that has gained notoriety as a magnet for predatory lenders.

Efficient financial markets should provide similarly-situated borrowers with equally competitive prices on subprime home loans. In fact, subprime lenders construct complicated pricing matrices in the form of "rate sheets" in an effort to meet this challenge. These rate sheets describe how to calculate applicable interest rates from a borrower's credit score, the amount of equity held by the borrower in the home, and several other factors that measure risk. Lenders' internal fair lending compliance operations aim to ensure that these criteria are valid and not based on impermissible discriminatory factors. This investment is prudent, since lenders face serious legal and reputational risks if they violate fair lending standards.

Yet, in multiple analyses that control for the major factors lenders explicitly use to set prices, we find that borrowers' race and ethnicity continue to exert a statistically-significant influence on the cost of their subprime mortgages. For several types of loan products, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk. Disparities tended to be larger for fixed-rate loans than for their adjustable-rate counterparts.

Our findings indicate that African-American and Latino borrowers face the highest risks for pricing disparities under different circumstances. Relative to white borrowers, African-American borrowers were at greatest risk of receiving a higher-rate loan when their subprime mortgage included a prepayment penalty. Specifically, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than similarly-situated white borrowers, depending on the type of interest rate (i.e., fixed or adjustable) and the purpose (refinance or purchase) of the loan. Latino borrowers were at greatest risk when they used their

For several types of loan products, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.

mortgage to purchase a home rather than to refinance an existing home loan. In these cases, they were 29 to 142 percent more likely to receive a higher-rate loan than similarly-situated white borrowers, depending on the type of interest rate and whether the loan contained a prepayment penalty.[38]

While no empirical analysis is without limitations,[39] the rich data used here, the stability of our findings in analyses that examine different combinations and forms of explanatory variables (see Appendix 6), and the consistency of findings across multiple product lines all indicate that the pricing disparities we identify are genuine and significant. What then could explain these results?

One explanation for the disparities could stem from differences in how individual lenders price loans. This explanation involves specific lenders charging borrowers of color rates that are higher than those charged similarly-situated white borrowers—i.e., "disparate loan pricing." In an alternative explanation, pricing disparities would be expected if borrowers of color disproportionately received their loans from lenders whose loans are generally priced higher than lenders that primarily serve white borrowers. For convenience, we generally refer to such a pattern as "market segmentation."

We stress that data was not available that would allow us to distinguish between these two underlying reasons or quantify their effects. However, given that both represent plausible factors, it is worthwhile to consider both scenarios in more detail:

A. Disparate Loan Pricing

While rate sheets do present objective pricing schedules for calculating a loan's interest rate, they are not definitive statements of a loan's price for a given borrower. Discretionary yield-spread premiums and other up-front charges, as well as negotiated exceptions to rate sheet guidelines, are common examples of how a loan's price can vary from prices displayed on a rate sheet. These variations could account for part or all of the differences in subprime loan pricing among white, African-American, and Latino borrowers.

1. Discretionary charges such as yield-spread premiums or other up-front charges are subjective elements that could lead to disparate pricing.

Frequently, mortgage originators adjust the interest rate on home loans without regard to any objective risk-based criteria. When these adjustments are used to increase the interest rate of a loan, they increase the value of the mortgage (also called the yield) to the lender. The difference between the new higher rate and the lowest rate for which the borrower qualified is called a "yield-spread." When a loan with an increased rate is sold to an investor or delivered by a broker to a lender, the investor or lender will pay a premium price for that loan. The difference between the price paid for this loan with an inflated interest rate and the price that would have been paid for the loan had the borrower received the lowest rate for which he or she qualified is called a yield-spread premium, or YSP for short.[40]

While YSPs theoretically can play a helpful role,[41] the exchange is a complicated one that is easily abused. Borrowers often wrongly assume or are misled into believing that mortgage brokers are working to find them the lowest-cost loan for which they qualify, even if they actually receive an over-priced or even predatory loan.[42] Even when borrowers are aware that brokers are not required to offer the best rate, determining whether a proposed loan carries a YSP, let alone performing the complex financial calculations necessary to compare prices across mortgages with and without YSPs, is surely overwhelming for many borrowers.[43]

We hypothesize that pricing disparities faced by African-American borrowers in the subprime market are at least partially driven by YSPs.

When YSPs are applied in ways that disparately affect borrowers in protected classes, including race and ethnicity, this form of discretionary pricing may carry serious fair lending implications. In fact, this is a prominent example of how borrowers may be "steered" into a higher-rate loan. In part, because of such concerns, a number of states have addressed YSPs in the context of predatory lending legislation.[44]

Unfortunately, it has been difficult to study the overall effects of YSPs. The precise amount paid in yield-spread premiums is disclosed only on the HUD-1/1A closing statement, which lenders must provide to borrowers. Though that information is generally unavailable to researchers, at least one researcher who has obtained copies of these documents has reached troubling conclusions. Examining loans from an affiliated set of lenders, Harvard Law School Professor Howell Jackson found that African-American and Latino borrowers paid mortgage brokers more for their services than other borrowers, and he hypothesizes that yield-spread premiums were at least partially responsible.[45]

Taking the results of Professor Jackson's research along with findings from this paper and previous research, we hypothesize that pricing disparities faced by African-American borrowers in the subprime market are at least partially driven by YSPs. On the one hand, we have the direct evidence from Professor Jackson and that is presented in this paper. On the other, we note that subprime lenders' rate sheets routinely stipulate that brokers can only maximize the amount of a YSP if the loan carries a prepayment penalty.[46] In practice, this linking of YSPs with prepayment penalties ensures that a lender will receive either extra-interest or penalty income sufficient to offset the up-front cash payment to a broker. Bocian and Zhai have previously shown that borrowers in communities of color were at greater risk of receiving a subprime loan with a prepayment penalty controlling for differences in credit quality, location, and property type.[47]

In addition to yield-spread premiums, non-interest up-front charges on home loans referred to as "points and fees" can vary over wide ranges.[48] Since the loan's APR reflects some (though not all) of these charges, variations in points and fees paid by borrowers of different races and ethnicities also may give rise to differences in APR spreads. Interestingly, recent research using some of the same data employed by Professor Jackson showed that borrowers paid the most when some of their brokers' compensation came from both yield-spread premiums and other up-front charges.[49] This evidence is consistent with brokers charging YSPs on top of, rather than in place of, other discretionary up-front fees.

2. Objective pricing criteria may be waived or modified disproportionately in favor of white borrowers.

Lenders appear to be under considerable pressure to deviate from objective pricing in order to secure loans originated by mortgage brokers. Accounting for an estimated 59 percent of subprime originations in 2005,[50] broker-originated mortgages comprise an important market segment. Lenders must compete against other lenders in the bid to provide loans to the large borrower base that obtain their mortgages from brokers. Available evidence suggests that the resulting pressure does indeed lead to exceptions to posted guidelines.

Select results from a recent survey of 2,400 mortgage brokers published by a leading industry trade publication suggested that the explicit discretion available to brokers in rate sheets may represent only part of subjective changes that occur in the pricing process.[51] In the survey, almost half (47 percent) of respondents said they dismissed rate sheets and automated pricing systems in favor of a phone call to determine the interest rate applicable to a loan. In addition, while the publication did not report specific statistics, it did affirm that brokers seek exceptions to the standard underwriting guidelines provided by lenders.

If such exceptions are made more for one group of borrowers than another, it would clearly have the potential to lead to disparate loan pricing between groups. This hypothesis is more than pure supposition. In closely related questions examined in matched-pair testing, Urban Institute researchers have found that borrowers of color received less favorable treatment in the mortgage application process.[52]

B. Market Segmentation

Borrowers of color also would be more likely to receive higher-rate subprime loans if they tended, on average, to receive their loans from lenders that generally charge more than the lenders predominately serving white borrowers. Such lenders might face a greater cost of funds, have higher overhead charges resulting from less streamlined operations, higher marketing expenses, or might simply demand greater returns.[53] While we generally expect that efficient markets will result in borrowers selecting for themselves loan options with the lowest costs,[54] substantial evidence, apart from the findings presented in this paper, exists to support the notion that borrowers are not finding their way to the best-priced home loan.[55] This section discusses three possible explanations for this pattern.

1. Higher-cost lenders may directly or indirectly target borrowers of color.

The most obvious explanation for why borrowers of color would disproportionately receive their loans from higher-rate lenders would be that higher-rate lenders target borrowers of color directly on the basis of race or ethnicity or indirectly on the basis of traits correlated with race or ethnicity. Some examples of the latter might include marketing targeted at borrowers living in certain geographic locations or who have education, wealth, unemployment rates, or other factors often associated with less financial sophistication.

Once identified, targeted borrowers who share these traits might be disproportionately subject to aggressive marketing techniques. In fact, William Apgar and Allegra Calder have noted that "even though mortgage loans are now readily available in low-income minority communities, by employing high-pressure sales practices and deceptive tactics, some mortgage brokers push minority borrowers into higher-cost subprime mortgages that are not well suited to their needs and can lead to

financial problems down the road." This observation is particularly troubling since it may be difficult even for an otherwise optimal market to correct such inefficiencies. That is, responsible lenders will be seriously challenged to compete for business in communities of color if unscrupulous lenders are using aggressive and deceptive tactics to persuade borrowers to accept their loans.[56]

Responsible lenders will be seriously challenged to compete for business in communities of color if unscrupulous lenders are using aggressive and deceptive tactics to persuade borrowers to accept their loans.

This sort of targeting might help explain the disparities observed among Latino borrowers in our dataset. We believe that the group of borrowers identified as Latino in HMDA data is broad, ranging from recent immigrants to fourth- or higher-generation Americans.[57] It might be the case, however, that Latinos who take a subprime mortgage to purchase a home are more likely to be recent immigrants. If so, the higher disparities we observe in the purchase market for Latinos may arise from the targeting of recent immigrants by higher-cost lenders. Under such a hypothesis, recent Latino immigrants might also face disparate outcomes in the refinance market that we are unable to capture since those results are blended with a broader Latino population.

Similarly, even if a lender is not directly involved in such targeting, it may be that mortgage brokers and other third parties involved in the transaction disproportionately refer borrowers to higher-cost lenders. Why? One explanation is that higher YSPs might motivate brokers to work with such lenders. Even if brokers or other third parties refer borrowers to lenders in a non-discriminatory way, if the brokers disproportionately serve borrowers of color and also disproportionately provide loans that cost more than retail loans, then borrowers of color would tend to get higher prices. As Apgar and Calder point out, this proposition is supported by empirical research:[58] A 2001 AARP survey of older borrowers found that 64 percent of African-American borrowers received their loan from a broker versus just 38 percent of white borrowers.[59] Also, Alexander et al. report that third-party subprime originations are more likely to default and that they therefore carry a higher rate than retail-originated loans.[60]

2. Relatively lower-cost subprime lenders might not compete aggressively for business in communities of color.

If brokers or other more expensive loan originators are disproportionately providing loans to borrowers of color, it is fair to ask whether lower-cost lenders are under-serving such customers. In this explanation, white borrowers receive disproportionately fewer higher-rate loans not because borrowers of color are targeted for such loans, but because the latter are excluded from lower-cost subprime loans. There is at least some anecdotal evidence that this problem continues to persist in the marketplace. For example, in 2004, the U.S. Department of Justice filed two cases against lenders for failing to lend in communities of color.[61]

The most potentially troubling hypothesis along these lines would be a scenario in which different affiliates of a lender essentially segmented their customers, with one disproportionately serving white borrowers with lower-cost subprime loans and the other marketing higher rates to communities of color. If this were the case, it is unclear whether the regulatory enforcement agencies have the infrastructure and resources necessary to detect and fully investigate such patterns.[62]

3. Higher-cost lenders may be more likely to flip borrowers.

A final possibility is that borrowers of color are no more likely to be served by higher-rate lenders than white borrowers—but are more likely to receive multiple loans within one year from a higher-rate lender. Because our dataset is comprised of loan transactions and not borrowers, we are unable to detect instances in which borrowers take multiple first-lien loans in a year. Loan flipping, where borrowers are repeatedly refinanced primarily for the purpose of generating income for the loan originators rather than for the benefit of the borrowers, has been identified as an important issue in the predatory lending context.[63] Recent research by Courchane, Surrette and Zorn indicates that borrowers' subsequent loans in the subprime market are explained in part by the market segment of their current loan: "We conclude, therefore, that previous mortgage segment is an important determinant of current market segment even after controlling for risk-related underwriting and demographic effects."[64] If rapid loan flipping (i.e., multiple loans within one calendar year) is concentrated in higher-rare subprime lenders, we note that it could contribute to the disparities we observe in refinance loans.

VI. POLICY RECOMMENDATIONS

Our research shows that, for most types of subprime mortgages, borrowers of color are more likely to receive higher-rate loans, and objective risk factors fail to explain the disparities. We have discussed several reasons that could explain this phenomenon related, broadly, to disparate loan pricing and the possible effects of market segmentation. It is likely that all of the factors discussed play some role in making subprime home loans more costly than necessary for people of color. In addition, the business practices that support excessive charges could apply equally to individual white borrowers in the subprime market who may lack the bargaining ability or financial experience to fully protect themselves.

Given the importance of wealth-building to all Americans, and the current wealth gap that exists between white Americans and communities of color,[65] these pricing disparities in the subprime market call for reform in the mortgage market. To encourage fair pricing of home loans that is based only on legitimate risk factors and facilitates economic progress for all borrowers, we recommend the following:

1. Curtail steering by requiring objective pricing standards.

Today, through advances in technology, lenders have a stronger ability than ever to apply risk-based pricing. Increasing the fairness and objectivity of the subprime home loan origination process would significantly improve outcomes for all families. Given the many explicit ways that American public policy supports homeownership, it is especially important that borrowers representing equivalent risks receive similar treatment from mortgage professionals. We believe the best way to reach this end is to eliminate discretionary pricing in the subprime loan market, prompting lenders to adopt transparent, market-driven prices for mortgages representing similar risks.

Eliminating discretionary pricing in the subprime loan market would not necessarily mean eliminating yield-spread premiums. We believe homeowners should retain the right to pay for home loans through a variety of mechanisms, including yield-spread premiums when they truly benefit borrowers.[66] A number of sound options exist for achieving more rational pricing in the subprime market while still permitting broker compensation through YSPs where appropriate:

• Include YSPs in laws designed to protect homeowners from abusive lending practices. The Federal Reserve has the discretion to include YSPs in the calculation whether or not a loan is high-cost under the Home Ownership and Equity Protection Act (HOEPA),[67] and therefore eligible for special protections. Given the prevalence of YSPs in documented cases of predatory lending,[68] it makes no sense to ignore these fees in a law specifically designed to protect borrowers from predatory lending. This is a glaring loophole that affects all subprime loans originated by mortgage brokers, well over half the market.

• Prohibit the combination of YSPs and prepayment penalties in the same subprime home loan. Prepayment penalties and YSPs work together in ways that are contrary to borrowers' interests: prepayment penalties allow lenders to lock in an above-market yield, making them more willing to pay inflated YSPs to brokers for over-priced loans. We believe that's why our previous research revealed the counterintuitive result that borrowers with subprime loans that include prepayment penalties fail to receive lower interest rates than similarly-situated borrowers without prepayment penalties.[69] With prepayment penalties attached to overpriced loans, lenders benefit either way—they get paid either through payment of penalties at early payoff or through the higher-than-necessary interest paid out over time. Without the prepayment penalty, borrowers who realize they paid too much for their mortgage could quickly refinance into a lower-cost loan, and, as the lender understands, has every incentive to do so.

The combination of YSPs and prepayment penalties also creates opportunities for deceptive marketing. Prepayment penalties are commonly justified as an option by which borrowers may lower the interest rate, while YSPs are commonly justified as an option offered to exchange a higher interest rate for reduced closing costs. Given the link between higher YSPs and prepayment penalties, the YSP may in fact counter the benefits borrowers supposedly receive from prepayment penalties. The net result, indeed, may be that a borrower pays twice for little or no benefit.[70] Even if either a YSP or a prepayment penalty had a benefit to the borrower, the combination of the two in a subprime loan creates a serious impediment to informed borrower choice, and may be an indicator of potential abuse.[71]

• Improve transparency of YSPs by requiring checks for YSPs to be written jointly to borrowers and brokers. Currently, borrowers see YSPs as a cryptic entry on a closing form—if they see the charge at all. A joint-payee provision would mean that brokers could not cash a check without a borrower's endorsement, helping to ensure the borrower has full knowledge of the broker's compensation.

In general, reining in discretionary pricing in the subprime market would simplify an incredibly complicated mortgage process, remove an opportunity to discriminate against unsuspecting borrowers, and promote competition.

2. Follow the lead of the securities industry and hold lenders and brokers responsible for providing loans that are suitable for a given borrower.

Investment professionals have long had an affirmative duty to ensure that the products they recommend are suitable for their customers. Buying a home is the biggest investment that most families ever make, and, since the home's equity is the major source of wealth for most families, refinancing is an investment decision of more relevance to most families than stock purchases. Arguably today's mortgage transactions are at least as complicated as financial decisions made with investment professionals, yet families do not have a similar assurance that their lender or broker will deal fairly with them by offering them loans that are suitable given their needs and circumstances. A securities broker who steers a borrower into an inappropriate investment risks punishment; a mortgage broker who does the same may reap higher compensation with no negative consequences. To protect homebuyers and homeowners, lenders and brokers should be required to recommend loans that are suitable and reasonably advantageous for borrowers.[72]

Mortgage brokers, in particular, should have a fiduciary duty to borrowers to use best efforts to obtain the best available loan for the borrower. Brokers now originate nearly 60 percent of subprime mortgages.[73] Borrowers expect their brokers to represent their best interests, and brokers should be held to that standard. The stakes are too high to allow misplaced incentives to harm families' chances of paying a fair price for their home and building their net worth.

3. Discourage pricing discrimination by requiring subprime lenders to disclose more detailed pricing and underwriting information in their HMDA data.

The collection of APR information, as described in this report, is a positive first step in assessing pricing information, but it is of only limited value without a full disclosure of points and fees on subprime mortgages, including up-front fees, yield-spread premiums, and prepayment penalties. Not all up-front fees are captured in the APR. Further, in most cases, the APR understates the true costs of even those fees it captures because it amortizes them over the term of the loan, typically fifteen or thirty years. In fact, the vast majority of subprime home loans are paid off within the first two-to-five years. As a result, although two loans might have the same APR, a loan with high up-front fees typically costs borrowers much more. Information on points and fees would allow for a more accurate analysis of what families pay for their home loans.

In addition, as this research shows, HMDA data currently lacks information that would be helpful in evaluating how lenders serve their markets. HMDA should be modified to include the disclosure of factors such as loan-to-value ratios and credit scores of borrowers. In addition, HMDA should include the origination channel for each loan, so that researchers could better assess pricing differences or similarities among broker, correspondent and retail originations. Working in good faith, interested parties can produce a workable mechanism for providing critical information without unduly compromising privacy.[74]

4. Ensure regulators have adequate resources and authority, and are held accountable, for fully enforcing fair lending laws.

Fair lending violations are serious concerns. One of the main goals of HMDA is to help identify potential discriminatory lending patterns and to enforce anti-discrimination laws. Last year, based on the raw disparities evident in the 2004 HMDA data, the Fed referred some 200 lenders to federal and state regulators for further investigation. These 200 lenders accounted for 48 percent of owner-occupied loans reported under HMDA in 2004.[75] To date, no information about the outcome of those referrals has been made public. In the meantime, lenders already have submitted 2005 HMDA data to their federal regulators and early reports suggest that disparities have increased since 2004.[76]

It is important that regulators review and act on the information available to them in a timely and transparent fashion. Whether or not the regulators find that lenders have violated applicable laws, borrowers and the larger public need to know that the investigation process is fair and effective. To this end, we recommend that each regulator report annually on the number of fair lending examinations performed and for each examination provide publicly-available information, including: (1) the indicators of potential discriminatory activity identified (if any); (2) the protected class or classes (e.g., gender, race) believed to be potentially disadvantaged by such activity; and (3) the outcome of each review (i.e., any actions taken).

In addition, turf battles should not impede efforts to protect borrowers. In the wake of the release of the 2004 HMDA data, at least one federal regulator has put significant energy into a court action to

prevent a state attorney general from having access to information necessary to evaluate potentially discriminatory practices by lending institutions.[77] We wish it were clear that the same energy has been put into getting to the root of racial and ethnic disparities in home lending. It will take concerted efforts from all interested parties to ensure that similarly-situated families receive fairly-priced loans.

5. Create incentives and support a policy framework that leads the market to better serve communities of color.

Some of the key goals of HMDA include determining whether financial institutions are serving the housing needs of their communities and helping public officials to make public investments in a way that attracts private investment in areas that need it. Over time, it has become clear that not all credit is good credit. As discussed above, one reason African-American and Hispanic families are more likely to receive higher-rate loans may be that they tend to receive loans from lenders that generally charge more. Policymakers should review whether lower-cost lenders need additional incentives to help meet the credit needs of communities of color. Conversely, regulatory enforcers of fair lending laws should actively evaluate whether the higher-cost lenders "reverse red-line" by targering communities of color for high-priced products unrelated to individual borrower risk.

When unscrupulous lending practices go unchecked, borrowers are not the only ones who suffer harm; lower-cost lenders and honest brokers also are placed at a disadvantage. They cannot compete with lenders or brokers who make loans on unfair or deceptive terms or who push-market loans that are not in a borrower's best interest. Laws and regulations that prohibit predatory, irresponsible subprime lending have proven effective in reducing the number of abusive loans while maintaining a vibrant market for subprime home loans.

A recent study by the Center for Responsible Lending showed that lenders have responded to strong state laws not by reducing the availability of subprime loans, but rather by making subprime home loans that do not contain the terms targeted by the laws.[78] Furthermore, the interest rates on subprime home loans were about the same or even lower than the rates in states that did not target those abusive loan terms.[79] Policymakers should endorse legislation that builds on the proven methods for protecting families from abusive lending while retaining access to subprime credit. Recognizing that new abuses continue to emerge, such laws should ensure that all those responsible for representing and protecting families have authority to act to address new problems.

APPENDIX 1: Credit Research Center Study

The Federal Reserve's report on 2004 HMDA data included research conducted by the Credit Research Center (CRC). In their analysis of loan data, the CRC found almost no disparities in the proportions of borrowers receiving higher-rate loans by race or ethnicity, after making adjustments for risk factors such as LTV and FICO scores. These findings have been erroneously cited to support the proposition that risk factors fully explain pricing disparities in the subprime market.[80] Even without considering the contradictory evidence presented in this paper, there are two reasons to be skeptical of this claim:

1. The data used in the CRC analysis does not appear to be representative of the subprime market.

CRC's analysis relied on 2004 HMDA data from eight unidentified subprime lenders, supplemented by proprietary information provided by those lenders. No information is provided on how these lenders were chosen nor whether they were representative of the subprime market as a whole. In fact, there is evidence that the composition of loans from these lenders is fundamentally different from that of the overall subprime market. For example, over 80 percent of both the purchase loans and refinance loans analyzed by CRC were higher-rate. However, CRL estimates that less than 50 percent of subprime lending falls into this category.[81] Since the data appears to be fairly non-representative of the subprime market, it is difficult to believe that rhe findings should be generalized to describe that market.

2. The methodology used in the CRC analysis is unclear and appears to be specified in a way that would limit disparities arising from brokered transactions.

The Fed's report does not contain important information on CRC's methodology, and it does not provide results for the control variables that were used in the analysis. This lack of clarity makes it difficult to understand the context for CRC's results and, consequently, what conclusions one can reasonably draw. Also of importance, CRC controlled for whether the loan was originated by a broker. This may be useful for isolating the impact of race and ethnicity on loan pricing on the one hand from the impact of the type of originator on the other. However, we believe that broker participation in loans itself is a potential source of disparities through discretionary up-selling by use of yield-spread premiums. The CRC's inclusion of the broker category as a control variable entirely ignores the effect that the broker plays in pricing loans to African-Americans or Latinos in a manner unrelated to risk, and therefore makes it impossible to assess whether these borrowers receive higher-cost mortgages than white borrowers unrelated to commonly-accepted risk factors.

APPENDIX 2: Matching HMDA Data with Another Database

We chose a conservative methodology to match HMDA reports and loans in the proprietary database in order to minimize the potential number of "bad matches." That is, we were willing to settle for a smaller number of loan matches in order to be confident that we were correctly matching specific loans. Below is a table outlining our matching process.

Process	Observations
Step 1: Select HMDA Loans: We first selected 2004 home purchase or refinance loan originations secured by owner-occupied, 1- to 4-unit or manufactured housing from selected HMDA lenders[82]	5,337,495 unique loan records
Step 2: Add Zip Code to HMDA: Next, we identified a dataset that provides a list of every census tract/zip code combination for the entire U.S. That is, for every census tract, there is a separate observation for every zip code that overlaps that tract. We merged our HMDA loans from step 1 with this census tract/zip code dataset	12,421,598 representing the 5,337,495 HMDA loans (there are multiple observations for loans with census tracts that overlap more than one zip code)
Step 3: Remove Non-Unique Loans: In step 3, we identified and removed HMDA loans that did not have unique combinations of the variables that were common to both datasets, namely lender name, state, zip code, loan purpose, property type, lien status, and loan amount.	9,292,170 (there are still multiple observations for loan with census tracts that overlap zip codes)
Step 4: Remove Overlapping Census Codes: To ensure that we had the right zip code for all of the loans in our analysis, in step 4 we deleted all loans that were not in census tracts that are completely encompassed within a single zip code.	1,968,148 unique HMDA loan records
Step 5: Select Loans: We then selected home purchase or refinance loans secured by owner-occupied 1-4 unit or manufactured housing originated in 2004 from the proprietary database.[83]	1,842,228 unique loan records from proprietary database
Step 6: Remove Non-Unique Loans: Next, we identified and removed loans from the proprietary database that did not have unique combinations of the following variables: i.e. state, zip code, loan purpose, property type, lien status, and loan amount.[84] Keep only loans from lenders in this dataset with more than 1,000 observations.	535,030 unique loan records from the proprietary database (includes loans in all census tracts, not just those fully encompassed in single zip codes)
Step 7. Merge HMDA and proprietary database sub-datasets: Finally, we merged the sub-datasets created in steps 4 and 6 by lender,[85] state, zip code, loan purpose, property type, lien status and loan amount. We kept only those loans that appeared in both datasets.	177,487 unique loan records in merged datasets

Using the 535,030 loans from the proprietary database that we tried to merge with HMDA as the denominator, we achieved a match rate of 33 percent. Since many of the loans in the proprietary database that we tried to match may have been removed from the HMDA loans eligible for matching due to "non-unique characteristics," this match rate seemed reasonable.

To check the validity of our matches, we selected a random sample of loans from the merged dataset. We searched for these loans in a third database called Leads-To-Loans.[86] We used data from the proprietary database to set the parameters in the following Leads-To-Loans search fields: origination date, origination amount, loan type, loan purpose, zip code and lender. Small ranges were used in the origination amount and date parameters, to account for slight variations in rounding or date entry. Loan information such as census tract and gender of borrower/co-borrower were then compared to comparable HMDA fields. Due to the limitations in Leads-To-Loans coverage, many of the loans that we randomly generated could not be found in Leads-To-Loans but, of the first 100 that were found, 93 were confirmed as matches.

APPENDIX 3: Comparison of Proprietary Database and Merged Dataset Mean Values by Loan Product

Table A.1 All Owner-Occupied Purchase Loans

Variable	All 2004 Loans in Proprietary Database (n = 725,262)	Merged Dataset Mean (n = 75,764)
FICO	663.7	652.6
LTV	86.3	87.0
TERM	340.6	341.0
ORIGINATION AMOUNT	181,252	191,792
INITIAL RATE	7.2	7.5
LOW/NO DOC STATUS (%)	46.4	44.0
PREPAYMENT PENALTY (%)	61.8	65.6
CENTRAL CITY (%)	33.3	33.4
OUTSIDE CENTRAL CITY (%)	58.4	58.2
RURAL (%)	8.3	8.4

Table A.2. All Owner-Occupied Refinance Loans

Variable	All 2004 Loans in Proprietary Database (n = 1,116,966)	Merged Dataset Mean (n = 101,723)
FICO	620.8	612.7
LTV	78.1	77.2
TERM	343.0	345.9
ORIGINATION AMOUNT	185,912	199,923
INITIAL RATE	7.1	7.3
LOW/NO DOC STATUS (%)	34.4	33.7
PREPAYMENT PENALTY (%)	66.3	68.0
CENTRAL CITY (%)	30.4	30.0
OUTSIDE CENTRAL CITY (%)	59.1	59.7
RURAL (%)	10.5	10.5

APPENDIX 4: The Expanded Models: Three-Stage, Least-Squares Model Specifications

Using our merged dataset, we employed logistical regressions to estimate the impact of race and ethnicity on the likelihood of a borrower receiving a "higher-rate" loan, that is, a loan that exceeds HMDA's APR spread reporting threshold.[87] Our "expanded" models (Models 2 and 3) correct for possible interdependence (or "endogeneity") between APR spread and several independent variables, namely LTV, origination amount, and prepayment penalties. As mentioned in the text of the report, the methodology and models are largely based on those used by Brent Ambrose, Michael LaCour-Little and Anthony Sanders, though modifications were made based on the availability of data and to reflect the different objectives of our analysis.[88]

To correct for possible the endogeneity of LTV and origination amount, which are continuous variables, with APR spread, we ran a Three-Stage, Least-Squares (3SLS) analysis:

1. First Stage: In the first stage, LTV and origination amount were each estimated using ordinary least squares regressions with the following independent variables, or "instruments": black, Latino, FICO, monthly_income, monthly_income2, refi, credit_spread, yield_curve, hpi_vol, rate_vol, hpi, subprime_rate,[89] prepay, full_doc, cdiv2-cdiv9, statelaw2-statelaw9, qtr2-qtr4, condo, n_ccity, rural, black_state, Latino_state, agency2-agency5. The estimations from these two regressions led to two new variables for each loan: LTV_instrumented and Orig_Amt_instrumented.

2. Second Stage: In the second stage, the actual LTV and origination amount variables were simultaneously estimated, using the following equations:

(A) ORIG_AMT = black Latino LTV_instrumented sub_rate monthly_income monthly_income2 HPI full_doc

(B) LTV = black Latino ORIG_AMT_instrumented FICO sub_rate monthly_income monthly_income2 HPI full_doc

3. Third Stage: In the third stage, the two equations in the second stage were automatically re-estimated, correcting for correlations between their error terms.

In the final logistic regression model we used the estimated LTV and origination amount variables from the third stage of the three-stage least squares regression instead of the actual LTVs and origination amounts. All other independent variables are identical to those in the base model. Using the estimated LTV and origination amount variables, rather than the actual values, avoids problems that would occur if these LTV and origination amount were, in fact, jointly-determined or "endogenous" with the APR of the loan.

Data Stratification for Binary Variable Prepayment Penalty

To correct for the potential endogeneity between APR spread and the existence of prepayment penalties (which is a binary variable), we ran the above expanded model specification separately for loans with and without prepayment penalties.[90] Specifically, Model 2 ran the model on loans without prepayment penalties and Model 3 ran the identical model on loans with prepayment penalties.

Variations on Methodology

To test the robustness of our model specification, we tried a few variations on our base model. Variations fell into three categories:

1. Less rigid restrictions on included loans: In one set of variations, we relaxed the criteria by which we included the matched data into our analysis dataset. Specifically, we allowed all matched loans to be included, regardless of whether the census tract was completely encompassed within a single zip code or overlapped multiple zip codes. This variation essentially doubled our sample size but slightly increased the chances that there would be "false" matches.

2. Changes in included independent variables: We also tried altering our model by modifying the independent variables that we included in the analysis. In one set, we removed the three state law dummy variables and replaced them with 49 state dummy variables. In another set, we added an interaction variable between FICO and LTV.

3. Altered functional form: Finally, we altered the functional form of two independent variables, using the logarithmic rathet than the natural forms of LTV and origination amount.

Importantly, none of these variations altered the basic findings of our analysis. That is, estimates of the impact of race and ethnicity on the odds of receiving a higher-rate loan were largely consistent with our principal analysis.

APPENDIX 5: The Limitations of APR

While information on the APR spread is essential to understanding patterns of loan pricing, it is not sufficient. Without discrete information on the points, fees, and interest rates associated with loans, it is impossible to fully evaluate the actual cost of credit to the average borrower.

Consider two 30-year loans: Loan A carries a note rate of 10 percent and has no points or fees; Loan B carries a note rate of 9 percent but has financed fees equal to 10 percent of the loan principal. Both of these loans have APRs roughly equal to 10 percent (10.0 percent for loan A versus 10.1 percent for loan B), but the actual cost of the loans would likely be very different since a typical subprime loan might remain outstanding for only two years. In fact, if both loans are repaid at the 24th month, the Loan B, high-fee, borrower will have paid a total of $29,668 in interest and fees versus just $19,891 for the Loan A, no fee borrower. In other words, the Loan B borrower will pay 49 percent more than the Loan A borrower, despite having almost the same APR. This counterintuitive result is produced because APR assumes that points and fees are spread out and repaid over the full loan term.

The fact that APR hides the size of fees for most borrowers is not merely of academic concern. Since the rate spread between APR and Treasury securities is the only price information that lenders are required to report under HMDA, there is an incentive for lenders to shift some of their compensation from rates to fees, since they can obtain much greater compensation without changing the APR. This result is exactly the opposite of what responsible lending principles would dictate. Loan pricing is the most important issue in understanding the fairness of the mortgage market, and it is essential that the loan pricing information collected provide an accurate and complete picture of the cost of credit. Although abusive lending is often thought to be associated with high interest rates, the primary issue is high fees charged to borrowers.

Because of incentives to rely on fees for compensation, it is important that lenders be held accountable for charging fees that are fair and equitable. As noted in the policy recommendations of our report, we strongly urge the Federal Reserve to include mortgage fee information in the data collected under HMDA.

Table A.3. 30-Year Fixed-Rate Purchase Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 3-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	7.2747	2.3130	0.0017	7.7156	6.6300	0.2445	6.2408	2.7267	0.0221
BLACK	0.5378	0.1393	0.0001	0.4919	0.2578	0.0564	0.6078	0.1744	0.0005
HISPANIC	0.4675	0.1434	0.0011	1.0599	0.3279	0.0012	0.5361	0.1664	0.0013
MONTHLY INCOME	0.000013	0.000015	0.4029	0.000714	0.000088	<.0001	0.000049	0.000020	0.0143
LTV	0.0973	0.00548	<.0001	0.0905	0.0430	0.0355	0.1013	0.00846	<.0001
FICO	-0.0257	0.00114	<.0001	-0.0234	0.00226	<.0001	-0.0239	0.00143	<.0001
ORIG_AMT	-0.00001	1.092E-6	<.0001	-0.00007	6.874E-6	<.0001	-0.00002	1.871E-6	<.0001
CREDIT_SPREAD	1.2211	2.1943	0.5779	0.1043	4.2675	0.9805	2.2961	2.6639	0.3887
YIELD_CURVE	0.6371	0.6708	0.3423	1.1143	1.3226	0.3995	0.5051	0.7970	0.5263
HPI_VOL	0.0106	0.0103	0.3037	0.0988	0.0243	<.0001	0.0339	0.0142	0.0170
RATE_VOL	3.4599	3.0742	0.2604	8.5546	5.9516	0.1506	2.0903	3.7311	0.5753
CDIV2	0.0751	0.2866	0.7932	0.1996	0.6436	0.7565	-0.0295	0.3756	0.9374
CDIV3	0.1270	0.3274	0.6981	-0.7542	0.7577	0.3196	0.3642	0.4201	0.3860
CDIV4	0.2396	0.3564	0.5014	-0.0403	0.7453	0.9568	-0.2470	0.4938	0.6170
CDIV5	-0.1123	0.3219	0.7273	-1.5140	0.8702	0.0819	-0.0987	0.3777	0.7938
CDIV6	-0.3128	0.3923	0.4252	-1.6956	1.0246	0.0979	-0.2250	0.4862	0.6435
CDIV7	0.2936	0.4260	0.4907	-2.9589	1.0777	0.0060	0.5705	0.5572	0.3059
CDIV8	-0.1582	0.3791	0.6765	-1.1203	1.1593	0.3339	-0.2941	0.4496	0.5131
CDIV9	-0.5227	0.3302	0.1135	-0.9371	0.7636	0.2198	-0.6083	0.4102	0.1381
STATELAW2*	-0.1989	0.2090	0.3413	0.5323	0.3742	0.1549	-0.5116	0.3142	0.1035
STATELAW3*	-0.3619	0.1688	0.0320	-0.5712	0.2994	0.0564	-0.5702	0.2369	0.0161
STATELAW4*	-0.6954	0.3410	0.0414	-0.8977	0.8857	0.3108	-0.8500	0.4194	0.0427
CONDO	-0.0642	0.1888	0.7338	-0.3173	0.3639	0.3832	-0.0123	0.2375	0.9588
MULTI	0.4119	0.2282	0.0711	0.4756	0.3472	0.1708	0.2431	0.3059	0.4268
N_CCITY	-0.0956	0.1128	0.3970	-0.5587	0.2446	0.0223	0.0570	0.1326	0.6674
RURAL	0.3171	0.1535	0.0389	0.4609	0.2782	0.0976	0.2733	0.1916	0.1539
FULL_DOC	-1.2570	0.1218	<.0001	-1.4716	0.2660	<.0001	-1.4544	0.1503	<.0001
PREPAY	0.1595	0.1274	0.2106	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.0268	0.0114	0.0185	0.0767	0.0256	0.0027	0.0187	0.0151	0.2137
HISPANIC_STATE	-0.0164	0.00762	0.0309	0.00565	0.0203	0.7811	-0.0198	0.00991	0.0453
AGENCY_CODE1**	-0.2057	0.1410	0.1447	-0.8857	0.2501	0.0004	0.6608	0.1904	0.0005
AGENCY_CODE2**	-0.3757	0.2818	0.1825	-0.2665	0.5122	0.6029	-0.1138	0.3391	0.7372
AGENCY_CODE3**	0.3726	0.2296	0.1047	0.7211	0.4529	0.1114	0.4145	0.2703	0.1252
AGENCY_CODE4**	0.4420	0.4692	0.3462	0.2114	0.9763	0.8286	0.6225	0.5634	0.2692
Q2	-1.0418	0.2134	<.0001	-0.8919	0.4047	0.0275	-1.0755	0.2560	<.0001
Q3	-0.3995	0.3964	0.3136	-0.8245	0.7662	0.2819	-0.2711	0.4780	0.5706
Q4	-0.0828	0.6104	0.8921	-1.1322	1.1487	0.3243	0.1919	0.7493	0.7979
Summary Statistics									
Number of Lenders	34			31			29		
Number of Observations	3679			1444			2235		
System R-Squared (3SLS Only)	NA			0.4522			0.4654		
Nagelkerke R-Squared	0.6150			0.6821			0.5748		
Cox-Snell R-Squared	0.4480			0.4661			0.4273		
KS Statistic" (all)	66.68			76.90			62.47		
KS Statistic (Black=1)	60.15			58.71			62.63		
KS Statistic (Hispanic=1)	66.59			73.26			64.11		
KS Statistic (Black=0, Hispanic=0)	67.24			80.42			60.93		

Table A.4. Descriptive Statistics for Table A.3 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Purchase Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 3-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.3571623	0.4792283	0.2617729	0.4397519	0.4187919	0.4934716
BLACK	0.1592824	0.3659890	0.1551247	0.3621489	0.1619687	0.3685045
HISPANIC	0.1777657	0.3823674	0.1239612	0.3296515	0.2125280	0.4091879
MONTHLY_INCOME	5320.20	3989.15	5704.64	3689.36	5071.81	4153.32
LTV	83.1778391	11.7312862	82.1244598	10.7256256	83.8584116	12.2919362
FICO	659.5216091	68.7125013	687.5948753	71.3951747	641.3838926	60.3506785
ORIG_AMT	132112.62	73693.26	138620.21	76339.48	127908.16	71635.35
CREDIT_SPREAD	0.7607774	0.0470407	0.7580956	0.0482189	0.7625101	0.0461917
YIELD_CURVE	2.4402800	0.4311356	2.3756163	0.4511046	2.4820582	0.4124714
HPI_VOL	13.5382162	10.2578874	14.0250821	10.0373188	13.2236595	10.3880042
RATE_VOL	0.2311453	0.1253267	0.2477549	0.1299524	0.2204140	0.1210684
CDIV2	0.1195977	0.3245346	0.1738227	0.3790882	0.0845638	0.2782937
CDIV3	0.1361783	0.3430244	0.1675900	0.3736312	0.1158837	0.3201570
CDIV4	0.0554499	0.2288873	0.0983380	0.2978742	0.0277405	0.1642651
CDIV5	0.1891818	0.3917062	0.2590028	0.4382389	0.1440716	0.3512409
CDIV6	0.0470236	0.2117182	0.0325485	0.1775131	0.0563758	0.2306977
CDIV7	0.1889100	0.3914903	0.0858726	0.2802729	0.2554810	0.4362288
CDIV8	0.0603425	0.2381527	0.0526316	0.2233742	0.0653244	0.2471527
CDIV9	0.1427018	0.3498161	0.0796399	0.2708287	0.1834452	0.3871177
STATELAW2*	0.3549878	0.4785747	0.2409972	0.4278368	0.4286353	0.4949916
STATELAW3*	0.3547160	0.4784922	0.3871191	0.4872600	0.3337808	0.4716680
STATELAW4*	0.0350639	0.1839663	0.0311634	0.1738194	0.0375839	0.1902302
CONDO	0.1002990	0.3004391	0.1170360	0.3215746	0.0894855	0.2855071
MULTI	0.0524599	0.2229829	0.0630194	0.2430820	0.0456376	0.2087446
N_CCITY	0.4514814	0.4977080	0.4736842	0.4994800	0.4371365	0.4961434
RURAL	0.1527589	0.3598038	0.1731302	0.3784909	0.1395973	0.3466463
FULL_DOC	0.7088883	0.4543367	0.6952909	0.4604436	0.7176734	0.4502322
PREPAY	0.6075020	0.4883730	NA	NA	NA	NA
BLACK_STATE	11.9206578	7.8753342	13.4023546	8.5182927	10.9633557	7.2735417
HISPANIC_STATE	13.2127752	11.9050320	10.5168283	10.3609508	14.9545861	12.5006922
AGENCY_CODE1**	0.3234575	0.4678592	0.6038781	0.4892598	0.1422819	0.3494172
AGENCY_CODE2**	0.0277249	0.1642059	0.0221607	0.1472569	0.0313199	0.1742198
AGENCY_CODE3**	0.0456646	0.2087850	0.0332410	0.1793274	0.0536913	0.2254579
AGENCY_CODE4**	0.0097853	0.0984487	0.0062327	0.0787282	0.0120805	0.1092700
Q2	0.3574341	0.4793093	0.3247922	0.4684594	0.3785235	0.4851276
Q3	0.2962762	0.4566763	0.2915512	0.4546342	0.2993289	0.4580666
Q4	0.1788529	0.3832812	0.2257618	0.4182278	0.1485459	0.3557198

Table A.5. 2/28 Adjustable-Rate Purchase Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 2-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	10.0637	0.9600	<.0001	4.5718	2.2035	0.0380	9.4497	1.1802	<.0001
BLACK	0.2184	0.0545	<.0001	0.3344	0.1032	0.0012	0.3400	0.0666	<.0001
HISPANIC	0.0592	0.0529	0.2632	0.4173	0.1174	0.0004	0.5075	0.0637	<.0001
MONTHLY INCOME	0.000010	6.701E-6	0.1322	0.000253	0.000029	<.0001	0.000341	0.000019	<.0001
LTV	0.0954	0.00264	<.0001	0.1713	0.0186	<.0001	0.1250	0.00704	<.0001
FICO	-0.0198	0.000450	<.0001	-0.0173	0.00101	<.0001	-0.0197	0.000596	<.0001
ORIG_AMT	-0.00001	3.868E-7	<.0001	-0.00003	2.385E-6	<.0001	-0.00004	1.278E-6	<.0001
CREDIT_SPREAD	-4.6146	0.8896	<.0001	-3.4968	1.6435	0.0334	-5.1180	1.0552	<.0001
YIELD_CURVE	-0.4503	0.2741	0.1004	-0.6806	0.5271	0.1966	-0.3402	0.3199	0.2876
HPI_VOL	0.0125	0.00407	0.0022	0.0581	0.01000	<.0001	0.0570	0.00524	<.0001
RATE_VOL	6.9312	1.2519	<.0001	5.7033	2.3425	0.0149	7.4766	1.4789	<.0001
CDIV2	0.1567	0.0984	0.1111	-0.2896	0.2311	0.2102	-0.1611	0.1505	0.2845
CDIV3	0.3828	0.1140	0.0008	-0.3992	0.3165	0.2072	-0.0549	0.1374	0.6893
CDIV4	0.6123	0.1239	<.0001	-0.0276	0.3064	0.9282	-0.5489	0.1560	0.0004
CDIV5	0.0965	0.1165	0.4074	-0.0727	0.3750	0.8462	-0.6686	0.1315	<.0001
CDIV6	0.1045	0.1530	0.4946	-0.7111	0.4851	0.1427	-0.7180	0.1754	<.0001
CDIV7	0.8475	0.1863	<.0001	-0.2746	0.5652	0.6271	-0.4771	0.2280	0.0364
CDIV8	0.1630	0.1402	0.2447	-0.6998	0.4803	0.1451	-0.8667	0.1667	<.0001
CDIV9	-0.0857	0.1235	0.4879	-0.1901	0.3069	0.5356	-1.1120	0.1522	<.0001
STATELAW2*	-0.1685	0.0849	0.0471	-0.7476	0.1712	<.0001	0.0826	0.1125	0.4631
STATELAW3*	-0.0411	0.0593	0.4884	-0.1405	0.1135	0.2157	-0.4484	0.0816	<.0001
STATELAW4*	-0.4508	0.1269	0.0004	-0.4470	0.2462	0.0694	-0.6028	0.1923	0.0017
CONDO	-0.0760	0.0659	0.2487	-0.1318	0.1235	0.2856	-0.0216	0.0778	0.7809
MULTI	0.4716	0.0830	<.0001	0.3591	0.1250	0.0041	0.5669	0.1115	<.0001
N_CCITY	-0.1470	0.0448	0.0010	-0.0853	0.0921	0.3541	-0.1407	0.0514	0.0062
RURAL	0.1509	0.0694	0.0296	0.1060	0.1335	0.4273	0.1642	0.0809	0.0424
FULL_DOC	-1.3165	0.0476	<.0001	-1.8540	0.1053	<.0001	-1.5877	0.0608	<.0001
PREPAY	-0.2295	0.0539	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.00567	0.00461	0.2190	-0.0146	0.0124	0.2376	0.00967	0.00600	0.1074
HISPANIC_STATE	-0.0144	0.00348	<.0001	0.00595	0.00936	0.5251	-0.0205	0.00429	<.0001
AGENCY_CODE1**	0.1873	0.0774	0.0156	0.2146	0.1709	0.2093	0.3614	0.0877	<.0001
AGENCY_CODE2**	1.4713	0.1707	<.0001	1.9051	0.2958	<.0001	1.3998	0.2063	<.0001
AGENCY_CODE3**	3.9680	0.1027	<.0001	4.1063	0.3032	<.0001	3.9572	0.1114	<.0001
AGENCY_CODE4**	-3.5262	0.2976	<.0001	-3.4359	0.7603	<.0001	-3.4687	0.3232	<.0001
Q2	-1.0721	0.0857	<.0001	-0.9739	0.1601	<.0001	-1.0746	0.1010	<.0001
Q3	-1.2467	0.1588	<.0001	-1.2600	0.2933	<.0001	-1.1533	0.1885	<.0001
Q4	-1.4299	0.2356	<.0001	-1.5617	0.4299	0.0003	-1.5209	0.2804	<.0001
Summary Statistics									
Number of Lenders	35			33			32		
Number of Observations	17978			4657			13321		
System R-Squared (3SLS Only)	NA			0.3273			0.4162		
Nagelkerke R-Squared	0.5247			0.4484			0.5393		
Cox-Snell R-Squared	0.3932			0.3358			0.4042		
KS Statistic (all)	58.52			54.30			59.63		
KS Statistic (Black=1)	59.88			57.64			60.84		
KS Statistic (Hispanic=1)	57.00			51.88			58.68		
KS Statistic (Black=0, Hispanic=0)	57.97			53.51			59.15		

Table A.6. Descriptive Statistics for Table A.5 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 2/28 Adjustable						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 2-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.5238625	0.4994441	0.5323169	0.4990081	0.5209068	0.4995815
BLACK	0.2020247	0.4015217	0.2447928	0.4300104	0.1870730	0.3899848
HISPANIC	0.2364557	0.4249170	0.2061413	0.4045766	0.2470535	0.4313143
MONTHLY_INCOME	5343.82	3514.17	5810.80	4215.86	5180.56	3217.36
LTV	85.1187657	9.0612566	84.8905025	9.2225980	85.1985662	9.0031550
FICO	626.4640116	56.2751246	630.4109942	58.6704740	625.0841528	55.3491950
ORIG_AMT	148115.69	75359.67	159016.83	80526.92	144304.67	73088.10
CREDIT_SPREAD	0.7636333	0.0474368	0.7610436	0.0483879	0.7645387	0.0470679
YIELD_CURVE	2.3808088	0.4306069	2.3530170	0.4432163	2.3905247	0.4256998
HPI_VOL	16.2474764	11.3368526	18.0448063	10.8214964	15.6191328	11.4455784
RATE_VOL	0.2509125	0.1248711	0.2583326	0.1271226	0.2483185	0.1239745
CDIV2	0.1185338	0.3232481	0.3231694	0.4677370	0.0469935	0.2116328
CDIV3	0.1698743	0.3755328	0.2370625	0.4253266	0.1463854	0.3535054
CDIV4	0.0574035	0.2326184	0.0609835	0.2393257	0.0561519	0.2302235
CDIV5	0.1742686	0.3793508	0.2001288	0.4001396	0.1652278	0.3714000
CDIV6	0.0366559	0.1879208	0.0141722	0.1182132	0.0445162	0.2062467
CDIV7	0.1087440	0.3113264	0.0092334	0.0956563	0.1435328	0.3506285
CDIV8	0.0793192	0.2702438	0.0380073	0.1912344	0.0937617	0.2915079
CDIV9	0.1464568	0.3535734	0.0429461	0.2027574	0.1826439	0.3863888
STATELAW2*	0.3020358	0.4591535	0.1477346	0.3548748	0.3559793	0.4788269
STATELAW3*	0.3487040	0.4765733	0.4584496	0.4983241	0.3103371	0.4626489
STATELAW4*	0.0310936	0.1735754	0.0543268	0.2266858	0.0229712	0.1498174
CONDO	0.1104684	0.3134814	0.1047885	0.3063136	0.1124540	0.3159361
MULTI	0.0733674	0.2607459	0.1183165	0.3230172	0.0576533	0.2330955
N_CCITY	0.5213038	0.4995598	0.5780545	0.4939229	0.5014639	0.5000166
RURAL	0.1139726	0.3177869	0.1185312	0.3232708	0.1123790	0.3158440
FULL_DOC	0.5921682	0.4914453	0.5267339	0.4993384	0.6150439	0.4866032
PREPAY	0.7409612	0.4381191	NA	NA	NA	NA
BLACK_STATE	11.2625987	7.3445345	13.9992270	8.1215011	10.3058779	6.7979462
HISPANIC_STATE	12.9946379	10.9334054	10.7371699	8.1750870	13.7838451	11.6433459
AGENCY_CODE1**	0.0730893	0.2602903	0.0459523	0.2094042	0.0825764	0.2752512
AGENCY_CODE2**	0.0136278	0.1159431	0.0193257	0.1376820	0.0116358	0.1072438
AGENCY_CODE3**	0.1232618	0.3287466	0.0839596	0.2773570	0.1370017	0.3438621
AGENCY_CODE4**	0.0086773	0.0927494	0.0073008	0.0851416	0.0091585	0.0952642
Q2	0.2995884	0.4580904	0.2883831	0.4530589	0.3035057	0.4597889
Q3	0.3478696	0.4763076	0.3459309	0.4757219	0.3485474	0.4765282
Q4	0.2077539	0.4057110	0.2329826	0.4227766	0.1989340	0.3992133

Table A.7. 30-Year Fixed-Rate Refinance Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 3-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	15.8297	1.4007	<.0001	11.6955	2.5423	<.0001	16.0805	1.7312	<.0001
BLACK	0.3631	0.0841	<.0001	0.2117	0.1364	0.1207	0.4801	0.1091	<.0001
HISPANIC	0.1008	0.0991	0.3095	0.2537	0.1617	0.1167	0.0688	0.1286	0.5929
MONTHLY INCOME	0.000015	0.000011	0.1433	-1.91E-6	0.000021	0.9265	-2.32E-6	0.000011	0.8345
LTV	0.0414	0.00243	<.0001	0.0667	0.00537	<.0001	0.0547	0.00346	<.0001
FICO	-0.0252	0.000736	<.0001	-0.0250	0.00118	<.0001	-0.0265	0.000953	<.0001
ORIG_AMT	-0.00002	7.162E-7	<.0001	-0.00001	1.599E-6	<.0001	-0.00001	8.293E-7	<.0001
CREDIT_SPREAD	1.7978	1.3217	0.1738	0.0965	2.2935	0.9664	2.8682	1.6516	0.0824
YIELD_CURVE	-0.9365	0.3945	0.0176	0.0820	0.7003	0.9068	-1.4983	0.4870	0.0021
HPI_VOL	-0.00865	0.00665	0.1934	-0.00866	0.0144	0.5480	-0.00168	0.00907	0.8531
RATE_VOL	-1.1198	1.8260	0.5397	2.5437	3.1980	0.4264	-2.9463	2.2781	0.1959
CDIV2	0.4600	0.1742	0.0083	0.7075	0.4341	0.1032	0.1009	0.2254	0.6545
CDIV3	0.2478	0.1990	0.2130	-0.4372	0.5200	0.4005	0.5203	0.2494	0.0370
CDIV4	0.2166	0.2099	0.3021	0.7391	0.4952	0.1355	-0.1361	0.2843	0.6320
CDIV5	0.5643	0.1961	0.0040	0.3421	0.6355	0.5904	0.5536	0.2197	0.0117
CDIV6	0.3284	0.2463	0.1824	0.0935	0.7645	0.9026	0.3345	0.2948	0.2565
CDIV7	0.4656	0.2785	0.0946	-0.0738	0.7595	0.9226	0.3011	0.3513	0.3914
CDIV8	0.0417	0.2382	0.8609	-0.0877	0.8053	0.9133	0.0119	0.2890	0.9671
CDIV9	-0.1919	0.2097	0.3601	-0.1810	0.5917	0.7596	-0.2426	0.2507	0.3332
STATELAW2*	-0.2214	0.1322	0.0939	-0.1506	0.2686	0.5751	0.0631	0.1815	0.7279
STATELAW3*	-0.2917	0.1060	0.0059	-0.3247	0.2060	0.1150	-0.1812	0.1391	0.1927
STATELAW4*	-0.0467	0.2154	0.8284	0.2262	0.5089	0.6567	0.1131	0.2588	0.6620
CONDO	0.0690	0.1345	0.6079	0.2613	0.2348	0.2658	0.0367	0.1682	0.8274
MULTI	0.2138	0.1649	0.1947	0.1121	0.2613	0.6678	0.3787	0.2159	0.0795
N_CCITY	-0.0760	0.0713	0.2868	-0.0291	0.1261	0.8178	-0.1521	0.0885	0.0858
RURAL	0.2939	0.0984	0.0028	0.5225	0.1679	0.0019	0.1335	0.1252	0.2863
FULL_DOC	-1.0787	0.0771	<.0001	-1.2074	0.1353	<.0001	-1.1375	0.0967	<.0001
PREPAY	-0.3831	0.0775	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	-0.00150	0.00693	0.8281	0.0224	0.0199	0.2600	-0.00345	0.00844	0.6826
HISPANIC_STATE	-0.00438	0.00525	0.4035	0.0123	0.0145	0.3954	-0.0171	0.00706	0.0156
AGENCY_CODE1**	0.0117	0.1200	0.9226	-0.4147	0.2034	0.0414	0.2008	0.1536	0.1911
AGENCY_CODE2**	-0.0886	0.1293	0.4932	-0.1293	0.2030	0.5242	-0.1307	0.1708	0.4443
AGENCY_CODE3**	0.2738	0.1460	0.0608	0.00968	0.2701	0.9714	0.3091	0.1762	0.0794
AGENCY_CODE4**	0.5487	0.2944	0.0623	0.8479	0.4803	0.0775	0.3273	0.3880	0.3989
Q2	-0.7977	0.1233	<.0001	-0.9243	0.2193	<.0001	-0.7621	0.1524	<.0001
Q3	-0.2754	0.2427	0.2565	-0.5904	0.4226	0.1624	-0.1372	0.3045	0.6522
Q4	-0.2275	0.3787	0.5480	-0.3493	0.6351	0.5823	-0.2133	0.4840	0.6594
Summary Statistics									
Number of Lenders	37			35			28		
Number of Observations	8799			2881			5918		
System R-Squared (3SLS Only)	NA			0.4703			0.5405		
Nagelkerke R-Squared	0.5426			0.5480			0.5357		
Cox-Snell R-Squared	0.3857			0.4057			0.3679		
KS Statistic (all)	61.97			60.55			63.19		
KS Statistic (Black=1)	58.58			55.23			64.82		
KS Statistic (Hispanic=1)	65.99			62.10			66.94		
KS Statistic (Black=0, Hispanic=0)	60.86			61.74			60.96		

Table A.8: Descriptive Statistics for Table A.7 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Refinance Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 3-Year Prepayment Penalties	
Mean	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.3116263	0.4631843	0.4026380	0.4905142	0.2673200	0.4425982
BLACK	0.1635413	0.3698798	0.1975009	0.3981825	0.1470091	0.3541449
HISPANIC	0.1663825	0.3724448	0.1516834	0.3587761	0.1735384	0.3787440
MONTHLY INCOME	5027.29	3753.60	5224.43	4042.48	4931.33	3601.05
LTV	74.3785794	17.0294092	74.7270878	15.4111633	74.2089186	17.7627082
FICO	622.1256961	61.5483839	617.7913919	64.7890156	624.2357215	59.7994058
ORIG_AMT	144755.23	75417.42	134762.92	74586.43	149619.68	75346.79
CREDIT_SPREAD	0.7598307	0.0470648	0.7587851	0.0469742	0.7603396	0.0471045
YIELD_CURVE	2.4846414	0.4291438	2.4466366	0.4417362	2.5031430	0.4216777
HPI_VOL	16.3065975	11.3412298	12.5721322	10.4541944	18.1246094	11.3119061
RATE_VOL	0.2179913	0.1247948	0.2280747	0.1287663	0.2130825	0.1225259
CDIV2	0.1170588	0.3215086	0.2054842	0.4041251	0.0740115	0.2618117
CDIV3	0.1138766	0.3176794	0.1277334	0.3338507	0.1071308	0.3093056
CDIV4	0.0429594	0.2027772	0.0527595	0.2235917	0.0381886	0.1916675
CDIV5	0.1717241	0.3771619	0.1818813	0.3858136	0.1667793	0.3728102
CDIV6	0.0371633	0.1891726	0.0156196	0.1240199	0.0476512	0.2130452
CDIV7	0.1525173	0.3595421	0.2877473	0.4527913	0.0866847	0.2813962
CDIV8	0.0640982	0.2449417	0.0430406	0.2029838	0.0743494	0.2623609
CDIV9	0.2007046	0.4005503	0.0458174	0.2091252	0.2761068	0.4471081
STATELAW2*	0.3811797	0.4857042	0.4015967	0.4903063	0.3712403	0.4831774
STATELAW3*	0.3420843	0.4744346	0.3703575	0.4829843	0.3283204	0.4696418
STATELAW4*	0.0281850	0.1655105	0.0114544	0.1064288	0.0363298	0.1871254
CONDO	0.0634163	0.2437241	0.0541479	0.2263485	0.0679284	0.2516442
MULTI	0.0505739	0.2191385	0.0558834	0.2297362	0.0479892	0.2137614
N_CCITY	0.5247187	0.4994170	0.4887192	0.4999595	0.5422440	0.4982543
RURAL	0.1297875	0.3360886	0.1384936	0.3454773	0.1255492	0.3313686
FULL_DOC	0.7371292	0.4402179	0.7125998	0.4526284	0.7490706	0.4335846
PREPAY	0.6725764	0.4692999	NA	NA	NA	NA
BLACK_STATE	11.2374702	7.7395043	13.5127039	7.4202481	10.1298412	7.6497172
HISPANIC_STATE	14.7443232	12.2263634	16.7137452	12.6442809	13.7855694	11.9013573
AGENCY_CODE1**	0.0814865	0.2735964	0.1263450	0.3322955	0.0596485	0.2368545
AGENCY_CODE2**	0.0636436	0.2441308	0.0694203	0.2542117	0.0608314	0.2390409
AGENCY_CODE3**	0.0479600	0.2136938	0.0395696	0.1949796	0.0520446	0.2221358
AGENCY_CODE4**	0.0100011	0.0995100	0.0124957	0.1111027	0.0087868	0.0933328
Q2	0.3809524	0.4856485	0.3668865	0.4820388	0.3877999	0.4872897
Q3	0.2634390	0.4405235	0.2776814	0.4479331	0.2565056	0.4367410
Q4	0.1572906	0.3640952	0.1794516	0.3837966	0.1465022	0.3536388

Table A.9. 2/28 Adjustable-Rate Refinance Loans

Dependent Variable: 1 if APR_Spread Exceeds HMDA Reporting Threshold; 0 otherwise.									
Independent Variables	Model 1: Base Model			Model 2: Expanded Model, No Prepayment Penalties			Model 3: Expanded Model, With 2-Year Prepayment Penalties		
	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value	Coeff	Std Err	P-Value
INTERCEPT	16.2362	0.8645	<.0001	12.7901	1.4367	<.0001	16.0448	1.0979	<.0001
BLACK	0.1486	0.0532	0.0052	0.0386	0.0845	0.6481	0.1599	0.0689	0.0202
HISPANIC	-0.0679	0.0569	0.2328	-0.1694	0.0958	0.0771	-0.0613	0.0711	0.3891
MONTHLY INCOME	0.000018	5.524E-6	0.0015	1.769E-6	3.22E-6	0.5827	-0.00001	6.581E-6	0.0579
LTV	0.0297	0.00152	<.0001	0.0600	0.00373	<.0001	0.0641	0.00319	<.0001
FICO	-0.0210	0.000446	<.0001	-0.0225	0.000771	<.0001	-0.0249	0.000619	<.0001
ORIG_AMT	-9.27E-6	3.472E-7	<.0001	-5.89E-6	5.056E-7	<.0001	-4.77E-6	2.799E-7	<.0001
CREDIT_SPREAD	-5.3585	0.8370	<.0001	-4.8445	1.3923	0.0005	-6.0564	1.0591	<.0001
YIELD_CURVE	-0.4180	0.2455	0.0887	0.0104	0.4135	0.9800	-0.6611	0.3071	0.0314
HPI_VOL	0.00714	0.00399	0.0733	0.00904	0.00897	0.3136	0.0142	0.00513	0.0057
RATE_VOL	7.1831	1.1513	<.0001	8.2869	1.9114	<.0001	6.6298	1.4509	<.0001
CDIV2	0.3503	0.0908	0.0001	0.3687	0.2216	0.0961	0.4139	0.1377	0.0027
CDIV3	0.4561	0.1126	<.0001	0.2167	0.2940	0.4610	0.7458	0.1390	<.0001
CDIV4	0.3843	0.1158	0.0009	0.4965	0.2816	0.0779	0.4343	0.1501	0.0038
CDIV5	0.3924	0.1163	0.0007	0.6267	0.3485	0.0722	0.3383	0.1324	0.0106
CDIV6	0.5309	0.1566	0.0007	-0.0242	0.4663	0.9585	0.7907	0.1809	<.0001
CDIV7	0.8109	0.1841	<.0001	1.2648	0.4375	0.0038	0.7804	0.2288	0.0006
CDIV8	0.3328	0.1407	0.0180	0.6997	0.4382	0.1103	0.3919	0.1729	0.0234
CDIV9	0.3854	0.1233	0.0018	1.0825	0.3095	0.0005	0.2833	0.1557	0.0689
STATELAW2*	-0.0306	0.0792	0.6997	-0.1880	0.1674	0.2613	0.000409	0.1061	0.9969
STATELAW3*	-0.1378	0.0549	0.0121	-0.1398	0.0971	0.1498	-0.0689	0.0786	0.3808
STATELAW4*	-0.0598	0.1127	0.5957	-0.0372	0.2178	0.8645	0.2412	0.1903	0.2050
CONDO	-0.1800	0.0704	0.0105	-0.0442	0.1312	0.7361	-0.1988	0.0841	0.0181
MULTI	0.1116	0.0861	0.1950	0.2234	0.1225	0.0683	0.0703	0.1232	0.5684
N_CCITY	0.0159	0.0441	0.7194	-0.0136	0.0819	0.8681	0.0221	0.0531	0.6777
RURAL	0.0774	0.0660	0.2408	0.2139	0.1134	0.0593	0.0145	0.0822	0.8595
FULL_DOC	-0.7106	0.0427	<.0001	-0.6839	0.0727	<.0001	-0.7708	0.0537	<.0001
PREPAY	-0.3096	0.0486	<.0001	NA	NA	NA	NA	NA	NA
BLACK_STATE	0.00227	0.00416	0.5859	-0.00314	0.0115	0.7845	0.000933	0.00528	0.8599
HISPANIC_STATE	-0.0148	0.00358	<.0001	-0.0240	0.00892	0.0072	-0.0122	0.00476	0.0100
AGENCY_CODE1**	-0.4308	0.0951	<.0001	-0.5866	0.2003	0.0034	-0.4432	0.1097	<.0001
AGENCY_CODE2**	1.0246	0.1226	<.0001	0.9463	0.2015	<.0001	1.0933	0.1557	<.0001
AGENCY_CODE3**	3.1346	0.1028	<.0001	3.4348	0.2349	<.0001	3.0866	0.1169	<.0001
AGENCY_CODE4**	-1.5514	0.1403	<.0001	-1.4069	0.2626	<.0001	-1.6542	0.1667	<.0001
Q2	-1.1222	0.0778	<.0001	-1.1334	0.1308	<.0001	-1.1306	0.0978	<.0001
Q3	-1.2237	0.1507	<.0001	-1.3236	0.2479	<.0001	-1.1872	0.1912	<.0001
Q4	-1.3254	0.2291	<.0001	-1.3604	0.3858	0.0004	-1.3964	0.2875	<.0001
Summary Statistics									
Number of Lenders	32			32			30		
Number of Observations	18470			6520			11950		
System R-Squared (3SLS Only)	NA			0.4013			0.4115		
Nagelkerke R-Squared	0.4443			0.4199			0.4582		
Cox-Snell R-Squared	0.3304			0.3086			0.3421		
KS Statistic (all)	52.97			52.50			53.33		
KS Statistic (Black=1)	53.47			50.73			55.66		
KS Statistic (Hispanic=1)	55.70			60.69			53.27		
KS Statistic (Black=0, Hispanic=0)	52.22			51.21			52.63		

Table A.10. Descriptive Statistics for Table A.9 Analyses

DESCRIPTIVE STATISTICS FOR LOANS INCLUDED: 30-Year Fixed-Rate Refinance Loans						
Independent Variables	Model 1: Base Model		Model 2: Expanded Model, No Prepayment Penalties		Model 3: Expanded Model, With 2-Year Prepayment Penalties	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
HMDA_THRESHOLD	0.5799675	0.4935771	0.6199387	0.4854388	0.5581590	0.4966268
BLACK	0.1720087	0.3773982	0.1993865	0.3995698	0.1570711	0.3638830
HISPANIC	0.1558744	0.3627460	0.1460123	0.3531456	0.1612552	0.3677816
MONTHLY INCOME	5353.42	7393.47	5642.15	9599.00	5195.88	5843.90
LTV	77.5913806	14.2486355	76.6494156	13.9957800	78.1053230	14.3592691
FICO	581.9901462	52.1422822	579.9953988	52.4949334	583.0784937	51.9187601
ORIG_AMT	158127.28	76419.73	157820.78	79767.94	158294.50	74532.41
CREDIT_SPREAD	0.7644564	0.0475109	0.7638696	0.0484686	0.7647766	0.0469792
YIELD_CURVE	2.3898370	0.4290033	2.3766656	0.4343851	2.3970234	0.4258848
HPI_VOL	17.1887053	11.3851665	16.7198476	11.1623787	17.4445172	11.4973055
RATE_VOL	0.2478475	0.1249930	0.2516119	0.1257642	0.2457937	0.1245275
CDIV2	0.1635625	0.3698881	0.3483129	0.4764723	0.0627615	0.2425437
CDIV3	0.1707634	0.3763123	0.1815951	0.3855400	0.1648536	0.3710639
CDIV4	0.0634001	0.2436878	0.0562883	0.2304954	0.0672803	0.2505174
CDIV5	0.1658365	0.3719439	0.1621166	0.3685860	0.1678661	0.3737630
CDIV6	0.0304277	0.1717657	0.0105828	0.1023349	0.0412552	0.1988883
CDIV7	0.0831619	0.2761342	0.1378834	0.3448040	0.0533054	0.2246513
CDIV8	0.0743368	0.2623252	0.0286810	0.1669211	0.0992469	0.2990057
CDIV9	0.1436925	0.3507871	0.0213190	0.1444566	0.2104603	0.4076526
STATELAW2*	0.2772063	0.4476313	0.2266871	0.4187206	0.3047699	0.4603292
STATELAW3*	0.3453167	0.4754843	0.4110429	0.4920607	0.3094561	0.4622888
STATELAW4*	0.0391987	0.1940727	0.0610429	0.2394274	0.0272803	0.1629059
CONDO	0.0795885	0.2706624	0.0633436	0.2435985	0.0884519	0.2839628
MULTI	0.0582025	0.2341323	0.0848160	0.2786290	0.0436820	0.2043952
N_CCITY	0.5621007	0.4961419	0.5857362	0.4926322	0.5492050	0.4975938
RURAL	0.1185707	0.3232914	0.1259202	0.3317849	0.1145607	0.3185043
FULL_DOC	0.6724418	0.4693354	0.6714724	0.4697138	0.6729707	0.4691477
PREPAY	0.6469951	0.4779171	NA	NA	NA	NA
BLACK_STATE	11.4531402	7.7867151	13.7248160	7.5573588	10.2136987	7.6292737
HISPANIC_STATE	12.3859394	10.6503757	13.2491411	10.0689991	11.9149707	10.9262702
AGENCY_CODE1**	0.0371413	0.1891131	0.0225460	0.1484624	0.0451046	0.2075422
AGENCY_CODE2**	0.0229561	0.1497677	0.0250000	0.1561369	0.0218410	0.1461703
AGENCY_CODE3**	0.0916622	0.2885563	0.0713190	0.2573767	0.1027615	0.3036598
AGENCY_CODE4**	0.0171088	0.1296805	0.0130368	0.1134408	0.0193305	0.1376897
Q2	0.2905793	0.4540420	0.2763804	0.4472415	0.2983264	0.4575426
Q3	0.3397401	0.4736337	0.3411043	0.4741167	0.3389958	0.4733882
Q4	0.2006497	0.4004973	0.2118098	0.4086221	0.1945607	0.3958787

*The state law variables rely on the categories created by Ambrose, LaCour-Little and Anthony Sanders in their paper "The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis." These categories are based on the legal environment in states with regard to judicial foreclosure and deficiency judgement. The states are grouped as follows:

STATELAW2 = AK, AZ, CA, ID, OK, ME, MN, MT, NC, OR, SD, TX, WA
STATELAW3 = CT, DE, FL, IL, IN, KS, KY, NJ, OH, PA, SC, VT
STATELAW4 = LA, ND, WI
(reference category = AL, AR, DC, GA, HI, MO, IA, MA, MD, MI, MS, RI, NE, NH, NM, NV, NY, TN, UT, VA, WV, WY, CO)

*The agency codes reflect the regulatory agency to which the lender reports. The codes represent the following:
AGENCY_CODE1 = OCC
AGENCY_CODE2 = FRS
AGENCY_CODE3 = FDIC
AGENCY_CODE4 = OTS
(reference category = HUD)

APPENDIX 7: ODDS AND LIKELIHOODS

When logistical regressions are used to test the relationship between categorical independent variables and a binary dependent variable (in our case, the relationship between race, ethnicity and whether the APR spread exceeded HMDA's reporting threshold), the most straightforward measure of the "impact" of the independent variable on the dependent variable is the odds ratio. While not often used outside of this type of analysis, odds ratios are fairly easy to understand and are closely related to likelihood ratios.

Difference Between Odds and Likelihood

In analyses of social outcomes, likelihoods are often used to draw conclusions. The likelihood of a particular event happening is the same as the probability that that event will happen. For example, if 40 percent of all subprime borrowers received a high-APR loan in 2004, then the likelihood that a randomly chosen subprime borrower received such a loan is 40 percent. The odds of an event happening, however, is equal to the probability of the event happening divided by the probability that the event will not happen. Thus, the odds of that randomly-selected borrower receiving a high-APR loan is simply equal to the likelihood that he will receive a high-APR loan divided by the likelihood that he will not. To put it in basic mathematic terms:

Odds = P/(1-P), where P is the probability or likelihood of a particular event happening and (1-P) is, therefore, the probability of that event not happening.

In our example above, the odds of a randomly selected subprime borrower receiving a high-APR loan is equal to 0.4/(1-0.4), or 67 percent.

By extension, an odds ratio, therefore, is simply the ratio between the odds for different types of borrowers. If, hypothetically, the probability of an African-American borrower receiving a high-APR loan is 30 percent, the odds for that borrower is 0.3/0.7 or 0.43. If the probability for a similarly-situated white borrower receiving a high-APR loan is 20 percent, the odds for that borrower is 0.2/0.8 or 0.25. The odds ratio between black and white borrowers, therefore, is 0.43/0.25 or 1.72. The interpretation of this odds ratio is as follows: The odds of an African-American borrower receiving a high-APR loan are 72 percent greater than those of a similarly-situated white borrower.

Odds ratios can be directly computed from logistic regressions. However, the underlying odds and, therefore, likelihoods cannot be directly calculated. This is why odds ratios, despite being less intuitive measures than likelihoods, are generally used when describing results from logistic regressions.

To convert the results into likelihoods, which are more intuitive, we conduct a simulation where we use our model coefficients to compute the average predicted probabilities of receiving a higher-rate loan for the African-American and Latino borrowers in our dataset and compare those to the average predicted probabilities for the same borrowers if they had been white. So, for our example, if for a specific loan product the average predicted probability of receiving a higher-rate APR was 30 percent for the African-American borrower in our dataset but would have been 20 percent if those same borrowers had been white, our "increased likelihood" would be (0.3-0.2)/0.2 or 50 percent.

NOTES

1 12 U.S.C. § 2801 *et seq.*

2 12 U.S.C. § 2901 et. *seq.*

3 15 U.S.C. § 1691 *et seq.*

4 12 U.S.C. § 1735f-7a.

5 *See, e.g.*, Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved With Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, Vol. 51, South Carolina Law Review, pp535–539, App. 1, pp576–587; Alan M. White, *Risk-Based Mortgage Pricing: Present and Future Research*, Vol. 15, Housing Policy Debate, pp512–513 (2004).

6 For a detailed timeline of key events in fair lending, see Fair Lending Timeline, Fried Frank (September 27, 2002), at www.ffhsj.com/fairlend/timtest.htm.

7 For a more detailed summary of the evolution of HMDA, see Joseph Kolar & Jonathan D. Jerison, *The Home Mortgage Disclosure Act: Its History, Evolution, and Limitations*, Buckley Kolar LLP (March 7, 2005), at http://www.buckleykolar.com/publications/documents/HomeMortgageDisclosureActbyJoeKolarandJonJerison.pdf.

8 For an overview of current HMDA reporting requirements, *see A Guide to HMDA Reporting: Getting it Right!*, Federal Financial Institutions Examination Council (December 2003), at http://www.ffiec.gov/hmda/pdf/2004guide.pdf.

9 In prior years, higher-cost loans were identified based on whether the originator was on a list produced by the U.S. Department of Housing and Urban Development (HUD) of predominantly subprime lenders. See *HUD Subprime and Manufactured Home Lender List*, U.S. Department of Housing and Urban Development (March 31, 2005), at http://www.huduser.org/datasets/manu.html. Although using lenders as a proxy for subprime loan status was useful, it risked some degree of misclassification since, for example, some predominantly prime lenders also originate subprime loans.

10 Alicia H. Munnell, Geoffrey M.B. Tootell, Lynn E. Browne & James McEneaney, *Mortgage Lending in Boston: Interpreting HMDA Data*, Vol. 86, No. 1, The American Economic Review pp25-53 (March 1996).

11 Critics of the Boston Fed study have suggested that the estimated impact on race and ethnicity could have been biased because of omitted variables, data errors, and potential problems with the model used. Nonetheless, the Boston Fed study remains one of the most comprehensive and robust analyses of discrimination in the mortgage market. For an excellent overview of the study and the critiques leveled against it, *see* Stephen L. Ross & John Yinger, *Does Discrimination in Mortgage Lending Exist? The Boston Fed Study and Its Critics, in Mortgage Lending Discrimination: A Review of Existing Evidence* (Margery Austin Turner & Felicity Skidmore, eds., The Urban Institute, June 1999), at http://www.urban.org/UploadedPDF/mortgage_lending.pdf.

12 *Curbing Predatory Home Mortgage Lending*, U.S. Department of Housing and Urban Development and U.S. Department of the Treasury (June 2000), at http://www.huduser.org/publications/hsgfin/curbing.html.

13 Calvin Bradford, *Risk or Race? Racial Disparities and the Subprime Refinance Market, Center for Community Change* (May 2002), at http://butera-andrews.com/legislative-updates/directory/Background-Reports/Center%20for%20Community%20Change%20Report.pdf.

14 Paul Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, Vol. 29, No. 4, Journal of Real Estate Finance and Economics (December 2004).

15 As of March 1, 2005, lenders covered by HMDA were required to make their 2004 loan information available to the public within 30 days of receiving a request. While many lenders complied, sending electronic, easily accessible data to those who requested it, many others sent only hard copies, PDF files, or other formats that made it virtually impossible to conduct comprehensive analyses on national data. As a result, reports prior to the federal release of the data tended to focus on pricing disparities of specific lenders, not the market as a whole.

16 *The 2004 Fair Lending Disparities: Stubborn and Persistent*, National Community Reinvestment Coalition (April 2005), at http://www.ncrc.org/pressandpubs/press_releases/documents/HMDApricing_Report.pdf; The High Cost of Credit: Disparities in High-Priced Refinance Loans to Minority Homeowners in 125 American Cities, ACORN Fair Housing (September 27, 2005), at http://www.acorn.org/index.php?id=9758; and Allen Fishbein & Patrick Woodall, *Subprime Cities: Patterns of Geographic Disparity in Subprime Lending, Consumer Federation of America* (September 8, 2005), at http://www.consumerfed.org/pdfs/Subprimecities090805.pdf.

17 *See, e.g., Experts: Prepare for Legal, Regulatory Fallout From HMDA Data*, Mortgage Banking (October 2005), at http://www.all-business.com/periodicals/article/606224-1.html.

18 Robert B. Avery, Glenn B. Canner & Robert E. Cook, *New Information Reported Under HMDA and Its Implication in Fair Lending Enforcement, Federal Reserve Bulletin* (Summer 2005), at http://www.federalreserve.gov/pubs/bulletin/2005/3-05hmda.pdf.

19 The Fed study uses mutually exclusive categories when comparing borrowers by race and ethnicity. Specifically, they compare African-Americans, regardless of ethnicity, to Hispanic whites and non-Hispanic whites.

20 Specifically, the disparity ratios of higher-rate lending to African-Americans to that of whites drops approximately 15% in both purchase (3.7 to 3.1) and refinance (2.7 to 2.3) loans. For Latino white borrowers, the ratio drops 17% (2.3 to 1.9) for purchase loans and only 7% (1.5 to 1.4) in the case of refinance loans. *See* Tables 10A and 10B, Avery *et al*, note 18, p34.

21 Even after both the borrower and lender adjustments, African-American borrowers remain 40% and 80% more likely than white borrowers to receive a higher-cost loan for refinance and purchase purposes, respectively. For white Hispanic borrowers, the corresponding increased likelihoods decrease but persist at 10% (1.1 times) and 30% (1.3 times). See Tables 10A and 10B, Avery *et al.*, note 18, p34.

22 We made this estimation by comparing loan volume in the proprietary database with several estimates of overall subprime mortgage volume from third parties.

23 *See* App. 1 for detailed information on our matching methodology.

24 *See* App. 2 for comparisons of average values of variables between the proprietary database and the merged dataset.

25 Specifically, we merged in information on Treasury and corporate bond rates from the Federal Reserve, state race and ethnic composition from the 2000 Census, and state housing price index from the Office of Federal Housing Enterprise Oversight (OFHEO). Categories of state laws with respect to judicial foreclosure and deficiency judgment were from Brent Ambrose, Michael LaCour-Little & Anthony Sanders, *The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis*, Vol. 32, No. 4, Real Estate Economics, pp541-569 (2004).

26 *See* Ambrose *et al.*, note 25.

27 We eliminated any loans with FICO scores less than 300 or greater than 850, assuming that such scores were erroneous.

28 Unlike the Fed paper, the sample size in this research was not large enough to permit controlling for originating lender. Instead, we control for the regulating agency of the originating lender, which controls for the type of lender if not the specific originator.

29 Limiting our original dataset to loans in these four product categories yielded 93,659 loans. When further selections were made to ensure loans were secured by a first-lien, lacked private mortgage insurance, were below jumbo threshold, and were made to either a Latino, African-American, or white borrower, we were left with 50,031 loans.

30 Like the Federal Reserve analysis in Avery, et al., New Information Reported under HMDA and Its Application in Fair Lending Enforcement (see note 18), we exclude from the analysis all loans in which the loan application was submitted prior to January 1, 2004. We also exclude loans for which the variables race, ethnicity and sex were all coded as "not applicable" as these loans are presumed to be for commercial, agricultural, or business purposes.

31 Jumbo loans are loans above the maximum limit for purchase by Fannie Mae and Freddie Mac. In 2004, the maximum limit was $333,700 in most states. *See Fannie Mae Announces Higher 2004 Conforming Loan Limit of $333,700; Higher Limit Will Bring Mortgage Savings to More Americans*, Fannie Mae (November 25, 2003), at http://www.fanniemae.com/newsreleases/2003/2860.jhtml.

32 Odds ratios are the convention because the exponential of the coefficient produced by the logistical regressions is the odds ratio corresponding to a one-unit change in the variable.

33 *See* App. 5 for more detail about APR.

34 For a discussion of this sort of targeting, see Elizabeth Renuart, *Toward One Fair and Competitive Mortgage Market: Suggested Reforms in a Tale of Three Markets Point in the Right Direction*, Vol. 82 Texas Law Review p421*et seq.* (December 2003), and Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets Revisited*, Vol. 82 Texas Law Review p439 et seq. (December 2003).

35 *See* App. 5 for an explanation of how APR tends to understate the cost of fees for borrowers. *See, also*, National Consumer Law Center, *The Cost of Credit: Regulation, Preemption and Industry Abuses* § 5.5.2.2.1 (3rd Ed. 2005) (example of a small mortgage with 10 points at 15% note rate, 25% APR; prepaid at two years costs borrower equivalent of 29.5%--nearly double the note rate and almost 5% more than the APR).

36 *2006 Predatory Lending Update: Breaking News on the Federal, State, and Local Fronts and How It Impacts You*, Inside Mortgage Finance Publications (transcript of remarks by Iowa Attorney General Thomas J. Miller during April 20, 2006 audio conference).

37 *See* untitled press release, Federal Reserve System Board of Governors (May 27, 2004) (announcing $70 million Citigroup settlement), at http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040527/default.htm; *Citigroup Settles FTC Charges Against the Associates Record-Setting $215 Million for Subprime Lending Victims*, U.S. Federal Trade Commission (September 19, 2002), at http://www.ftc.gov/opa/2002/09/associates.htm; and Press Release, *Ameriquest Announces Agreement with States*, Ameriquest (January 23, 2006), at http://www.ameriquestmortgage.com/releaseArticle.html?news=news20060123.

38 We caution that, while the ranges of African-American-to-white and Latino-to-white disparities presented here appear to differ in magnitude, the 95% confidence interval of the underlying odds ratio estimates frequently overlap (e.g., for the nine odds ratios that are significantly different from 1 and associated with the Latino or African-American variables, eight of them have a 95% confidence interval including 1.55). In other words, while the estimates presented here are helpful, the magnitude of African-American-to-white disparities are largely indistinguishable from Latino-to-white disparities.

39 *See* discussion above in Section III. Also, we recognize that our analytic framework treats the risk factors on rate sheets as legitimate factors and assumes that borrowers are in loan types (e.g., adjustable-rate mortgages) that reflect their true preference. As such, our methods are unlikely to detect discriminatory effects that might result from using certain factors to measure risk when they more directly serve as a proxy for race or ethnicity or from attempts to influence borrowers to accept more costly products. Also, we note that while researchers have found that borrowers of color are disadvantaged in the mortgage application process, our methods would be unable to detect disparities resulting from such differences. For example, if a white applicant received assistance and consequently was able to submit a stronger application than an identically-situated borrower of color who did not receive the same assistance, then the application could lead to a loan with a lower rate even though there was no substantive difference in the borrowers' qualifications. Since our analyses use data collected after the application process, we cannot detect such patterns. *See* Margery Austin Turner, Fred Freiberg, Erin Godfrey, Carla Herbig, Diane K. Levy & Robin R. Smith, *All other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*, *The Urban Institute* (April 2002) (reporting differences in pre-application treatment of white borrowers and borrowers of color by mortgage lenders), at http://www.huduser.org/Publications/PDF/aotbe.pdf.

40 "Yield-spread premium" is a term usually reserved for brokered transactions. In loans wholly originated by a lender, the same type of premium is usually referred to as an "overage."

41 We acknowledge that, in some instances, yield-spread premiums may play a helpful function, allowing borrowers to close their mortgage without any out-of-pocket costs or increase in the amount borrowed. In this scenario, lenders effectively provide a borrower with a credit in exchange for their agreement to pay a higher interest rate than their risk profile warrants. This credit is then applied to pay a broker or other loan originator's fee and other costs such as fees for an appraisal or title insurance.

42 For example, in a $250,000 loan originated by a large nationwide subprime lender through a broker and reported to the Center for Responsible Lending by the borrower, the broker received $5,000 in up-front fees that were financed into the amount borrowed, an additional $5,000 yield-spread premium, and the lender received an additional $1,282.50 in fees—and the borrower still had to pay other closing costs. These amounts total more than 4.5% of the loan amount, 13 times higher than the 0.36% average initial points and fees reported for single-family conventional loans in the first three months of 2006. For information on points and fees, see Table 1 of *Monthly Interest Rate Survey*, Federal Housing Finance Board (April 2006), at http://www.fhfb.gov/GetFile.aspx?FileID=4587. See, also, Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans*, (AARP Public Policy Institute Data Digest No. 83 (2003) (70% of older borrowers with broker-originated loans relied "a lot" on brokers to find the best mortgage for them, and of those with broker-originated loans, 21% reported they did not receive the best loan for them, as compared to 9% with lender-originated loans, and 20% received worse loans than expected, as compared to 8% with lender-originated loans).

43 For a discussion of the complexity of consumer shopping behavior, see Jack Guttentag, *Another View of Predatory Lending*, Financial Institutions Center, The Wharton School, University of Pennsylvania (revised August 21, 2000), at http://fic.wharton.upenn.edu/fic/papers/01/0123.pdf. *See also* James M. Lacko & Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, Federal Trade Commission Bureau of Economics (February 2004) (documenting consumer confusion with *simplified* disclosures), at http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf; Patricia A. McCoy, *A Behavorial Analysis of Predatory Lending*, Vol. 38, Akron Law Review (2005); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*,, Vol. 14, Cornell Journal of Law & Public Policy, pp199, 229-239 (2005); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, Vol. 13.2, Stanford Law & Policy Review (2002).

44 *See, e.g.*, the Georgia Fair Lending Act, which measures both yield spread premiums and prepayment penalties in its assessment of points and fees to determine whether a loan is high cost and deserving of additional protections. Ga. Code § 7-6A-1 *et. seq.*

45 Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, pp121-129 (January 8, 2002), at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf. Annual Review of Banking (forthcoming 2005). Similar findings have been made in the context of similar rate-based mark-ups in the automobile financing setting. *See, e.g.*, Mark A. Cohen, *Report on the Racial Impact of GMAC's Finance Charge Markup Policy* (August 29, 2003) (reporting that African Americans paid "more than 2 _ times the amount in subjective markup compared to whites,"), at http://www.consumerlaw.org/initiatives/cocounseling/gmacreport-bystate.shtml.

46 *See, e.g.*, White, note 5, pp510-11 (providing an example of a lender limiting YSPs to 1% of the loan amount in loans without prepayment penalties, 1.5% for loans with a one-year prepayment penalty, 2% for loans with a two-year prepayment penalty, and 3% for loans with a three-year prepayment penalty).

47 Debbie Gruenstein Bocian & Richard Zhai, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending (January 2005), at http://www.responsiblelending.org/pdfs/rr004-PPP_Minority_Neighborhoods-0105.pdf.

48 Rate sheets provided by lenders to brokers frequently provide an overall cap for such charges, but we are aware of none that explicitly determines these origination charges.

49 Marsha J. Courchane, Douglas McManus & Peter M. Zorn, *An Analysis of Mortgage Closing Costs* (August 2004) (unpublished manuscript quoted with permission, on file with authors).

50 *Brokers Flex their Muscle in 2005, Powering Record Subprime Year*, Inside B&C Lending (March 17, 2006).

51 *Service Remains the Key to Wooing Mortgage Brokers*, IMF Poll Finds, Inside B&C Lending (January 6, 2006).

52 *See* Turner *et al.*, note 39 (reporting differences in pre-application treatment of white borrowers and borrowers of color by mortgage lenders).

53 We note that while we were not able to control for the specific identity of lenders due to data limitations, we did include a variable to control for the identity of the lenders' primary federal regulator. This adjustment, in essence, should control for differences in cost of funds that result from corporate form (e.g., national bank versus non-depository state lender).

54 While it is theoretically possible that these lenders are competing in beneficial ways on dimensions other than price, the loan products selected for analysis in this paper are quite standard—to the point where we may consider them commodities—and, consequently, the findings cannot be readily explained by observing that the loans represent unique options for borrowers.

55 Paul S. Calem, Jonathan E. Hersaff & Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, Vol. 15, No. 3, Housing Policy Debate (2004), at http://www.fanniemaefoundation.org/programs/hpd/v15i3-index.shtml (reporting that borrower and neighborhood demographics are significant factors in determining whether a borrower receives a loan from a predominantly prime or a higher-cost, predominantly subprime lender). While not studying the role of race and ethnicity, recent research from Lax et al. shows that borrowers are not efficiently sorted between the prime and subprime sector and that up to one percentage point in interest rates charged in the subprime market could not be explained by risk. Howard Lax, Michael Manti, Paul Raca & Peter Zorn, *Subprime Lending: An Investigation of Economic Efficiency*, Vol. 15, No. 3, Housing Policy Debate, pp568-69 (2004), at http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Lax.pdf. In addition, Freddie Mac has publicly commented that more than one-in-five recent subprime borrowers in recent years could likely have qualified for a prime loan. Mike Hudson & E. Scott Reckard, *More Homeowners with Good Credit Getting Stuck with Higher-Rate Loans*, Los Angeles Times pA-1 (October 24, 2005). It stands to reason that such inefficiencies in borrower sorting might also be reflected in the present analysis that examines only the distribution of loans within the subprime sector.

56 William C. Apgar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, 2005 President and Fellows of Harvard College, W05-11, p1 (December 2005), at http://www.jchs.harvard.edu/publications/finance/w05-11.pdf.

57 In practice, HMDA regulations ensure among the broadest possible coverage of Latino borrowers. Under the rules, even in instances when such information is not provided by borrowers, lenders are required to report ethnicity, race, and gender "on the basis of visual observation or surname." See 12 C.F.R. § 203, App. B.

58 *See* Apgar *et al.*, note 56, pp4, 21.

59 Kim-Sung *et al.*, note 42.

60 William P. Alexander, Scott D. Grimshaw, Grat R. McQueen & Barrett A. Slade, *Some Loans Are More Equal than Others: Third-Party Originations and Defaults in the Subprime Mortgage Industry*, Vol. 30, No. 4, Real Estate Economics, pp667-697 (2002) (concluding that third-party originations are more likely to default and that they therefore carry a higher rate than retail originated loans). On this same point, Federal Reserve researchers examining the 2004 HMDA data reported that loans thought more likely to be brokered (because they were from outside of lenders retail assessment area established for Community Reinvestment Act purposes) were more likely to be high-APR loans. *See* Avery *et al.*, note 18.

61 *See* United States v. First American Bank (N.D. Ill.) (filed July 13, 2004) *and* United States v. Old Kent Financial Corporation and Old Kent Bank (E.D.S.D. Mich.) (filed May 19, 2004).

62 While lenders are screened for fair lending compliance, it is less clear that the lending patterns of affiliated lenders are scrutinized

on a consolidated basis. Indeed, the challenge of a review that would necessarily cut across regulatory agency lines is considerable. Consider the resources and coordination necessary to review an institution that has a bank holding-company structure, with a national bank (supervised by the Office of the Comptroller of the Currency), a state bank (supervised by a state regulator and the Federal Deposit Insurance Corporation), and a non-depository finance company (supervised by the Federal Reserve Board and a state regulator).

63 See e.g., Joint HUD/Treasury Report, note 12; Eric Stein, Quantifying the Economic Cost of Predatory Lending, Coalition for Responsible Lending (rev. October 30, 2001), at http://www.responsiblelending.org/pdfs/Quant10-01.pdf; and Elizabeth Renuart, An Overview of the Predatory Lending Process, Vol. 15, No. 3, pp467-502 (2004) at http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Renuart.pdf.

64 Marsha J. Courchane, Brian J. Surrette & Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, Vol. 29, No. 4, Journal of Real Estate Finance and Economics pp365-392 (2004).

65 The median net worth of non-white and Latino households was just 17.6% that of white households in 2004. Brian K. Bucks, Arthur B. Kinnickell & Kevin B. Moore, *Recent Changes in U.S. Families Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Vol. 92 Federal Reserve Bulletin pA4 (February 2006).

66 See note 41.

67 15 U.S.C. § 1602(aa)(4)(D). Some courts have differed over whether YSPs are captured by the existing HOEPA definition of fees and points. *See generally*, National Consumer Law Center, *Truth in Lending* § 9.2.6.3.4 (5th Ed. 2003 and 2005 supplement).

68 *See, e.g.*, USA v. Delta Funding Corp., No. CV 00 1872 (S.D.N.Y Mar. 30, 2000), *available at* www.usdoj.gov. Cf. USA v. Long Beach Mortgage Co., No. CV 96-6159 (C.D. Cal., settlement agreement and order filed Sept. 5, 1996) (discriminatory pricing resulting from related originator compensation practices). For litigation involving YSPs and overages *see generally*, National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* §§ 11.5.4.3, 12.2.1.5.1 - .6 (RESPA), 12.5 (text accompanying notes 475-476); National Consumer Law Center, *Credit Discrimination*, §§ Chap. 8, 12.4.1.5

69 Christopher A. Richardson & Keith Ernst, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages*, Center for Responsible Lending (2005), at www.responsiblelending.org/pdfs/rr005-PPP_Interest_Rate-0105.pdf.

70 The majority of borrowers with subprime loans with prepayment penalties do in fact pre-pay. For example, a CRL internal analysis of California subprime loans orginated in 2003 showed that 71% had prepaid within 24 months, the average term for most prepayment penalties. This analysis utilized data from MBS offerings, courthouse records, and the proprietary database used here. Similarly, an analysis by Ralph DeFranco and Paul Calem, *Why Have Subprime Loans Been Prepaying so Fast?* (August 2005) at http://www.sme-online.com/sme/efeature/efeature0509.html/) shows that subprime loans nationally have comparable prepayment rates.

71 The extent to which prepayment penalties and YSPs are actually explained and offered as genuine options to borrowers in the subprime market is the subject of dispute in any event. For example, false, misleading or deceptive representations concerning prepayment penalties were among the issues present in the states' actions against both Household and Ameriquest, and consequently were the subject of injunctive relief in the settlements against both.

72 For a thoughtful discussion of suitability standards in the securities framework and their adaptability to the mortgage context, see Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, Vol. 80 Texas Law Review pp1317-1363 (May 2002) and Engel & McCoy, note 34, p440.

73 *See Brokers Flex their Muscle*, note 50.

74 *See, e.g.*, Patricia A. McCoy, Banking on *Bad Credit: New Research on the Subprime Home Mortgage Market*, Remarks at 2005 Federal Reserve Research Conference (July 26, 2005) (arguing for such an arrangement), at http://www.chicagofed.org/cedric/files/2005_conf_discussant_session1_mccoy.pdf.

75 *HMDA Targets Big Lenders on "Predatory" Loans*, Vol. 4, No. 6, Home Equity Wire (November 15, 2005).

76 *See, e.g., Inner City Press' Community Reinvestment Reporter* (April 10, 2006), at http://www.innercitypress.org/crreport.html.

77 *See* Office of the Comptroller of the Currency v. Spitzer, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal pending*.

78 *See* Li and Ernst, note 22, pp2, 11-14.

79 *See* Li and Ernst, note 22, pp3, 15-17.

80 *See, e.g.*, Ken Markison, Melissa Richards & Raymond Snytsheuvel, *Regulatory Update: Home Mortgage Disclosure Act (HMDA)*,

Ney-Kanjorski, RESPA Reform, State Predatory Lending and Licensing Laws, FACTA and FCRA, Data Security and RESPA Enforcement, Mortgage Bankers Association, PowerPoint presentation at MBA Residential Underwriting Conference 2005, at http://events.mortgagebankers.org/resundr2005/signatureconferences/resundr/images/img/Comprehensive.PPT.

81 Keith S. Ernst & Deborah N. Goldstein, *Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data*, p5 (Sept. 14, 2005), at http://www.responsiblelending.org/pdfs/cb001-FRB-091505.pdf.

82 HMDA lenders were chosen to correspond to originators with more than 1,000 loans for 2004 in the proprietary database.

83 Though included in the matching process, jumbo loans and loans secured by manufactured housing ultimately were not included in the final analyses.

84 Because of a high incidence of missing lender names in the proprietary database, a loan was considered "non-unique" and removed if state, zip code, loan purpose, property type, lien status and loan amount were the same as another loan, regardless of the lender name.

85 Unlike HMDA, the proprietary database does not have a consistent format for the names of lenders. Therefore, we relied on key words in the lender identification fields of the two databases when matching the loans.

86 See LeadsToLoans at http://www.leadstoloans.com.

87 Beginning with the 2004 HMDA data, borrowers can report multiple racial categories. In addition, HMDA contains an ethnicity variable indicating whether the borrower is Latino that is distinct from the race variables. We coded any borrower who listed "Black or African American" as one or more of the racial designations as black regardless of how they identified their ethnicity. Similarly, we coded all borrowers who indicated their ethnicity was "Hispanic or Latino" as Latino, regardless of their racial categorization. Finally, we coded borrowers who chose only "white" in the racial categories and only "Not Latino or Latino" in the ethnicity category as "white." The remaining records were not coded into racial and ethnic categories and are excluded from the analysis.

88 While Ambrose *et al.* (note 25) included age as an independent variable in their interim models, we did not have that information. However, we included information not in the Ambrose model, such as level of documentation. In addition, we stratified our data by loan purpose, which Ambrose *et al.* did not. Finally, whereas Ambrose and his colleagues model only conforming fixed-rate loans, we also analyze adjustable rate loans, which dominated the subprime market.

89 HPI is the state quarterly Housing Price Index from OFHEO, and the subprime rate is the 30-year, B-credit, 80 percent LTV rate from *Inside B&C Lending*.

90 Unlike the LTV and origination amount variables, which are continuous, whether or not a loan had a prepayment penalty is binary. As a result, 3SLS cannot be used to correct for potential endogeneity between APR spread and prepayment penalty status. However, by running separate models for loans with and without prepayment penalties, any potential endogeneity is eliminated.

91 KS is a non-parametric statistic that measures the maximum deviation of empirical distribution between two samples. Here KS statistics provide a relative goodness-of-fit measurement of the logistic regression model. A model with KS statistics of 0 has no predictive power, a model with a KS statistics of 100 predicts the data perfectly, and good models tend to have a KS statistic greater than 50. For the "ALL" group, the KS statistic was calculated for all data in the model; for "Black," KS was calculated for the Black borrowers, etc. This is used to demonstrate that the model fits the data equally well for all racial and ethnic groups. See Lax et al., note 55.

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.

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ATTACHMENT H



Borrowers in Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans

A research report by the
Center for Responsible Lending

Principal Investigators: Debbie Gruenstein Bocian and Richard Zhai

January 2005

CENTER FOR RESPONSIBLE LENDING

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Introduction

Unlike borrowers in the prime mortgage market, borrowers with less-than-perfect credit typically receive subprime mortgage loans that come with a significant penalty for paying off the loan early. In fact, while only two percent of loans in the prime market contain prepayment penalties, these penalties are found in up to 80 percent of subprime mortgage loans.[1] The widespread use of prepayment penalties in the subprime mortgage market raises major issues for borrowers, particularly homeowners in communities of color. **This report finds that borrowers in minority neighborhoods face greater odds of receiving a subprime prepayment penalty by a statistically significant margin**.

This finding has important implications for homeownership in communities of color and the ability of minority borrowers to build wealth. Two-thirds of the net wealth held by African Americans and Latinos consists of home equity.[2] Prepayment penalties threaten these savings by putting families in a no-win situation. First, for homeowners who improve their credit position enough to refinance into a cheaper prime mortgage product, prepayment penalties act as just that – penalties. The equity savings accumulated by these families are eroded when they must pay a substantial fee -- typically three to five percent of the total loan amount -- to escape their subprime mortgage loan. Second, if this prepayment penalty is too large, these families are effectively trapped in high-interest loans, when otherwise their credit would enable them to refinance at a lower rate.

In a companion study published today by the Center for Responsible Lending (CRL), we find that prepayment penalties, despite assertions by the mortgage industry, do not provide a benefit to borrowers in the form of a lower interest rate. Given the role of home equity in establishing economic security, the detrimental effects of prepayment penalties, and the importance of homeownership to minority wealth creation, CRL investigated whether these penalties have any disparate impact on minority communities.

Key Findings

To analyze this issue, CRL researchers Debbie Gruenstein Bocian and Richard Zhai examined the incidence of prepayment penalties in zip code areas with defined concentrations of minority residents. This study is based on a nationwide sample of 1.8 million loans originated from January 2000 to July 2004.

This analysis shows that borrowers in minority neighborhoods receive a disproportionate number of loans with prepayment penalties. For borrowers living in zip code areas where more than half of residents represent minority groups, the odds of receiving prepayment penalties are 35 percent higher than those of similarly situated borrowers in zip codes where minorities comprise less than ten percent of residents. The odds of borrowers receiving prepayment

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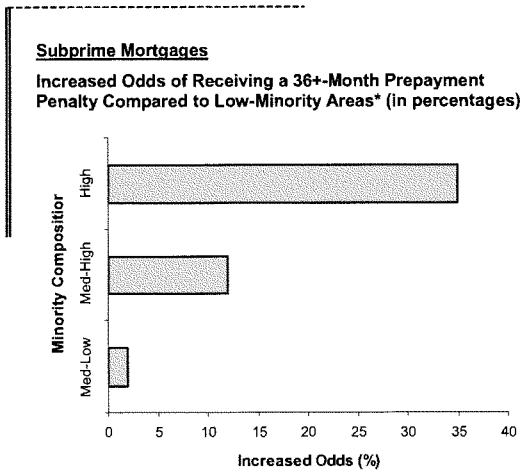
penalties are consistently and positively associated with minority concentration, and the differences are statistically significant.

As a sample, the chart to the right depicts our findings for penalty terms effective for three years or longer. Each result represents increased odds of receiving a prepayment penalty compared to residents in zip code areas with a "low"* concentration of minority residents. The chart shows that borrowers who live in zip code areas with a "medium-low" concentration of minority residents have slightly increased odds (about two percent) of receiving a prepayment penalty. The odds rise to 11.9 percent greater for borrowers in zip code areas with medium-high concentrations of minorities, and for those in high-concentration areas, the odds are nearly 35 percent greater.



* Minority concentration was defined as "low" (less than 10 percent of zip code residents); "medium-low" (10 – 24 percent); "medium-high" (25 – 49 percent); and "high" (greater than or equal to 50 percent).

CRL recently published a study that showed a similar preponderance of prepayment penalties in rural communities.[3] Specifically, that analysis revealed that borrowers in rural communities are more likely than similar urban borrowers to receive subprime mortgages with prepayment penalties that have terms of three years or longer. Given the relatively low levels of wealth held by residents in rural and minority areas, the two studies reveal that prepayment penalties are disproportionately stripping away savings from already disadvantaged communities.

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Background

The wealth gap between whites and people of color is well established and growing. According to a recent report by the Pew Hispanic Center,[4] in 2002 African Americans and Latinos had a median net worth of $5,998 and $7,932, respectively, compared to white Americans' median net worth of $88,651. In other words, white families' median net worth is about 11 times greater than Latinos' and nearly 15 times greater than the median net worth held by African Americans. Moreover, these figures represent a **decline** from median net worth held by minority families in 2000, which was $7,500 for African Americans and $9,750 for Latinos, compared to an increase from $79,400 for white Americans. Among African American and Latino homeowners, the median family in each group held 88 percent of its total wealth in the form of home equity. These figures illustrate that home equity is a critical factor in determining economic progress among these populations.

When prepayment penalties are imposed, the equity drained from a borrower's home can be significant. A typical penalty is equal to six months' interest on any prepayment greater than 20 percent of the mortgage balance. In the context of a subprime loan with an interest rate of 10 percent, this penalty amounts to approximately four percent of the loan balance. For example, a borrower with a $150,000 mortgage would incur a $6,000 fee for prepaying this loan -- more than the median level of wealth owned by African-American families. Also, because penalty amounts increase as interest rates climb, many borrowers with adjustable-rate mortgages face higher penalties at precisely the time they might otherwise realize greater benefits from refinancing.

Borrowers refinance for many reasons, including family emergencies, tapping into equity for important investments such as education, or to obtain a less costly loan. Prepayment penalties in the subprime market may harm these borrowers in several ways:

1. Draining equity. Many homeowners with subprime loans have worked hard for years to accumulate equity in their homes. A prepayment penalty, routinely amounting to thousands of dollars, directly drains home equity when a borrower refinances and must pay the penalty.

2. Creating a high-cost trap. Sometimes borrowers simply cannot afford the cost of the prepayment penalty. In such cases, they may be forced to continue paying a higher interest rate when they could otherwise refinance and qualify for a more affordable loan.

3. Providing an incentive for kickbacks. When brokers deliver loans at a higher interest rate than the lender requires, the lender typically pays the broker a kickback, known as a "yield spread premium." Because lenders want to recoup the cost of the kickback even if the borrower pays off early, they are more willing

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> to pay yield spread premiums on loans with prepayment penalties. For this reason, prepayment penalties facilitate brokers charging higher interest rates for borrowers who could otherwise qualify for lower rates.

Prepayment penalties have become increasingly common in the subprime market in recent years, at a level far out of proportion to the prime mortgage market. The wide disparity between the two markets raises substantial doubts as to whether consumer choice explains the prevalence of prepayment penalties in the subprime market, especially given subprime borrowers' incentive to build a good credit history and refinance as soon as feasible.

Concurrently with the present analysis, the Center for Responsible Lending (CRL) is releasing research showing that homeowners receive no interest rate benefit on refinanced subprime mortgages with prepayment penalties, and homebuyers actually pay a higher interest rate than similarly situated borrowers for subprime purchase loans.[5] This research refutes the claim made by many subprime lenders who assert that their borrowers accept prepayment penalties in return for a lower interest-rate than otherwise would be available.

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Data and Methodology

This study employed multivariate regression models to examine the effects of living in zip code areas of various minority concentrations on the odds of receiving a prepayment penalty. A geographic proxy was used because direct information on borrower demographics was not available. The analysis relies on logistic regressions performed on 1.8 million loans from the Loan Performance Asset-Backed Securities database of securitized subprime loans.[6] The results estimate the odds that subprime borrowers in neighborhoods with different racial compositions will receive prepayment penalties, controlling for a host of borrower, property and loan characteristics, as shown in Appendix 1. Appendix 2 displays the regression results for various prepayment penalty terms.

Reflecting general trends in the subprime mortgage market as a whole, 70 percent of loans carried a prepayment penalty.[7] More than 65 percent of the sample loans had a prepayment penalty term of at least two years. One in ten loans included a prepayment penalty with a term of five years or longer. Appendix 3 displays a cross-tabulation of the data by minority concentration in zip code areas and prepayment penalty terms.

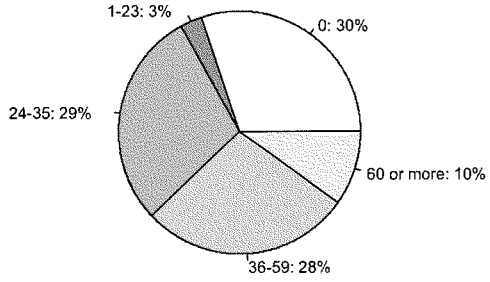
Database Characteristics

Number of loans examined	1.8 million
Origination period	January 2000 – July 2004
Refinances	68%
Single-family residences	84%
Average loan amount	$115,266
Adjustable rates	52%
Loans with prepayment penalties	70%

The figure below shows the percentage breakdown of the loans by prepayment term.

Distribution of Subprime Prepayment Penalties by Length of Term in Months

January 2000 – July 2004, Sample Size: 1.8 million subprime loans



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Findings

As shown in the chart below, subprime borrowers who live in zip code areas with a higher-minority concentration have a greater chance of receiving a prepayment penalty than similarly situated subprime borrowers who live in lower minority areas.

For borrowers in medium-high minority areas, the odds of receiving prepayment penalties of two years or more is 10 percent greater than that of similarly situated borrowers in low minority areas. The increase in odds rises to 12 percent and 17 percent for prepayment penalties of three or more years and five or more years, respectively. Even more striking, the odds of borrowers in high minority areas receiving any prepayment penalty (of at least two years) are more than 30 percent higher than those in low-minority areas.[8]

Subprime Mortgages

Increased Odds* of Receiving Prepayment Penalties with Various Terms in Zip Code Areas Characterized by Concentration of Minority Residents (in percentages)

Penalty Term	Minority Concentration		
	Med-Low	Med-High	High
24+ months	0.3**	10.4	35.3
36+ months	1.9	11.9	34.9
60+ months	3.4	17.0	32.7

* Compared to residents in areas with "low" minority populations. Minority concentration was defined as "low" (less than 10 percent of zip code residents); "medium-low" (10 – 24 percent); "medium-high" (25 – 49 percent); and "high" (greater than or equal to 50 percent).
** All results are statistically significant ($p<0.001$) except this cell.

It is important to emphasize that this analysis compares *similarly situated* borrowers -- i.e., we controlled for key borrower, property and loan characteristics, such as borrower credit scores -- to ensure that the results were not based on differences in risk factors. By isolating the effects of minority concentration in a large sample of zip codes, the study uncovered a statistically significant disparity in the incidence of prepayment penalties between areas with predominantly white residents and those with higher concentrations of racial and ethnic minorities.

To extend this analysis, we also examined the absolute odds of receiving a prepayment penalty for a typical subprime borrower in 2004.[9] The analysis attributed a uniform set of properties to a single borrower based on median values for key dataset characteristics such as loan-to-value, loan amount, debt-to-income and FICO score. Through this method, we were able to estimate the odds of receiving a prepayment penalty for a borrower with no relevant distinguishing factors except neighborhood racial composition. The chart on the following page displays the results.

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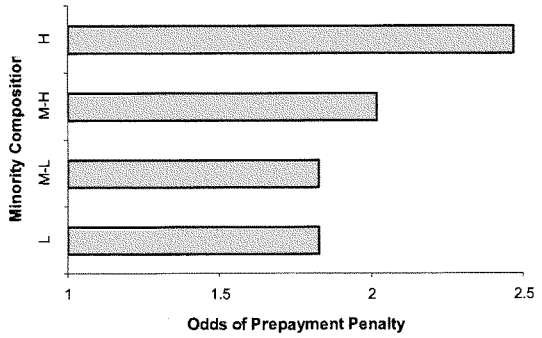
Subprime Mortgages

A Typical Borrower's Odds of Receiving a Prepayment Penalty by Racial Composition in Zip Code Area (Loans originated in 2004)



As shown above, for a typical borrower living in a low or medium-low minority area, the odds of receiving a prepayment penalty are essentially the same.[10] For every subprime borrower in lower minority areas without a prepayment penalty, 1.8 typical subprime borrowers in the same areas will receive one. The similar result for both of the lower minority categories reflects the general high prevalence of prepayment penalties in the subprime market. However, in areas with a medium-high concentration of minority residents, the odds increase to two borrowers with the prepayment penalties for every borrower without one. For typical borrowers in communities with the highest portion of minority residents, the odds of receiving a prepayment penalty are the highest, showing 2.5 typical borrowers with prepayment penalties for every borrower without one.

Taken together, both our comparative and "typical borrower" findings show that neighborhood racial composition is a significant factor associated with receiving a prepayment penalty in the subprime market. In the simplest terms, the odds of avoiding a prepayment penalty on a subprime loan are significantly better for borrowers who live in predominantly white neighborhoods.

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Conclusion and Comments

The drain on savings caused by prepayment penalties in the subprime market, the lack of compensating benefits, and the disproportionate impact on communities of color combine to create a powerful indictment of a practice that imposes higher costs on citizens who have less access to traditional markets. Given that subprime mortgage lending with prepayment penalties has increased exponentially at the same time as minority family wealth has suffered a historic drop, our findings raise critical questions regarding the preservation of homeownership in minority families.

In order to protect family wealth, policymakers should take steps to ban abusive prepayment penalties in subprime mortgage loans. The problematic nature of subprime prepayment penalties is already widely recognized. Numerous states have passed laws and issued regulations to prohibit or restrict the use of prepayment penalties in the home mortgage market. Currently, laws banning prepayment penalties are effective in at least nine states, including states that allow for limited exceptions.[11] Other states have imposed specific limits, including limits on the amount of fees associated with the penalties, permissible loan types, or additional lender disclosure requirements. Freddie Mac and Fannie Mae both have announced that they will not invest in subprime home loans with prepayment penalties that remain in effect for more than three years.[12] Currently, federal law and regulations offer few restrictions on prepayment penalties and enable some mortgage lenders to ignore state law restrictions on prepayment penalties.

Some individual lenders already have taken steps to voluntarily limit the use and scope of prepayment penalties. Responsible subprime mortgage lenders throughout the nation have a strong interest in abiding by fair lending laws and ensuring that loan transactions adhere to those laws both in letter and in spirit. In any case, it is clear that the issue of prepayment penalties in the subprime mortgage market carries major implications for the future economic state of minority communities, and is one to be taken seriously.

For most families, homeownership is a critical component of building assets and securing a more prosperous future. Asset building is even more critical in rural communities and in communities of color, where the overall populations lag far behind both in wealth and ownership. For this reason, the impact of prepayment penalties in subprime mortgage loans is a key issue that has major ramifications for borrowers in disadvantaged groups throughout the country.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership 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.

For additional information, please visit our website at www.responsiblelending.org

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Notes

[1] See Standard & Poor's, "NIMS Analysis: Valuing Prepayment Penalty Fee Income," at http://www.standardandpoors.com (January 3, 2001); *see also* Standard & Poor's, "Legal Criteria Reaffirmed for the Securitization of Prepayment Penalties," at http//www.standardandpoors.com (May 29, 2002); "Prepayment penalties prove their merit for subprime and 'A' market lenders," http://www.standardandpoors.com (January 3, 2001); *see also* "Freddie offers a new A-, prepay-penalty program," *Mortgage Marketplace*, at 1-2 (May 24, 1999); see also Joshua Brockman, "Fannie revamps prepayment-penalty bonds," *American Banker* at 16 (July 20, 1999).

[2] Rakesh Kochkar, "The Wealth of Hispanic Households: 1996 to 2002" (Pew Hispanic Center, 2004).

[3] John Farris and Christopher A. Richardson, "The Geography of Subprime Mortgage Prepayment Penalty Patterns" in *Housing Policy Debate* (Fannie Mae Foundation), vol. 15, issue 3 (2004). Also available at CRL's website at www.responsiblelending.org.

[4] Kochkar, ibid.

[5] "Prepayment Penalties Convey No Interest Rate Benefits on Subprime Mortgages," CRL report released January 13, 2005. Available at www.responsiblelending.org.

[6] For more information on this database, see Farris and Richardson, pp. 689-690.

[7] The results discussed here may be conservative given that the portion of prepayment penalties in the general subprime market is often reported to be considerably higher, representing up to 80 percent of all subprime loans.

[8] Prepayment penalty terms less than 24 months were not needed in the study because of their relatively infrequent occurrence.

[9] In 2004, our typical borrowers received a 30-year adjustable-rate refinance loan of $100,000. Other typical characteristics include residence in a large central city, a credit score of 628, a loan-to-value of 85 percent, and a debt-to-income ratio of 40 percent.

[10] Due to rounding, the figures displayed do not show small differences.

[11] For example, in North and South Carolina, the ban on prepayment penalties is limited to loan amounts less than $150,000.

[12] We note that these restrictions have had no discernible effect on the availability of subprime mortgages or the rapid growth of the subprime market. According to *Inside B&C Lending* (Nov. 18, 2004), nearly 21 percent of all mortgage loans are now subprime, more than double the percentage in 2001 – 2003.

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APPENDIX 1

Definition of Variables

Variable Name	Description
A_cen	Loans with zip codes in an MSA with population of 1 million or more and in the central city of an MSA
A_ncen	Loans with zip codes in an MSA with population of 1 million or more but not in the central city of an MSA
B_cen	Loans with zip codes in an MSA with population of 250,000 ~999,999 and in the central city of an MSA
B_ncen	Loans with zip codes in an MSA with population of 250,000 ~999,999 but not in the central city of an MSA
C_ncen	Loans with zip codes in an MSA with population of 100,000 ~249,999 but not in the central city of an MSA
D_cen	Loans with zip codes in an MSA with population less than 100,000 and in the central city of an MSA
Rural	Loans with zip codes not included in any MSA
Fico *	Borrowers' credit score at origination
Orig_amt*	Loan origination amount
DTI*	Borrowers' debt to income ratio
LTV*	Original loan to value ratio
Less_30yrs	Loans with term less than 30 years
Refi	Loans for refinance purpose
Low_doc	Loans not clearly indicating that they are full documented
No_doc	Loans under a no documentation program
Condo	Loans with property type as condo
Coop	Loans with property type as coop
Townhouse	Loans with property type as twonhouse
PUD	Loans with property type as Planned Unit Development
MH	Loans with property type as manufactured house
ARM	Adjustable rate mortgage
Balloon	Loans with balloon payment
Orig_2001	Loans originated in 2001
Orig_2002	Loans originated in 2002
Orig_2003	Loans originated in 2003
Orig_2004	Loans originated in 2004
AMPTA_rev	Loans originated after 07/01/2003 when the revised Parity Act law enacted
Race_medlow**	Loans originated in areas with minority percentage of 10%~25%
Race_medhigh**	Loans originated in areas with minority percentage of 25~50%
Race_high**	Loans originated in areas with minority percentage greater than 50%

* Denotes continuous numerical variables; all other independent variables are dummy variables.

** Latinos and multiracial individuals are classified as minority even if one of the races they self-identify as is Caucasian.

APPENDIX 2

Output of Logistic Regression Models Predicting the Probability of Receiving Various Prepayment Penalty Terms (2000-July 2004 Originations: ALL LOANS)

	2+ Years PP			3+ Years PP			5+ Years PP		
	A	B	C	A	B	C	A	B	C
Intercept		3.4381			1.1183			1.6042	
a_cen	0.866	-0.1443	***	0.829	-0.1871	***	0.893	-0.1129	**
a_ncen	0.893	-0.1136	***	0.858	-0.1532	***	0.917	-0.087	
b_cen	1.034	0.0332		0.984	-0.0166		1.128	0.1208	**
b_ncen	1.011	0.0112		0.949	-0.0527		1.055	0.0531	
c_cen	1.005	0.00494		0.941	-0.0608	*	1.108	0.1029	*
c_ncen	1.005	0.00464		0.964	-0.037		1.099	0.0948	*
d_cen	1.002	0.00217		1.029	0.0282		1.114	0.108	
rural	1.095	0.0906		1.084	0.0807	**	1.428	0.3564	***
fico	0.995	-0.00549	***	0.999	-0.0009	***	0.997	-0.0027	***
orig_amt	1	0.0000019	***	1	0.0000013	***	1	0.0000024	***
DTI	1.011	0.0107	***	1.007	0.0073	***	1.001	0.00102	***
ltv	0.997	-0.00337	***	0.989	-0.0113	***	0.979	-0.0215	***
less_30yrs	0.498	-0.6969	***	0.545	-0.6075	***	0.824	-0.1931	***
Refi	0.979	-0.0215	***	1.825	0.6016	***	1.95	0.6676	***
low_doc	0.744	-0.2955	***	0.771	-0.2605	***	0.773	-0.2571	***
no_doc	0.541	-0.6149	***	0.792	-0.2334	***	1.05	0.0492	
condo	0.864	-0.1463	***	0.844	-0.1699	***	0.968	-0.0323	**
coop	1.256	0.2278	*	1.198	0.1804		1.172	0.1588	
townhouse	0.897	-0.1085	***	1.26	0.2311	***	1	0.000132	
PUD	0.772	-0.2588	***	0.684	-0.3803	***	0.767	-0.2656	***
MH	0.991	-0.00917		1.191	0.1752	***	1.01	0.0103	
ARM	2.165	0.7726	***	0.291	-1.2329	***	0.203	-1.5928	***
balloon	1.372	0.3161	***	0.78	-0.2482	***	1.088	0.0847	***
orig_2001	1.045	0.0439	***	0.898	-0.1071	***	0.572	-0.5591	***
orig_2002	0.793	-0.2318	***	0.571	-0.5611	***	0.332	-1.1037	***
orig_2003	0.723	-0.3249	***	0.471	-0.7537	***	0.129	-2.0452	***
orig_2004	0.75	-0.2882	***	0.335	-1.0949	***	0.22	-1.5164	***
AMPTA_rev	0.957	-0.0434	***	0.908	-0.096	***	0.654	-0.4251	***
race_medlow	1.003	0.0029		1.019	0.0188	***	1.034	0.0332	***
race_medhigh	1.104	0.0991	***	1.119	0.1124	***	1.165	0.1529	***
race_high	1.352	0.3016	***	1.349	0.2993	***	1.327	0.2827	***
2*Log Likelihood		1712905			2001917			861338	
Cox and Snell R^2		0.2969			0.2002			0.1335	
Nagelkerke R^2		0.4101			0.2736			0.2912	

A Odds ratios
B Parameter estimates

C *** Significant at 99% confidence level
** Significant at 95% confidence level
* Significant at 90% confidence level

All models control for fixed state effects through state dummy variables (not shown)

APPENDIX 3

Cross-Tabulation of Subprime Mortgage Loans Analyzed, n=1.8 million
(By Prepayment Penalty Term and Minority Concentration)

PP term in months	Minority Concentration in Zip Code Areas				Total
	Low	Middle Low	Middle High	High	
0	6.36[1]	8.87	7.51	7.25	
	21.20[2]	29.58	25.04	24.18	***30.00***
	27.90[3]	34.42	31.99	25.97	
1 - 23	0.81	0.88	0.68	0.89	***3.26***
	24.74	26.99	21.00	27.27	
	3.53	3.41	2.91	3.18	
24 - 35	5.89	7.06	7.19	9.06	***29.20***
	20.16	24.18	24.62	31.03	
	25.83	27.39	30.61	32.44	
36 - 59	7.25	6.79	6.07	8.08	***28.19***
	25.72	23.31	21.54	28.67	
	31.80	8.46	25.86	28.94	
60 or more	2.49	2.18	2.03	2.65	***9.35***
	26.66	23.31	21.70	28.33	
	10.94	8.46	8.64	9.48	
Total	***22.8***	***25.78***	***23.48***	***27.93***	**100.00**

[1] Table percentage.
[2] Row percentage.
[3] Column percentage.

ATTACHMENT I

Kickbacks or Compensation: The Case of Yield Spread Premiums

by

Howell E. Jackson* and Jeremy Berry**

Over the past few years, the federal courts have been inundated with lawsuits challenging the payment of yield spread premiums in residential mortgage originations. The amounts involved are substantial – on the order of hundreds of millions in dollars of payments annually – and as the cases arise under the Real Estate Settlement Procedures Act of 1974 (RESPA or the Act), [1] which provides for treble damages, the stakes are extremely high. Yet within the academic community attention to the controversy has been limited. Most of what has been written on the subject has focused on procedural issues involving class certification. The remaining commentary has explored doctrinal questions regarding the interpretation of section 8 of RESPA,[2] which is the provision

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* Finn M.W. Caspersen and Household International Professor of Law, Harvard Law School. This article is substantially similar to an expert report which Professor Jackson prepared on behalf of the plaintiffs in Glover v. Standard Federal Bank, Civil No. 97-2068 (DWF/SRN) (U.S. District Court, District of Minnesota) (submitted July 9, 2001). Professor Jackson's work on this article was supported in part by Harvard Law School and the John M. Olin Center for Law, Economics & Business. David Cope provided extremely helpful consultations on many aspects of our analysis.

** Harvard Law School, '03.

1 Pub. L. No. 93-533, 88 Stat. 1724 (1974).

2 Section 8 reads as follows:

> Prohibition against kickbacks and unearned fees
> (a) Business referrals
> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.
> (b) Splitting charges
> No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.
> (c) Fees, salaries, compensation, or other payments
> Nothing in this section shall be construed as prohibiting (1) the payment of a fee (A) to attorneys at law for services actually rendered or (B) by a title company to its duly appointed agent

under which the cases are typically brought. Almost no academic writing has seriously grappled with the more fundamental question of whether the behavior at issue in these cases is, in fact, harmful and should be prohibited. This article offers one perspective on these issues.

We begin with a brief explanation of yield spread premiums. Today, one of the principal ways that borrowers obtain home mortgage financing is with the assistance of a mortgage broker. These brokers provide a number of services including helping customers complete loan application forms and providing other services, such as property appraisals and credit reports, necessary to obtain mortgages. In addition and of particular relevance to the debate over yield spread premiums, mortgage brokers typically choose a lending institution to fund the customer's mortgage. Most mortgage brokers have correspondent relations with a number – perhaps twenty – lending institutions. Every day and sometimes even several times in the course of a day, these lenders will supply their mortgage brokers prices at which they are willing to fund mortgages. When the broker is ready to lock in the financing terms for a particular customer, the broker must pick among the terms that correspondent lending institutions offer. Almost invariably, the customer accepts the mortgage broker's recommendation.

> for services actually performed in the issuance of a policy of title insurance or (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed, (3) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers, (4) affiliated business arrangements . . . or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture.

12 U.S.C.A. § 2607 (West 2001).

The controversy over yield spread premiums concerns the manner in which mortgage brokers are compensated for their services. One traditional way brokers are compensated is through the direct payments of various fees from their customers. For example, a mortgage broker might receive an origination fee of one percent of the loan amount. In addition, brokers sometimes supplement their income with various other fees, such as document preparation fees, application fees, and processing fees. All of these fees would typically be paid directly by the borrower at or before closing.

Yield spread premiums constitute a separate and less well known way that mortgage brokers are compensated for their services. Yield spread premiums are paid from lending institutions to mortgage brokers. A number of factors influence the setting of yield spread premiums, but the most significant is the rate of interest on the borrower's loan. In the mortgage banking industry, a "par loan" is a loan that a lending institution funds at 100 cents on the dollar. An "above par" loan is one that bears a somewhat higher interest rate and for which lending institutions are willing to pay more than 100 cents on the dollar, for example 102 cents. Typically, the excess over par is paid to mortgage brokers in the form of a yield spread premium. The average amount of yield spread premiums is typically in the range of $1000 to $2000 per loan, and, when present, is usually the largest component of mortgage broker compensation. The more an interest rate charged on an above par loan exceeds the rate for a comparable par loan, the greater the yield spread premium payment to the mortgage broker. Box A on the next page offers a concrete example of these payments.

Box A

Illustration of the Calculation of Yield Spread Premiums

To provide a more concrete example of how yield spread premiums are calculated, consider the following illustration drawn from one of the loan files included in the empirical analysis presented in part three of this article. More complete documentation for this file, in redacted form, is reproduced in Appendix A. These materials illustrate how yield spread premiums are determined.

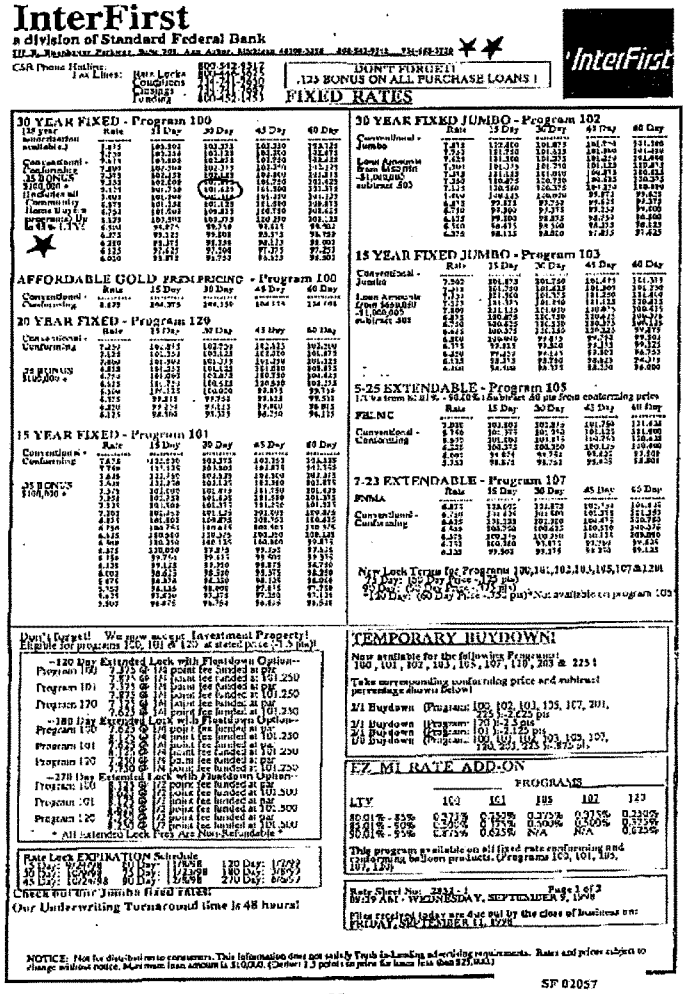
The yield spread premium for this loan was calculated from the rate sheet of one particular lending institution (InterFirst) in effect at 9:39 AM on September 9, 1998. A copy of this rate sheet appears on the next page. At the time, the borrower in question was seeking a 30-year fixed conventional mortgage for $106,850 with an interest rate of 7.125 percent (This information appears on a rate lock commitment, reproduced in Appendix A, which the lending institution sent to the mortgage broker to confirm the transaction on September 16, 1998.) The loan had a lock term of 30 days, meaning that the proposed rate was available through October 9, 1998. (Again, this information appears on the rate lock commitment.)

Based on the foregoing information, the loan's yield spread premium can be determined by reference to the accompanying rate sheet. Located in the upper right hand corner of the sheet are prices for 30-year fixed conventional mortgages – Program 100. The price for a particular mortgage depends on the interest rate proposed (7.125 percent in this case) and the lock period (30 days). On the accompanying rate sheet, the price for such a loan is 101.625 (circled). This figure means that InterFirst was prepared to pay a premium of 1.625 percent to fund this particular loan. That premium implies a yield spread premium with a base amount of $1,736.13 (or 1.625 percent of $106,850).

To determine net adjustments on this premium, one must read the fine print of the relevant rate sheet. Directly to the left of the prices for Program 100 is a note indicating that InterFirst will pay an additional 0.25 premium for conventional conforming loans in excess of $100,000 (marked with a single star). The loan in question qualifies for this amount because it exceeds the $100,000 threshold. In addition, at the top of this particular rate sheet is a second incentive premium of 0.125 percent for purchase loans (marked with two stars). Again, the loan qualifies because it is for a home purchase, not a refinancing. (This can be determined from the HUD-1 statement included in Appendix A.) Accordingly, the net adjustment on this loan is $ 400.69 (or 0.25 percent of $106,850 plus 0.125 percent of $106,850).

Based on the foregoing analysis, one would predict a total price for this loan to be 102.0, which is in fact the price reported on the rate lock commitment sheet reproduced in Appendix A. In addition, one would predict a total yield spread premium of $ 2,137 (the base amount of $1736.13 plus net adjustments of $404.69). And, in fact, this is the amount of yield spread premium indicated on the third page (line 816) of the HUD-1 statement for this loan.

Jac



InterFirst
a division of Standard Federal Bank

C&R Phone Hotline: 800-542-8317
Fax Lines: Rate Locks 800-466-3815
Couriers 734-741-4210
Closings 734-741-4249
Funding 800-454-1981

DON'T FORGET! .125 BONUS ON ALL PURCHASE LOANS !

FIXED RATES

30 YEAR FIXED - Program 100

15 year amortization available	Rate	15 Day	30 Day	45 Day	60 Day
	7.375	100.500	100.375	100.250	100.125
	7.500	100.750	100.625	100.500	100.375
Conventional - Conforming	7.625	101.000	100.875	100.750	100.625
	7.750	101.250	101.125	101.000	100.875
$5 BONUS $100,000 + (Includes all Community Home Buyer's Program)	7.875	101.500	101.375	101.250	101.125
	8.000	101.750	101.625	101.500	101.375
	8.125	102.000	101.875	101.750	101.625
	8.250	102.250	102.125	102.000	101.875
	8.375	102.500	102.375	102.250	102.125
	8.500	102.750	102.625	102.500	102.375

AFFORDABLE GOLD FREDDIPRICING - Program 100

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	8.875	104.375	104.250	104.125	104.000

20 YEAR FIXED - Program 120

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	7.250	100.875	100.750	100.625	100.500
	7.375	101.125	101.000	100.875	100.750
	7.500	101.375	101.250	101.125	101.000
$5 BONUS $100,000 +	7.625	101.625	101.500	101.375	101.250
	7.750	101.875	101.750	101.625	101.500
	7.875	102.125	102.000	101.875	101.750
	8.000	102.375	102.250	102.125	102.000
	8.125	102.625	102.500	102.375	102.250

15 YEAR FIXED - Program 101

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	7.000	100.500	100.375	100.250	100.125
	7.125	100.750	100.625	100.500	100.375
	7.250	101.000	100.875	100.750	100.625
$5 BONUS $100,000 +	7.375	101.250	101.125	101.000	100.875
	7.500	101.500	101.375	101.250	101.125
	7.625	101.750	101.625	101.500	101.375
	7.750	102.000	101.875	101.750	101.625
	7.875	102.250	102.125	102.000	101.875
	8.000	102.500	102.375	102.250	102.125

30 YEAR FIXED JUMBO - Program 102

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Jumbo	7.375	100.875	100.750	100.625	100.500
	7.500	101.125	101.000	100.875	100.750
Loan Amounts from $453,101 - $1,000,000 subtract .505	7.625	101.375	101.250	101.125	101.000
	7.750	101.625	101.500	101.375	101.250
	7.875	101.875	101.750	101.625	101.500
	8.000	102.125	102.000	101.875	101.750
	8.125	102.375	102.250	102.125	102.000
	8.250	102.625	102.500	102.375	102.250
	8.375	102.875	102.750	102.625	102.500

15 YEAR FIXED JUMBO - Program 103

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Jumbo	7.000	100.875	100.750	100.625	100.500
	7.125	101.125	101.000	100.875	100.750
Loan Amounts from $453,101 - $1,000,000 subtract .505	7.250	101.375	101.250	101.125	101.000
	7.375	101.625	101.500	101.375	101.250
	7.500	101.875	101.750	101.625	101.500
	7.625	102.125	102.000	101.875	101.750
	7.750	102.375	102.250	102.125	102.000
	7.875	102.625	102.500	102.375	102.250
	8.000	102.875	102.750	102.625	102.500

5-25 EXTENDABLE - Program 105

1/1 w/a term at all % - 98.20% Lockout at 60 dys from conforming price

FEMC	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	7.375	100.875	100.750	100.625	100.500
	7.500	101.125	101.000	100.875	100.750
	7.625	101.375	101.250	101.125	101.000
	7.750	101.625	101.500	101.375	101.250
	7.875	101.875	101.750	101.625	101.500
	8.000	102.125	102.000	101.875	101.750
	8.125	102.375	102.250	102.125	102.000

7-23 EXTENDABLE - Program 107

FNMA	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	6.875	100.875	100.750	100.625	100.500
	7.000	101.125	101.000	100.875	100.750
	7.125	101.375	101.250	101.125	101.000
	7.250	101.625	101.500	101.375	101.250
	7.375	101.875	101.750	101.625	101.500
	7.500	102.125	102.000	101.875	101.750
	7.625	102.375	102.250	102.125	102.000
	7.750	102.625	102.500	102.375	102.250
	7.875	102.875	102.750	102.625	102.500

New Lock Terms for Programs 100,101,102,103,105,107 & 120:
15 Day: (.05 Day Price -.125 pts)
30 Day: (Par Day Price - .375 pts)
*120 Day: (60 Day Price -.625 pts) *Not available on program 103

Don't Forget! We now accept Investment Property! Eligible for programs 100, 101 & 120 at stated prices (+1.5 pts)

--120 Day Extended Lock with Floatdown Option--
Program 100 7.375 @ 1/4 point fee funded at par
Program 101 7.375 @ 1/4 point fee funded at 101.250
Program 120 7.375 @ 1/4 point fee funded at 101.250
7.125 @ 1/4 point fee funded at par
7.625 @ 1/4 point fee funded at 101.250

--180 Day Extended Lock with Floatdown Option--
Program 100 7.625 @ 1/4 point fee funded at par
7.875 @ 1/4 point fee funded at 101.250
Program 101 7.625 @ 1/4 point fee funded at par
7.875 @ 1/4 point fee funded at 101.250
Program 120 7.750 @ 1/4 point fee funded at par
7.950 @ 1/4 point fee funded at 101.250

--270 Day Extended Lock with Floatdown Option--
Program 100 8.125 @ 1/2 point fee funded at par
8.375 @ 1/2 point fee funded at 101.500
Program 101 8.125 @ 1/2 point fee funded at par
8.375 @ 1/2 point fee funded at 101.500
Program 120 8.250 @ 1/2 point fee funded at par
8.450 @ 1/2 point fee funded at 101.500

* All Extended Lock Fees Are Non-Refundable *

Rate Lock EXPIRATION Schedule

15 Day:	1/23/02	30 Day:	1/30/02	120 Day:	5/7/02
45 Day:	2/6/02	60 Day:	2/14/02	180 Day:	7/6/02
45 Day:	10/29/98	60 Day:	1/4/99	270 Day:	8/6/02

Check out the Jumbo fixed rates!
Our Underwriting Turnaround time is 48 hours!

TEMPORARY BUYDOWN!

Now available for the following Programs:
100, 101, 102, 103, 105, 107, 120, 203 & 2251

Take corresponding conforming price and subtract percentage shown below!

2/1 Buydown (Programs: 100, 102, 103, 105, 107, 201, 225 1-2.625 pts
3/1 Buydown (Program: 120) 0-2.5 pts
5/1 Buydown (Programs: 101 0-2.125 pts
7/6 Buydown (Programs: 100, 101, 102, 103, 105, 107, 120, 203, 225 0-1.875 pts

EZ MI RATE ADD-ON

LTV	PROGRAMS 100	101	105	102	103
80.01% - 85%	0.375%	0.250%	0.375%	0.375%	0.250%
85.01% - 90%	0.500%	0.375%	0.500%	0.500%	0.375%
90.01% - 95%	0.875%	0.625%	N/A	N/A	0.625%

This program available on all fixed rate conforming and conforming balloon products. (Programs 100, 101, 105, 107, 120)

Rate Sheet No: 2201 - 1 Page 1 of 2
WED 9 AM - WEDNESDAY, SEPTEMBER 5, 1998

Files received today are due out by the close of business on: FRIDAY, SEPTEMBER 11, 1998

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Yield spread premiums are controversial on numerous dimensions. While the existence of these lender payments to mortgage brokers is revealed on government mandated disclosure statements made available to borrowers at closing and sometimes earlier, the form of disclosure is cryptic and does not reveal the relationship between the interest rate charged on the borrower's mortgage and the magnitude of the yield spread premium. In addition to issues of fraud and ethical concerns of such compensation arrangements, the practice raises the unresolved legal question of whether the payments constitute a violation of section 8 of RESPA, which proscribes the payment of kickbacks, referral fees, and unearned payments in connection with real estate settlements. Moreover, there is substantial disagreement about the effect of market forces in this context. A recurring claim of industry representatives is that yield spread premiums do not harm borrowers because market forces demand that compensating reductions be made in other forms of mortgage broker compensation, thus eliminating any additional expense to borrowers. Critics of the practice contest this characterization and argue that yield spread premiums serve principally to enhance the revenues of mortgage brokers and increase the cost of residential mortgage financing.

In this article, we seek to introduce the debate over yield spread premiums to a wider audience. In Part One, we review the legislative background of the Real Estate Settlement Procedures Act, which forms the statutory basis of the yield spread premium litigation. This review illuminates the concerns that motivated Congress to intervene in the area and also provides valuable insight into the kinds of market failures that were widely perceived to exist in the field in the early 1970's. Part One then reviews the actions that federal administrative agencies have so far taken with respect to yield spread premiums and summaries the mounting number of legal decisions address the issue.

In Part Two, we locate the provisions of RESPA in the broader context of financial regulation and argue that the Act's prohibition against kickbacks is characteristic of government interventions in a host of different financial areas. We identify this class of problem as the trilateral dilemma of financial regulation. In brief, this problem arises when a market professional gains de facto control over financial decisions of consumers. In exercising such discretion, the market professional often hires third parties to perform services for which the consumer pays. In such situations, numerous different third party providers may compete among themselves to be chosen to provide these services, and for any particular service provider there will be an incentive to make a side payment to the market professional in order to be selected. Under certain conditions – particularly where consumers are unable to monitor how the market professional selects service providers and are unlikely to police the cost of the provider's services – these practices can become wide-spread and unnecessarily raise costs for some consumers. In addition, the existence of such side payments may permit market professionals to price discriminate among consumers. Part Two concludes with a demonstration of how the practice of paying yield spread premiums shares all of the key ingredients of a trilateral dilemma.

In Part Three we test our theoretical assertions through an empirical investigation of more than two thousand mortgage financings of one affiliated group of lending institutions. The data for this study was obtained through discovery in the case of Glover v. Standard Federal Bank, for which one of the authors is serving as expert witness on behalf of the plaintiff class. In our view, this data offers compelling evidence that for transactions involving yield spread premiums, mortgage brokers received substantially more compensation than they did in transactions without yield spread premiums. Depending on the method of comparison, the estimated difference in costs to borrowers

ranges from $800 to over $3000 per transaction, and our best guess of the cost impact is approximately $1046. This difference in mortgage broker compensation and borrower costs is statistically significant at the 99.99% level and robust to a variety of formulations. These findings strongly suggest that yield spread premiums are not a good deal for borrowers, but serve primarily to increase compensation paid to mortgage brokers.

As a separate test of the economic impact of yield spread premiums, we used a series of regression analysis to explore the relationship between yield spread premiums and direct cash payments to mortgage brokers. Industry representatives have argued that yield spread premiums are not harmful to consumers because these payments are recouped through lower direct payments to mortgage brokers. However, our analysis suggests this claims is baseless. With the highest degree of statistical confidence and using multiple formulations, we can reject the notion that consumers fully recoup the cost of yield spread premiums. Our best estimate is the consumers get only twenty-five cents of value for every dollar of yield spread premiums. Seventy-five percent of yield spread premiums serve only to increase payments to mortgage brokers. On average, a very bad deal from consumers.

Our study also provides evidence that the payment of yield spread premiums allows mortgage brokers to engage in price discrimination among borrowers. In transactions where yield spread premiums are not at issue, the vast majority pay mortgage brokers total compensation of not more than 1.5 percent of loan value, and the largest group (on the order of 40 to 45 percent) pay mortgage brokers compensation in the range of 1.0 to 1.5 percent of loan values. In other words, in these markets, there is a pretty clear market price for mortgage broker services. But, when yield spread premiums are present, there is no single market price for mortgage broker services. Most

borrowers pay more than 1.5 percent of loan value; more than a third pay more than 2.0 percent of loan value; and roughly ten percent pay more than 3.5 percent of loan value. This price dispersion strongly suggests that yield spread premiums are not simply another form of mortgage broker compensation, but rather that the payments constitute a deceptive device that the mortgage broker industry employs to extract unnecessary and excessive payments from unsuspecting borrowers.

In an effort to corroborate the hypothesis that compensation practices of mortgage brokers disadvantage less well-educated and less financially sophisticated borrowers, we examined the relationship between mortgage broker compensation and the racial identity of borrowers. The results indicated that mortgage brokers charged two racial groups – African-Americans and Hispanics – substantially more for settlement services than other borrowers. For African Americans, the average additional charge was $474 per loan, and for Hispanics, the average additional charge was $580 per loan. While we expect to do more work on this aspect of our analysis, these preliminary results are consistent with our hypothesis that current industry practices allow mortgage brokers to exploit less sophisticated borrowers by imposing higher charges.

Part I: The Legal Context of the Yield Spread Premium Controversy

The controversy over the payment of yield spread premiums can be traced back to the early 1970's when real-estate settlement practices first gained national attention. In this part we begin with a review of the legislative process that lead to the enactment of RESPA in 1974 and the adoption of section 8's prohibition on kickbacks and unearned fees in real estate settlements. We then trace HUD's efforts in the past decade to regulate the payment of yield spread premiums under RESPA. The part concludes with a summary of the wave of recent class action lawsuits that have challenged the payment of yield spread premiums as violations of section 8's prohibitions.

A. The Enactment of RESPA and Section 8's Prohibitions

As described below, the legislative history of RESPA demonstrates that Congress was confronted with substantial and uncontroverted evidence that the settlement of real estate transactions in the United States in the early to mid 1970's was characterized by a number of abusive practices, which appeared to be imposing substantial costs on the American public. Various solutions to the problem of settlement costs were proposed, including direct regulation of settlement costs by the federal government. But in the end, Congress chose to impose a less intrusive solution, relying principally on a combination of mandatory disclosure rules and section 8's prohibition of kickbacks and unearned fees. In this section, we describe how Congress reached this compromise, focusing particular attention on facets of the legislative history that were most closely associated with the Act's inclusion of section 8's anti-kickback rules.

1. The 1972 HUD/VA Report on Mortgage Settlement Costs

Although RESPA was enacted in 1974, the legislative history of the Act dates back several years earlier. In 1970, Congress adopted section 701 of the Emergency Home Finance Act of 1970

in an effort to lower settlement costs in the housing market and assist moderate-income families to purchase homes.[3] Under section 701, which RESPA ultimately superseded, the Department of Housing and Urban Development (HUD or the Department) and the Veterans Administration (VA) were charged with the task of prescribing standards governing the amount of settlement costs on FHA-insured and VA-guaranteed loans.[4] The two agencies were also instructed to undertake a joint study on how best to reduce and standardize settlement costs across the country. That study, completed in March of 1972, greatly influenced congressional actions leading up to the passage of RESPA and affords valuable insight into the contemporaneous thinking about the mortgage settlement business that underlay Congress's decision to enact section 8's prohibition on kickbacks and unearned fees.[5]

One of the 1972 HUD/VA Report's principal findings concerned the payment of referrals and kick-backs in the conveyance (that is, sales) of real estate:

> Competitive forces in the conveyance industry manifest themselves in an elaborate system of referral fees, kickbacks, rebates, commissions and the like as an inducement to those firms and individuals who direct payment of business. These practices are widely employed, rarely inure to the benefit of the home buyer, and generally increase total settlement costs.[6]

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[3] Pub. L. No. 91-351, § 701 84 Stat. 450, 537-38 (1970).

[4] S. Rep. No. 866, 93rd Cong., 2d Sess. *reprinted in* 1974 U.S. Code Cong. & Admin. News 6546, 6558 [hereinafter 1974 Senate Report].

[5] See Mortgage Settlement Costs: Report of the Department of Housing and Urban Development and Veterans' Administration (Mar. 1972) (Comm. Print of the Senate Committee on Banking, Housing and Urban Affairs, 93rd Cong. 2d Sess.) [hereinafter 1972 HUD/VA Report].

[6] Id. at 3.

The 1972 HUD/VA Report proceeded to explore the "underlying problems" in the mortgage settlement industry, and among other things documented a substantial amount of "economic waste" in the industry. As the following passage illuminates, the report concluded that competition in this sector was not focused on lowering costs for consumers but rather on benefitting commercial concerns in the position to refer lucrative opportunities to those in the business of offering settlement services:

> In most cases, competition in the conveyancing industry is directed toward other participants in the industry, and not toward the home buying public. Lenders compete to get business from realtors or escrow companies. Title companies compete to get business from attorneys, brokers, or lenders, and so on.
>
> The buyer seldom decides who will provide settlement service for him. If there is a choice, he will usually depend on the advice of this broker, escrow agent, or settlement attorney.
>
> The competition that exists in this industry, therefore, is not based on price, because the ultimate consumer has a small voice in that decision. Although the industry is very competitive in many areas, the competitive forces that do exist manifest themselves in an elaborate system of referral fees, kickbacks, rebates, commissions and the like. These practices are widely employed and have replaced effective price competition.
>
> These referrals or kickbacks paid by or to lawyers, lenders, title insurance companies, real estate brokers and others result in unnecessarily high costs. Referral fees, kickbacks, or other similar arrangements explain, in part, why fees for conveyancing services often do not relate to work performed. Information obtained from this study indicates that referral practices are widespread. The system of referral fees has become so entrenched; and frequently, little is done to hide the fact that these fees are paid. . . . [7]

This passage offers a picture of the problem of real estate settlement, as presented to Congress in the early 1970's. According to the report, borrowers either did not participate in the selection of providers of settlement services or were dependent on the advice of a broker or other professionals. Given this power to "direct the placement of business," these professionals routinely extracted kick-

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[7] Id. at 15-16.

backs and referral fees, thereby increasing total settlement costs.[8] According to the report, the practice of extracting kickbacks and referral fees was so widespread in the industry that little attempt was made to hide the practice. That is, general knowledge that such payments were being made was not, apparently, sufficient to eliminate the practice or to permit borrowers to recoup the cost of kickbacks and referral fees through an off-setting reduction in other expenses.

Another element of the 1972 HUD/VA Report's findings concerned the manner in which settlement charges were calculated: "Settlement charges often are based on factors unrelated to the cost of providing the services. The overall level of charges tends to be significantly lower when the charge for a service is not directly related to the sales price of the property."[9] The Report later elaborated:

> [T]he fees for many services are charged on the basis of sales prices. This is seldom justifiable. There is no implicit reason for undiscovered title defects to increase with the sales price; yet the fee for title insurance does. Neither is there any reason for a broker's job to necessarily be more difficult on a more expensive home. These fees are the result of tradition and not the result of economics."[10]

The implication of this aspect of the Report is that settlement costs would have been lower if fees were not calculated in a manner that bore so little relationship to the costs of providing the services in question.

The 1972 HUD/VA Report concluded that practices in the mortgage industry were so

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[8] Id. at 2-3.

[9] Id. at 3.

[10] Id. at 33.

problematic that the federal government should establish maximum allowable settlement costs.[11] This proposal to regulate rates was highly controversial, and the ensuing congressional debate leading up to the enactment of RESPA two years later was largely cast in terms of a choice of whether to adopt the 1972 HUD/VA Report's draconian rate regulation proposal or some more modest form of governmental intervention.

2. Contemporaneous Press Accounts

Another important influence underlying the passage of RESPA were contemporaneous press accounts documenting abuses in the real estate settlement practices. Particularly noteworthy were a series of press accounts in the *Washington Post* early in 1972, just before the 1972 HUD/VA Report was released. These articles were introduced at hearings of the subcommittee on Housing of the House Committee on Banking and Currency,[12] and also cited in congressional reports accompanying the Act as ultimately passed.[13] To begin with, the *Washington Post* stories confirmed the existence of market failures of the sort identified in the 1972 HUD/VA Report. According to the

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[11] Id. at 69-70. In addition to this regulation of rates, HUD also proposed to adopt regulations prohibiting the payment of kickbacks in connection with HUD-insured loans: "The proposed regulation is aimed at prohibiting the payment by the mortgagee of fees to realtors and others who refer or place the loan with the lender. . . . The buyer or seller indirectly pays such fees when they are included." Id. at 71.

[12] See Real Estate Settlement Costs: FHA Mortgage Foreclosures, Housing Abandonment, and Site Selection Policies: Hearings Before the Subcomm. on Housing of the House Comm. On Banking and Currency 1 (1972) [hereinafter 1972 House Housing Hearings] (the articles were introduced into the record by Subcommittee Chair Rep. William A. Barrett).

[13] See, e.g., 1974 Senate Report, *supra* note 4, at 6558 (additional views of Senator Proximire).

Washington Post, settlement costs were a "mystery to most home buyers."[14] There was, moreover, evidence that this ignorance on the part of consumers allowed for substantial variation in settlement costs in different regions of the country, with home buyers in the Washington, D.C., area paying two to three times more than comparable buyers in, for example, Boston.[15] A commonly advanced explanation for this variation in fees was the prevalence of kickbacks and other hidden payments in certain parts of the country. While contemporaneous press accounts revealed that kickbacks were paid in many different contexts, an illustrative example concerned payments made from title companies to settlement attorneys. The *Washington Post* explained the practice in the following terms:

> The most common arrangements in the Washington area were found to be kickbacks and other hidden payments given by lawyers and by title insurance companies. . . .
>
> Although some lawyers, title insurance companies, lenders, developers, builders, and brokers will have no part of the deals, many of the practices are so pervasive that it is difficult to find exceptions.
>
> What such kickbacks amount to, says Seymour Glanzer, chief of the U.S. attorney's fraud unit, is "commercial bribery" that directly inflates settlement costs paid by home buyers.
>
> The purpose of giving kickbacks and hidden payments is to gain referral of home buyers' settlement business, and the referral methods are not always subtle.
>
> . . . .
>
> Almost without exception, Maryland lawyers pocket a quarter to a third of the title insurance premium that home buyers with mortgages are required to pay. This is their commission for choosing a particular insuring company and accounts for 27 per cent of premiums paid by home buyers to Washington's four major title insurance companies.
>
> Although they are legal, the commissions, according to bar association

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[14] 1972 House Housing Hearings, *supra* note 12, at 2.

[15] See id. In the 1972 HUD/VA Report, government investigators also documented substantial regional variations in settlement costs. See 1972 HUD/VA Report, *supra* note 5, at 2. 32-33.

> officials, would violate bar ethics unless lawyers obtain buyers' permission to take them. However, buyers are seldom consulted.[16]

A noteworthy aspect of the *Washington Post* series was the assertion that the payment of kickbacks and unearned referral fees was widespread in certain markets notwithstanding the fact that the practice was in violation of legal norms, in particular standards of professional responsibility. Similar assessments appeared throughout the hearings leading up to the enactment of RESPA.[17]

3. Perspectives from Congressional Hearings

Against the background of the 1972 HUD/VA Report and the mounting press coverage of mortgage settlement practices, Congress held a series of hearings between 1972 and 1974.[18] A variety of views were expressed, but a common opinion was that, while rate regulation of the sort advanced in the 1972 HUD/VA Report would be cumbersome and potentially counter-productive, some federal action was needed, particularly to enhance the level of consumer understanding of settlement costs and to alleviate the problems of kickbacks and referral fees. Illustrative of this sentiment was testimony of Representative Robert G. Stevens, Jr., sponsor of one of the bills that eventually formed the basis of RESPA:

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[16] See id.

[17] Consider, for example, the following testimony of Thomas R. Bomar, Chairman of the Federal Home Loan Bank Board:

> [Referral payments for settlement services] violate anti-kickback statutes. In addition, they are violative of the canons of ethics of the legal and real estate professions. Moreover . . . such actions may well violate existing federal criminal law dealing with commercial bribery . . ."

Real Estate Settlement Costs: Hearings Before the Subcomm. On Housing of the House Comm. on Banking and Currency, 93rd Cong. 2d. Sess. 56 (1974) [hereinafter 1974 House Hearings]. See also 1972 House Hearings, *supra* note 12, at 1-19.

[18] See sources cited *supra* notes 12 & 17.

> The proponents of federal rate fixing have said that the establishment of maximum charges is needed because of the abuses that exist in the settlement process. I find this line of argument to be totally without merit. If there are abuses, let us correct them; if there are particular problems that give rise to unnecessarily high settlement costs, let us deal with them. The imposition of federal rate regulation on so many businessmen and attorneys cannot be justified when the *underlying problems and abuses* can be dealt with directly by the Congress.[19]

Throughout the hearings, Congress was repeatedly urged to eschew price controls for settlement costs in favor of more targeted regulation aimed at specific abuses.[20]

One of the most frequently cited abuses was the practice of granting kickbacks and referral fees. Witnesses from disparate corners of the real estate industry concurred that kickbacks and referrals in real estate settlements should be outlawed. The following excerpts suggest the tenor of the debate on this point:

> "A final provision which we feel to be vital to any legislative package on settlement costs would be a prohibition on kickbacks and unearned fees."[21]
>
> * * * *
>
> "In your kickbacks, I am rather shocked at the things that occurred that brought this to public light, and I had no notion they went on."[22]
>
> * * * *
>
> "In the [Montgomery County (Md.) Lawyers Association]'s view, real estate practices involving payoffs, kickbacks, and referral fees should be prohibited because these practices increase costs to home buyers while providing them no additional benefits. . . .

---

[19] 1974 House Hearings, *supra* note 17, at 50 (emphasis in original).

[20] See, e.g., id. at 305 (testimony of H. Harland Crowell, Jr., National Association of Realtors) ("In this country, we believe that a free market, functioning correctly, is the most efficient and equitable way of allocating goods and services. If the market breaks down, we should try to determine the specific failing and correct it so that the simplicity and essential fairness of the market system can be preserved.").

[21] Id. at 61 (testimony of Sheldon B. Lubar, Ass't HUD Secretary for Housing Production and Mortgage Credit).

[22] Id. at 107 (testimony of William P. Dickinson, Chairman, ABA Special Committee on Residential Real Estate Transactions).

> Kickbacks and referral fees represent not only net direct economic loss to the home buyer but a significant obstacle to free market forces as well."[23]
>
> * * * *
>
> "The American Land Title Association has already placed itself on record as favoring appropriate regulation to prohibit such considerations and inducements [for other than services rendered]."[24]

Indeed, the hearings leading up to the passage of RESPA display a remarkable consensus of the general contours of the legislation. Price controls were thought to be excessively burdensome and unnecessary; measures to enhance disclosure and consumer understanding were strongly supported; and prohibitions on the sorts of kickbacks and referrals that the 1972 HUD/VA Report and contemporaneous press accounts had uncovered were almost universally acclaimed. Representative of this perspective was the testimony of Thomas B. Bomar, Chairman of the Federal Home Loan Bank Board, which touched upon all of these points:

> [1.) On the 1972 HUD/VA Report's Proposal to Set Maximum Settlement Charges:]
>
> First, rate regulation in this case is merely symptomatic treatment. It is like the administration of a painkiller as a remedy for appendicitis.
>
> Second, rate regulation in this case is likely to create a bureaucratic monstrosity.
>
> Third, rate regulation is contrary to this country's traditional philosophy regarding the role of the marketplace.
>
> Fourth, generally speaking, rate regulation not only does not work well, but itself creates serious distortions and instabilities in the market.
>
> [2.) On Proposals to Enhance Disclosure:]
>
> First, let me discuss one provision in the bills dealing with increased availability of information. It is almost universally agreed that we must take action to reduce, and eliminate if possible, the imperfections in this market.
>
> It is a fundamental economic concept that a competitive market cannot exist when the buyer is uninformed. For that reason the Board supports the concept . . . relating to special information booklets which describe the nature and costs of real estate statements.
>
> Additionally, the Board supports the provisions of the proposed legislation relating to the development of a uniform settlement statement. Such a statement would better enable buyers to make cost comparisons. . . .
>
> [3.) With Respect to Kickbacks:]
>
> Dealing with kickbacks, the real estate settlement market is characterized by nonprice competition. One of the principal forms of nonprice competition is advertising,

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[23] Id. at 151, 162 (testimony of B. George Ballman, Chairman of the Montgomery County (Md.) Lawyers Association).

[24] Id. at 375 (Memorandum on Behalf of the American Land Title Association).

> which has little overt use in the real estate settlement market because of the antisoliciation canons of several of the professions engaged in the market. Recourse is therefore especially made to another classic form of nonprice competition, that is, the use of a system of discounts, rebates, commissions, concessions, and kickbacks.
>
> . . . [B]oth settlement cost bills before the subcommittee provide criminal and civil penalty for such actions. The Board prefers the provisions concerning kickbacks and unearned fees in H.R. 9989 to those of H.R. 11183. In H.R. 11183, a separate [arguably weaker] provision is made for commission to attorneys. It is our preference to use comprehensive language dealing with the elimination of kickbacks across the board as provided in H.R. 9989.[25]

4. Congressional Reports and the Resulting Statutory Provisions

Following the consensus that emerged in the course of hearings, Congress adopted a targeted strategy to address the special problems associated with what were perceived to be excessively high settlement costs. While some members – most notably Senator Proxmire of Wisconsin – remained supportive of more stringent intervention in the form of price controls,[26] the legislation that was enacted relied upon a combination of disclosure requirements and prohibitions of specific practices such as kickbacks and referrals that most witnesses had advocated.[27] The key provision of RESPA was section 8 of the Act. In a section-by-section summary, the principal Senate Report explained

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[25] 1974 Hearings, *supra* note 17, at 51-53.

[26] See 1974 Senate Report, *supra* note 4, at 6557-68 (additional view of Senator Proxmire) (lamenting the Senate Committee's decision not to adopt price controls and noting the substantial role of industry representatives in shaping the structure of the final bill).

[27] For example, the House Report summarized the goals of the legislation as follows:

> The bill would proceed directly against the problem [of settlement costs] pointed out above in three basic ways: (1) prohibiting or regulating abusive practices, such as kickbacks, unearned fees, and unreasonable escrow accounts; (2) requiring that home buyers be provided both with greater information on the nature of the settlement process and with an itemized statement of all settlement charges well in advance of settlement; and (3) taking steps toward the simplification of the land recordation process . . . .

H.R. Rep. No. 1177, 93rd Cong., 2d Sess. 4 (1974).

the provision as follows:

> *Prohibition against Kickbacks and Unearned Fees –*
>
> Subsection (a) of this section prohibits any person from giving or receiving any fee, kickback, or thing of value pursuant to any agreement that business incident to a real estate settlement involving a federally-related mortgage loan shall be referred to any person.
>
> Subsection (b) prohibits the acceptance of any portion of any charge for rendering of a real estate settlement service other than for services actually performed.
>
> Subsection (c) provides that the section does not apply in certain enumerated situations where services are actually performed.
>
> Subsection (d) imposes a fine of not more than $10,000 or imprisonment for not more than one year, or both on any person who violates the provisions of this section. In addition, any person who violates the provisions of section (a) is liable in a civil action for treble damages sustained by injured parties.[28]

In enacting RESPA, the responsible committees explicitly relied upon the record developed in the 1972 HUD/VA Report on settlement costs. Among other things, the Senate Report quoted liberally from the 1972 HUD/VA Report's findings regarding "abusive and unreasonable practices in the real estate settlement process" as well as the "lack of understanding on the part of most home buyers about the settlement process and its costs."[29] In justifying the decision to prohibit kickbacks and referral fees, congressional staff drafting RESPA's legislative history drew on precisely the same examples that had previously been uncovered in the 1972 HUD/VA Report and in contemporaneous press accounts:

> In a number of areas of the country, competitive forces in the conveyances industry have led to the payment of referral fees, kickbacks, rebates and unearned commissions as inducements to those persons who are in a position to refer settlement business. Such payments may take various forms. For example, a title insurance company may give 10% or more of the title insurance premium to an

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[28] 1974 Senate Report, *supra* note 4, at 6556.

[29] Id. at 6547.

> attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application. . . . An attorney may give a portion of his fee to another attorney, lender or realtor who simply refers a prospective client to him. . . . .
>
> In all of these instances, the payment or thing of value furnished by the person to whom the settlement business is referred tends to increase the cost of settlement services without providing any benefit to the home buyer. While the making of such payments may heretofore have been necessary from a competitive standpoint in order to obtain or retain business, and in some areas may even be permitted by state law, it is the intention of section [8] to prohibit such payments, kickbacks, rebates or unearned commissions.
>
> Section [8](c) makes clear that section [8] is not intended to prohibit the payment by title insurance companies, attorneys, lenders, and others for goods furnished or services actually rendered, so long as the payment bears a reasonable relationship to the value of the goods or services received by the person or company making the payment. . . . The value of the referral itself (i.e., the additional business obtained thereby) is not to be taken into account in determining whether the payment is reasonable.[30]

5. Summary of Salient Points About the Legislative History

There emerges from RESPA's legislative history a fairly clear picture of the factors that led Congress to adopt Section 8's prohibition on kickbacks and unearned fees:

- First, the market for real estate settlement services was found to be infected with serious market imperfections:
  - Home buyers only rarely purchased homes and had little knowledge of the considerable complexities of real estate settlement procedures or the appropriate costs of settlement services.[31]
  - Home buyers therefore tended to rely heavily on certain industry professionals, including attorneys, brokers, and real estate developers, to select providers of settlement services.[32]

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[30] Id. at 6551.

[31] See text accompanying notes 14, 29. See also 1974 Senate Report, *supra* note 4, at 6557 ("The typical homebuyer is a babe in the woods with pitifully little bargaining power.") (additional views of Senator Proxmire).

[32] See text accompanying note 7.

- In many parts of the country, these industry professionals were exploiting their ability to direct the purchase of settlement services in order to extract kickbacks and unearned referral fees from the providers of settlement services.[33]

- Second, substantial evidence presented to Congress suggested that the cost of these kickbacks and unearned referrals fees was borne by the home purchaser (and not offset by the reduction of costs for other settlement services).[34] In other words, market forces were not causing these kickbacks and unearned referral fees to be offset by a reduction of other settlements costs. Rather the ultimate effect of kickback and unearned referral fees was to increase the overall cost of real estate transactions. Thus, the problem of kickbacks and unearned referral fees was directly linked to what were perceived to be excessively high costs of home purchases in certain parts of the country.

- Third, many witnesses attributed the problem of kickbacks and unearned referral fees to the absence of robust competition in certain areas of the real estate settlement industry.[35] In particular, where settlement service providers were unable to compete on the basis of price, industry professionals with the power to select service providers exploited that power to extract kickbacks and unearned referral fees. These payments were demanded and paid notwithstanding the existence of legal and ethical prohibitions in many parts of the country and a general acknowledgment (at least in congressional testimony) that the practices were shocking and unethical.

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[33] See text accompanying notes 7, 14-15, 30.

[34] See text accompanying note 6, 16, 23.

[35] See text accompanying notes 7, 25 30.

- Fourth, the problems associated with real estate settlement industry were sufficiently egregious that simple disclosure of abusive practices were not deemed to be an adequate solution to the problem. This conclusion is implicit in the structure of the legislation ultimately adopted (which includes a prohibition on kickbacks as well as elaborate disclosure rules), but it is also reflected in testimony to Congress that in some markets little effort was made to hide the existence of kickbacks and unearned referral fees and still the practice persisted.[36] In addition, the 1972 HUD/VA Report and contemporaneous press accounts made the practices widely publicized in the two years leading up to the enactment of RESPA and there is no indication in the legislative history – even from industry representatives – that this publicity had eliminated the problem or ameliorated its negative impact on consumers.

- Finally, the legislative history of RESPA suggests that Congress was concerned with all kickbacks and unearned referral fees, not just their payment when the overall compensation of the recipient was unreasonable. Most of the abuses at which section 8 was targeted involved payments to individuals who also provided legitimate settlement services – for example, (i) an attorney retained to handle the settlement who then makes a referral to a title insurance company willing to pay a referral fee or (ii) a real-estate developer that constructed a house and then demanded kickbacks from attorneys selected to handle the closing.[37] Unearned referral fees in these contexts were to be prohibited and were not

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[36] See text accompanying note 7 ("little is done to hide the fact that these fees are paid").

[37] See text accompanying notes 7, 16, 30.

defensible on the grounds that attorneys or real estate developers performed some other sort of work on the transaction that arguably bore reasonable relationship to the total amount of compensation the recipient earned on the transactions. In other words, the legislative history suggests that Congress did not intend for the legality of payments to be dependent on the reasonableness of a party's aggregate compensation in relationship to all the services that the party provided to a transaction. Rather, the test Congress seems to have envisioned was whether the recipient performed legitimate services in connection with each payment that party received.[38] Indeed, an alternative interpretation would be inconsistent with the clear congressional resolve to outlaw the extraction of kickbacks and unearned referral fees by market professionals who gained the confidence of home purchasers by having some other role in the underlying real estate transactions. Moreover a legal standard that turns on the reasonableness of compensation associated with particular transaction would require courts to engage in just the sort of public rate regulation that Congress expressly eschewed in the legislative compromise under the enactment of RESPA.

[38] Indeed, if one reviews the portion of the legislative history quoted *supra* note 30, Congress appears to have intended to prohibit referral fees even when the referring party expended a nominal amount of effort, such as "placing a telephone call . . . or filling out a simple application," directly related to the referral.

B. The Application of RESPA to Yield Spread Premiums

1. Initial Administrative Response

When Congress enacted RESPA in the mid-1970s, the practice of paying yield spread premiums to mortgage brokers had not yet developed, and indeed the role of mortgage brokers in residential mortgage financing was extremely limited. Only in the late 1980's did mortgage brokers begin to assume importance in the industry and only then did the payment of yield spread premiums become widespread in the United States until the early 1990's. At that point, the Department of Housing and Urban Development was called upon to consider the relationship between the RESPA and these payments. Initially, the agency chose to address the issue through an amendment to Regulation X, the HUD rules that implement RESPA's disclosure requirements.[39] In particular, the agency amended its regulations in 1992 to require that "[a]ny other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium" be disclosed to the borrower on the HUD-1 Settlement Statement.[40]

The issue that the agency did not address explicitly in 1992 was whether the payment of yield spread premium ran afoul RESPA's prohibition on kick-backs and unearned fees. As subsequent events have demonstrated, the Department's reluctance to address this question is

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[39] 24 C.F.R. § 3500 (1999).

[40] Id. Appendix B, Para. 13 (2001). For a review of this amendment process, see 62 Fed. Reg. 53,912-01 (Oct. 16, 1997) (proposed but as yet unadopted HUD safe harbor for yield spread premiums).

understandable. To begin with, the relevant statutory provisions are difficult to decipher. On the one hand, section 8(a) of RESPA prohibits the payment of "any fee, kickback, or thing of value" for the referral of a settlement service. Section 8(c), however, exempts the payment of "a bona fide salary or compensation." Critics of yield spread premiums assert that these payments constitute referral fees prohibited under section 8, whereas the mortgage broker industry counter that they constitute "bona fide compensation." Faced with these competing characterizations, the Department's response in 1992 was to seek a middle ground of sort, asserting that to qualify as "bona fide compensation" under 8(c), payments must bear a "reasonable relationship to the market value of the goods or services provided."[41]

[The Balance of This Section is in Draft Form for Those Interested in the Doctrinal and Institutional Aspects of the Yield Spread Premium Controversy]

2. The Onslaught of Litigation

HUD's initial effort to solve the problem of yield spread premiums through disclosure requirements prove unsuccessful, and the controversy soon move to the federal courts. The early case law on the subject of yield spread premiums revealed extensive confusion over both the correct legal standard to apply and the appropriateness of class actions. One of the first pronouncements on the subject was Mentecki v. Saxon Mortgage, Inc., where, in denying the defendant's motion to dismiss, the court "concludes that the payment of a yield spread premium is a referral prohibited

[41] 24 C.F.R. § 1500.15(g)(2) (1999). [add discussion on the difficulty of reconciling this approach with the statutory language of RESPA.]

by [RESPA Section 8].[42] *The court based its reasoning on the fact that the defendant alleged no service that was provided in exchange for the payment, as the broker was already compensated directly from the borrower for all services rendered. Conversely, in Barbosa v. Target Mortgage Corp., the court held as a matter of law that yield spread premiums were just another form of compensation for the broker and did not violate RESPA.*[43] *In granting the defendant's summary judgment motion, the district court in Culpepper v. Inland Mortgage Corp. (Culpepper I) held that yield spread premiums were permissible payments for goods, those goods being loans with yield spread premiums, with prices set by the market.*[44] *Many courts eschewed a per se ruling and, looking to Regulation X, adopted a reasonableness standard. This reasonableness inquiry was generally thought to preclude class action certification under FED. R. CIV. P. 23(b)(3) since individual issues would predominate.*[45]

In the past several years, more than 150 lawsuits have been brought seeking class action certification under RESPA to challenge the practice of lenders making indirect payments to mortgage brokers.[46] *Despite the fact that Section 8 of RESPA allows awards of treble damages and attorneys fees to prevailing plaintiffs, the relatively small amount of money at stake for any individual plaintiff, combined with the vast costs of litigating the practice of yield spread premiums,*

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[42] Mentecki v. Saxon Mortgage, Inc., 1997 WL 45088 (E.D. Va. 1997).

[43] See Barbosa v. Target Mortgage Corp., 968 F.Supp. 1548 (S.D. Fla. 1997).

[44] See Culpepper v. Inland Mortgage Corp., 953 F.Supp. 367 (N.D. Ala. 1997) [hereinafter Culpepper I].

[45] See, e.g., Moniz v. Crossland Mortgage Corp., 175 F.R.D. 1 (D.Mass. 1997); Dubose v. First Sec. Sav. Bank, 183 F.R.D. 583 (M.D. Ala. 1997).

[46] See Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 FR 10080, 10083 (Dep't of Housing and Urban Dev't March 1, 1999) [hereinafter HUD Policy Statement].

renders class action certification particularly crucial in this context. Because Section 8 prohibits both the giving and receiving of any kickback or referral fee, plaintiffs can choose to sue either the mortgage broker or the lending institution.[47] *For purposes of class action certification, determining which to sue could in theory be a complicated decision, since each mortgage broker has relationships with dozens of lending institutions, and each lending institution has relationships with many mortgage brokers. However, plaintiffs have generally sought class action certification against a single lending institution, as the outcome of the litigation may eventually turn on the agreement between the mortgage broker and the lending institution, and each lending institution generally uses the same form contract with each mortgage broker with which it has an established relationship.*[48] *The courts have yet to reach a consensus on whether the legality of yield spread premiums can be determined solely from the form contracts used.*

Plaintiffs have typically filed for class action certification under FED. R. CIV. P. *23(b)(3), requiring the usual prerequisites of 23(a) [i.e., numerosity, commonality, typicality, and adequacy of representation] as well as a finding by the court that "questions of law and fact common to members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."*[49] *The requirements of Rule 23(a) have not usually been an impediment for plaintiffs*

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[47] See RESPA Section 8, codified at 12 U.S.C. 2607(a).

[48] See Brancheau v. Residential Mortgage Group, Inc., 177 F.R.D. 655 (D.Minn. 1997) (denying plaintiff's Motion to Amend Complaint in which it seeks to expand the proposed class to include all loans brokered by the defendant mortgage broker, regardless of the lender, as well as all loans funded by the defendant lender, regardless of the mortgage broker used, because the Motion seeks to redefine the class in such a way as to diffuse the judicial inquiry amongst the divergent loan referral practices of literally scores of brokers and lenders throughout the breadth of the nation).

[49] FED. R. CIV. P. 23.

challenging yield spread premiums, as Rule 23(b)(3)'s requirement that issues common to the class predominate has been the principal obstacle. Because Rule 23(b)(3) requires the court to determine what questions of law or fact are at issue, the granting of class certification turns on what legal standard the court is to apply to judge the legality of yield spread premiums. Plaintiffs claim that the legality of yield spread premiums can be determined based upon the standard agreement between the lending institution and the its correspondent mortgage brokers. Defendant lending institutions generally argue that class certification is inappropriate because the goods and/or services provided by the mortgage broker will vary with each individual loan transaction, thus requiring individual questions of law and fact to predominate.

In January of 1998 the Eleventh Circuit, becoming the first and as yet only Court of Appeals to address the issue of yield spread premiums, reversed the district court's granting of summary judgment in Culpepper I and vacated the denial of class certification.[50] *The court held that yield spread premiums could be prohibited referral fees under Section 8(a), and that Section 8(c)'s exemption for compensation for goods provided or services performed was inapplicable in the present case. Interpreting Regulation X, the court articulated a two-pronged test to be used to determine the legality of yield spread premiums. First, were goods or services provided in exchange for the yield spread premium. If not, then the payment is a prohibited referral fee. If goods or services were provided, the court would go on to examine the reasonableness of the fees, presumably on a transaction-by-transaction basis.*

The Circuit Court first rejected the logic of Moniz and other precedents that yield spread

[50] See Culpepper v. Inland Mortgage Corp., 132 F.3d 692 (11th Cir. 1998) [hereinafter Culpepper II].

premiums constituted payments for goods, the good being the loans. In rejecting the claim that a good was provided, the court noted that the Culpepper's loan was table-funded, meaning that the mortgage broker did not initially fund the loan and then sell it to the lender. Rather, "in table-funded transactions the lender, not the broker, owns the loan from the outset. [The mortgage broker] could not sell the Culpeppers' loan to [the lender] because [the lender] already owned it." Since the loan itself could not be the good provided in exchange for the payment, the defendant also tried to argue that the right to direct the business constituted an ownership interest that qualified as a good. This argument, too, was rejected by the court, with the court noting that this would have the effect of nullifying Section 8 of RESPA since any referral fee could be justified on these grounds.

Having found that the yield spread premium was not a payment for a good, the Circuit Court then went on to find that it was also not a payment for a service rendered. Although the court admitted that the mortgage broker had provided valuable services to the borrower, it noted that the payments to the broker directly from the borrower were intended to compensate the broker fully for these services. In addition, the court noted that the method by which yield spread premiums are calculated (based on the loan's amount of interest above the par rate) proved that the only difference in services provided for a loan with a yield spread premium as opposed to a loan without one is in the value of the referral. Since there is no meaningful difference in services provided, the payment cannot be for any service performed by the mortgage broker.

By rejecting other courts' market-value tests in favor of a two-pronged test first requiring that a good or service be provided in exchange for the payment at question, the Circuit Court made the granting of class certification much more likely. Where the reasonableness of a fee is the central

issue, class certification seems inappropriate since each transaction will inevitably have different services performed by the mortgage broker. However, where the issue is if any good or service was provided in exchange for the payment, questions common to the class could conceivably predominate, thus making class certification possible.

3. The HUD Policy Statement of 1999

After the Eleventh Circuit issued its decision in Culpepper II, there was a flurry of litigation as plaintiffs sought to utilize this new two-pronged test and the favorable precedent to obtain class certification. As a direct result of the uncertainty surrounding the legality of yield spread premiums after Culpepper II and its progeny, Congress ordered HUD to make its views on the subject known. The two-pronged test HUD articulated in Policy Statement 1999-1 requires a court to ask, first, "whether goods or facilities were actually furnished or services actually performed for the compensation paid."[51] *"The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed."*[52] *HUD elaborates that, in utilizing this test, total compensation is to be examined and not simply the yield spread premium payment itself.*

In explaining the first prong of the test, HUD provides a non-exhaustive list of services that mortgage providers typically provide that HUD deems compensable.[53] *In addition to these services, HUD also recognizes that mortgage brokers may provide goods (such as appraisal, credit reports,*

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[51] HUD Policy Statement, 64 FR 10080, 10084.

[52] Id.

[53] Id. at 10085.

or other documents) or facilities in exchange for the total compensation. HUD has declared that while these and other goods may be compensable, the loan itself cannot be described as a good provided by the broker to the lender, at least not in table-funded transactions.

In elaborating on the reasonableness test, HUD explains:

> *If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities, or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA.*[54]

HUD also notes that while RESPA is not a rate-making statute, HUD is authorized to ensure that payments such as yield spread premiums are reasonably related to the value of the goods or services provided, and are not compensation for the referrals of business, splits of fees, or unearned fees.[55]

The policy statement purports to "provide[] HUD's views of the legality of fees to mortgage brokers from lenders under existing law,"[56] *and sets forth a two-prong test for legality. In a subsequent letter, HUD explained that in accord with this language, it "did not intend for the Policy Statement to create a new legal standard or to change existing law."*[57] *Because of this letter, courts*

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[54] Id at 10086.

[55] Id. at 10086.

[56] Id. at 10084.

[57] Letter from Gail Laster, HUD General Counsel, to Hon. Bruce Vento, dated December 17, 1999.

have disagreed on the impact of HUD's Policy Statement and whether it is binding legal authority.

4. Litigation Since the HUD Policy Statement

Although the HUD Policy Statement was in response to a directive from Congress for HUD to clarify its views on the issue of yield spread premiums, the Policy Statement appears to have raised more questions than it answered for the courts. As one court recently put it, "In short, the HUD Policy Statement has not resolved the struggle by the courts to determine the proper legal standard to apply in RESPA yield spread premium cases."[58] *The biggest question faced by the courts is whether the tests set out in Culpepper II and the HUD Policy Statement conflict, and, if so, which one controls.*

Faced with this question, the majority of district courts have found that the HUD test is more favorable to the lenders than the Culpepper II test.[59] *For example, the court in Levine v. North American Mortgage stated that, "[w]hile not a model of clarity, the first step in the [HUD Policy] Statement's analysis addresses simply whether any goods or services were actually furnished or performed, rather than, as under analysis suggested in Culpepper, whether the goods or services the broker provided can be tied directly to the payment."*[60] *Courts finding the HUD Policy Statement test to be more favorable to the lenders have also found it to be nonetheless a rational*

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[58] Marbury v. Colonial Mortgage Co., 2001 WL 135719, at *8 (M.D. Ala. 2001).

[59] See, e.g., Levine v. North American Mortgage, 188 F.R.D. 320 (D.Minn. 1999); Golon v. Ohio Sav. Bank, 1999 WL 965593 (N.D. Ill. 1999); Potchin v. Prudential Home Mortgage Co., Inc., 1999 WL 1814612 (E.D.N.Y. 1999) (all adopting an interpretation of the HUD Policy Statement that is more favorable than their interpretation of the Culpepper test, finding the agency regulation to be binding on them).

[60] Levine, 188 F.R.D. at 326.

agency interpretation of RESPA that is neither arbitrary and capricious nor manifestly contrary to the purposes of the statute, and thus deserving of deference.[61]

Conversely, some courts have read the HUD Policy Statement to be in accord with the Culpepper II analysis, and that the Policy Statement was thus a restatement of the law. In disagreeing with the aforementioned courts that a difference exists between the first prong of the two tests, these courts have relied upon a variety of arguments. One line of reasoning argues that the defendant's interpretation of the HUD Policy Statement, requiring merely a showing that services were performed, cannot be what was intended by HUD since to do so would be contrary to the language of RESPA. The argument asserts that this view of the Policy Statement would actually allow some referral fees and kickbacks, those a court later finds to be "reasonable." Section 8 (a), it is argued, bans all kickbacks and referral fees, whether or not they are reasonable. As one court phrased it, "The ultimate result of this system would render the referral fee prohibition moot. Courts could no longer consider the nature of the fee, only the totality of the "compensation".[62] *A referral fee could be legal, the argument goes, if the lender can subsequently prove that the total compensation was reasonable, perhaps because of fortuitously finding that an extra settlement service was in fact performed on a loan with a yield spread premium.*

Another theory advanced by plaintiffs to prove that the two tests are equivalent relies upon a theory about what the HUD Policy Statement means in the first prong when requiring that goods or services be provided for the compensation. Several courts have focused on the word "for" and

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[61] See note 21, supra.

[62] Heimmermann v. First Union Mortgage Corp., 188 F.R.D. 403, 406 (N.D. Ala. 1999).

read it to mean that HUD requires a payment to be in exchange for services rendered. In requiring this quid pro quo, at least one court[63] *has focused on a letter sent by HUD to Representative Bruce Vento in which HUD explains:*

> *HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for"—i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker.*[64]

One commentator, Robert Jaworski, has criticized this line of reasoning as being faulty on several grounds.[65] *For one thing, Jaworski notes, the HUD Policy Statement's first prong requires that goods or services be provided for (indeed, even in exchange for) the total compensation of the broker. Jaworski asserts the court mistakenly interpreted the first prong as requiring that there be a quid pro quo for the yield spread premium as opposed to the total compensation. In support of this claim, Jaworski notes that the HUD Policy Statement states that for the first prong, "the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker."*[66] *Jaworski also argues that HUD has rationally differentiated between mortgage brokers, whose essential service provided to*

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[63] Perry v. Mid South Mortgage, Inc., Civil Action No. CV-98-3205-W (N.D. Ala. Aug. 30, 2000).

[64] Letter from Gail Laster, HUD General Counsel, to Hon. Bruce Vento, dated December 17, 1999. At least one commentator has asserted that this letter constitutes a clear rejection by HUD of the lenders' interpretation of the HUD Policy Statement. See David R. Donaldson, *RESPA Yield Spread Premium Litigation: A Brief History*,Search Term Begin Search Term End 1242 PLI/CORP 203 (2001).

[65] See Robert M. Jaworski, *RESPA Section 8: The YSP Waiting Game Continues*, 56 BUS. LAW. 1207 (May, 2001).

[66] 64 FR 10080, 10085 (emphasis added)

borrowers is a referral of a loan, and other settlement service providers. Jaworski fails to note that the HUD Policy Statement does not list the referral of a loan to a lender as a compensable service; indeed, the Statement actually states that HUD has expressed "concern that a fee for steering a customer to a particular lender could be disguised as compensation for 'counseling- type' services."[67] *Thus, it would appear that HUD has not, in fact, declared the referral of a loan to be an essential and compensable service provided by mortgage brokers.*

Most recently, the Eleventh Circuit again moved to the forefront of the yield spread premium debate by upholding a class certification by the district court in the Culpepper litigation.[68] *In upholding the class certification, the court admitted that in deciding whether class certification was appropriate, it had to settle on a rule of liability for yield spread premiums. The court then proceeded to discuss the defendant's position (contending, as usual, that the HUD Policy Statement is less stringent and controlling in this context), as well as the plaintiff's position that the two tests are equivalent. In finding the plaintiff's position to be the correct one, the court relied upon both the arguments previously discussed that have been used to uphold the Culpepper test. First, the court found that the first prong of the HUD Policy Statement test required a quid pro quo of goods or services provided in exchange for the payment of the yield spread premium. Although not relying on the Laster letter for this finding, the court nonetheless came to the same conclusion as Judge Clemon in Perry v. Mid South Mortgage, Inc. In Culpepper III, the Court of Appeals also found that the defendant's reading of the HUD Policy Statement's first prong, allowing any service provided to be enough to justify payments, as running afoul of the purpose of RESPA Section 8(a). "If*

[67] Id.

[68] See Culpepper v. Irwin Mortgage Corp., 253 F.3d 1324 (11th Cir. 2001) [hereinafter Culpepper III].

[defendant] has read the HUD Statement correctly, however, HUD has now decided that § 8(c) deems some such referral fees legal--that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were."[69]

As Culpepper III makes clear, the debate over the legality of yield spread premiums is far from over. Although a majority of district courts in other circuits have adopted the less stringent interpretation of the HUD Policy Statement generally urged by lenders, the Eleventh Circuit Court of Appeals and a majority of district courts within it have determined that the first prong of the HUD Policy Statement is merely a re-articulation of the first prong of the original Culpepper II analysis. Although most of the recent decisions ostensibly address only the appropriateness of class certification, as the Culpepper III court noted, "[w]hether transaction-specific evidence is necessary or relevant, of course, depends on the rule of liability."[70]

As to the merits of paying yield spread premiums, defendants defend the practice by asserting that it allows consumers to obtain loans with reduced/zero upfront costs. Plaintiffs generally argue that the mortgage brokers have already received full compensation for their services from the origination fee and other fees paid directly by the borrower, and so the yield spread premium constitutes a prohibited referral fee or kickback. The fact that the yield spread premium is calculated solely based on the higher interest rate on above-par loans, plaintiffs assert, proves that it cannot be based upon services rendered. One commentator put the plaintiffs' usual claim thusly:

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[69] Id., at 1330. (emphasis in original).

[70] Id. at 1328 (citations omitted).

> *[T]he lenders' argument that YSPs are paid for services rendered is not always true. YSPs vary not by the quantum of services provided, but by how aggressive the broker/lender may be and how little the consumer knows.*[71]

5. Pending Reform Initiatives

In its policy statement, HUD reiterates that it believes RESPA is in need of reform, and that appropriate reforms would go a long way towards resolving the confusion over the legality of yield spread premiums. In October 1997, HUD published a proposed rule proposing a qualified safe harbor for payments to mortgage brokers under Section 8.[72] *The proposal would have HUD presume broker fees, both direct and indirect, to be legal so long as a broker enters into a contract with consumers explaining the broker's functions and the total compensation the broker would receive in the transaction before the consumer applied for the loan. The proposed rule would also require a test, as yet undeveloped, to ensure that the safe harbor would not preclude unreasonable fees.*

Other proposed reforms HUD feels would resolve the issue of the legality of yield spread premiums are contained in the July 1998 joint report of HUD and the Board of Governors of the Federal Reserve,[73] *containing legislative proposals to reform RESPA and the Truth in Lending Act. The HUD/Federal Reserve report recommended that lenders and mortgage brokers give consumers either a guarantee of the closing costs of the loan or a more accurate good-faith estimate. Those*

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[71] Barren E. Ramos, *Materials on Residential Mortgage Litigation Preface*, 1242 PLI/CORP 203, 206 (2001).

[72] Codified at 62 FR 53912.

[73] See Joint Report of HUD and Federal Reserve Board on Reform Proposals for the Truth in Lending Act and Real Estate Settlement Procedures Act, available at http://www.federalreserve.gov/boarddocs/RptCongress/tila.pdf (August 09, 2001).

choosing to provide a guarantee of closing costs would receive a safe harbor from Section 8 litigation challenging the legality of these costs. In general, the report recommends fuller disclosure of all costs related to the mortgage loan, and that such disclosure occur earlier in the mortgage application process to facilitate comparison-shopping by consumers. To date, these proposed reforms have not been adopted, leaving the HUD Policy Statement 1999-1 as the agency's most definitive guideline for determining the legality of yield spread premiums.

Part II: The Trilateral Dilemma of Financial Regulation

The problem that Congress confronted with the enactment of RESPA in 1974 is a common phenomenon in the financial services industry. In many different kinds of financial transactions, market professionals occupy positions that permit them to extract other side payments as a result of their capacity to steer the financial decisions of members of the general public. Regulatory problems of this sort typically involve three separate parties: a consumer, a market professional with authority to make or influence decisions made on the consumer's behalf, and a third party who will profit from those decisions and can also make side payments to the market professional in order to influence the professional's decision. In these situations, consumers are ill-equipped to prevent market professionals from exploiting their power to demand side payments in abusive and economically wasteful ways. Reflecting the three-cornered nature of these transactions and the quandary they pose for consumers, we call this kind of problem the trilateral dilemma of financial regulation.

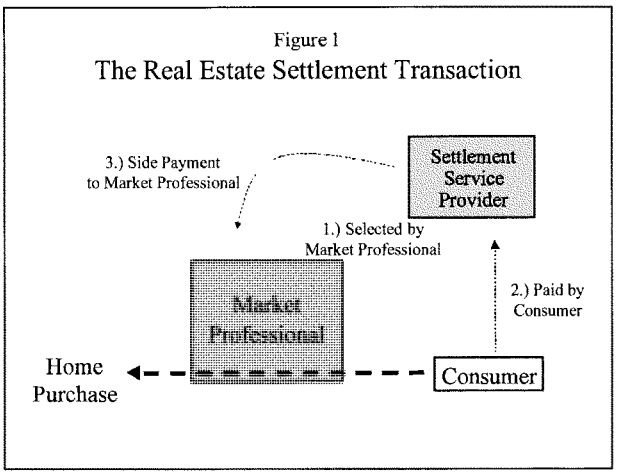
We begin this part with a restatement of the problem of settlement costs as an illustration of a trilateral dilemma and then discuss the reasons why usual competitive forces cannot be expected to solve these problems. As this analysis makes clear, the considerations that led Congress to enact RESPA in the first place are quite similar to the reasons why real estate settlement presents a trilateral dilemma. In the second section, we review several other regulatory contexts in which similar problems arise and summarize how Congress and regulatory agencies have attempted to deal with trilateral dilemmas in other contexts. As we will explain, RESPA's combination of disclosure requirements and anti-kickback rules is characteristic of the kinds of government interventions used

to deal with the recurring problem of trilateral dilemmas in the financial services industry. We conclude this part by locating the payment of yield spread premiums within this framework.

A General Description of the Problem of Real Estate Settlement Services

As documented in the legislative history of RESPA, real estate settlement transactions present a classic illustration of the trilateral dilemma. Consumers typically become involved in the settlement process when they purchase a new home, a major financial commitment and one that typically occurs only a limited number of times in any individual's lifetime. To effect these transactions, consumers rely upon a variety of market professionals – attorneys, realtors, developers, etc. – to provide certain services and offer guidance with respect to other aspects of the transactions. Often, this guidance involves the selection of other settlement service providers, including, for example, title insurance companies and attorneys. While the market professionals play a role in selecting among a range of possible settlement service providers, the consumer pays the cost of those services. And, again as documented in the legislative

Figure 1
The Real Estate Settlement Transaction



history of RESPA, service providers in the early 1970's often received side payments (kickbacks and unearned referral fees) as a reward for selecting particular third-party service providers. Figure 1 illustrates these relationships, noting (1) the market professional's selection of a service provider; (2) the consumers's payment of the provider's fees; and (3) the third party's side payment to the referring market professional. The dilemma for the consumer is that market professionals face strong incentives to select the settlement service provider that makes the largest side payment as opposed to the one that offers the best and most cost-effective services for the consumer.

While the preceding paragraph and accompanying figure reflect the problem of real estate settlement services in RESPA's legislative history, one might wonder why ordinary market forces do not protect consumers in this context. For example, if settlement service providers are making side payments to market professionals won't market professionals then lower their own charges to consumers? And if some market professionals do not make these offsetting reductions, won't other market professionals come forward who are willing to make offsetting reductions in their charges and then won't consumers migrate to these lower cost providers?

From the legislative history of RESPA, it is clear that Congress did not believe that market forces were operating in this way in the real estate settlement industry. At multiple points in the congressional reports, testimony at hearings, and administrative documentation such as the 1972 HUD/VA Report, the point was made that kickbacks and unearned referral fees were not being offset by lower charges in other contexts, but rather were increasing the overall costs of home purchases for American consumers.[74] There are ample theoretical grounds to believe that this

[74] See text accompanying note 6, 16, 23.

congressional judgment was sound.

First, for market mechanisms to work in this context, consumers must have some understanding of the services they are acquiring and the price those services should cost. As the congressional record demonstrates, however, consumers typically are not sophisticated about real estate settlement services nor are they likely to have good information about the appropriate price for particular services. In the words of Senator Proxmire, they are "babe[s] in the woods."[75] Under these circumstances consumers have a limited ability to police the costs of settlement services or punish market professionals who encourage them to pay excessively high settlement costs.

Second, the legislative history of RESPA emphasized the position of trust and power that market professionals often assume in real estate settlement transactions. The congressional record suggests that consumers typically allow themselves to be guided by the advice of market professionals in selecting service providers. Indeed, it is precisely this power of the selection that permitted market professionals to obtain kickbacks and unearned referral fees in the first place. The existence of this relationship of trust and reliance further diminishes the likelihood that consumers will carefully monitor the cost of settlement service providers these trusted market professionals select.

Third, the multi-faceted nature of real estate settlement transactions further complicates the operation of market forces in this context. As the legislative history of RESPA documents, consumers in real estate transactions are purchasing a wide array of settlement services, each with

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[75] See *supra* note 31.

its own price and value. In addition, there is the real estate transaction itself, which will involve much more money and will therefore be much more significant for the consumer than any particular settlement service. There is ample evidence in economic literature that when faced with such complex, multi-faceted transactions, consumers will tend to limit their attention to one or two of the most salient factors, such as the home purchase itself and perhaps the selection of a single market professional upon whom to rely for advice and guidance.[76] Under these circumstances, it is not surprising that consumers do not carefully monitor prices of individual settlement services.

Finally, the "mysterious" nature of settlement services and kickbacks allows market professionals to discriminate in the price they charge different kinds of consumers. For customers who are sophisticated – for example those who know about the existence of side payments and the possibility of offsets in other professional fees – the market professionals can lower their prices. For other less sophisticated consumers, market professionals can simply pocket the side payment . Price discrimination of this sort disrupts ordinary market forces and reduces the likelihood that competitive pressures will work to the benefit of all consumers, particularly those who are less informed.

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[76] There is extensive academic literature on this subject. See, e.g., Jonathan Baron, Thinking and Deciding 295-97 (3rd ed. 2000) (discussing how decision making may be affected when multiple decisions are integrated); Robin Hogarth, Judgement and Choice 82-83 (2d ed. 1987) (discussing the limited ability of individuals to deal with complex decisions); Scott Plous, The Psychology of Judgment and Decision Making 94-95 (1993) (reviewing evidence that consumers often "satisfice" rather than optimize when faced with certain decisions).

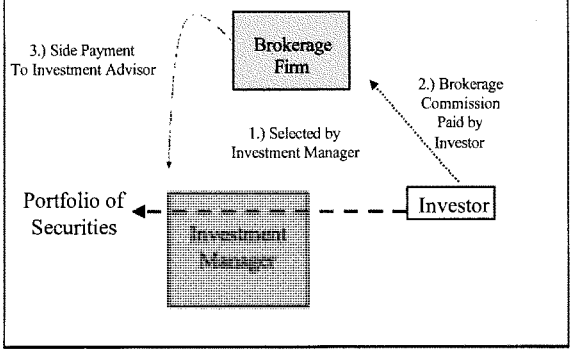
B. Illustrations of the Trilateral Dilemma in Other Financial Contexts

We now briefly review several other illustrations of the trilateral dilemma in other financial contexts. Each is structurally similar to the problem of real estate settlement transactions, and each offers another instance in which Congress and regulatory officials have chosen to intervene to protect consumers rather than relying on mere disclosure or ordinary mechanisms of market control.

1. Investment Managers and Investors

In the financial services industry, one of the best known examples of a trilateral dilemma involves the relationship between investment managers and the investing public. Investors often rely on mutual fund companies and other firms to invest their savings in securities markets. In this capacity, investment managers typically make a number of decisions about the investor's portfolio, including the decision of which brokerage firm to hire to do the actual buying and selling of securities on stock exchanges and in other markets. These brokerage firms earn a commission on each purchase or sale of security and the cost of that commission is passed on to the investor.

Figure 2
Investment Managers and Excessive Commissions



In the late 1960's and early 1970's, investors discovered that investment managers were receiving substantial side payments from brokerage firms, particularly for transactions involving retail investors. A flood of lawsuits ensued, and a number of prominent investment firms were found liable for breaching their fiduciary duties to investors.[77]

As illustrated in Figure 2, side payments to investment managers in exchange for the selection of certain brokerage firms is a classic illustration of a trilateral dilemma. The investment manager's control over an investor's portfolio includes the authority to select brokerage firms (1). The costs of the brokerage firm's commissions is passed on to the investor (2). And the investment manager profits through the receipt of side payments from the brokerage firm (3). There are, in addition, reasons to believe that ordinary market forces will not easily correct the problem. To begin with, the mechanisms for making the side payments were, for many years, not well publicized and difficult for consumers to understand. Particularly the fact that larger, institutional investors were getting offsets for the arrangements was not known to most consumers. Furthermore, the complexity of the transaction diminished the ability of consumers to police the behavior of investment advisors. The investors' principal concern, after all, was for the performance of their underlying portfolio of securities, not the payment of relatively small commissions paid to brokerage firms. In addition, there was the relationship of trust and reliance between the investor and his or

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[77] This litigation and its aftermath is discussed in Howell E. Jackson & Edward L. Symons, Jr., The Regulation of Financial Institutions 755-65, 851-70 (1999). Also discussed in that book is a more recent permutation of this problem: payment for order flow from alternative trading markets to brokerage firms. See id. at 796-810. To date, federal regulators have dealt with this problem principally to the imposition of additional disclosure requirements, but more intrusive forms of regulation have also been proposed. See Allen Ferrell, A Proposal for Solving the "Payment for Order Flow" Problem, 74 S. Cal. L. Rev. 1027 (2001).

her investment manager, heightened by the fiduciary obligations imposed on the investment manager.

Congress addressed this problem, which has come to be known as "soft dollar" arrangements, in 1975. In addition to taking steps to encourage market forces to lower the level of all brokerage commissions, Congress enacted section 28(e) of the Securities Exchange Act of 1934, a new legal regime limiting the circumstances under which an investment manager could receive side payments from a brokerage firm charging a commission higher than otherwise available commissions.[78] In essence, section 28(e) sanctions side payments to investment managers only if they are made in the form of research services which are used to benefit the manager's investment accounts. Even then, the investment manager is required to make certain periodic disclosures about these side payments, and over the years the Securities and Exchange Commission has expanded the scope and detail of these disclosures.[79] In practice, the effect of section 28(e) has been to prevent investment advisors from obtaining other kinds of side payments from brokerage firms.

2. Corporate Sponsors of 401(k) Plans

Another illustration of a trilateral dilemma arises in the context of 401(k) retirement savings plans that corporations are increasingly offering their employees instead of more traditional

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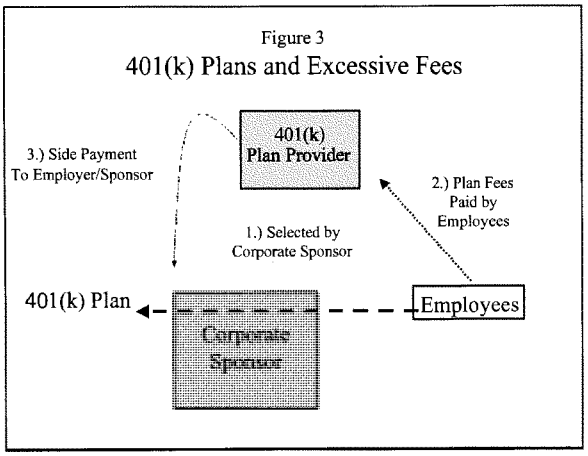
[78] 15 U.S.C.A. § 78bb(e) (West 2001).

[79] See Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds (Sept. 22, 1998) (report of the SEC Office of Compliance, Inspections and Examinations) (available at <http://www.sec.gov/news/studies/softdolr.htm>). See also Thomas P. Lemke & Gerald T. Lins, Soft Dollars and Other Brokerage Arrangements 61 (1999).

forms of pension plans. Although 401(k) plans are designed to encourage retirement savings for workers, only their employers can establish or sponsor these plans. And, when a corporation sponsors a 401(k) plan it must choose from among a host of companies that provide the services necessary to run a 401(k) plan, including various administrative and bookkeeping functions as well as the management and investment of the employee's retirement savings. Typically, these 401(k) service providers are compensated through annual fees charged to participating employees or deducted from their account balances. In recent years, the financial press and regulatory authorities have focused on the fact that 401(k) service providers are making side payments to corporate sponsors of 401(k) plans by assuming various administrative functions that the corporate sponsor would otherwise have to bear itself.[80] The 401(k) plan provider



[80] See Study of 401(k) Plan Fees and Expenses (Apr. 13, 1998) (study of the Department of Labor, Pension and Welfare Benefits Admin.) [hereinafter 1998 Study of 401(k) Fees] (available at <http://www.dol.gov/dol/pwba/public/pubs/401kRept.pdf>); Don't Minimize Differences In 401(K) Expenses, Sun-Sentinel Ft. Lauderdale, Nov. 17, 1997. See also Yolanda Sayles, ERISA Section 404(C) Plan Fees and Expense: Is There An Affirmative Fiduciary Duty to Disclose?, 25 Wm. Mitchell L. Rev. 1461, 1470 (1999).

then recovers the cost of these payments by charging the employees higher fees on their 401(k) plans.

Again, this situation has the hallmarks of a trilateral dilemma. (See Figure 3.) The corporate sponsor selects the 401(k) plan provider (1); the cost of the provider is borne by the employees through annual 401(k) plan fees (2); and the plan provider makes side payments to the corporate sponsor in the form of additional administrative services (3). The kinds of market imperfections outlined in previous examples are also present here. Many employees will not be sophisticated about 401(k) fees and cannot be expected to police costs in a meaningful way. In addition, the transactional setting is complex and multi-faceted. Not only is the employee's primary financial concern with the overall performance of his or her retirement savings, but there is the added complexity of the employment relationship surrounding the transactions. How realistic is it to expect employees to change jobs because of higher-than-average fees on an employer's 401(k) plan or even to check the nature of retirement benefits at this level of detail before accepting a job in the first place?

As a result of these problems, the Department of Labor recently undertook a number of actions to respond to perceived abuses in the area. In addition to publishing a series of substantial studies of the subject, the Department has produced a model disclosure form that employers can now use to explain 401(k) fees to employees.[81] The Department clarified its position that the federal statute governing retirement savings – the Employee Retirement Income Securities Act of 1974 –

[81] Charles Lerner, Department Of Labor Enforcement Developments, SF53 ALI-ABA 245, 251 (2001).

establishes substantive duties on corporate sponsors to act in the best interest of participating employees and to search for 401(k) plans that minimize costs for employees.[82] Corporate sponsors who breach these duties are subject to a variety of penalties, including government enforcement actions and private litigation. In sum, the governmental response to this trilateral dilemma was a combination of disclosure and substantive prohibitions.

3. Financial Institutions and Private Consumer Information

A final and quite recent example of a trilateral dilemma concerns misuse of private consumer information on the part of financial institutions. Over the past few years, there have been an increasing number of reports of financial institutions selling private consumer financial information to third party vendors – often telemarketing firms. This information can include information about the consumer's finances and spending patterns, credit card information, and even (in the case of insurance companies) information about a consumer's health and medical conditions. The third parties then use this information to market products to the consumers, and recover the cost of purchasing the private information through the sale of products and services.

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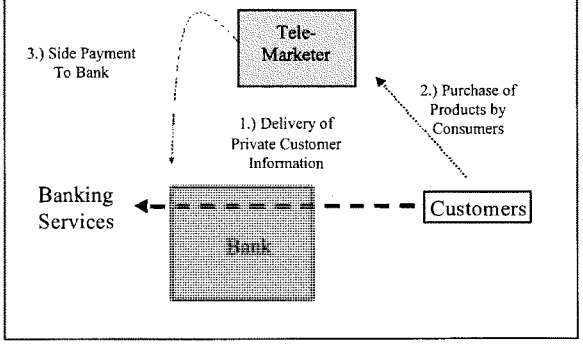
[82] See 1998 Study of 401(k) Fees, *supra* note 79, at 39-40.

These practices present an extreme form of the trilateral dilemma, illustrated in Figure 4. A bank (or other financial institution) obtains a variety of private information about consumers in the course of ordinary banking relationships. The bank can then decide which telemarketers or other third parties to whom to provide this information (1), and then that firm uses the information to sell products and services to the consumer (2). The third-party telemarketer compensates the bank, presumably from profits derived as a the result of its marketing efforts to bank customers (3). As with other instances of the trilateral dilemma discussed above, there are a host of reasons to suspect that these practices do not serve the best interest of consumers. To begin with, banks seldom disclosed that they were selling information in this manner nor did telemarketers typically disclose from where they had obtained a consumer's name or other contact information. In addition, even if a consumer somehow discovered that its bank was disclosing information in this way, it might be difficult or costly for the customer to change banks just because of this practice.

Figure 4
Banks and Consumer Privacy



Because market forces did not seem likely to protect consumer interests in this area, Congress in 1999 passed a new law regulating how financial institutions deal

with confidential consumer information.[83] Essentially, the legislative response has two components. First, financial institutions are now required to make periodic disclosures to consumers about their privacy policies and, in particular, whether they make private consumer information available to third parties. (These statements are being distributed for the first time this year.) Second, Congress gave a consumer the unconditional right to "opt out" of any institution's plan to share certain private information about that consumer with third parties. If a consumer exercises this opt-out right, the financial institution is not allowed to profit from selling that consumer's private information to other third parties. Again this substantive right is granted to consumers in addition to the right to obtain periodic disclosures about the privacy policies of banks and other financial institutions.

C. Locating the Payment of Yield Spread Premiums within this Framework

Against this background, we turn now to the practice of paying yield spread premiums at issue in this litigation. We first explain how the basic structure of the practice satisfies the formal requirements of a trilateral dilemma outlined above. We then consider whether it is plausible that the institutional context in which yield spread premiums are paid reflects the sort of market imperfections that originally motivated Congress to enact RESPA in 1974 and that are generally associated with trilateral dilemmas in other area of the financial services industry.

1. Formal Requirements of a Trilateral Dilemma

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[83] See Gramm-Leach-Bliley Financial Modernization Act of 1999, Title V, Pub. L. No. 106-102, 113 Stat. 1338 (1999). See also Priscilla A. Walter, Privacy Provisions of Gramm-Leach-Bliley: No Small Compliance Task, ABA Bank Compliance, May/June 2000, at 7.

In many respects, the phenomenon is quite similar to the kinds of real estate settlement practices that prompted Congress to enact RESPA in 1974. A consumer, who is in the process of purchasing or refinancing a home or other property, comes to a mortgage broker for assistance in obtaining a mortgage. The mortgage broker provides an array of services to the consumer, including helping the consumer complete a variety of application forms, hiring other providers of settlement services (such as appraisers and title insurance companies), and working through various other issues that may arise in the course of the transaction.[84] One of the mortgage broker's responsibilities is to recommend a lending institution to finance the consumer's mortgage.[85] Typically, mortgage brokers have correspondent relationships with a larger number of lending institutions. As a large number of factors are relevant in determining which lending institution is selected for any particular consumer, the mortgage broker has considerable latitude in selecting a lending institution for a particular consumer. Individual consumers, therefore, are heavily dependent upon mortgage brokers to select lending institutions in an appropriate manner.

Lending institutions on the other hand have strong incentives to originate as many mortgages as possible and therefore have incentives to compete to get as many referrals from

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[84] The Department of Housing and Urban Development has identified fourteen different kinds of services that might be provided in connection with a loan origination. See RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10,080, 10,085 (Mar. 1, 1999). See also Deposition of Ronald Altman 12 (July 8, 1998) (explaining that a borrower's "situation and his goals" determine selection of lending institution).

[85] Industry surveys have estimated that the average mortgage broker has correspondent relations with 20 lending institutions. See Mortgage Brokers 1998 at 9 (May 1999) (report prepared by Wholesale Access) [hereinafter Wholesale Access Report].

mortgage brokers as possible. Profits of lending institutions derive from two basic sources: Profits from the resale of mortgages into the secondary mortgage market and ancillary benefits from originating loans.

- *Mark-Up on Resale into the Secondary Market:* Nowadays, lending institutions typically do not retain mortgages on their balance sheet. Instead, shortly after a mortgage is originated, the lending institution resells the mortgage on the secondary mortgage market as part of a mortgage pool. Lending institutions typically offer to finance mortgages at a rate that will allow them to make a standard amount of profit when the mortgage is sold in the secondary market.[86] So the more mortgages a lending institution originates, the greater its profits.

- *Ancillary Benefits:* In addition to profiting from the resale of mortgages into the secondary market, lending institutions derive certain other benefits from originating new mortgages.[87] The most important of these are "mortgage servicing rights" – that is the right to provide a variety of administrative services over the repayment period of the mortgage.[88] This right is valuable because mortgage service providers are paid

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[86] The pricing models of defendant lending institutions are discussed in Deposition of Phillip Miller 21-23, 27, 44 & pricing sheet attachment (May 24, 2001); Deposition of Steven Kapp 13 (May 19, 1998); Deposition of David Pritchard at 44, 47 (Mar. 11, 1998) . For purposes of our analysis in this report, we assume the accuracy of the claim that the re-sale profit of lending institutions do not vary with respect to the interest rate or yield spread premium associated with the individual mortgages.

[87] These additional benefits and their impact on the calculation of yield spread premiums are discussed in Deposition of Phillip Miller 23 (May 24, 2001); Deposition of Steven Kapp 13, 26 (May 19, 1998); Deposition of David Pritchard at 51, 109 (Mar. 11, 1998).

[88] The right to hold escrow balances (advanced payments for insurance and taxes that many borrowers make in connection with their monthly mortgage payments) also can be valuable. The right to retain escrow balances makes loan origination even more profitable for lending institutions, and also increases with the size of particular mortgages and the period of time those mortgages remain outstanding. Telephone Conversation with Charles Guy (June

> an annual fee for their services, typically 3/8th of one percent of the outstanding balance on a mortgage. The more mortgages a lending institution originates, the more mortgage servicing rights it obtains. In addition, the larger the size of any particular mortgage and the longer the mortgage remains outstanding, the greater the value of mortgage servicing rights.[89]

Together these two sources of profit create strong incentives for lending institutions to want mortgage brokers to select them as loan originators for as many potential borrowers as possible.

Yield spread premiums offer a mechanism through which a lending institution might make side payments to mortgage brokers in order to influence the brokers' decision regarding the selection of a lending institution on the part of various consumers. And, indeed, if one considers the way in which the defendant lending institutions in this litigation have calculated the amount of yield spread premiums they pay mortgage brokers, the payments seem well-designed both to maximize the number of mortgages that mortgage brokers will place with defendant lending institutions and to create extra incentives for mortgage brokers to place particularly profitable mortgages with defendant lending institutions. (Box A, see pages 4-5 above, reviews how the yield spread premium was calculated in one illustrative loan from the empirical analysis presented elsewhere in this report. The base amount of the yield spread premium creates an incentive for mortgage brokers to place loans with defendant lending institutions when borrowers are not aware of prevailing interest rates

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2001) (industry expert retained by plaintiffs' counsel).

[89] Because the cost of mortgage servicing is largely fixed – that is, the cost does not vary with the size of a mortgage – servicing larger mortgages is more profitable than servicing smaller mortgages. The value of mortgage servicing rights also increases, the longer a mortgage remains outstanding because the mortgage service provider receives its annual fees for a longer time.

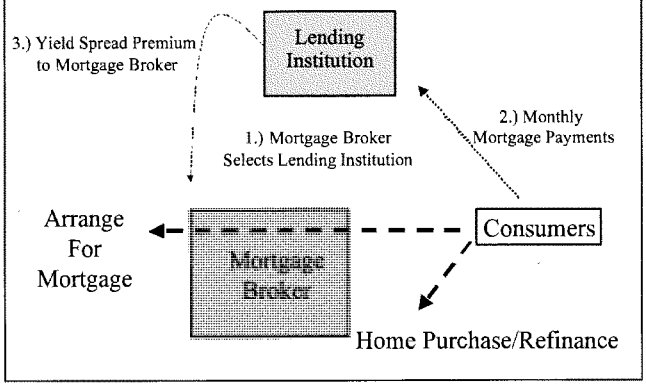
for par loans; the net adjustments increase these incentives for, among other things, larger loans that generate the ancillary benefit of greater profitability for defendant lending institutions on mortgage servicing.)

From the perspective of mortgage brokers, yield spread premiums offer a potentially lucrative mechanism for enhancing compensation. To the extent that mortgage brokers can retain these payments (and not make offsetting reductions in other forms of compensation or incur additional expenses for transactions involving yield spread premiums), the payments will increase mortgage broker compensation and create potentially substantial incentives to steer consumers towards lending institutions that pay higher yield spread premiums. Moreover, to the extent that the practice of paying yield spread premiums becomes widespread, lending institutions may have little choice but to offer yield spread premiums in order to maintain an acceptable volume of loan originations.[90]

[90] The legislative history of RESPA offers considerable evidence that in the early 1970's many settlement service providers were similarly trapped into paying kickbacks and unearned referral fees in order to stay in business. See text accompanying note 30 ("making of such payments may heretofore have been necessary from a competitive standpoint in order to obtain or retain business").

Thus, as summarized in Figure 5, payment of yield spread premiums satisfies the formal requirements of a trilateral dilemma. Mortgage brokers, in practice, select the lending institution to originate the consumer's mortgage (1). The consumer ends up paying the monthly mortgage payments, which constitute both the asset that the lending institution resells into the secondary market and also the source of the ancillary benefits the lending institution derives from the transactions (2). Finally, the yield spread premiums constitute a side payment that can potentially increase the mortgage broker's overall compensation and thereby influence its selection of a lending institution (3).

Figure 5
Yield Spread Premiums as a Trilateral Dilemma



2. Market Imperfections in the Payment of Yield Spread Premiums

As is always the case in considering contexts with the potential for trilateral dilemmas, there remains the possibility that such practices do not seriously harm consumers because competitive markets force the value of side payments to be passed along to consumers either through the

reduction of other expenses (like other compensation paid to mortgage brokers) or through the provision of additional services.[91] Within the financial services industry, however, market forces often do not function smoothly, and so Congress and regulatory authorities regularly intervene to regulate trilateral dilemmas and prohibit certain sorts of side payments. As explained below, a number of factors lead me to conclude that the institutional context in which yield spread premiums are paid reflects the same sort of market imperfections typically associated with trilateral dilemmas that require governmental intervention.

a) Barriers to Consumers' Monitoring of Yield Spread Premiums

The manner in which yield spread premiums are calculated and paid creates a number of barriers that restrict the ability of consumers to monitor yield spread premiums and ensure that they receive the value of those payments. To begin with, there is considerable question whether consumers understand what yield spread premiums are or that the costs of these premiums are financed by consumers through their monthly mortgage payments. For example, if one reviews the HUD booklet on settlement costs, there is no direct discussion of yield spread premiums or how these premiums are financed. The only tangentially relevant disclosure is a statement that "[y]our mortgage broker may be paid by the lender, you as the borrower, or both."[92] There follows this

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[91] In making this statement, we do not mean to suggest that section 8 of RESPA exempts kickbacks and unearned referral fees when market conditions force those payments to be used for the benefit of consumers. The text of the provision does not include such an exemption, and the legislative history of the Act strongly suggests that Congress intended to establish a categorical prohibition.

[92] See Buying Your Home: Settlement Costs and Helpful Information 8 (Jun 1997) (prepared by the U.S. Department of Housing and Urban Development). This document is

additional advice: "You may wish to ask about the fees that the mortgage broker will receive for its services."[93] Elsewhere the booklet notes the section of the HUD-1 form where mortgage broker compensation, including yield spread premiums, would typically (although not invariably) be located.[94] Even if a consumer were to read and comprehend these statements, it is not clear what that consumer would think when he or she reviewed a HUD-1 statement with the words such as "Deferred Premium to Heartland Mortgage paid by Standard Federal (POC$2137.00) 2%" on line 816 of an addendum to the consumer's HUD-1 Form.[95] To begin with, the language suggests that the payment is being made by the lender and not the borrower, and the implication is reinforced by the fact that the amount is not added into the line denominated "Total Settlement Charges [Paid from Borrower's Funds at Settlement]" at the bottom of the second page of the HUD-1 form. Critically absent is disclosure of the fact that the borrower him or herself finances the cost of yield spread premiums through higher monthly mortgage payments. Indeed, were a borrower to consult standard reference books on how to purchase a home, it is unlikely that he or she would be enlightened as to the significance of yield spread premiums.[96] So while defendants' experts concede (as they must)

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appended as Exhibit D to the June 15, 2001, report of defendants' expert Bruce A. Robb as an example of the kinds of disclosures typically made to consumers in this context.

[93] Id.

[94] Id. at 22.

[95] This is the actual language that is on the HUD 1 statement associated with the illustrative transaction described in Box A. See supra pp 4-5. A copy of the HUD-1 statement is attached as Appendix A.

[96] See, e.g., W. Frazier Bell, How to Get the Best Home Loan (2d ed. 2000); Ilyce R. Glink, 100 Questions Every First-Time Home Buyer Should Ask (2d ed. 2000); Robert Irwin, Tips & Traps When Mortgage Hunting (2d ed. 1999). As an illustration of the kinds of

that consumers bear the economic costs of yield spread premiums,[97] the vast majority of consumers will not be aware of this relationship even if they studiously review the documentation that typically accompanies a mortgage transaction or popular guides on purchasing and financing a home.

Moreover, even if consumers were aware of the relationship between yield spread premiums and a borrower's financing costs, evaluating the trade-off between paying higher interest rates to finance yield spread premiums and paying higher closing costs is not a simple matter. For example, on a 30-year fixed rate mortgage for $106,850, what is the difference in the cost to a consumer of paying a 7.125 percent interest rate as opposed to a 6.5 percent rate? This is precisely the sort of calculation necessary to evaluate a yield spread premium.[98] From a technical perspective, valuing

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information a savvy home buyer might obtain about closing costs in these guides (and the absence of any discussion of yield spread premiums, see chapter 10 of the Bell book, which is reproduced as Appendix B. While the legal academic literature is beginning to confront the issue of yield spread premiums, see, e.g., Chris Byrd, The Rise and Fall of Consumer Protection Under RESPA, 68 UMKC L. Rev. 329 (1999); Eloisa C. Rodriguez, RESPA – Questioning its Effectiveness, 24 Hamline L. Rev. 68 (2000); Bruce A. Wahl, Yield Spread Premium Class Action under RESPA: Confusion Predominates, 19 Rev. Litig. 97 (2000), and government regulators are starting to pay attention to the topic, see, e.g., HUD Statement of Policy 1999-1, *supra* note 84, the practice has not been widely publicized. Another reflection of the relatively low level awareness of the practice of yield spread premiums is the fact that the 1997 edition of the National Consumer Law Center's manual on Unfair and Deceptive Acts and Practices did not include any discussion of yield spread premiums. Only in the more recent Cumulative Supplement to the manual did a warning regarding yield spread premiums appear. See National Consumer Credit Center, Unfair and Deceptive Acts and Practices ¶ 5.1.10 (1997 & 2000 Cumulative Supp.).

[97] See, e.g., Report of Professor Edwin S. Mills 9 (June 2001) ("all mortgage broker compensation is ultimately paid by borrowers").

[98] This is the implicit choice facing the borrower involved in the transaction described in Box A. As structured, the loan (a 30-year fixed conventional loan) carried an interest rate of 7.125, and the lending institution priced the loan at 102.0 and generated a yield spread premium of $2137 (or two percent of the loan amount of $106,850). With a lower

this difference is complex. To begin with, the consumer must determine monthly mortgage costs for both alternatives. In addition, as the comparison entails determining the present value of future cash payments, the consumer must select an appropriate discount rate and also estimate how long the loan is likely to remain outstanding in order to determine the cost of the difference to the consumer. Having undertaken this valuation, the consumer must then compare the benefits to be derived from paying the higher mortgage payments associated with a yield spread premium, with either the reduction of other payments to the mortgage broker or other benefits. Inter-temporal comparisons of this sort are notoriously difficult for consumers to evaluate effectively.[99]

As evidence that consumers are not now fully and adequately informed about costs in mortgage transactions and the relationship between interest rates and settlement charges, one need only look to the recent report of the Federal Reserve Board and Department of Housing and Urban Development.[100] One of the principal issues that this report addresses is the confusion that consumers face when they have to compare trade-offs between closing costs (such as the ones at issue in this litigation) and interest rates. The report concludes that the current disclosure rules, under which consumers must evaluate these two expenses separately, are inherently confusing. The

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interest rate of approximately 6.5 percent, the loan would have become a par loan (priced at 100.00) with no yield spread premium.

[99] See Richard H. Thaler, The Winner's Curse 92-106 (1992) (discussing problems of intertemporal choice).

[100] See Joint Study on The Truth in Lending Act and the Real Estate Settlement Procedures Act by the Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development (available at <http://www.federalreserve.gov/boarddocs/RptCongress/tila.pdf>.)

report then recommended that Congress adopt a new disclosure regime in which settlement charges would be factored into a single adjusted interest rate.[101] If adopted, these reforms would extend to real estate transactions of the sort discussed in this report. That a joint report by the staffs of the Federal Reserve and HUD determined that disclosure in this area is in need of substantial reforms supports our assessment that consumers have serious difficulty understanding the relative significance of interest rates and other costs associated with loan transactions of the sort at issue here.

b) Reliance on Mortgage Brokers in Selection of Lending Institutions

Mortgage brokers also quite clearly have a major role in selecting among lending institutions on behalf of individual consumers.[102] The range of possible financing options is quite large and brokers have a wide range of discretion in selecting among different lending institutions as well as different programs and pricing options offered by particular lenders.[103] The discretionary power of

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[101] See id. at 8-16.

[102] In an affidavit filed in this litigation, Stephen C. Kapp, vice president of Standard Federal Bank, summarized the role of the mortgage broker in the following terms:

> Among the most important services a mortgage broker performs for a borrower is to select an appropriate wholesale lender for the mortgage broker's customer, taking into account such factors as the kinds of loan products a wholesale lender offers, the underwriting requirements of particular lenders and their underwriting flexibility, the lender's ability to make underwriting decisions quickly, and other aspects of the wholesale lender's program.

Affidavit of Steven C. Kapp of January 14, 1999, at ¶ 23.

[103] Consider the description of the process from the perspective of defendant Standard Federal:

> Standard Federal's wholesale price sheets include many loan products and combinations of interest rates, yield spread premiums and discount points that a

mortgage brokers is even more pronounced in this area because much of the information that consumers would need to compare different borrowing possibilities are not typically available to the consumer. For example, one important piece of information that consumers need to evaluate the desirability of obtaining a loan with a large yield spread premium is information about the interest rate that the borrower would pay on a comparable "par loan" for which no yield spread premium would be paid. However, consumers are typically not permitted to see the rate sheet that includes the range of pricing options, and it is our understanding that this information is rarely, if ever, disclosed orally.[104] In the absence of good information about the significance of yield spread premiums or the options available to them, consumers are quite likely to defer to the mortgage broker's selection of lending institutions.

c) Complex and Multi-Faceted Nature of the Process

The process of obtaining a mortgage has the complexity and multi-faceted characteristics that are associated with the trilateral dilemma in other contexts. Whether the consumer's mortgage loan will be approved and whether the underlying home purchase or refinancing will go through as planned are all likely to have greater salience to the consumer than the amount of compensation the

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> mortgage broker may select for his/her customer. The flexibility provided by these numerous options allows brokers to determine the appropriate retail price in light of the borrower's needs and the broker's revenue requirements.

Id. at ¶ 30.

[104] For example, at the bottom of the rate sheet discussed in Box A is the warning "Not for distribution to consumers." See supra pp 4-5.

mortgage broker earns on the transaction.[105] In addition, as a practical matter, there may be considerable time pressures associated with these transactions. Once a consumer has begun to work with a mortgage broker on a mortgage application and some degree of personal trust has developed, it is plausible that the consumer will not inquire too strenuously when the broker proposes a particular lending institution that the broker represents to be appropriate for the transaction and the consumer's financing requirements.

d) Possibility of Price Discrimination Among Consumers

Finally, to the extent that some borrowers do carefully monitor the selection of lending institutions, understand the significance of yield spread premiums, and insist on receiving appropriate compensation for the cost of those premiums, mortgage brokers have a mechanism for satisfying those customers. The broker can "credit" the customer for all or a portion of the yield spread premium. As is presented in the next section of this report, mortgage brokers do occasionally grant such credits, but only for a small percentage of loans on which yield spread premiums are collected. From a theoretical perspective, however, the credits are important because they provide a vehicle whereby mortgage brokers can satisfy the demands of a small number of "sophisticated" consumers without disrupting the standard practice of obtaining yield spread premiums. Like other forms of price discrimination, granting ad hoc credits allows mortgage brokers to set yield spread premiums at the highest level that each consumer will accept. Were mortgage brokers to set yield spread premiums in this way, it would deny consumers the protections afforded in markets where all consumers pay the same "market" price.

e) Relevance of A Competitive Secondary Mortgage Market

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[105] See *supra* note 76 and accompanying text.

Finally, we should add a few words on the relevance of a competitive market for secondary mortgages. A number of defendants' experts have addressed the size and depth of the secondary mortgage market and the dramatic impact that this market has had on the cost of residential mortgage loans in this country.[106] We do not understand these opinions to be in conflict with the analysis presented above. The trilateral dilemma facing consumers in this context has nothing to do with the efficiency of the secondary mortgage market. We have assumed for purposes of our analysis that market forces determine the price at which lending institutions can sell their mortgage pools and that lending institutions set their interest rates on particular loan programs so that they earn a standard "mark-up" on each transaction.[107] That these prices are set competitively and efficiently does not influence our analysis. The relationship that We are addressing in this report is the one between the mortgage broker and individual consumers. The question is whether this relationship has characteristics that might make it possible and advantageous for mortgage brokers to steer certain consumers to financing arrangements that increase their overall costs in ways that are inefficient and unfair. Our view, as explained in this part, is that the relationship between mortgage brokers and consumers seems to have structural characteristics that make such abuses possible. The relationship, in other words, has the characteristics of a trilateral dilemma, requiring governmental intervention.

As further evidence that trilateral dilemmas can exist on the periphery of efficient markets, consider the example of investment managers and brokerage commissions.[108] In that case, the underlying transactions involved the sale and purchase of common stock and other securities. Many

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106 See, e.g., Report of Ann B. Schnare, Ph.D (June 15, 2001).

107 See *supra* note 85 and accompanying text.

108 See *supra* Part II.B.

of these transactions occurred on the New York Stock Exchange, which is the archetypical efficient market. Still it was possible for investment managers to exploit consumers by hiring brokerage firms that charged excessively high commissions (and then make side payments to investment managers). If the efficiency of the New York Stock Exchange somehow "solved" this problem, then Congress and the SEC would never have had to concern themselves with soft dollar arrangements. Unfortunately, efficiency in one market does not protect consumers in related transactions.

Part III An Empirical Assessment of Yield Spread Premiums

In this final part, we report the results of an empirical investigation of the payment of yield spread premiums that Professor Jackson undertook in his capacity as an expert witness in the Glover v. Standard Federal Bank litigation. The goal of this investigation was to explore the following issues:

> First, what is the magnitude of yield spread premiums for loans that defendant lending institutions funded during the class period both in absolute amounts and in comparison to other principal sources of mortgage broker compensation?
>
> Second, when mortgage brokers received yield spread premiums in connection with loans funded by defendant lending institutions during the class period, was the cost of these yield spread premiums offset by a comparable reduction in other borrower costs?
>
> Third, what evidence is there to suggest that yield spread premiums are associated with additional services being provided to borrowers in connection with loans that defendant lending institutions funded during the class period?

This part begins with a discussion of the methodology underlying this investigation, including a review of the data we have examined and a discussion of procedures followed in inputting data. We then consider each of the three issues presented above, presenting and assessing the implications of our findings as well as relating those findings to the theoretical discussions of yield spread premiums in Part II.C. We conclude with a discussion of the relationship between this empirical assessment and the considerations that motivated Congress in 1974 to prohibit kickbacks and unearned referral fees in real estate settlement transactions.

A. Overview of Methodology

1) Groups of Loan Available for Analysis

For the purposes of this analysis, we had available to us HUD-1 statements for three different groups of loans.

1. The Heartland Loans: This group consists of 111 loans obtained by members of the plaintiff class and other borrowers and originated during the class period through Heartland Mortgage Corporation. The HUD-1 statements for the Heartland loans were produced by defendants in response to discovery requests for all members of the plaintiff class with mortgages that were originated through Heartland Mortgage Corporation on which yield spread premiums were paid. As produced, however, the group also included a number of loans on which yield spread premiums were not paid, and thus apparently consists of all loans funded by defendant lending institutions and originated through Heartland Mortgage Corporation during the class period.

2. The Plaintiffs' Sample. This sample of approximately 800 loans was selected under the supervision of the court on behalf of the plaintiffs and with the agreement of the parties. Under these negotiated procedures, eight dates during the class period were selected across the class period. For each date, the defendants were required to produce HUD-1 statements for 25 randomly selected loan files from each of four separate categories:

> *2a. Above Par Loans:* This subsample was designed to include loans which defendant lending institutions originated through mortgage brokers and for which defendant lending institutions paid more than the loan amount (i.e., a total price of more than 100.0). The premium on these loans (i.e., the amount by which the total price exceeds par) would typically be paid to the mortgage broker in the form of a yield spread premium.
>
> *2b. Par Loans:* This subsample was designed to include loans which defendant lending institutions originated through mortgage brokers and for which

defendant lending institutions paid exactly a par price (i.e., a price of 100.0). Typically there would be no explicit yield spread premium paid on these loans.

2c. Below Par Loans: This subsample was designed to include loans which defendant lending institutions originated through mortgage brokers and for which defendant lending institutions paid less than the loan amount (i.e., a total price of less than 100.0). Typically, no explicit yield spread premium would be paid on below par loans, and the borrower would typically be required to pay "discount points" to the lender in order to cover the difference between the amount of the loan and the total price.

2d. Retail Loans: This subsample was designed to include loans that the defendant lending institutions made directly to retail customers and for which a mortgage broker did not participate. No yield spread premiums are paid to mortgage brokers on retail loans.

On certain dates selected for producing the Plaintiffs' Sample, defendant lending institutions did not produce enough par loans or below par loans to generate a sample of 25 loans, in which case loans were selected from another date within a short period of time.

3. Defendants' Sample. Another sample of approximately 2,100 loans was selected under the supervision of the court on behalf of the defendants. For this sample, counsel for defendants requested that the court select another series of dates from which to draw a sample of all loans that defendant lending institutions made on those dates. As a result of these sampling procedures, the Defendants' Sample includes a combination of above par loans, par loans, and below par loans. On many of these loans, yield spread premiums were paid to mortgage brokers. There were no retail loans in the Defendants' Sample.

2) Data Entry Procedures

As an initial stage of the investigation, I arranged for the data from the more than 3,000 loans files described above to be encoded digitally into a series of databases. As each file has several hundred possible fields, this was a substantial undertaking. I established the following

procedures. First, under my supervision, a research assistant with substantial experience in data analysis developed a template through which to enter each loan file. My research assistant and I used this template to enter the files for the Heartland Loans. Then, we prepared a detailed set of instructions for data entry, as well as additional templates for both the Plaintiffs' Sample and the Defendants' Sample. These templates and instructions were distributed to accountants and in some cases legal assistants associated with plaintiffs' lawyers in these cases. The files for the Plaintiffs' Sample and Defendants' Sample were then entered under my supervision.

To ensure the accuracy of the data entry process, a number of "tests" were written into our input templates. For example, the HUD-1 statements include figures representing total costs paid by borrowers. One of our tests checked to make sure that the borrower costs inputted for each file added to the figure reflected on that HUD-1 statement for total borrower costs. In addition, once data entry was completed for each sample, a research assistant reviewed all files to confirm that the values critical to my analysis were entered correctly. This review process was completed in the summer of 2001 for the loans in the Plaintiffs' Sample and in the fall of 2001 for loans in the Defendants' Sample.[109]

In addition to the data entered from the HUD-1 forms produced in discovery, I have received a substantial amount of data from defendants. This additional data has come in both electronic and paper form. Under my supervision, my research assistants have entered much of this supplemental data into a combined database. The database covers the Heartland loans as

[109] For the Defendants' Sample, my research assistants spent on average more than ten minutes checking each of the approximately 2,100 HUD-1 forms from which this portion of our database was derived. In addition, my most experienced research assistant reviewed all of the files, ran a number of diagnostic checks, and when questions arose re-examined the files in question. In a further effort to validate our data entry procedures, I have, where possible, compared our data with analyses prepared by defendants or defendants' experts in connection with this litigation. With a high degree of reliability, I have been able to replicate the defendants' results. Where discrepancies have arisen, I have checked the underlying documentation and satisfied myself that the difference was the result of a data entry error or misinterpretation on the part of defendants or defendants' experts. However, these discrepancies have arisen in only a small number of cases.

well as the loans in both the Plaintiffs' Sample and the Defendants' Sample – a total of approximately 3,050 loans. For each loan, this combined database includes as many as several hundred fields of data. All of the statistical analyses presented in this report are based on data in the combined sample. A copy of that combined sample, in electronic form, is attached to this report as Electronic Exhibit A.

3) Files Available for Analysis

As a result of the data entry process described above, I had potentially available for analysis approximately 3,050 loan files, divided into the groups indicated in Table 1. For a variety of technical reasons, not all of these loans could be used in this report. A certain number of loans (65 loans or approximately two percent of the total sample) could not be entered, principally because the files were either illegible or incomplete. Thus the number of files that my assistants and I actually entered was 2,985. A further reduction in loans available for analysis relates to inability to match all of the loans in our sample to the defendants data. As is explained in more detail below, various aspects of our analysis required use of both data we compiled from HUD-1 forms and information supplied to us by defendants and their experts. While the matching process worked in most cases, we were unable to match some 38 loans, and therefore the actual number of loans available for our analysis was 2,947 loans. Table 1 provides further details on the composition of the loans available for analysis as well as the impact of the various reductions on each group of loans.

We performed one additional adjustment on loans in the Plaintiffs' Sample. As described above, the Plaintiffs' sample was designed to include several subsamples of above par, par, and below par loans, classifications based on the price of particular loans. When we received defendants' data on loan prices, we discovered a number of discrepancies between that information and the classification of loans for purposes of creating the subsamples of the Plaintiffs' Sample. For example, for some loans initially included in the Above Par Sample – which were supposed to have prices above 100.0 – defendants reported actual prices of 100 or

less. On the assumption that defendants' pricing data was more accurate measure of loan type, we reclassified a number of loans in the Plaintiffs' sample. This reclassification, which is reported in the final column of Table 1, caused minor changes in the number of loans included in

Table 1

Loans Available for Analysis

	Original Number	Available for Analysis	Matched with Defendants Data	Reclassified Based on Price
Heartland Loans	**111**	**111**	**108**	**108**
Plaintiffs' Sample	**802**	**764**	**747**	**747**
Above Par	202	202	202	190
Par	200	191	191	186
Below Par	200	183	182	199
Retail	200	188	172	172
Defendants' Sample	**2137**	**2110**	**2092**	**2092**
Total Loans	**3050**	**2985**	**2947**	**2947**

the various subsamples.[110]

[110] As explained in the text, this adjustment is based on our assessment of the relative reliability of data provided us by defendants. We have rerun our critical findings, presented below, to confirm that our conclusions would not be materially affected had we used the initial classifications of the Plaintiffs' Sample rather than the reclassification described in the text.

B. Presentation of Results

1. What are the incidence and magnitude of yield spread premiums for loans that defendant lending institutions funded during the class period both in absolute amounts and in comparison to other principal sources of mortgage broker compensation?

a) Incidence of Yield Spread Premiums

We began by considering the frequency with which mortgage brokers received yield spread premiums on the loans we were analyzing. To address this issue, we examined the three groups of loans in which yield spread premiums might be present: the Heartland Loans, the Above Par Sample, and the Defendants' Sample.[111] Within these groups of loans, we had two mechanisms for determining the incidence of yield spread premiums. First, we inspected the HUD-1 forms associated with each loan to determine whether a yield spread premium was disclosed on the form. Second, we used the defendants' electronic database to determine whether yield spread premiums were present for loans in the group. Table 2 reports the results of both methods of investigation.

Overall, the incidence of yield spread premiums reported in Table 2 is quite high – over 80 percent by all measures. For certain groups, this high incidence of yield spread premiums is an artifact of the manner in which the groups were constructed. For example, one would expect yield spread premiums to be paid on all loans in the Above Par Sample, as this sample was limited to loans with prices above 100.0. The rate of yield spread premiums in other groups, however, represents a reasonable estimate of the incidence of yield spread premiums in the overall population of loans originated by defendant lending institutions through mortgage brokers

[111] As explained above, yield spread premiums are not associated with retail loans, and the two remaining subsamples were limited to loans with a price of 100.0 or less, on which yield spread premiums were not expressly charged.

during the class period. Given its size and the manner in which it was constructed, I believe the incidence of yield spread premiums in the Defendants' Sample reported in Table 2 – between 85 and 90 percent – represents a good estimate of the incidence of yield spread premiums in the overall population. In other words, on six out of seven loans that defendant lending institutions made through mortgage brokers during the class period, a yield spread premium was paid to the mortgage broker.

Table 2

Incidence of Yield Spread Premiums

	Loans In Group	*YSPs Found on HUD-1s*	*Percent of Total Loans*	*YSPs Reported in Defendants' Data*	*Percent of Total Loans*
Heartland Loans	108	98	90.74%	99	91.67%
Above Par Subsample	190	182	95.79%	190	100.00%
Defendants Sample	2092	1728	82.60%	1806	86.33%
Total	**2390**	**2008**	**84.02%**	**2095**	**n.a.**

The difference in Table 2's estimates of yield spread premiums is noteworthy. Our estimates of yield spread premiums based on examination of the paper HUD-1 forms disclosed to borrowers were invariably lower than estimates based on defendants' electronic records. The source of this difference is not clear. One possibility is that settlement agents failed to include the mandated disclosure of yield spread premiums in these cases. Another possibility is that the yield spread premiums were disclosed on these forms and my research assistants were not able to find them.[112] Finally, it is possible that defendants' electronic records were in error and yield spread premiums were not present in these cases. For purposes of our analysis, we have proceeded under the assumption that the defendants' electronic data represents the best estimate of yield spread premiums actually paid and we have therefore incorporated that estimate into subsequent analysis.[113]

[112] As discussed elsewhere in this report, disclosure of yield spread premiums in HUD-1 forms is often cryptic and confusing. Our difficulty in identifying yield spread premiums reinforces this point. In the first stage of our data entry procedures, our entry teams found yield spread premiums in only 69 percent of the loan files examined, even though these teams consisted of trained para-legals and accountants who were expressly and repeatedly instructed to look carefully for these payments and given detailed instructions as to where on the HUD-1 forms the information was likely to be found. In the next stage, with a second team of assistants, consisting of Harvard Law School students working under my direction, we achieved the 82.6 percent incidence reported in Table 2, but only after prompting the researchers to renew their efforts in cases in which defendants' electronic data suggested that a yield spread premium was present. (These students spent, on average, more than ten minutes reviewing each of the 2100 HUD-1 forms in the Defendants' Sample.) In the end, there were still 78 loans in the Defendants' Sample in which we could not find a yield spread premium even though the defendants' electronic records indicated one had been paid. As indicated in the text, there remains a possibility that yield spread premiums were disclosed in some of these cases, however, I think it is more likely that they were not disclosed on the relevant forms.

[113] Defendants' experts have also apparently proceeded on this assumption. See Deposition of Susan E. Woodward at 10 et seq. (July 31, 2001). An alternative approach would be to limit our analysis to loans in which identical estimates of yield spread premiums were reported under both methods. As explained below, we retested our principal findings using this alternative approach and found comparable results.

b) The Magnitude of Yield Spread Premiums.

In terms of both absolute dollar amounts and as a percentage of loan amounts, yield spread premiums constitute both a substantial cost for consumers and a substantial source of compensation for mortgage brokers. Table 3 presents summary statistics on the average level of yield spread premiums for the three groups of loans where yield spread premiums were charged. As this table indicates, the average amount of yield spread premiums was in excess of $1,800 for both the Above Par Sample and those loans from the Defendants' Sample. Measured in terms of the average percentage of loan amounts, yield spread premiums for these two samples were both 1.54 percent. In the case of the Heartland Loans, yield spread premiums were somewhat smaller by both measures ($1,442 or 1.16 percent of loan amount) but still quite large. The final column of Table 3 reports the total amount of mortgage broker compensation that yield spread premiums generated for the three groups of loans. For example, on the 190 loans in the Above Par Sample, yield spread premiums generated $356,731 of revenue for mortgage brokers. For the 1,806 loans with yield spread premiums in the Defendants' Sample, these fees generated more than $3.3 million of income for mortgage brokers. These numbers indicate that yield spread premiums constitute a substantial expense for borrowers and a major source of revenue for mortgage

Table 3

Magnitude of Yield Spread Premiums For Loans Where YSPs Were Paid

Group	Average **(percent of loan amount)**	Average **(dollars)**	Total **(dollars)**
Heartland Loans (99)	1.16 %	$ 1,442	$ 142,743
Above Par Sample (190)	1.54%	$ 1,878	$ 356,731
Defendants' Sample (with ysp) (1806)	1.54 %	$ 1,848	$ 3,337,585

brokers, both in absolute terms and as a percentage of loan amount.

In certain respects, the foregoing analysis may actually understate the overall importance of yield spread premiums. In the course of our analysis, we discovered that borrowers were paying mortgage brokers substantial amounts of loan discount fees on many transactions. Loan discount fees have been traditionally associated with below par loans; borrowers use these fees to "pay down" the interest rate on these loans. Our analysis revealed that these fees were also being paid on loans in the Above Par Sample, the Par Sample, and the Defendants' Sample as well as on certain of the Heartland Loans. Table 4 reports the number of loans with loan discounts in each group, the percentage of loans with discounts in each group, the average amount of loan discounts when such discounts were paid, and the total dollar amount of discounts at issue.[114]

There is some question how to interpret these loan discounts. On the HUD-1 forms, they appear as a separate cost for borrowers and thus a separate source of mortgage broker compensation. However, a strong argument could be made that these loan discount fees are

[114] Like yield spread premiums, loan discounts are not consistently and clearly reported on HUD-1 Forms. Sometimes loans discount fees are reported on HUD-1 forms, but it is not clearly indicated to whom they are paid. Other times, no loan discount fees are reported on the HUD-1 forms, but defendants' electronic records indicate that the loans in question have below par prices and that loan discount fees should have been paid to defendant lending institutions. This problem was particularly acute for below par loans. Of the 199 loans in the Plaintiffs' Below Par Sample, our efforts to calculate the loan discount fee paid to the defendant lending institutions based on a review of the HUD-1 forms matched the corresponding entry in defendants' electronic records only 69 times or basically a third of the cases. In the face of these ambiguities, we adopted the following convention. We assumed that defendants' electronic records were the most accurate measure of the true amount of loan discount fees paid to defendant lending institutions. When these discount fees were greater than the discount fees reported on the associated HUD-1 form, we inferred that the difference was paid to the mortgage broker as additional compensation. When the loan discount fee paid to the lender was more than the amount of loan discount fees reported on the associated HUD-1 form, we inferred that the difference was funded through a credit from the mortgage broker.

indirectly attributable to yield spread premiums. After all, borrowers pay loan discount fees in order to lower interest rates on their loans. Thus, when a borrower pays a loan discount fee on an above par loan or even a loan that ends up being a par loan, negotiations must have started with the interest rate on that loan being set at a level above the rate of a comparable par loan.[115] In the

Table 4

Loan Discount Fees as a Source of Additional Compensation for Mortgage Brokers

	Number	Percentage of Group	Average When Paid (dollars)	Total Amount (dollars)
Heartland Loans (108)	16	14.8 %	$ 744	$ 11,909
Above Par Sample (190)	19	10.0 %	$ 1,109	$ 21,070
Par Sample (186)	51	27.4 %	$ 1,335	$ 68,096
Below Par Sample (199)	85	42.7 %	$ 1,174	$ 99,777
Defendants' Sample (2092)	306	14.6 %	$ 1,228	$ 375,919

absence of negotiation, that loan would have generated a higher yield spread premium than whatever premium is ultimately reported on the borrower's HUD-1 form. In essence, when a borrower buys down his or her interest rate under these circumstances, a portion of the pre-negotiation yield spread premium is simply converted into a loan discount fee. As such one could reasonably attribute the loan discount fees reported in Table 4 to the ability of mortgage brokers to recommend in the first instance above par loans with yield spread premiums. Under this line of reasoning, the magnitude of yield spread premiums would be even greater than the levels

[115] When a borrower pays loan discount fees to a mortgage broker on what ultimately turns out to be a below par loan, negotiations over interest rates may also have started out at an above par rate.

reported above.

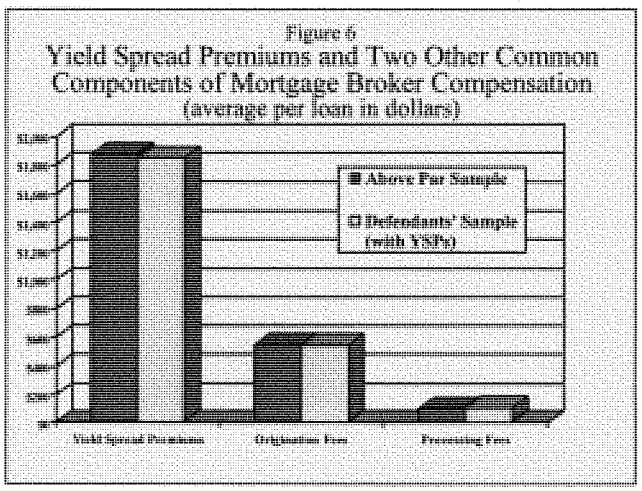
The ambiguous effect of loan discount fees paid to mortgage brokers is relevant to subsequent portions of our analysis when we attempt to compare mortgage broker compensations in loans in which yield spread premiums are paid to other loans untainted by yield spread premiums. To eliminate the possibly confounding effect of loan discount fees, we further segmented the Par Loans and Below Par Loans into subsamples of True Par Loans and True Below Par Loans. These subsamples included the 135 Par Loans and 114 Below Par Loans for which mortgage brokers did not receive any loan discount fees. As explained later, we used these subsamples, and particularly the subsample of True Par Loans, as our primary benchmarks against which we compared samples of loans in which yield spread premiums were paid.[116] In some of our analyses of the Defendants' Sample, we also made adjustments for discount fees paid to mortgage brokers.

c) Amounts as Compared with Other Common Components of Mortgage Broker Compensation

Another way to assess the magnitude of yield spread premiums is to compare these payments to other fees that borrowers pay mortgage brokers. Figures 6 and 7 compare the

[116] As with many other aspects of our analysis, we reran our principal tests using our original Par Loan and Below Par Loan samples. While the size of the effects noted in the text differ somewhat for these alternative tests, our conclusions and their statistical significance were unaffected. Illustrations of these differences are reported in the margins below.

average level of yield spread premiums to the average levels of two other fees commonly paid to mortgage brokers in these transactions: loan origination fees and processing fees. The figures report averages from two different groups of loans: those in the Above Par Sample, and those in the Defendants' Sample. Figure 6 illustrates these averages in dollar amounts. As this table indicates, for both the Above Par Sample and the Defendants' Sample, average yield spread premiums are much bigger than origination fees or processing fees. For example, in the case of the Above Par Loans, average yield spread premiums were $1,877, whereas average origination fees were $541 and average processing fees were $100 . For loans with yield spread premiums in

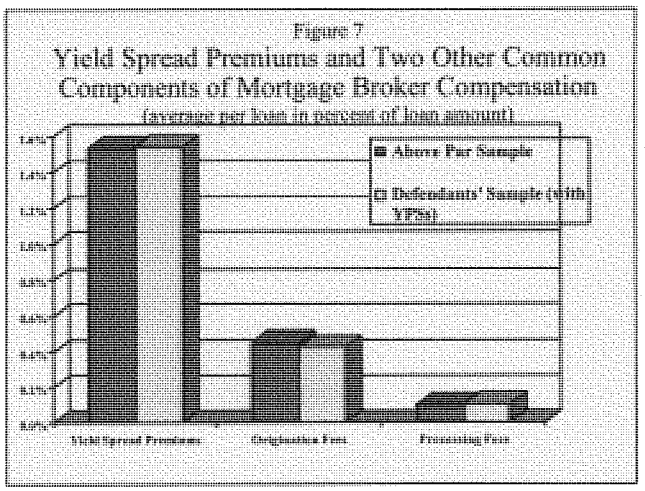


the Defendants' Sample, average yield spread premiums were $1,848, where average origination fees were $456 and average processing fees were $105. [117]

[117] Average yield spread premiums also exceeded other averages in the case of the Heartland Loans, but the differential is not as great. For the most part, our analysis in the text focuses on data regarding the Plaintiffs' Sample and the Defendants' Sample, as these are the loans that are representative of the overall practices of defendant lending institutions. The Heartland loans are not – and were not

An alternative way of presenting this data is to consider fees as a percentage of loan amounts. As some fees, such as origination fees, are commonly determined as a percentage of loan amount, this alternative presentation controls for the size of individual loans and reduces the possibility that loan size might be confounding our analysis. Figure 7 illustrates average borrower fees as a percentage of loan amounts for both the Above Par Sample and the Defendants' Sample with yield spread premiums. Viewed in this way, yield spread premiums again constitute the largest component of mortgage broker compensation. Taken together, Figures 6 and 7 leave little doubt that yield spread premiums constitute the principal source of mortgage broker compensation in loans where yield spread premiums are charged.

Figure 7



d) Distribution of Yield Spread Premiums Compared to Other Costs

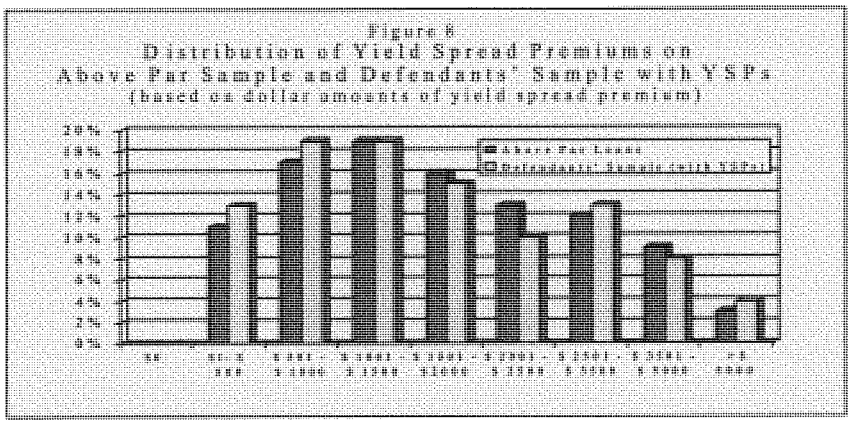
selected to be – a representative sample.

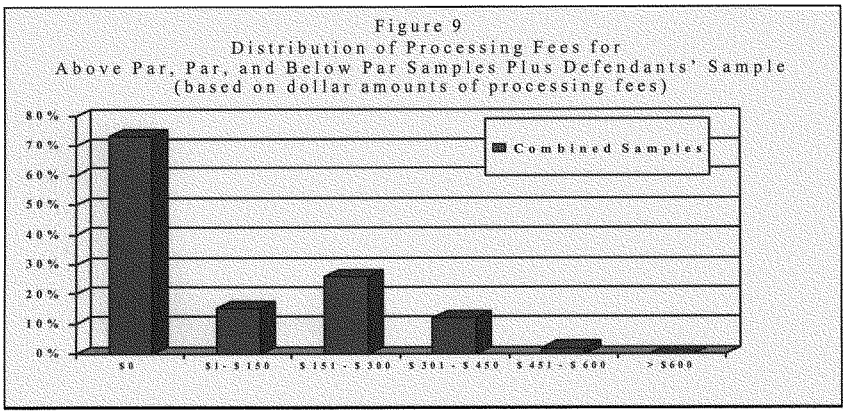
We also examined variations in the amount of yield spread premiums that borrowers paid on various loans in our sample. Figures 8 and 10 present these distributions, first for the absolute amount of yield spread premiums, and then for yield spread premiums as a percentage of loan amounts. What these figures reveal is that there is substantial and unusual variation in the amount of yield spread premiums paid on particular loans. This is true of all the groups of loans in which yield spread premiums are paid.[118] Looking, for example, at the bar graphs (in dark red on Figure 8) representing yield spread premiums paid in the Above Par Sample, while seventeen percent of borrowers paid yield spread premiums of between $501 and $1,000, and another nineteen percent paid yield spread premiums in the $1,001 to $1,500 range, sixteen percent of borrowers paid $1,501 to $2,000, and another thirteen percent paid premiums in the $2,001 to $2,500 range. Figure 10 indicates that this variation is not simply a result of the fact that yield spread premiums are calculated as a percentage of loan amount (which would tend to make yield spread premiums higher for loans with larger loans amounts). Reporting yield spread premiums as a percentage of loan amount for the same three groups of loans, Figure 10 indicates that this wide variation persists even when these payments are adjusted for loan size. As indicated in the yellow bars on Figures 8 and 10, yield spread premiums across the Defendants' Sample had a similarly wide dispersion.

To provide a better sense of how much variation there is in yield spread premiums, I have reproduced beneath Figures 8 and 10, comparable distributions for other sources of compensation for mortgage brokers. First, beneath figure 8 (which reports yield spread premium distribution expressed in absolute dollar amounts), I present the distribution for processing fees charged on all loans in the Plaintiffs' Sample funded through mortgage brokers and also all loans in the Defendants' Sample. The price of the processing fee is typically calculated in a dollar amount. As Figure 9 reveals, the distribution of processing fees is tightly bunched around two points on

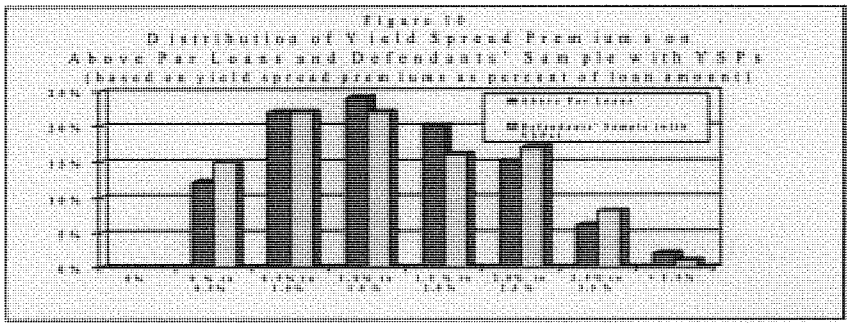
[118] The text reports the distributions of the Above Par Sample and the Defendants' Sample with yield spread premiums – our two representative samples of loans with yield spread premiums. A similar distribution is present across the Heartland loans, which do not constitute a representative sample.

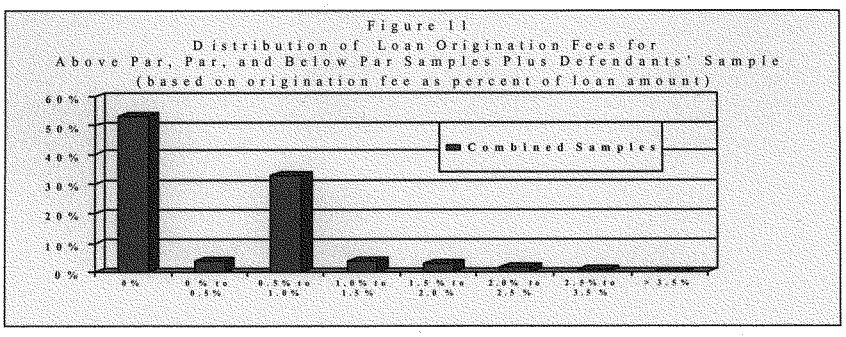
the distribution: zero when no fee is charged and between $150 and $300 otherwise. The absolute amounts of yield spread premiums shown in Figure 8 show no such bunching.





Figures 10 and 11 offer a comparable comparison involving origination fees, which are typically calculated as a percentage of loan amount. As Figure 11 indicates, loan origination fees, if they are imposed, are heavily concentrated in the range of 0.5 to 1.0 percent of loan amounts. As Figure 10 indicates, yield spread premiums exhibit no similar modal value.





e) Interpretation of Analysis

The analysis presented above is important in several respects. To begin with, our data clearly establish that yield spread premiums represent a substantial expense for borrowers obtaining loans from defendant lending institutions in transactions involving mortgage brokers. This is true whether yield spread premiums are measured in absolute terms, as a percentage of loan amounts, or in comparison to other common components of mortgage broker compensation. The magnitude of yield spread premiums is enhanced by the fact that these charges appear to be imposed in nearly all loans that defendant lending institutions fund through mortgage brokers. Based on our analysis, our best estimate is that these payments are imposed in between 85 and 90 percent of such transactions.

In light of the magnitude of yield spread premiums as an expense for borrowers and as a source of revenue for mortgage brokers, it is remarkable that consumers are not provided better information about the existence and magnitude of these fees.[119] The absence of adequate consumer information about yield spread premiums and the financial importance of these payments, in my opinion, suggest the existence and operation of the sort of trilateral dilemma I described in Part II.C of this report. With this much money at stake, mortgage brokers face a strong financial incentive to steer consumers to lending institutions that pay yield spread premiums and, similarly, lending institutions face strong incentives to offer yield spread premiums in order to increase or even maintain their volume of loan originations and particularly loan originations with large ancillary payments.

The high level of variation in yield spread premiums is also a noteworthy finding. For

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[119] See *supra* note 61 and accompanying text. See also *supra* note 75 and accompanying text (discussing the difficulty our research team had in finding disclosures of yield spread premiums).

one thing, the high degree of variation in the payment of yield spread premiums hinders the ability of consumers to monitor these payments. While a consumer can figure out that origination fees are typically one percent of loan value and processing fees ordinarily are in the $150 to $300 range, the foregoing analysis suggests that no such rules of thumb are possible with respect to yield spread premiums, whether considered in absolute terms or as a percentage of loan amounts. Moreovcr, to the extent that my previous discussion has raised the possibility that mortgage brokers might be using yield spread premiums to discriminate among borrowers, the analysis presented here is consistent with that possibility. If mortgage brokers were using yield spread premiums to get the most compensation possible out of each customer, then you would expect to see the wide distribution of yield spread premiums reported in Figures 8 and 10 above. At a minimum, this data would seem to put the burden on defendants to explain why there is so much more variation in yield spread premiums than in other common sources of compensation for mortgage brokers, as presented in Figures 9 and 11. I consider possible explanations for this variation below.[120]

[120] See infra pages 99-109.

2. When mortgage brokers received yield spread premiums in connection with loans funded by defendant lending institutions during the class period, was the cost of these yield spread premiums offset by a comparable reduction in other forms of mortgage broker compensation or other borrower costs?

In this subsection, we attempt to answer this question from a variety of perspectives. First we consider the relationship between total compensation paid to mortgage brokers in connection with groups of loans on which yield spread premiums are paid as compared with other groups of loans in which mortgage broker compensation is not affected by yield spread premiums. Next we perform a similar comparison of total borrower costs for groups of loans on which yield spread premiums are paid as compared with groups of loans in which mortgage broker compensation is not affected by yield spread premiums. Finally, we use regression analysis to estimate the extent to which the payment of yield spread premiums is offset by reductions in other forms of mortgage broker compensation in groups of loans in which yield spread premiums are paid.

a) Mortgage Broker Compensation

i.) Definition of Total Mortgage Broker Compensation

To examine the impact of yield spread premiums on overall mortgage broker compensation, we had first to establish a definition of mortgage broker compensation. Based on consultations with Charles Guy, an industry expert retained by the plaintiffs, and an independent review of relevant literature, I concluded that the following fees paid to mortgage brokers and

required to be reported on HUD-1 statements constitute an accurate measure of mortgage broker compensation:

	Yield Spread Premiums
+	Loan Origination Fees
+	Other Compensation[121]
-	Offsets for Settlement Costs Paid by Mortgage Broker
	Total Mortgage Broker Compensation

For the most part, this formula is self-explanatory. However, two points of clarification are in order. The first concerns the deduction for settlement costs paid by mortgage brokers. On a relatively small number of HUD-1 statements, mortgage brokers are shown to have paid a portion of borrowers' costs, either through a credit on the first page of the statement or through the payment of expenses, sometimes outside of closing.[122] Because the payment of these fees

[121] For these purposes, other compensation includes the following fees designated on HUD-1 statements as paid to the mortgage broker: underwriting, processing, funding, application fee, commitment fee, broker fee, closing fee, administration fee, document preparation, lender's inspection fee (or mortgage insurance inspection fee), assumption fee, and loan discount (when paid to mortgage broker). Not included in this list are certain itemized fees, such as appraisal fees and credit report fees, that are supposed to be passed-through to third parties. As explained below, these itemized fees are considered in our analysis of total borrower costs.

[122] For example, within the Plaintiffs' Sample, credits were reported in 15 instances with the Above Par Sample (7.9 percent of cases) with an average credit, when paid, of $874. Among the Par Sample, credits were reported in 10 cases (5.4 percent of cases) with an average credit, when paid, of $970. Within the Defendants' Sample, credits were present in 269 transactions (or 12.9 percent of the total sample). The average amount of credits was $962. The incidence of credit was somewhat lower among loans in the Defendants' Sample without yield spread premiums (11.5 percent) than it was among loans in the Defendants' Sample with yield spread premiums (13.1 percent). In relationship to gross mortgage broker compensation, credits are quite small – less than three percent in the case of the Above

reduces a mortgage broker's revenues, these expenses were deducted from our calculation of mortgage broker compensation. The second point concerns our treatment of the payment of fees and other costs by the seller. On a relatively small number of HUD-1 statements, sellers are shown to have paid some or in rare cases many costs that are typically borne by borrowers. We have included these fees in our calculations on the grounds that these fees (if paid to mortgage brokers) increase mortgage broker compensation and are indirectly paid by the borrower in the form of a higher purchase price.

In a report prepared on behalf of defendants in this litigation, Bruce Robb has developed a similar definition of total mortgage broker compensation, and we have analyzed his results to understand his methodology, which is not explicitly revealed in his report. Based on our analysis, Mr. Robb's definition treats offsets and seller costs in the same manner as our definition does. The only difference between our two approaches appears to derive from the fact that his definition includes somewhat fewer fees in other compensation.[123] The two definitions of total mortgage broker compensation are thus quite similar. Although we rely primarily on our own definition of total mortgage broker compensation in the analysis presented below, we have conducted the same analysis using Mr. Robb's definition and none of the results is materially different. For various key results, we present our analysis using both definitions of total mortgage broker compensation.

ii.) Analysis of Groups of Loans with Yield Spread Premiums

Par Sample. Moreover, credits are not exclusively associated with loans with yield spread premiums.

[123] Mr. Robb's definition of other compensation appears to be limited to processing fee, flood certification fee, courier fee, and loan discount (when paid to mortgage broker).

To estimate total mortgage broker compensation, we began by examining the three groups of loans where yield spread premiums were routinely paid: the Heartland Loans, the Above Par Sample, and the Defendants' Sample (with yield spread premiums). Table 5 reports the average amount of total mortgage broker compensation in each group. The data presented in this table reveal a fair degree of uniformity. For all three of these groups, the average amount of total mortgage broker compensation falls within a fairly tight range, from $2,548 in the Defendants' Sample to $2,784 in Heartland Loans. It is also noteworthy that the average amounts of offsets in all three samples are quite small and especially small for the Above Par Sample and the Defendants' Sample with yield spread premiums.

Table 5
Total Mortgage Broker Compensation for Groups of Loans with Yield Spread Premiums
(average amounts in dollars)

	Yield Spread Premium	*Origin. Fee*	*Other MB Comp.*	*Offsets*	*Total MB Comp.*
Heartland Loans (w/ ysp) (99)	$ 1,442	$ 1,194	$ 402	($ 186)	$ 2,852
Above Par Sample (190)	$ 1,878	$ 541	$346	($ 69)	$ 2,696
Defendants' Sample (w/ ysp) (1806)	$ 1,848	$ 456	$368	($124)	$ 2,548

Two graphic illustrations of the same data appear on the next page. Figure 12 presents the components of total mortgage broker compensation in dollar amounts whereas Figure 13 presents the same components as a percentage of loan amount. These two figures nicely illustrate how similar the averages of total mortgage broker compensation (as well

as constituent components) are for the Above Par Sample and the Defendants' Sample with yield spread premiums. Although two samples were constructed in different ways, the similarity of results adds confidence that we have obtained a good estimate of total mortgage broker compensation in the underlying population – loans originated by defendant lending institutions through mortgage brokers.

Figure 12
Total Mortgage Broker Compensation
for Groups of Loans With Yield Spread Premiums
(average in dollars)

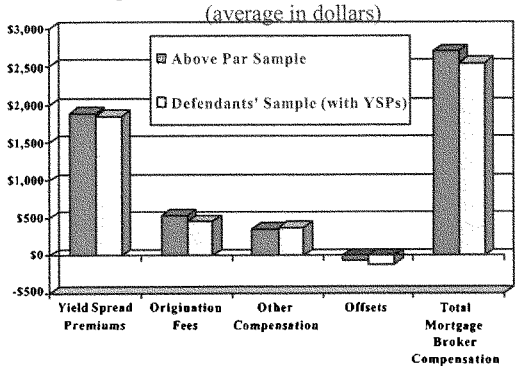
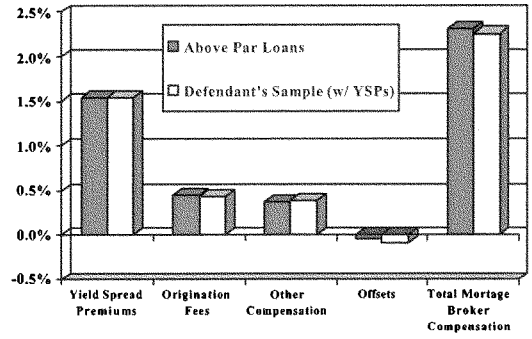


Figure 13
Total Mortgage Broker Compensation
for Groups of Loans With Yield Spread Premiums
(average percent of loan amounts)

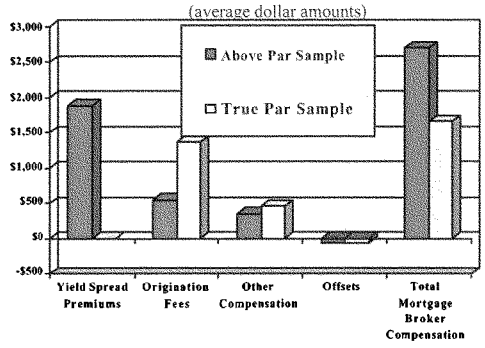


iii.) Comparison of Mortgage Broker Compensation in other Comparable Groups of Loans

The next stage of our analysis was to compare total mortgage broker compensation on loans in which yield spread premiums were not paid and for which we could get comparable estimates of total mortgage broker compensation. Here we focused our analysis on the subsets within the Plaintiffs' Sample because all subsets were constructed in the same way and were therefore likely to be most comparable. Our goal therefore was to compare total mortgage broker compensation in the Above Par Sample (the subset of the Plaintiffs' Sample with a high

concentration of yield spread premiums) with a comparable subset of the Plaintiffs' Sample in which yield spread premiums did not influence total mortgage broker compensation. As explained above,[124] the subset of True Par Loans is, in our view, the most comparable subset for making these comparisons. However, for all of the analysis described below, we repeated our comparisons using a wide variety of comparisons and methodologies.

Figure 14
Comparison of Mortgage Broker Compensation:
Above Par Loans v. True Par Loans
(average dollar amounts)

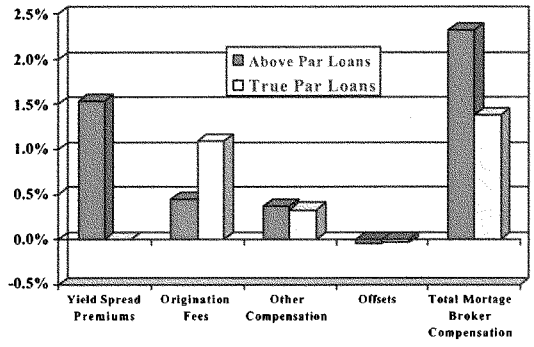


Our first comparison was between the dollar amount of mortgage broker compensation in the Above Par Sample and the dollar amount of mortgage broker comparison in the True Par Sample. As illustrated in the bar graphs of Figure 14, average total compensation paid to

[124] See *supra* page 60-62.

mortgage brokers in the Above Par Sample was $1,046 dollars more than the average total mortgage broker compensation for the True Par Sample. Using standard statistical analyses, we confirmed that the difference in compensation was significant at greater than the 99 percent level.[125]

Figure 15
Comparison of Mortgage Broker Compensation:
Above Par Loans v. True Par Loans
(average percent of loan amounts)



To control for potential differences in loan size, we also compared average levels of total mortgage broker compensation as a percentage of loan across groups. The results were similar to those obtained for dollar amounts of total mortgage brokerage compensation. As summarized in Figure 15, the average amount of total mortgage broker compensation for the Above Par

[125] Here and throughout the subsequent analysis, we used two separate measures of statistical significance: a two-sample "t" test of differences in means as well as a non-parametric test (Wilcoxon Signed Ranks). In all contexts and under both tests, the results reported were statistically significant at greater than the 99 percent level.

Sample was 2.312 percent of loan amount or 0.924 percent higher that total mortgage broker compensation for loans in the True Par Sample (1.388 percent of loan amount). This difference was statistically significant at greater than the 99 percent level.

In addition to the two basic comparisons of mortgage broker compensation summarized in Figures 15 and 16, we conducted numerous alternative formulations of the comparison, using both dollar amounts of compensation[126] and compensation as a percentage of loan amount.[127] A summary of the results is set forth in the margin. In each case, our analysis was consistent with the results reported above: total mortgage broker compensation was substantially higher for loans on which yield spread premiums were charged than was total mortgage broker compensation on other groups of comparable loans in our samples. Moreover in all cases these differences were statistically different at great than the 99 percent level..

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[126] The following table summarizes our findings (using average dollar amounts) of the amounts by which total mortgage broker compensation on loans with yield spread premiums exceeded total brokerage compensation on groups of loans without yield spread premiums:

Comparison	*Average Excess*
Above Par v. Par	$ 815
Above Par v. True Par (Robb Definition of Compensation)	$1,122
Defendants' Sample (with YSP) v. True Par	$ 899
Defendants' Sample (with Adjusted YSP) v. Defendants' Sample (w/out)	$1,033
Above Par (based on YSP reported on HUD-1 Forms) v. True Par	$ 1,097

Note: All differences statistically significant at the 99 percent level.

[127] The following table summarizes our findings (using average percentage of loan amount) of the amount by which total mortgage broker compensation on loans with yield spread premiums exceeded total brokerage compensation on groups of loans without yield spread premiums:

Comparison	*Average Excess (percent)*
Above Par v. Par	0.651 percent
Above Par v. True Par (Robb Definition of Compensation)	0.881 percent
Defendants' Sample v. True Par	0.868 percent
Defendants' Sample (with Adjusted YSP) v. Defendants' Sample (w/out)	1.055 percent
Above Par (YSP on HUD-1 Forms) v. True Par	0.941 percent

Note: All differences statistically significant at the 99 percent level.

In my view, the comparison between the Above Par Sample and the True Par Sample offers the most accurate comparison of total mortgage broker compensation in groups of loans in which yield spread premiums are paid and total compensation in comparable loans in which yield spread premiums do not play a role. In plain language, what this analysis suggests is that mortgage brokers earned on average $1,046 more on loans where yield spread premiums were paid than on comparable loans in which yield spread premiums were not paid or, if one were to speak in terms of compensation as a percentage of loan amounts, extra compensation equal on average to 0.924 percent of loan amounts. This evidence is inconsistent with the proposition that the payment of yield spread premiums does not affect total mortgage broker compensation. Rather, the evidence unequivocally demonstrates that mortgage brokers earn substantially more on loans when yield spread premiums are paid.

b) Measures of Total Borrower Costs

An alternative way to consider the impact of yield spread premiums is to consider their impact on total borrower costs – that is, not only borrower costs associated with mortgage broker compensation but total borrower costs associated with the loan originations. To pursue this approach, we also analyzed our samples using this broader definition of costs. In particular, we analyzed:

Total Mortgage Broker Compensation

\+ Itemized Mortgage Broker Expenses (typically passed-through to other parties)

\+ Fees Charged by the Lender

\+ Other Pass-Through Expenses Reflected on the HUD-1 (including itemized fees paid through Lender)

Total Borrower Costs

In essence this formula reflected all borrower costs shown on HUD-1 forms, except for charges specifically related to the transaction (such as real estate commissions, pre-paid interest and taxes, etc.). In addition, this calculation does not include loan discount fees paid to the lender on below par loans to lower the loans' interest rates.

Table 6
Total Borrower Costs and Components for Various Groups of Loans
(average amounts in dollars)

	Total MB Comp.	*MB Itemized Expenses*	*Fees to Lenders*	*Other Pass-through Charges*	*Total Borrower Costs*
Above Par Sample (190)	$ 2,696	$ 221	$ 252	$ 1,075	$ 4,244
Defendants' Sample (with YSPs) (1806)	$ 2,548	$202	$ 257	$ 1,336	$ 4,346
True Par Sample (135)	$ 1,649	$ 185	$ 287	$ 1,089	$ 3,210
Retail Sample (170)	---	---	$ 671	$377	$ 1,048

Using the foregoing definition, we calculated average total borrower costs for various groups of loans. A summary of the results of this analysis is presented in Table 6. In all critical respects these results are consistent with our findings with respect to total mortgage broker compensation. In particular, the average amount of total borrower costs for groups of loans with yield spread premiums – in Table 6 represented by the Above Par Sample (dark red) and the Defendants' Sample with yield spread premiums (yellow) – were substantially higher than averages for loan groups without yield spread premiums. Focusing on what I believe to be the most appropriate comparison – the

Above Par Sample as compared with the True Par Sample – the difference in average Total Borrower Costs is $1,034. This difference is statistically significant at greater than the 99 percent level. A similar difference ($1,136) separates averages for the Defendants' Sample with yield spread premiums and the True Par Sample. These differences are illustrated graphically in Figure 16.

An alternative graphic presentation of Total Borrower Costs appears in Figure 17. This figure presents total borrower costs as a percent of loan amounts. Among other things, the figure shows that total borrower costs for loans unaffected by yield spread premiums – that is, the True Par Sample – were on average lower than total borrower costs for the Above Par Sample by 1.14 percent of loan amounts and lower than total borrower costs for the Defendants' Sample with yield spread premiums by 1.30 percent of loan amounts.

Figure 16
Total Borrower Costs and Components:
Above Par Sample v. Loans without Yield Spread Premiums
(average percent of loan amounts)

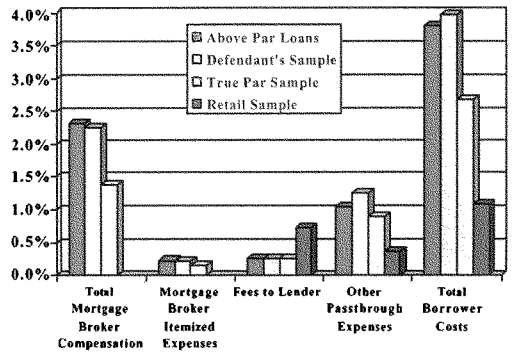
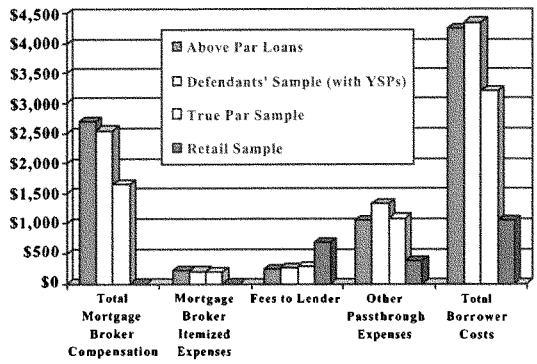


Figure 17
Total Borrower Costs and Components:
Above Par Sample v. Loans without Yield Spread Premiums
(average in dollars)



One noteworthy feature of this comparative analysis of total borrower costs, as presented in Figures 16 and 17 as well as in Table 6, is the extremely low costs reported for the Retail Sample. Our prior comparative analysis, which focused on mortgage broker compensation, did not include reference to the Retail Sample, because no mortgage broker compensation is paid on loans in the Retail Sample. The defendant lending institutions originated these loans directly. The foregoing analysis suggests that average borrower costs associated with the Retail Sample were substantially lower than the other groups of loans analyzed, all of which were originated through the offices of mortgage brokers. The differences are pronounced. For example, as reported in Table 6, average total borrower costs for the Retail Sample were only $1,048, that is less than a quarter of the comparable cost for loans in the Above Par Sample ($4,244) or the Defendants' Sample with Yield Spread Premiums ($4,346). This difference is striking and warrants additional investigation.

When we first discovered the size of this difference, I hypothesized that the defendant lending institutions might be charging much higher interest rates for retail borrowers. Such a difference might explain the dramatically lower direct borrower costs in the Retail Sample. In effect, the defendant lending institutions would be earning an implicit yield spread premium on these loans. To test this hypothesis, we examined the interest rate actually paid on retail loans and compared those rates (as well as several other observable characteristics) to other groups of loans. A summary of these comparisons is presented in Table 7. Even though retail loans seem comparable to other groups in terms of average of loans, the interest rates charged on retail loans were actually lower than those charged on loans with yield spread premiums. For example, the average interest rate on the Retail Loans was 7.38 percent, which is lower than the average for all other groups of loans on which yield spread premiums were charged. Perhaps the best comparison is with the Above Par Loans – which had an average interest rate of 7.62 percent – because this sample was constructed in the

Table 7
Price and Other Observable Characteristics of Retail Loans and Other Groups

Group	*Loan Size (average)*	*Government Loans (percent)*	*Interest Rate (average)*
Loans with Yield Spread Premiums:			
Heartland (99)	$ 131,801	4.0 %	**7.55 %**
Above Par (190)	$ 129,602	13.2 %	**7.62 %**
Defendants' Sample (1806)	$127,142	11.4%	**7.48 %**
Retail Sample (170)	$130,541	2.4 %	**7.38 %**

same manner as the Retail Sample. Thus, contrary to our original hypothesis, this evidence suggests that borrowers in the Retail Sample were on average paying lower interest rates than were borrowers with loans in other groups. Accordingly, while additional investigation of this issue is needed,[128] our analysis suggests that loans in the Retail Sample have much lower costs than groups of loans associated with high incidence of yield spread premiums. There is, moreover, no obvious way in which defendant lending institutions are imposing additional charges on borrowers from the Retail Sample.

In sum, our analysis of borrower costs is inconsistent with the proposition that borrowers do not pay higher costs on loans with yield spread premiums. Indeed, our evidence strongly suggests that total borrower costs on loans with yield spread premiums are on average much higher. A good estimate of the extra amount that borrowers pay on loans with yield spread premiums is on average more than 1.0 percent of loan amounts or, in dollar terms, more than $1,100.

[128] Our comparison of the observable characteristics of the Retail Sample and other groups of loans, presented above, is fairly crude and intended as only a quick check of whether the dramatically lower settlement costs associated with the Retail Sample could be explained by higher interest rates. Our analysis suggests that this is not a plausible explanation. As discussed in more detail below, see *infra* pp. 132-34, one of defendants' expert witnesses attempted to use more sophisticated statistical methods to show that the interest rates on retail loans were actually much higher than those charged on other loans, once one controlled for a number of different factors. As we explain below, this analysis was marred by several elementary errors in statistical analysis. See *id.*

c) Regression Analysis

In some filings in this litigation, defendants have claimed that yield spread premiums are fully offset through the reduction of other charges imposed on borrowers. Defendants' theory of "full financial offset" implies that for every dollar paid in yield spread premiums, borrowers are given a dollar offset or reduction of more traditional up-front cash payments to the mortgage broker. Such a pricing policy is said to be economically neutral because borrowers pay the same amount for obtaining a mortgage, whether they pay yield spread premiums or more traditional up-front costs. Similarly, mortgage brokers would be indifferent to yield spread premiums because they obtain the same revenue however borrowers choose to make their payments.[129]

The foregoing analysis largely rebuts that claim. Within the Plaintiffs' Sample, loans with yield spread premiums – that is, the Above Par Sample – generated much higher revenue for mortgage brokers and much higher total settlement costs for borrowers than did comparable loans without yield spread premiums. These substantial differentials indicate that yield spread premiums were not offset by a reduction in other charges. In an effort to corroborate these findings, we undertook another form of analysis on the Defendants' Sample. This alternative analysis is known as regression analysis and is a method that economists typically use to explore the relationship between different characteristics within a particular group. Here we are using the technique to explore the relationship between yield spread premiums and other mortgage broker compensation in loans originated by defendant lending institutions.

Before turning to our regression results, it is important to understand their relationship to defendant's theory of full financial offset. As explained above, defendants claim that there is a

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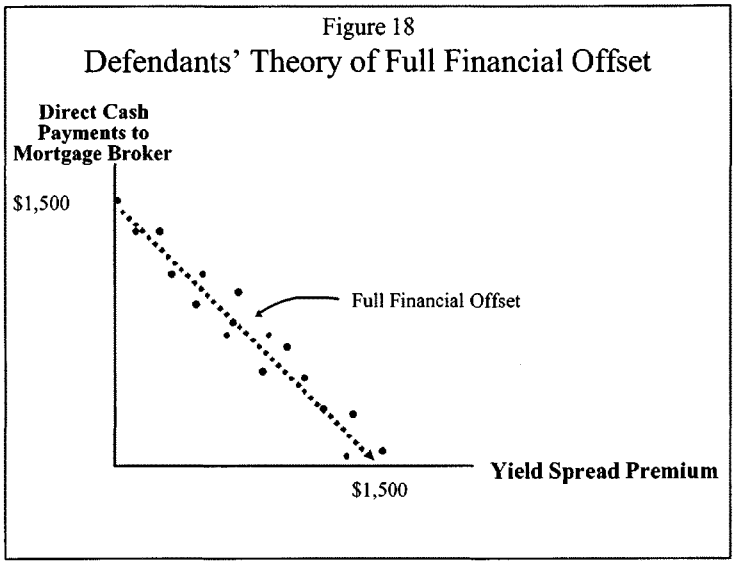
[129] See, e.g., Defendant Standard Federal Bank's Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment 8-9 (filed Sept. 10, 2001); Defendant Standard Federal Bank's Memorandum of Law Supporting Motion for Class-wide Summary Judgment or Alternatively for Class Decertification 9-10 (filed Aug. 13, 2001) (yield spread premiums "redistribute the up-front costs between the borrower and the lender"). See also HUD RESPA Statement of Policy 2001-1 (Oct. 15, 2001) (characterizing yield spread premiums as a "third option" for covering settlement costs).

dollar for dollar trade-off between yield spread premiums and direct cash payments to mortgage brokers. Figure 18 provides a graphic illustration of this theory. The vertical axis of the graph represents direct cash payments to mortgage brokers and the horizontal axis payments made through yield spread premiums. Any combination of direct cash payments and yield spread premiums can be plotted on this graph. The dashed line represents an economically neutral combination of fee arrangements that would provide total mortgage broker compensation of $1,500. At one extreme, the entire fee could be paid in up-front cash payments. Or the full amount could be paid as yield spread premiums. Or, half the fee could be paid in up-front charges and half as yield spread premiums. According to defendants, the line shown in Figure 18 reflects the manner in which defendant lending institutions and mortgage brokers in this case actually employ yield spread premiums – i.e., for every additional dollar paid through yield spread premiums, there is an offsetting reduction in charges paid through up front cash payments. Thus, if one were to plot, for each of defendants' loans, the amounts of direct cash compensation paid to mortgage brokers on each loan and the amount of yield spread premiums for that loan, the points should fall along the economically neutral line shown in Figure 18.

Figure 18

Defendants' Theory of Full Financial Offset



Regression analysis provides a scientific mechanism for testing claims of this sort. What we do with regression analysis is, in essence, to plot the actual yield spread premiums and direct cash payments for the 2,092 loans in the Defendants' Sample. We then draw a line that best reflects the relationship between these two kinds of costs and see how closely this line matches the one that defendants advance under their theory of full financial offset. With regression analysis, we can determine with a high degree of precision whether the data fit the defendants' theory of full financial offset. As explained in considerable detail below, our analysis of the Defendants' Sample unambiguously and resoundingly rebuts defendants' claim of full financial offset.

i.) Simple Regressions

We begin with two simple linear regressions measuring the relationship between yield spread premiums and direct cash payments to mortgage brokers.[130] Figure 19 provides a graphic presentation of this data as well as a dotted line, presenting the regression software's best guess of a straight line representing the relationship between yield spread premiums and direct cash payments to mortgage brokers in the Defendants' Sample. This graph is noteworthy in several respects. First, as illustrated in Figure 19, the data clearly do not match the line associated with defendants' theory of full financial offset.[131] There is no strong and obvious relationship between the two variables, and the line that best describes the relationship is much flatter than the line associated with full financial offset. In other words, the graph strongly suggests that for every dollar added in yield spread premiums there is not an offsetting dollar reduction in direct cash payments to mortgage brokers. This analysis suggests that we can reject defendants' theory of full financial offset with greater than 99 percent confidence.

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[130] For these purposes, direct cash payments to mortgage brokers is defined to be Total Mortgage Broker Compensation, described above, minus yield spread premiums, and thus accounts for all credits paid by mortgage brokers at closing. Our regression analysis was performed on SYSTAT 10.0 software using data included in our electronic database.

[131] The data presented in Figure 19 is limited to the ranges indicated; the regression line, however, reflects all 2,092 loans in the Defendants' Sample.

[Insert Figure 19 Here]

Regressions provide a more precise way of presenting the same information. In the following box marked Simple Regression A, we present the regression output for the data shown in Figure 19. In essence, the regression constitutes the formula (in blue) of the line shown in Figure 19. The first number in the equation (1261.81) is known as the constant and represents the best guess of the amount of direct cash payments when there is no yield spread premium: $1,261.81 The next term in the equation is the coefficient for the yield spread premium variable. The most natural interpretation of this coefficient (-0.263) is the amount by which direct cash payments to mortgage brokers goes down for every dollar of increase in yield spread premiums. Thus, the regression suggests that on average direct cash payments to mortgage brokers go down by only 26 cents for every dollar that yield spread premiums go up. By contrast, defendants' theory of full financial offset implies that direct costs should go down by a full dollar for every dollar of increase in yield spread premiums.

Simple Regression A: Direct Cash Payments as a Function of Yield Spread Premiums
(Dollar Amounts for Defendants' Sample; n = 2092)

1261.81	- 0.263 x	Yield Spread Premium	= Direct Cash Payments
(39.68***)		(0.018***)	

Notes: Adjusted Multiple R Squared = 0.089
Standard errors shown in parentheses.
*** designates significance at the 99.9 percent level.

Several other aspects of the regression results reported above are relevant to our inquiry. First of all, the numbers and asterisks appearing in parentheses beneath the equation tell us how confident we should be that the relationship expressed in the equation is a close approximation o f the actual tradeoff between yield spread premiums and direct cash payment in the overall population of loan transactions that defendant lending institutions originate d through mortgage

brokers during the class period. The triple asterisks indicate that we can be highly confident that these estimates are accurate and even more confident that the relationship is not the dollar for dollar trade-off upon which defendants' theory of full financial offset is based.[132] Also noteworthy is the relatively low Adjusted Multiple R Squared of 0.089 (reported in the first line of Notes to Regression A.) This statistic reports how much of the variation in direct cash payments is related to increases in yield spread premium, and here the percentage is only 9 percent. Ninety-one percent of the variation is attributable to other factors that this simple regression does not measure. This low level of explanation further rebuts defendants' theory of full financial offset, which implied that there was a strong and consistent negative relationship between yield spread premiums and direct cash payments to mortgage brokers. (For the defendants' theory to be confirmed, the coefficient would have to be negative one.)

As with prior analyses, we wanted to make sure that our regression results were not somehow affected by differences in loan amounts across loans in the Defendants' Sample. Accordingly, we conducted a similar simple regression, but this time using direct cash payments as percentages of loan amounts and yield spread premiums as percentages of loan amounts as our two variables. The results are presented below in the box marked Simple Regression B.

[132] Technically speaking, to rebut defendants' theory of full financial offsets, one needs to reject the hypothesis that the coefficient for yield spread premiums is negative one.

Simple Regression B: Direct Cash Payments as a Function of Yield Spread Premiums

(Amounts as a Percentage of Loan Amounts for Defendants' Sample; n = 2092)

0.998	- 0.145 x	Yield Spread Premium	= Direct Cash Payments
(0.039***)		(0.023***)	

Notes: Adjusted Multiple R Squared = 0.018
Standard errors shown in parentheses.
*** designates significance at the 99 percent level.

This alternative approach is even more at odds with the defendants' theory of full financial offset. To begin with, when one controls for loan size by expressing both direct cash payments and yield spread premiums as percentages of loan amounts, the relationship between the two variables further declines. The line reflecting the best guess of the relationship between direct cash payments and yield spread premiums is even flatter, suggesting that there is only a 0.145 percent average reduction in direct cash payments for every percentage point increase in yield spread premiums. Moreover, the predictive value of the regression – reported in the Adjusted Multiple R Squared – has declined to only 2 percent of overall variation.

In the course of our analysis, we also performed two more simple regressions using a different and arguably more accurate measure of yield spread premiums. As explained above, mortgage brokers sometimes convert yield spread premiums into direct payments by having the borrower buy down an above par interest rate through payments of loan discount fees to the mortgage brokers. In my view, this kind of discount fee – as opposed to the traditional form of discount fees paid to lenders – is really a disguised yield spread premium. Accordingly, we constructed a new variable (adjusted yield spread premiums), which includes yield spread premiums plus discount fees paid to mortgage brokers. We then ran two more regressions. In the first regression, we examined the relationship between adjusted yield spread premiums and

adjusted direct cash payments to mortgage brokers.[133] The results of this regression appear below as Simple Regression C. With this formulation – which is likely a better reflection of the true relationship between yield spread premiums and direct mortgage broker costs – the implicit offset declines to under 20 cents per dollar of yield spread premiums.

Simple Regression C: Adjusted Direct Cash Payments as a Function of Adjusted Yield Spread Premiums
(Dollar Amounts for Defendants' Sample; n = 2092)

1016.35	- 0.199 x	Adjusted Yield Spread Premium	= Adjusted Direct Cash Payments
(36.02***)		(0.015***)	

Notes: Adjusted Multiple R Squared = 0.074
Standard errors shown in parentheses.
*** designates significance at the 99 percent level.

In our final simple equation, which uses the same variables, but this time expressed as a percentage of loan amount in order to control for variations in loan size, the results suggest an even lower offset. As summarized in Simple Regression D, below, the estimated offset for adjusted yield spread premiums in this formulation is estimated at 12.4 percent.

[133] Adjusted direct cash payments to mortgage brokers does not include loan discount fees paid to mortgage brokers, as these fees are included in the adjusted yield spread premium measure.

Simple Regression D: Adjusted Direct Cash Payments as a Function of Adjusted Yield Spread Premiums

(Amounts as Percentage of Loan Amounts for Defendants' Sample; n = 2092)

0.817 - 0.124 0x Adjusted Yield Spread Premium = Adjusted Direct Cash Payments
(0.033***) (0.017***)

Notes: Adjusted Multiple R Squared = 0.025
Standard errors shown in parentheses.
*** designates significance at the 99 percent level.

ii.) Alternative Techniques to Control for Loan Amount

In the course of our analysis of the Defendants' Sample, we experimented with a number of different functional forms of regressions. One approach, which was also used by defendants' experts, is to employ multiple regression techniques that allow for the use of additional explanatory variables. So, for example, if direct cash payments to mortgage brokers were affected by some other factors – such as the type of loan involved or some characteristic of the borrower – multiple regression analysis affords a technique for controlling for these other factors and obtaining a clearer understanding of the true relationship between direct cash payments and yield spread premiums. Multiple regression analysis is, however, much more complex than simple regression analysis and is prone to misapplication and misinterpretation.

A good example of this complexity can be seen in the multiple regression presented below. Like Simple Regression A above, this multiple regression seeks to explain the relationship between direct cash payments to mortgage brokers and yield spread premiums. The regression differs only in that it also includes a new explanatory variable for loan amount. As interpreted by defendants' experts, the coefficient for yield spread premium in this regression (-0.327) suggests that an increase of a dollar in yield spread premiums on average reduces direct

cash compensation for mortgage brokers by just under 33 cents. While this estimate implies an offset of less than a third of the amount paid in yield spread premiums, the figure is somewhat higher than our prior estimates of offsets, which ranged from 0 cents to 26.3 cents for each dollar of yield spread premiums).

Multiple Regression E: Direct Cash Payments as a Function of Yield Spread Premiums and Loan Amounts
(Dollar Amounts for Defendants' Sample; n = 2092)

867.619	- 0.327 x Yield Spread Premium	+ 0.004 x Loan Amount=	Direct Cash Payments
(58.367***)	(0.019***)	(0.00***)	

Notes: Adjusted Multiple R Squared = 0.123
Standard errors shown in parentheses.
*** Designates significance at the 99 percent level.

There are, however, serious problems with this form of multiple regression. In the course of our analysis, we discovered that there is a relationship between the two explanatory variables in this regression – that is between yield spread premiums and loan amounts – that complicates interpretation of the regression results. This complication is known as "interaction."[134] As a result of this interaction, the interpretation of multiple regressions including both yield spread premiums and loan amounts advanced by defendants' experts must be qualified in significant respects. Accordingly, I do not rely on the results of Multiple Regression E in formulating my

[134] For an introduction to the concept of interaction, see James T, McClave, P. George Benson, Terry Sincich, Statistics for Business and Economics 574-79 (8th ed. 2001) [hereinafter cited as Benson, Statistics) (where interaction exists "then the first order model [– here the model using only loan amounts and yield spread premiums as explanatory variables --] is not appropriate for predicting [direct cash payments]"). In his deposition, Professor Benson acknowledged the importance of testing for interaction and claimed to have done so for his models. See Benson Deposition of Sept. 28, 2001, at 299-301. However, when we tested Multiple Regression E for interaction, we found a statistically significant coefficient for the interactive term, thus indicating the presence of interaction in the method recommended by the Benson Statistics text. As indicated above, this finding makes it inappropriate to rely upon the coefficients reported in Multiple Regression E.

opinions in this report, other than as necessary for discussing the work of defendants' experts.

Instead, I have employed two other alternative techniques to control for loan amount in analyzing the Defendants' Sample. The first technique was presented above in Regressions B and D. In those regressions, both yield spread premiums and direct cash payments to mortgage broker are expressed as percentages of loan amount. This technique fully controls for loan amount and suggests there is no systemic offset in direct cash payments when the level of yield spread premiums is increased. Indeed, in these formulations, the estimated levels of offset (14.5 cents and 12.4 cents) are actually lower than the estimates for comparable equations with dollar amounts (26.4 cents and 19.9 cents).

My second alternative technique entails a segmentation of the Defendants' Sample into ten different groups (or deciles) of approximately 210 loans. The first decile consists of the 208 smallest loans in the Defendants' Sample; the second decile consists of the next 209 next smallest loans; etc. Having segmented the sample in this way, I then ran ten different simple regressions exploring the relationship between direct cash payments to mortgage brokers and yield spread premiums. This is the same functional form used in Simple Regression A, above, for the full sample. This technique controls for loan size because the loans in each decile are basically the same size. The results of this analysis are presented in two boxes in the following pages.

Simple Regression F1 to F5:

Direct Cash Payments as a Function of Yield Spread Premiums

(Ten Sub-samples from Defendants' Sample)

Decile No. 1: Loan Amounts = $ 19,000 to $ 57,000 (n=208)

679.88 + 0.002 x Yield Spread Premium = Direct Cash Payments
(81.10***) (0.087)

Note: Adjusted Multiple R Squared = 0.00

Decile No. 2: Loan Amounts = $ 57,000 to $ 75,000 (n= 209)

1135.82 - 0.349 x Yield Spread Premium = Direct Cash Payments
(115.15***) (0.095**)

Note: Adjusted Multiple R Squared = 0.057

Decile No. 3: Loan Amounts = $ 75,000 to $ 91,698 (n=209)

997.29 – 0.161 x Yield Spread Premium = Direct Cash Payments
(98.55***) (0.065**)

Note: Adjusted Multiple R Squared = 0.024

Decile No. 4: Loan Amounts = $ 91,800 to $ 106,000 (n=209)

863.68 - 0.048 x Yield Spread Premium = Direct Cash Payments
(106.46***) (0.067)

Note: Adjusted Multiple R Squared = 0.000

Decile No. 5: Loan Amounts = $ 106,000 to $ 118,300 (n=209)

1216.96 - 0.237 x Yield Spread Premium = Direct Cash Payments
(111.79***) (0.057**)

Note: Adjusted Multiple R Squared = 0.072

Standard errors shown in parentheses.
** designates significance at the 95 percent level.
*** designates significance at the 99 percent level.

Simple Regression F6 to F10:

Direct Cash Payments as a Function of Yield Spread Premiums

(Ten Sub-samples from Defendants' Sample)

Decile No. 6: Loan Amounts = $ 118,400 to $ 132,500 (n=209)

1416.68 - 0.369 x Yield Spread Premium = Direct Cash Payments
(108.950***) (0.052***)

Note: Adjusted Multiple R Squared = 0.189

Decile No. 7: Loan Amounts = $ 132,500 to $ 150,000 (n=209)

1444.91 - 0.365 Yield Spread Premium = Direct Cash Payments
(112.29***) (0.048***)

Note: Adjusted Multiple R Squared = 0.211

Decile No. 8: Loan Amounts = $ 150,000 to $ 175,000 (n=209)

1541.83 - 0.240 x Yield Spread Premium = Direct Cash Payments
(154.50***) (0.062***)

Note: Adjusted Multiple R Squared = 0.062

Decile No. 9: Loan Amounts = $ 175,000 to $ 210,500 (n=209)

1594.07 – 0.380 Yield Spread Premium = Direct Cash Payments
(158.23***) (0.054***)

Note: Adjusted Multiple R Squared = 0.187

Decile No. 10: Loan Amounts = $ 211,000 to $ 642,100 (n=212)

2201.75 - 0.441 x Yield Spread Premium = Direct Cash Payments
(217.81***) (0.065***)

Note: Adjusted Multiple R Squared = 0.175

Standard errors shown in parentheses.
** designates significance at the 95 percent level.
*** designates significance at the 99 percent level.

The results of this decile analysis is interesting in numerous respects. To begin with, the levels of estimated offsets are all less than 45 cents on the dollar, and average 24.6 cents on the dollar – very close to the estimate of Simple Regression A (26.3 cents). Thus, even when the defendants' sample is divided into subsamples of comparable loan amounts, there is no evidence of full financial offset. Indeed, these regression results suggest that defendants' theory of full financial offset can be rejected at the 99 percent confidence level for all deciles.[135]

Our decile analysis shows several noteworthy variations across deciles. The estimated amounts of offsets are consistently lower for smaller loans and higher for larger loans. For example, the estimated offset for the smallest loans, which are in the first decile, is essentially zero and the average for the first five deciles is only 15.9 cents, whereas the estimated offset for the largest loans is 44.1 cents and the average for second five deciles is 33.3 cents.[136] In addition, the incidence of yield spread premiums is somewhat lower in the higher deciles, whereas the incidence of credits from mortgage brokers is somewhat higher.[137] While further analysis would be necessary to understand fully this data, the relationships uncovered to date are consistent with the possibility that wealthier and more sophisticated borrowers – who are likely to be obtaining larger loans – are more capable than less sophisticated borrowers – who tend to obtain smaller loans – in obtaining offsets from brokers for other direct costs. However, even the borrowers in the largest deciles get less than fifty cents of offsets, on average, for every dollar of yield spread premiums.

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[135] Using the coefficients and standard errors reported in the text, one can reject the theory of full financial offset which implies a coefficient of negative one for the yield spread premium variable.

[136] This change in off-sets across deciles is a manifestation of the interaction discussed above in note 93.

[137] For example, the incidence of yield spread premiums was 90.1 percent and 91.4 percent in the smallest two deciles and 86.6 percent and 81.1 percent in the largest two. Similarly, the incidence of credits was 9.1 percent and 9.1 percent in the smallest two deciles and 15.8 percent and 16.0 percent in the largest two.

3. What evidence is there to suggest that yield spread premiums are associated with additional services being provided to borrowers in connection with loans that defendant lending institutions originated during the class period?

In theory, one could accept the weight of the evidence presented in the previous sections of this Part – that is, accept the proposition that mortgage broker compensation and borrower costs are higher for groups of loans with high incidence of yield spread premiums and the further evidence that the payment of yield spread premiums offset direct cash costs by less than 25 cents on the dollar – and still defend the practice on the grounds that loans with yield spread premiums are somehow different and more expensive to originate than other loans and that variations in yield spread premiums are being used to compensate mortgage brokers for different levels of effort required for various transactions. That is, one could argue that the higher costs associated with these loans merely reflect more expensive services incurred in originating these loans.[138] My goal in this final section of this Part is to consider the plausibility of this theoretical objection. [139]

a) Qualitative Reasons To Doubt the Claim

The entire manner in which yield spread premiums are determined raises serious doubts as to whether these payments are directly tied to additional services. As outlined earlier in this report,[140] the formulas for calculating yield spread premiums all relate to the pricing of loans on

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[138] In posing this possible objection, I do not mean to imply that this claim represents a legal defense for an alleged violation of Section 8 of RESPA.

[139] As the quantitative analysis I had intended to present in this final section of my report was to be based in part on information that defendants have not yet supplied, my analysis here will necessarily be abbreviated and I reserve the option to supplement my analysis when I receive additional information from defendants or am able to replicate that information from other sources.

[140] See *supra* Box A on page 38.

the secondary mortgage market and the value of ancillary benefits to defendant lending institutions. None of these features speaks to additional services being provided to borrowers. In theory, I suppose, one could imagine mortgage brokers first calculating the additional amount of services required for a particular loan and then reverse-engineering the right type of loan terms to recommend in order to generate the yield spread premium necessary to cover the costs associated with those additional services. But this supposition is implausible on multiple dimensions. To begin with, in none of the lengthy depositions and other discovery conducted in this case have defendants' witnesses suggested that this sort of calculation is undertaken.[141] Indeed, their testimony has indicated an absence of the sort of records and bookkeeping that such calculations would require.[142] Moreover, HUD-1 instructions require all costs incurred in connection with loan originations to be reported on HUD-1 statements, and if special services were being provided in connection with these loans, one would expect them to be reported on the HUD-1 statements. On the records we reviewed, there is no evidence of such additional costs.

b) Reasons to Doubt the Claim Derived from Sample Data

A further reason to question the claim that yield spread premiums are being used to compensate mortgage brokers for the extra costs associated with different borrowers is the high degree of variation in the amounts of mortgage broker compensation revealed in our samples. As explained below, within samples with a high incidence of yield spread premiums, there is a very large variation in mortgage broker compensation. This variation does not exist in samples unaffected by yield spread premiums. It is highly unlikely that unobserved services justify a wide variation in mortgage broker compensation within loans with yield spread premiums, when

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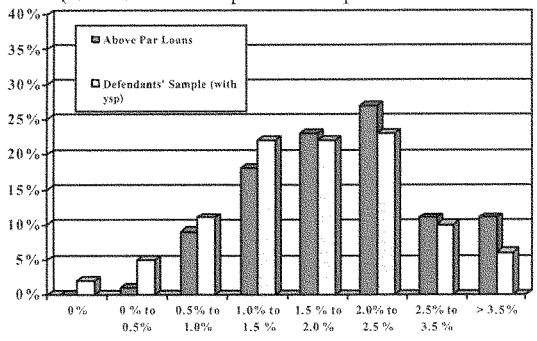
[141] For evidence from representatives of defendant lending institutions that broker services are not factored into the calculation of yield spread premiums, see Deposition of Phillip Miller 29 (May 24, 2001); Deposition of David Pritchard at 44, 47 (Mar. 11, 1998) .

[142] For evidence that mortgage brokers do not maintain records of itemized services associated with particular yield spread premiums, see Deposition of Ronald Altman 22 (July 8, 1998).

no similar variation exists in other samples.

The evidence of variation in mortgage broker compensation is contained in Figures 20 and 21. The first, in Figure 20, shows the distribution of total mortgage broker compensation as a percentage of loan amount for the True Par Sample. Notice the large percentage of loans in which total mortgage broker compensation is in the range of 1.0 to 1.5 percent of loan value. This indicates that, with True Par Loans, where consumers can easily observe the actual amount of mortgage broker compensation, total compensation is in the range of 0.5 percent to 1.5 percent of loan value for a substantial majority of loans. There is, in effect, a market price of the services that mortgage brokers provide.

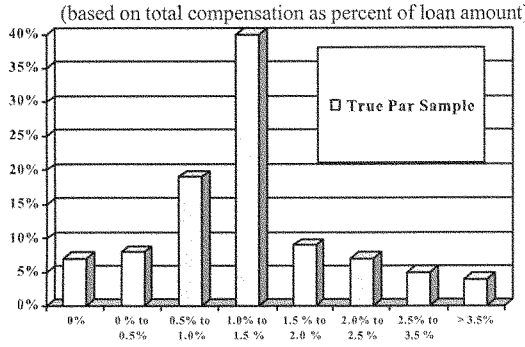
Figure 21
Distribution of Total Mortgage Broker Compensation
On Above Par Loans and Defendants' Sample (with ysp)
(based on total compensation as percent of loan amount)



Now compare Figure 20 with Figure 21, which reports on the same scale a distribution of mortgage broker compensation for the two samples with high incidence of yield spread premiums. Notice how much flatter this distribution is, indicating that many borrowers on loans in these samples are paying total mortgage broker compensation that is much higher than the market price suggested in Figure 20. Indeed, most borrowers are paying more than 1.5 percent

of loan amounts. This is exactly the distribution that one would expect to see if mortgage brokers were using yield spread premiums to extract extra profits from vulnerable customers.

Figure 20
Distribution of Total Mortgage Broker Compensation
On True Par Sample
(based on total compensation as percent of loan amount)



Moreover, yield spread premiums would be an extremely effective mechanism for effecting this sort of price discrimination because consumers have so little understanding of the mechanisms through which yield spread premiums are imposed.

The combined impact of the above evidence renders highly implausible the proposition that yield spread premiums are used to finance additional costs associated with groups of loans with high incidence of yield spread premiums. Rather the evidence strongly, indeed overwhelmingly, supports the view that these payments are being used for other purposes – to wit, to extract additional, excessive mortgage broker compensation from consumers. Indeed, if one thinks back to the history of abuses in the real estate settlement industry that gave rise to the enactment of RESPA in the first place, the similarities are striking. As with the kickbacks and unearned referral fees of the early 1970's, yield spread premiums appear to be imposing substantial costs on borrowers. As with the abusive practices documented in RESPA's legislative history, the costs associated with yield spread premiums are not being offset in reductions of other fees. Rather the costs of these charges are being used to inflate the compensation of mortgage brokers and increase the costs of borrowing. For precisely the same

policy reasons that motivated Congress to enact section 8 of RESPA in the first place, that provision should properly be interpreted to prohibit the payment of yield spread premiums at issue in this litigation.

c. Employing Multiple Regression Analysis to Explore the Relationship

In this final section, I return to multiple regression analysis to explore the extent to which a variety of variables might explain the levels of yield spread premiums.[143] The form of the regressions in this portion of my report is slightly different from those in the preceding section because the variable that I am trying to predict is the level of total compensation paid to mortgage brokers (not direct cash payments or yield spread premiums). My purpose in this analysis is to explore the extent to which the existence of yield spread premiums influences the amount of total mortgage broker compensation after controlling for a variety of other factors.

I begin with a relatively straight-forward regression in which total mortgage broker compensation is the dependent variable (the variable we are attempting to predict) and there are two "dummy" explanatory variables: one for yield spread premiums and the second for discount fees paid to mortgage brokers.[144] What this equation represents is a statistical estimate of the average impact of yield spread premiums and discount fees paid to mortgage brokers on total

[143] The multiple regressions reported in this section represent, in my view, a preliminary attempt to understand the relationship between yield spread premiums, overall mortgage broker compensation, and a variety of other factors. The analysis here is primarily intended to rebut claims made by defendants. It is not intended to provide a full explanation of mortgage broker compensation. Considerable additional analysis, including consideration of issues such as interaction among variables, exploration of alternative functional forms, and other extensions of analysis, will be necessary to complete this larger project. In the future, I plan to explore these topics in a related academic paper on the subject.

[144] A dummy variable is variable that has a value of one of a factor is present (such as the payment of yield spread premiums) and zero if it is not present. In regressions of this sort, the coefficient of the dummy variable represents the average effect of the factor in question.

mortgage broker compensation.[145] The equation indicates that, in the absence of yield spread premiums or discount fees paid to mortgage brokers, the average level of total mortgage broker compensation is $ 1,416. When a yield spread premium is present, average total mortgage broker compensation increases by $1,043, and when mortgage brokers receive discount fees, total mortgage broker compensation increases by another $803. All of these estimates are significant at above the 99 percent level.

Regression G: Impact of Yield Spread Premiums on Total Mortgage Compensation

(Dollar Amounts: Defendants' Sample; n = 2092)

1416 + 1043 x Dummy for YSP + 830 x Dummy for MB Discount Fees = Total MB Compensation
(102***) (105***) (102***)

Notes: Adjusted Multiple R Squared = 0.058
Standard errors shown in parentheses.
*** designates significance at the 99 percent level.

Our next task was to consider whether these substantial effects remained after controlling for a variety of other factors. The factors we examined were divided into four groups. First were factors associated with the type of loans involved.[146] Second were factors related to the credit-worthiness of the borrower and thus the effort required of mortgage brokers in originating

[145] We include discount fees paid to mortgage brokers because, as explained above, see supra pp. 60-62, these fees are functionally the same as yield spread premiums and can only be imposed when a mortgage broker proposes an above par interest rate.

[146] These loan characteristics were the size of loans, whether the loan was a 30-year fixed rate mortgage, whether the loan was a FHA loan, whether the loan was a conventional uninsured loan, and whether the loan was for refinancing (as opposed to initial home purchase). These variables were taken from a combination of HUD-1 statements and the defendants' electronic database. We included these variables to control for the extent to which the characteristics of particular loans might explain the variable in total mortgage broker compensation.

the loan,[147] Third were factors related to other demographic characteristics of the borrower.[148] And fourth were geographic variables.[149] A full list of the variables we examined is set forth in the margins along with brief explanations why we thought these variables might influence total mortgage broker compensation.

After running regressions with a number of different combinations of these variables, we arrived at the formulation in Figures 22 and 23 as the most appropriate formulation.[150] The results are striking in numerous respects.

- First, even after controlling for all the other variables reported in Expanded Regression G, the impact of yield spread premiums ($929) and discount fees ($706) is largely unchanged from our initial analysis. Thus, even with this more elaborate formulation, regression analysis confirms that loans with yield spread premiums are associated with substantially higher mortgage broker compensation than other loans and further rebuts defendants' theory of full financial offset.

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[147] These factors included a credit score for each loan and also the loan to value ratio of each loan. Both of these variables were taken from defendants' electronic records. We included these variables to explore the extent to which variations in total mortgage broker compensation might be related to the creditworthiness of individual borrowers and thus the effort that mortgage brokers might need to expend in originating different loans.

[148] These variables included the appraised value of borrowers' homes as a proxy for wealth and then several dummy variables for six racial groups identified for borrowers in the defendants' electronic database. Appraised home value was derived from loan amounts and loan to value ratios. We included these variables to explore the extent to which variations in total mortgage broker compensation might be associated with either the wealth or racial identity of borrowers.

[149] We limited our analysis of geographic variables to the five large states: California, Florida, Illinois, New York, and Texas. We included these geographic variables to consider whether differences in local mortgage markets might explain variation in mortgage broker compensation.

[150] This formulation drops several variables, such as appraised value of homes and certain racial dummy variables, that did not have statistically significant explanatory power. We left a number of variables that were also not statistically significant because in certain cases the absence of a significant impact was a noteworthy finding.

- Second, a number of loan characteristics do have a statistically significant impact on the amount of total mortgage broker compensation. For example, total mortgage broker compensation is, on average, $187 higher for 30 year fixed loans and $303 higher for FHA loans. Furthermore, total mortgage broker compensation on conventional uninsured loans is on average $143 lower. On the other hand, the fact that a loan is refinancing as opposed to an original home purchase loan seems to have no statistically significant impact on total mortgage broker compensation.

- Third, the variables associated with creditworthiness and, by hypothesis, mortgage broker

Figure 22
Expanded Regression G
(Dependent Variable = Total MB Compensation in Dollars)
(Sample = 1677 Loans in Defendants' Sample with Available Data)

	Coefficient	*Standard Error*
Constant	208	358
Yield Spread Premium Variables:		
Yield Spread Premium Dummy	929	100***
MB Discount Fee Dummy	706	98***
Loan Characteristic Variables:		
Loan Size	0.011	0.001***
30-Year Fixed Dummy	187	75**
Conventional Uninsured Dummy	-143	85
Government Loan Dummy	303	135**
Refinancing Dummy	2.86	75
Credit Quality/Mortgage Broker Effort Variables:		
Credit Score	-1.192	0.34***
Loan to Value Ratio	8.135	2.417***
Racial Variables:		
Racial Group Three	474	176***
Racial Group Four	580	181***
Geographic Variables:		
California Dummy	-23	135
Florida Dummy	-66	109
Illinois Dummy	-133	120
New York Dummy	408	144***
Texas Dummy	-200	153

Adjusted Multiple R Squared: 0.267
** Indicates Statistical Significance at the 95 percent Level.
*** Indicates Statistical Significance at the 99 percent Level.

effort also have the expected impacts. The better credit scores for borrowers are associated with lower total compensation for mortgage brokers, whereas high loan-to-value ratios tend to be associated with higher total mortgage broker compensation. While both of these effects are statistically significant, their overall impact on total

mortgage broker compensation would rarely be more than one or two hundred dollars, as the variation in credit scores and loan to value ratios is relatively limited.

- Fourth, for the most part, geographic variation seems to have very limited impact on total mortgage broker compensation. In addition, the geographic dummies we included were not statistically significant. Thus, the results of Expanded Regression G are not consistent with the hypothesis that variations in total mortgage broker compensation are explained by local market conditions.

- Finally, Expanded Regression G suggests that mortgage brokers may be varying their compensation based on the racial characteristics of borrowers. Although we could not determine which racial groups are involved, our statistical analyses indicated that Racial Group Three (African American), which constituted 3.4 percent of the Defendants' Sample, paid on average $474 in total mortgage broker compensation, whereas Racial Group Four (Hispanic), which constituted 3.5 percent of Defendants' Sample, paid $580 more in total mortgage broker compensation. Both of these effects are statistically significant at the 99 percent level, and are consistent with my hypothesis that mortgage brokers could be using their complex compensation mechanisms to exploit unsophisticated borrowers.

Figure 23 offers an alternative presentation of Expanded Regression G with the dependent variable, Total mortgage broker compensation, expressed as a percentage of loan amount rather than as dollars. All of the important effects – including the higher costs associated with both yield spread premiums and Racial Groups Three and Four are the same as reported above for Figure 22. The only difference in statistical significance between the two formulations is that the dummy variable for New York is not significant in this second formulation, whereas it

was for the first.

Figure 23

Expanded Regression G

(Dependent Variable = Total MB Compensation as % of Loan Amount)

(Sample = 1677 Loans in Defendants' Sample with Available Data)

	Coefficient	*Standard Error*
Constant	2.751	0.0306***
Yield Spread Premium Variables:		
Yield Spread Premium Dummy	0.89	0.085***
MB Discount Fee Dummy	0.918	0.084***
Loan Characteristic Variables:		
Loan Size	-0.000	0.000***
30-Year Fixed Dummy	0.157	0.064**
Conventional Uninsured Dummy	-0.115	0.072
Government Loan Dummy	0.682	0.115***
Refinancing Dummy	0.025	0.064
Credit Quality/Mortgage Broker Effort Variables:		
Credit Score	-0.002	0.000***
Loan to Value Ratio	0.001	0.002
Racial Variables:		
Racial Group Three	0.433	0.15***
Racial Group Four	0.566	0.154***
Geographic Variables:		
California Dummy	0.119	0.115
Florida Dummy	0.03	0.093
Illinois Dummy	-0.161	0.102
New York Dummy	0.147	0.123
Texas Dummy	-0.112	0.131

Adjusted Multiple R Squared: 0.305

** Indicates Statistical Significance at the 95 percent Level.

*** Indicates Statistical Significance at the 99 percent Level.

C. Conclusion

In this Part, I have presented a large volume of information about the manner in which defendant lending institutions and their mortgage brokers make use of yield spread premiums. My principal findings, however, can be summarized fairly briefly.

First, yield spread premiums are a major source of compensation for mortgage brokers. These payments appear in between 85 and 90 percent of all transactions. The average amount of yield spread premiums is high– in the range of $1,850 per transaction. The payments, moreover, constitute by far the largest source of compensation for mortgage brokers in loans financed by defendant lending institutions.

Second, measured either in terms of total mortgage broker compensation or total borrower costs at settlement, loans associated with yield spread premiums are substantially more expensive than other comparable loans. Though the amount of the difference varies somewhat depending on the basis of comparison, the difference is probably best estimated to average around $1000 to $1100 per transaction.

Third, our regression analyses convincingly refutes defendants' theory of full financial offset. In particular, we find no evidence to suggest that the payment of yield spread premiums gains borrowers a dollar for dollar offset in direct cash payments at settlement. Rather, our analyses suggest that the amount of offset is rather small, probably on the order of 20 to 25 cents per dollar. In other words, by our estimates, 75 to 80 cents of every dollar paid in yield spread premiums goes to enrich mortgage brokers. This effect persists even after using statistical means to control for a wide variety of other factors, including loan characteristics, borrower creditworthiness, loan to value ratios, geographic regions, and other demographic factors.

Fifth, one of the most disturbing aspects of yield spread premiums is that the practice appears to allow mortgage brokers to discriminate among borrowers in the amount of

compensation the industry charges. My hypothesis is that the industry uses this power to extract additional payments from unsophisticated borrowers. Our analysis, however, also suggests that industry practices allow for certain racial groups to be charged on the order of $500 to $600 more per transaction in mortgage broker compensation.

The analyses presented in this Part may also have important implications for the legal status of yield spread premiums for this litigation. To begin with, my statistical analyses uniformly confirm that loans with yield spread premiums are different from other loans that defendant lending institutions finance. Loans with yield spread premiums cost borrowers more than other loans. The differences are substantial, in excess of $1000 per transaction, and invariably statistically significant at the 99 percent level or higher. In lay terms, what this evidence means is that loans with yield spread premiums have something in common that distinguish them in an important way from other loans.

My analysis also has relevance for the location of yield spread premiums in this case under Section 8 of the RESPA. To the extent that the court must determine whether yield spread premiums are illegal referral fees or bona fide compensation, my analysis strongly suggests that unearned referral fees is the better choice. Overwhelmingly, the evidence presented in this Part indicates that the largest portion of yield spread premiums goes to increasing mortgage broker compensation and only a fraction – say 20 to 25 cents on the dollar – goes to cover the costs of legitimate goods and services. If payment must be characterized as either referral fees or compensation, my analysis suggests that they should be characterized as referral fees.

Finally, to the extent that the court is called upon to opine as to the reasonableness of the yield spread premiums paid in this case,[151] my analysis supports a finding of unreasonableness.

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[151] As indicated in the previous paragraph, my own view is that the yield spread premiums in this case are best characterized as referral fees. Under this view, there would be no need for the court to reach the issue of reasonableness.

While this is admittedly a subjective determination, my view is that fees which generate borrowers only 20 to 25 cents of value for every dollar of payment are not reasonable.[152] Moreover, as my analysis demonstrates that the costs for loans with yield spread premiums can be distinguished from the costs of other loans with a statistical significance of 99 percent or higher, I believe it would be appropriate for the court to make an assessment of reasonableness of these fees on a class-wide basis.

[152] In this regard, see my discussion of the implicit interest rate on yield spread premium "financing" discussed infra 127-130.

Part IV. Rebuttal of Reports from Defendants' Experts

In this final part of my report, I respond to certain aspects of reports that defendants' experts Professor George Benson and Ms. Susan Woodward have filed in this litigation. Although my analysis covers a much broader range of issues, Professor Benson's and Ms. Woodward's reports offer statistical analyses similar to certain aspects of my report. I begin this Part with an overview of the various studies, identifying first the aspects of my analysis that Professor Benson and Ms. Woodward have not contested and then focusing on the principal issue upon which we differ: our estimate of the amount of offsets in other direct costs that borrowers obtain for yield spread premiums. While all three of us agree that the offset is not complete – that is, there is no evidence of full financial offset – we differ in our estimates of the actual degree of offset. I next provide a more detailed critique of the work of defendants' experts. While my criticisms of Professor Benson's work are largely technical, Ms. Woodward's analysis contains serious errors of data collection and statistical analysis. After summarizing these shortcomings, I rerun the principal regressions of Professor Benson and Ms. Woodward using in some instances our database, which is substantially more complete and better validated than the database upon which defendants' experts relied. Finally, I take issue with several other aspects of Ms. Woodward's analysis. First, I consider two new justifications for yield spread premiums that Ms. Woodward advances in her report and explain why these arguments are implausible in theory and entirely inconsistent with the evidence of defendant lending institutions actual practices. In addition, I identify several major mistakes in Ms. Woodward's Equation 8, which is intended to demonstrate that the interest rates on loans in the Retail Sample are substantially higher than the interest rates on other comparable loans.

A. Overview of Studies

1. Issues Not Contested

Let me begin by reviewing the aspects of my analysis which defendants' experts do not contest.[153]

- First, neither Professor Benson nor Ms. Woodward contest my findings that the incidence of yield spread premiums among loans originated by defendant lending institutions is very high (present in 85 to 90 percent of the loans that defendant lending institutions originate through mortgage brokers); that the average amount of yield spread premiums is substantial (in excess of $1800 per loan); and that these fees constitute the single most important source of compensation for mortgage brokers originating mortgages on behalf of defendant lending institutions.[154]

- Second, neither Professor Benson nor Ms. Woodward contest my analysis of the Plaintiffs' Sample in which I find robust differences between average levels of mortgage broker compensation and total borrower costs for loans with yield spread premiums as opposed to other loans that are not associated with yield spread premiums.[155] That is, defendants' experts do not offer alternative comparisons of average compensation across groups of loans, either using total dollar amounts of compensation or compensation as a percentage of loan amounts. Defendants' experts rely exclusively on regression analysis to address this issue.

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[153] I limited myself to aspects of my analysis that were fully presented in my July 9, 2001, report, which both Professor Benson and Ms. Woodward had reviewed before they made their most recent versions of their reports.

[154] See supra pp. 56-64.

[155] See supra pp. 70-83.

- Third, defendants' experts do not challenge my findings that loans with yield spread premiums have an unusual dispersion of total mortgage broker compensation, and that other loans in our samples do not have a similar dispersion in total mortgage broker compensation, but rather exhibit a much narrower (and more typical) range of payments, mostly in the neighborhood of 1.0 percent to 1.5 percent of loan amounts.[156]

- Finally, neither of defendants' experts offer evidence that the borrowers on loans with yield spread premiums have any observable characteristics that would justify the substantially higher levels of compensation that mortgage brokers obtain on these transactions. Nor did either expert address my opinion that the manner in which yield spread premiums are imposed makes it highly implausible that these payments were being used to compensate mortgage brokers for additional costs associated with particular loans.[157]

2. The Focus of Our Disagreement: The Extent of Financial Offset

The principal point on which defendants' experts and I disagree is the extent to which mortgage brokers lower other forms of compensation when yield spread premiums are present. Even here, however, the extent of our disagreement is not that large. Neither of defendants' experts offers any evidence of full financial offset (that is, dollar for dollar offset). What they present is evidence of partial offset, much like the evidence I present in Part III. To be sure, the magnitudes of their estimates are somewhat greater than my own. Whereas my regression analyses suggests an offset for yield spread premiums in the range of 20 to 25 cents on the dollar, the offset estimates of defendants' experts range from 22 cents to 75 cents on the dollar and average about 55 cents. (See Figure 24 for a summary of the offset estimates of defendants'

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156 See supra pp. 65-67, 101-04.

157 See supra pp. 100-01.

experts.) But the critical point is that none of the statistical evidence offered by the experts in this litigation suggests anything close to full financial offset.

Quite possibly this is enough agreement to decide the case. Even if one were to credit the higher levels of offset reported in the work of defendants' experts – and, as I explain shortly, a

Figure 24
Estimates of Offsets from Defendants Experts

Source	*Estimates*
Defendants' Experts:	
Equation 1 of Woodward (July 9th), p. 27	$0.68
Equations 3-4 of Woodward (July 27th), p. 5 & 6	$0.18
Equation 5 of Woodward (July 27th), p.7	$0.32
Equations 6-7,9 of Woodward (July 27th), p.9-10	$0.76
Equations 9 of Woodward (July 27th), p.16	$0.71
Models 1a & 1b of Benson (July 9th) App. p.1	$0.32
Models 2a & 2b of Benson (July 9th) App. p. 4	$0.75
Models 3a & 3b of Benson (July 9th) App. p.7	$0.62
Models 4a & 4b of Benson (July 9th) App. p. 10	$0.85
Models 1a - 1c of Benson (Aug. 8th) App. pp.1-2	$0.25
Models 2a - 2c of Benson (Aug. 8th) App. pp.3-4	$0.66
Average of Estimates	**$0.55**

number of these estimates are clearly flawed – there is no reason to believe that Congress did not intend to prohibit activities generating excessive charges of this sort. As explained above in Part I, the statutory language of section 8 has no exception for kickbacks that are offset to a certain extent. Indeed, if one looks back to the legislative history of RESPA, it is clear that Congress was principally concerned with payments in which only 10 to 30 percent were passed on as referral fees and therefore at least 70 to 90 percent were attributable to real services. Thus, the payments that motivated the enactment of section 8 were at least 70 to 90 percent offset with real

services. Yet Congress still saw fit to proscribe them. Given this legislative guidance, the evidence of defendants' own experts suggests to me that yield spread premiums are illegal referral fees under section 8 of RESPA. At a minimum, I believe, payments that generate only 55 cents of value on the dollar, are unreasonable forms of compensations and therefore actionable under Section 8.

B. Principal Shortcomings in the Statistical Analysis of Defendants' Experts

In this section, I will briefly summarize the principal shortcomings of the estimates that defendants' experts made regarding offsets of yield spread premiums. Where possible, I have attempted to correct these shortcomings and recalculated the estimates, in some instances making use of our more complete database. Figure 27, which appears at the end of this section, summarizes these critiques and suggests that, correctly formulated, the analyses of defendants' experts suggests an offset of approximately 27 cents on the dollar.

1. Estimates Based on Small and Nonrepresentative Group of Loans

Several of the regressions of defendants' experts must be rejected because they are based solely on the Heartland loans or a subgroup thereof. The list of affected regressions would include Ms. Woodwards Equation 1 (July 9th) and Equation 9 (July 27th), as well as Professor Benson's Models 1 through 4 (July 9th). It is a fundamental premise of inferential statistics that analysis should be based on representative samples.[158] While the loans in the Defendants' Sample satisfy this requirement and the loans in the Plaintiffs' Sample do as well for certain purposes, the Heartland loans do not. By definition ,all of these loans were originated through a

[158] See Benson, Statistics, supra note 93, at 16 ("[I]f we wish to apply inferential statistics, we must obtain a *representative sample*.") (emphasis in original). See Deposition of Susan Woodward 202 (July 31, 2001) (acknowledging that Heartland loans are not a representative sample of all loans originated by defendant lending institutions). See also Deposition of George Benson 270-73 (Sept. 28, 2001).

single mortgage broker and thus cannot be assumed to be representative of the entire class.[159] For this reason, none of the regressions based on the Heartland Loans can be reliable estimates of the overall practices of defendant lending institutions.

2. Major Errors in Ms. Woodward's Analyses

A series of separate and even more fundamental errors mar much of the analysis of Ms. Woodward. Though these errors occur in a number of places, they are most evident in Equations 6 through 9 of her August 8th Report. In these regressions, she attempts to explore the influence of yield spread premiums on NETRECEIPTS, which is her measure of total mortgage broker compensation. There are two basic problems with her analysis here.

First, she commits an elementary error of statistical design in that she uses a dependent variable (NETRECEIPTS) that includes one of her explanatory variables (yield spread premiums). In my view, this is not an appropriate functional form, and it is something that neither Professor Benson[160] nor I do in comparable equations. Apparently, aware that she is presenting an unorthodox formulation, Ms. Woodward explains why her structure conforms to her own understanding of the problem.[161] But then, she goes on to make the clearly inaccurate claim that her formulation is "[s]tatistically . . . equivalent" to standard formulations. This is just wrong. As any student of regression analysis should immediately recognize, Ms. Woodward's formulation inflates the R squared of her equation. This problem renders highly misleading Ms. Woodward's assertion that her "regressions explain about 70 percent of the

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159 Our examination of the Heartland loans in Part III confirms that they differ in certain important respects from the loans in the Plaintiffs' Sample and Defendants' Sample.

160 See Deposition of Professor Benson at 298 (Sept. 28, 2001).

161 See Woodward Report of August 8, 2001, at 9.

variation in loan-related settlement costs."[162] Had Ms. Woodward constructed her regressions in the appropriate manner, her R Squared would have been in the same low range as those of mine and Professor Benson's.[163]

The second major flaw in Ms. Woodward's use of NETRECEIPTS as a dependent variable stems from fundamental problems in the construction of this variable. In reviewing the database from which Ms. Woodward derived the NETRECEIPTS, we discovered that the variable is not constructed in the manner she intended. As explained in her deposition, what Ms. Woodward intended to do was to create a dependent variable that was the sum of all revenue received by the mortgage broker in each transaction. Thus, the dependent variable would include yield spread premiums plus other direct cash payments to mortgage brokers. Then, as described above, she also proposed to use yield spread premium as one of the explanatory variables in her equation. Apparently, however, Ms. Woodward or her associates got confused when they attempted to carry out this plan. The yield spread premium variables they used in creating NETRECEIPTS (called BRYSP and SFYSP in their database) were different than the one they used as the explanatory variable (called YSP in their database) in their equation.[164] In my view, this is clearly not what Ms. Woodward intended, and indeed there is no theoretical reason why one definition of yield spread premium should be used for the first purpose and another for the second. Moreover, the second yield spread premium variable was poorly constructed, apparently based on an incomplete review of the HUD-1 forms, whereas the first variable came from the

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[162] See Woodward Report of July 9, 2001, at 23.

[163] I assume that Ms. Woodward understands this effect, although I must admit that certain portions of her deposition suggest that she may be confused on this elementary aspect of regression analysis. See Deposition of Susan Woodward 305 (July 31, 2001) (Question: "Do you think . . . that your R-square is higher becuase you put the yield spread premium on both sides of the equation?" Answer [of Woodward]: "No.").

[164] See generally Deposition of Ms. Susan Woodward at 150 et seq (July 31, 2001).

defendants' electronic database.[165] To run the regression she intended, Ms. Woodward clearly should have used, for both purposes, the first yield spread premium variable, that is the one from defendants' electronic database. Using a correct and consistent yield-spread-premium variable substantially changes the regression results.

To give a sense of the magnitude of this error, consider Woodward's Equation 6. As summarized in the first two columns of Figure 24, the critical aspect of this equation is the 0.26 coefficient of the yield spread premium variable. According to Ms. Woodward, this coefficient suggests that for every dollar of yield spread premiums, borrowers enjoyed a 74 cent offset in other

[165] See supra note 76 and accompanying text. For example, on loan 6011250601, defendants' electronic records indicate the presence of a yield spread premium of $9,350, but the second YSP variable used in Ms. Woodward's regression showed no yield spread premium. On loan 601260998, defendants' electronic records showed a yield spread premium of $8032, but Woodward's YSP variable again showed no such payment. Similar discrepancies exist for many other loans in the sample.

Figure 25
Replication of Woodward Equation 6

(Dependent Variable = NETRECEITPS)

	In Original Report		Replicated with Erroenous Data		Replicated with Consistent YSP	
Explanatory Variables:	*Coefficient*	*Standard Error*	*Coefficient*	*Standard Error*	*Coefficient*	*Standard Error*
Constant	-206	524	-206	524	-288	424
Loansize	-0.0043	0***	-0.004	0.001***	0.004	0***
YSP	0.26	0.03***	0.0262	0.025***	0.687	.020***
[13 variables not reported	---	---	---	---	---	---
	R Squared = 0.114		R Squared = 0.114		R Squared = 0.411	

*** Denotes statistical significance at the 99 percent level.

costs (1.00 minus 0.26). (This is one of Ms. Woodward's highest offset estimates.) But, as Figure 24 indicates, the only way to generate this result is to rely on the erroneous data transformation process described above.[166] If one use the correct data – that is, if one does what Ms. Woodward claims she initially intended to do[167] – the coefficient of the yield spread premium variable increases to 0.687 percent and the implicit offset drops to 31 cents (1.00 minus 0.69).

A similar data construction problem affects Ms. Woodward's Equation 5. If rerun with

[166] The next two columns of Figure 24 report our regression results using the corrupted data. The substantial similarity of the critical coefficient and the identical R Square convince me that we have correctly replicated what Ms. Woodward actually did in her Equation 6.

[167] See Deposition of Ms. Susan Woodward at 150 et seq (July 31, 2001).

the correct yield spread premium variable, her Equation 5 regression suggests an offset of 27 cents per dollar of yield spread premiums as opposed to the 32 cents reported in Woodward's flawed formulation.

Given space and time constraints, I will only briefly summarize other flaws in Ms. Woodward's analyses. One major problem with her regression analysis is that she did not keep track of the number of different variables she considered before coming up with the multiple regression equations presented in her report.[168] This is a fundamental error of regression technique and is known as data mining. This practice severely compromises the value of her work as one has no idea how many explanatory variables she examined before finding the ones included in her equation. Nor does she offer any theoretical explanation why certain of her variables – such as market points or market rates – should have an impact on mortgage broker compensation. Indeed, as her colleague Professor Benson notes, Ms. Woodward's goal in conducting her regression analysis was "to come up with . . . a high R square that explained as much variation as she could possibly explain" and "to get a model that had, you know, a real high coefficient for the yield spread premium."[169] These goals, in my view, are not appropriate objectives in constructing regression analyses, and they clearly compromise the integrity of Ms. Woodward's work.

2. Technical Critique of Professor Benson's Offset Estimates

My comments on Professor Benson's analysis are more limited because, for the most part, his work is well-presented and professional. I do, however, have several suggestions as to how Professor Benson's analysis might be improved upon.

First, all of the models in Professor Benson's report of July 9, 2001, were based on an

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[168] See Deposition of Ms. Susan Woodward 288-89 (July 31, 2001).

[169] See Deposition of Professor George Benson 279-81 (Sept. 28, 2001).

analysis of the Heartland loans. As discussed above and as Professor Benson himself acknowledged in his deposition,[170] these loans do not constitute a representative sample and do not form an appropriate basis for drawing inferences about the overall activity of defendant lending institutions. Accordingly, the models presented in Professor Benson's July 9, 2001, report are not valid estimates of the overall practice of defendant lending institutions.

Second, there is the issue of interaction. In his professional writings and in his deposition, Mr. Benson has been quite clear that it is important to check for interaction between key explanatory variables in a multiple regression equation[171] and the appropriate mechanism for testing for interaction.[172] However, when we examined Model 1 from Professor Benson's August 8th Report, we discovered interaction between the yield spread premium and loan size variables.[173] The presence of this interaction complicates the interpretation of the regression results of Professor Benson's Model 1 analysis (and further compromises many of Ms. Woodward's multiple regressions).

Third, in my view there are problems in the functional form of the Model Two regressions included in Professor Benson's August 8th Report. Although we had some difficulty replicating Professor's Benson's results in this model,[174] we were largely able to reproduce his analysis using similar variables from our database. Presented in Figure 26 below are Professor Benson's original results for Model 2b and then our best guess at replicating the analysis. Both

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[170] See Deposition of Professor George Benson 265-66 (Sept. 28, 2001).

[171] See id at 300-301.

[172] See id. at 302.

[173] See supra note 93 and accompanying text (reporting the same interaction in similar multiple regressions).

[174] In his deposition, Professor Benson was unable to explain how his dependent variable was constructed. See id at 151 et seq.

Professor Benson's model and our replication are limited to the Defendants' Sample.

Figure 26
Replication of Benson Model 2b

	In Benson Report		Replicated with Our Database		Replicated with Additional Dummy	
Explanatory Variables:	*Coefficient*	*Standard Error*	*Coefficient*	*Standard Error*	*Coefficient*	*Standard Error*
Constant	1685	89***	1628	93***	1087	95***
Loansize	0.00274	0***	0.001	0.000**	0.001	0.000**
YSP Dummy	-1277	75***	-1033	78***	-693	78***
Discount Fee to MB Dummy	---	---	---	---	1148	76***
	R Squared = 0.143		R Squared = 0.079		R Squared = 0.171	

*** Denotes statistical significance at the 99 percent level.
** Denotes statistical significance at the 95 percent level.

As Figure 26 indicates, we were able to replicate Benson's analysis with a reasonable degree of accuracy. The critical element of this regression is the coefficient of the dummy variable for yield spread premiums. Professor Benson's model suggests that other compensation goes down by $1,277 when a yield spread premium is paid; our replication of his analysis suggests an offset of $1,033. Both formulations imply an offset of more than fifty cents on the dollar because the average size of yield spread premiums in the Defendants' Sample is $1,848. To be more specific, Professor Benson's original analysis suggests an offset of 69 cents on the dollar, whereas our replication suggests an offset of 56 cents.

The problem with both formulations, however, is that they do not control for the fact that yield spread premiums influence mortgage broker compensation in indirect ways. As mentioned above, discount fees paid to mortgage brokers are functionally equivalent to yield spread premiums and they inflate mortgage broker compensation in a substantial number of cases.[175] In an effort to control for this effect, I reran Professor Benson's Model 2b with the addition of a dummy variable for transactions in which mortgage brokers receive discount fees as part of their compensation. As indicated in Figure 26, this new dummy variable had a substantial impact on the equation. Most notably, the coefficient for yield spread premiums dropped from negative 1033 to negative 693. This new estimate implies an offset of only 38 cents for every dollar of yield spread premium, which is more consistent with our other estimates of yield spread premium offsets and, in my view, a more accurate formulation of the impact of yield spread premiums.

[175] See supra pp 60-62.

3. Summary

In an effort to summarize the foregoing analysis, I have presented in Figure 27 a review of the original estimates of defendants' experts and my reformulation of those estimates. As indicated, once the refinements outlined above are taken into account, the average level of offsets suggested by the analytical techniques of defendants' experts declines to an average of 27 cents -- still a bit higher than my own average estimate (22 cents), but not far off. In my view, this is the level of offset for yield spread premiums implied by the regression analyses of defendants' experts, once corrected for clear errors in design.

Figure 27
Summary of Offset Estimates of Defendants' Experts
(original and corrected)

Source	*Original Estimates*	*Summary of Technical Problems*	*Corrected Estimates*
Defendants' Experts:			
Equation 1 of Woodward (July 9th), p. 27	$0.68	Not a Representive Sample	---
Equations 3-4 of Woodward (July 27th), p. 5 & 6	$0.18	Interactivity Not Reported	$0.18
Equation 5 of Woodward (July 27th), p.7	$0.32	Interactivity & Data Entry Error	$0.26
Equations 6-7 of Woodward (July 27th), p.9-10	$0.76	Interactivity & Data Entry Error	$0.31
Equations 9 of Woodward (July 27th), p.16	$0.71	Not a Representive Sample	---
Models 1a & 1b of Benson (July 9th) App. p.1	$0.32	Not a Representive Sample	---
Models 2a & 2b of Benson (July 9th) App. p. 4	$0.75	Not a Representive Sample	---
Models 3a & 3b of Benson (July 9th) App. p.7	$0.62	Not a Representive Sample	---
Models 4a & 4b of Benson (July 9th) App. p. 10	$0.85	Not a Representive Sample	---
Models 1a - 1c of Benson (Aug. 8th) App. pp.1-2	$0.25	Interactivity & Variable Undefined	$0.25
Models 2a - 2c of Benson (Aug. 8th) App. pp.3-4	$0.66	Omited Variable & Variable Undefined	$0.38
Average of Esimates	**$0.55**		**$0.27**

C. Critique of Other Aspects of Ms. Woodward's Report

In this final section, I address three other elements of Ms. Woodward's report: her claim that the payment of yield spread premiums constitutes a reasonable mechanism for financing up-front settlement costs; her assertion that higher settlement costs on loans with yield spread premiums are a plausible artifact of the Internal Revenue Code; and her Equation 8 which purports to demonstrate the loans in the Retail Sample have substantially higher interest rates than other comparable loans. In my view, each of these arguments is patently and demonstrably incorrect.

1. Yield Spread Premiums as a Mechanism for Financing Settlement Costs

In her report, Ms. Woodward makes the claim that yield spread premiums constitute a legitimate mechanism for financing a borrower's settlement costs.[176] And, she implies that failure of mortgage brokers to offer a full financial offset for yield spread premiums is reasonable because the difference represents some sort of interest or finance charge.[177] Whether this characterization is plausible for some other lenders, it is clearly not how defendant lending institutions and their mortgage brokers are using yield spread premiums.[178]

To begin with, as far as I know, none of the industry witnesses in this litigation described

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[176] See, e.g., Woodward Report of July 27, 2001, at 11 ("yield-spread premiums are not referral fees but are financial transactions that brokers are compensated for arranging").

[177] Id.

[178] In its recent policy statement, the Department of Housing and Urban Development has suggested that some lenders and brokers may in fact be using yield spread premiums as legitimate financing transactions, see HUD RESPA Statement of Policy 2001-1, supra note 86, at 8, but also recognized that other "less scrupulous brokers and lenders take advantage of the complexity of settlement transactions and use yield spread premiums as a way to enhance the profitability of mortgage transactions without offering the borrower lower up front fees." Id. at 9. The implicit interest rates reported in the text – as well as the low offset estimates discussed elsewhere – suggest to me at least that defendant lending institutions and their brokers fall in the latter category.

the payment of yield spread premiums in this manner. Borrowers were not told that yield spread premiums are being imposed as a financing mechanism, and the disclosures required for consumer finance – such as the Truth in Lending Act requirements – were never made in these transactions with respect to payment of yield spread premiums. It is difficult to understand how yield spread premiums can properly be characterized as mechanisms of financing when none of the parties to the transaction understood the payments in this way.

Moreover, if one takes Ms. Woodward's assertion seriously and attempts to calculate the financing charge implicit in the yield spread premiums charged in this case, the results are breathtaking. For example, in Figure 28, I calculate the "financing" cost of the yield spread premium in the transaction that I used to illustrate how yield spread premiums are imposed earlier in this report. I accepted Ms. Woodward's characterization that borrowers pay the cost of the yield spread premium in order to finance the purchase of a certain amount of broker services. The cost of the yield spread premium is the amount by which monthly payments on the above par loan actually made in this case exceeded the monthly payments that the borrower would have had to make on a par loan of the same amount at the same time.[179] To calculate the amount of services financed, I relied first on the average estimate of defendants' own experts regarding the amount by which yield spread premiums actually reduce up-front costs: that is 55 percent. As alternative formulations, I also used my own average estimate of yield spread premium offsets (22 percent) as well as the

average of my corrected estimates of defendants' experts (27 percent).

[179] To make this calculation, I used the rate sheet applicable to the loan, and I assumed that the loan would stay outstanding for seven years – the average duration of a residential mortgage in the United States.

In all three formulations, the implicit interest rates on "yield spread premium financing"

Figure 28
Derivation of Interest Rates Implicit in
Ms. Woodward's Financing Theory

An Example of YSP Financing: Loan 604006859

(Loan Amount = $106,850; YSP = $ $2137; Loan Rate = 7.13%; Contemporaneous Par Rate = 6.5%)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7 with Payoff
Payments on Loan As Structured	$8,719	$8,719	$8,719	$8,719	$8,719	$8,719	$105,961
Payments If at Par without YSP	$8,182	$8,182	$8,182	$8,182	$8,182	$8,182	$104,542
Cost of "YSP Financing"	$537	$537	$537	$537	$537	$537	$1,419

Amount of Goods and Services Financed and Implicit Cost of YSP Financing

Offset Estimate	*Value of YSP*	*Implicit Interest Rate*
Average Original Offset Estimate of Defendants' Experts (55 cents):	$1,175	44.8 percent per year
Average Corrected Offset Estimate of Defendants' Experts (27 cents):	$577	93.5 percent per year
My Average Offset Estimate Estimate (22 cents):	$470	114.6 percent per year

are usurious. Using the average estimate of defendants' experts, the implicit interest rate on yield spread premium financing is 44.8 percent per year With what I believe to be the more plausible offset estimates of my own and the defendants' experts, this rate of interest rises to the stratospheric level of 114.6 percent per year and 93.5 percent per annum, respectively. Clearly these are not reasonable interest charges, and – in my view – equally clear financing up-front costs is not the true function of yield spread premiums.

Further evidence that yield spread premiums are not a bona fide source of financing can be seen from a casual inspection of the loan to value ratios of individual borrowers. Within the Defendants' Sample, a substantial majority of borrowers were not at the maximum loan to value ratio for their loans.[180] What this fact demonstrates is that most of these borrowers could have easily raised the amount of their loan had they wanted to finance up-front settlement costs. We know exactly what these borrowers would have paid for this financing: the interest rate charged on par loans at the time, which was typically between seven and eight percent per year. It is inconceivable that so many borrowers with this readily available low-cost source of financing would have willingly chosen to resort instead to the yield spread premium "financing" at the rates our analyses – and the analyses of defendants' experts – imply. Why would anyone borrow money at rates in excess of 44 percent per year, when alterative financing of under eight percent was readily available?

2. Yield Spread Premiums as an Artifact of the Internal Revenue Code

A further, equally contrived claim in Ms.Woodward's report is her assertion that the Internal Revenue Code somehow explains the high levels of mortgage broker compensation on loans with yield spread premiums.[181] As I understand the argument, Ms. Woodward is asserting that, on an after-tax basis, the cost of mortgage broker compensation for loans with yield spread premiums is closer – or perhaps even equal to – the cost of mortgage broker compensation on other loans. Putting aside the fact that Ms. Woodward makes no serious effort to quantify this

[180] In particular, of the 1806 loans in the Defendants' Sample with yield spread premiums, 46 percent had loan to value ratios of less than 80 percent and 79 percent had loan to value ratios of less than 95 percent. Further analysis indicates that the borrowers of 77.4 percent of all loans in the Defendants' Sample with yield spread premiums had sufficient excess capacity to borrow the full amount of their yield spread premiums without exceeding the 95 percent loan to value ratio that defendant lending institutions typically set for their loans.

[181] See Woodward Report of July 27, 2001, at 17-20.

hypothetical tax code effect,[182] I think it is fairly easy to demonstrate that the claim is clearly incorrect.

Let me begin with the theoretical point itself. Ms. Woodward's argument seems to be that it is appropriate for mortgage brokers to raise their fees whenever Congress extends a tax benefit to home mortgage borrowers. In fact, she would have us assume that mortgage brokers should take the full amount of this tax benefit and that borrowers should face the same after-tax costs for home financing as they did before the tax benefit was put into place. This strikes me as a dubious and improper understanding of the tax code.

In addition, Ms. Woodward's understanding of the tax code is itself clearly incomplete. The income tax effect she is describing – which allows deductions for interest charges but not for up-front origination fees – is only applicable to refinancings. On home purchase loan, borrowers can deduct both customary origination fees and interest payments.[183] Most of the borrowers in our samples were obtaining home purchase loans not refinancing loans. For example, in the Defendants' Sample, only thirty-nine percent of the loans were refinancings; the rest were home purchase loans. Accordingly, Ms.Woodward's asserted tax effect is not even theoretically applicable to the majority of loans at issue here.

Finally, if one focuses on the refinancing loans, it is clear that Ms. Woodward's asserted effect is not present. In both her regressions and some of my own, a dummy for refinancing loans was included as an explanatory variable. In all contexts, this variable was not statistically

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[182] For example, she does not consider how many borrowers itemize their deductions or into what tax brackets these borrowers fall.

[183] For an overview of the tax treatment of home purchases, see IRS Publication 530: Tax Information for First-Time Homeowners (2000) (available at http://www.irs.gov/forms_pubs/pubs/p530toc.htm).

significant.[184] If Ms. Woodward were correct that mortgage brokers were marking up their fees on loans where yield spread premiums were tax favored, then the refinancing dummy would have picked up this effect. The absence of a statistically significant coefficient for the refinancing dummy conclusively rebuts Ms. Woodward's hypothesized tax effect.

3. Errors in Ms. Woodward's Equation 8

A final element of Ms. Woodward's Report is her effort to demonstrate that interest rates on loans in the Retail Sample were actually much higher than interest rates on other comparable loans. According to the regression reported in her Equation 8, interest rates on these retail loans are 44 basis points higher than other comparable loans. Defendants have already relied on this finding in briefs filed in this case.[185] Unfortunately, Equation 8 is flawed by serious errors in data manipulation.

The problem with Equation 8 is that Ms. Woodward included several explanatory variables for which her database had only incomplete information. In particular, the dummy variables for 30 year fixed mortgages and the dummy variable for jumbo loans did not include any information for loans from the Retail Sample – presumably because the Retail Sample was created in a slightly different way than the other samples. We know from independent analysis of these variables that a number of loans in the Retail Sample were jumbo loans, and we have strong reasons to believe

[184] See, e.g., Woodward Report of July 27, 2001, at 12 (Equation 8). See also supra pp. 107, 110 (Expanded Regression G).

[185] See, e.g., Defendant Standard Federal Bank's Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment at 6 (Sept. 10, 2001).

that a substantial number of loans in the Retail Sample were fixed rate 30-year mortgages. The correct way of dealing with this problem would have been either to obtain the missing information for the incomplete variables or to omit these variables from the equation. In her deposition, Ms.Woodward acknowledged this point, noting that the alternative – converting the missing fields into zeros – would produce "junk." Nevertheless, that is precisely what she or her assistants did in Equation 8. In her database, all of the entries for the 30-year fixed dummy and jumbo dummy are zero.

In Figure 28, we summarize Ms. Woodward's reported results for Equation 8 and then present an alternative formulation in which the 30-year fixed dummy is removed and a completed jumbo dummy included. In the alternative formulation, the coefficient of the retail dummy drops precipitously from 0.44 to 0.087. This suggests that the rate differential between

Figure 29
Ms. Woodward's Equation 8: Original and Reformulated
(n= 3082)

	In Original Repor		Reformulated Without 30-Year Fixed Dummy And With Corrected Jumbo Dummy	
	Coefficient	*Standard Error*	*Coefficient*	*Standard Error*
Constant	-0.627	0.034***	-0.108	0.038***
Retail Dummy	0.441	0.028***	0.087	0.032***
30-Year Fixed Dummy	0.522	0.015***	---	---
Original Jumbo Dummy	0.327	0.040***	---	---
Corrected Jumbo Dummy	---	---	0.329	0.047***
[14-15 variables not reported	---	---	---	---
	R Squared = 0.550		R Squared = 0.353	

interest rates on loans in the Retail Sample and other comparable loans is less than a fifth of

what Ms. Woodward reported. Moreover, this alternative formulation entirely undercuts her larger point that higher interest rates on retail loans offsets the dramatically lower settlement costs we discovered on loans in the Retail Sample.[186]

[186] See supra pp.82-83.

EXHIBIT BOOK

HOUSE COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

CHAIRMAN EDOLPHUS TOWNS

HEARING

"The Silent Depression: How are Minorities Faring in the Economic Downturn?"

SEPTEMBER 23, 2009

City of Baltimore 74 Motion to file first amended complaint,
Document 74-2 through Document 74-22

Attachments
J-S

ATTACHMENT J



Using Credit Scores to Analyze High-Cost Lending in Central-City Neighborhoods

May 28, 2008

Presentation by Chris Herbert





Abt

Abt Associates Inc.

Overview of the Issue

- Since 2004 data reported under the Home Mortgage Disclosure Act (HMDA) identifies "high-cost" loans
- Previous research has shown that minority neighborhoods have much higher shares of high-cost loans even accounting for income, house prices, and other neighborhood characteristics
- BUT most of these studies do not have information on credit scores, raising questions about whether racial/ethnic differences are mostly due to differences in creditworthiness
- Availability of Experian Scores through the Casey Foundation allowed us to examine high-cost lending in selected central city neighborhoods while controlling for credit scores to see if there are any unexplained disparities related to the neighborhood's racial/ ethnic composition

Overview of Analysis Approach

- Analyze 2006 HMDA data for 13 counties surrounding central cities in areas where the Casey Foundation has been supporting community based organizations—referred to as Making Connections neighborhoods
  - In Baltimore the neighborhoods examined included East Side Revitalization Area and Sandtown-Winchester—an area with about 20,000 residents
- Estimate statistical regression models to predict high-cost loan shares at the census tract level for both purchase and refinance loans
- Regression models include key measures of mortgage risk for the neighborhood—including credit scores, income, housing prices, and homeownership rates—as well as minority population shares

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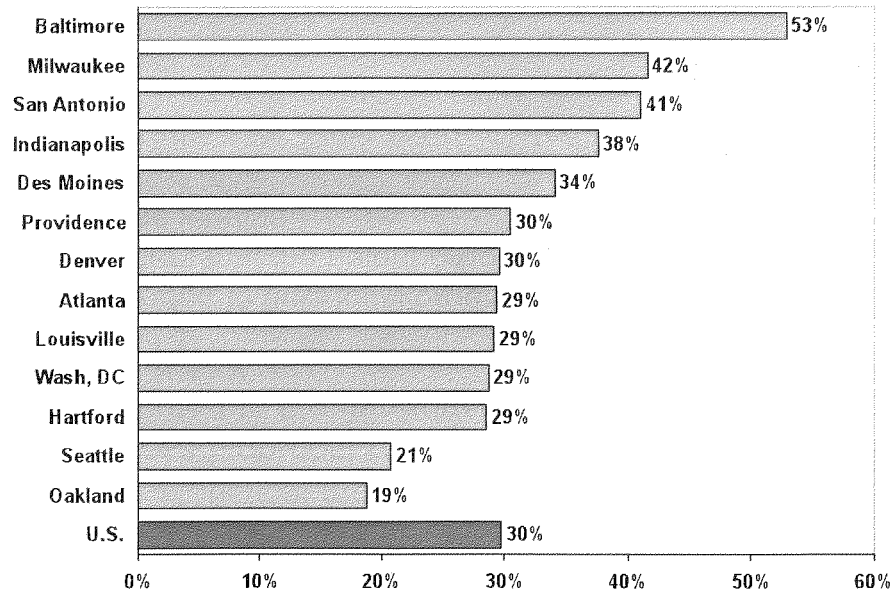
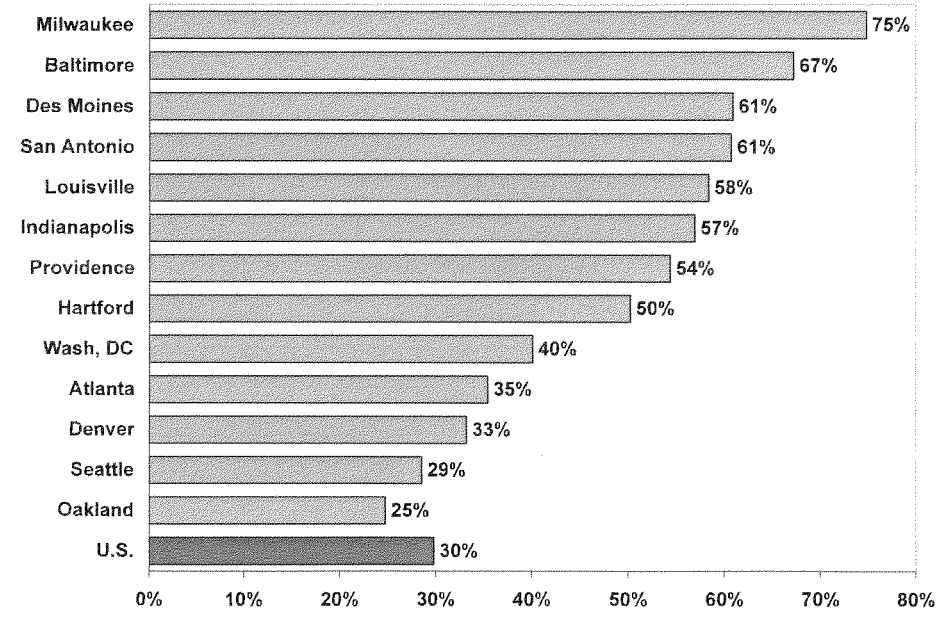
Overview of Analysis Approach (cont'd)

- Use the statistical model results to estimate how much of the excess high-cost mortgage shares in target areas can be attributed to the minority composition of the neighborhood
  - Intended to help local organizations make the case to lenders that the neighborhood should have higher levels of prime lending
- Case studies for each market also presented information on lenders active in the market areas that might have been able to help improve access to prime mortgages for the neighborhood

High-Cost Refinance Mortgage Shares in 2006 in Market Areas Studied



High-Cost Refinance Mortgage Shares in Making Connections Neighborhoods in 2006



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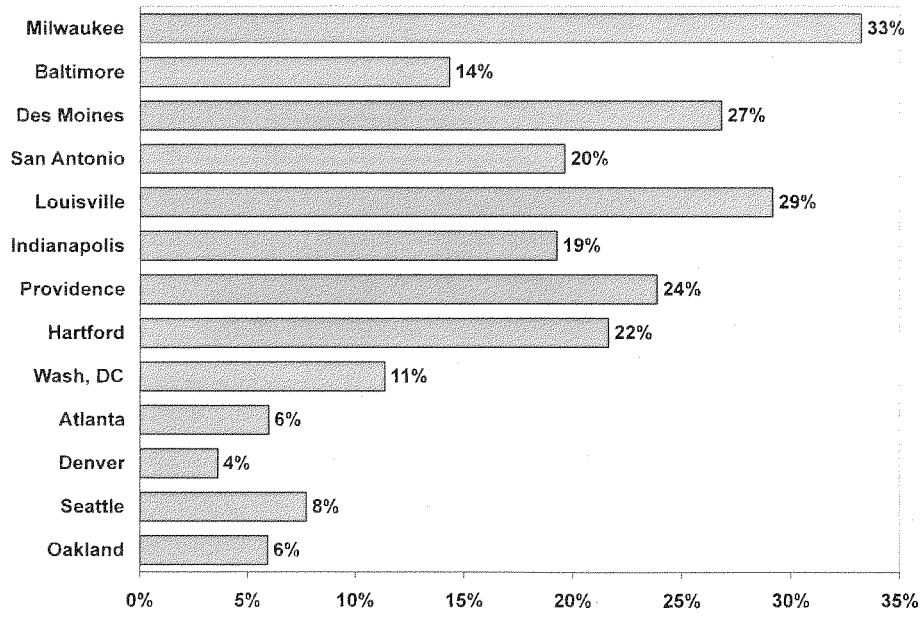
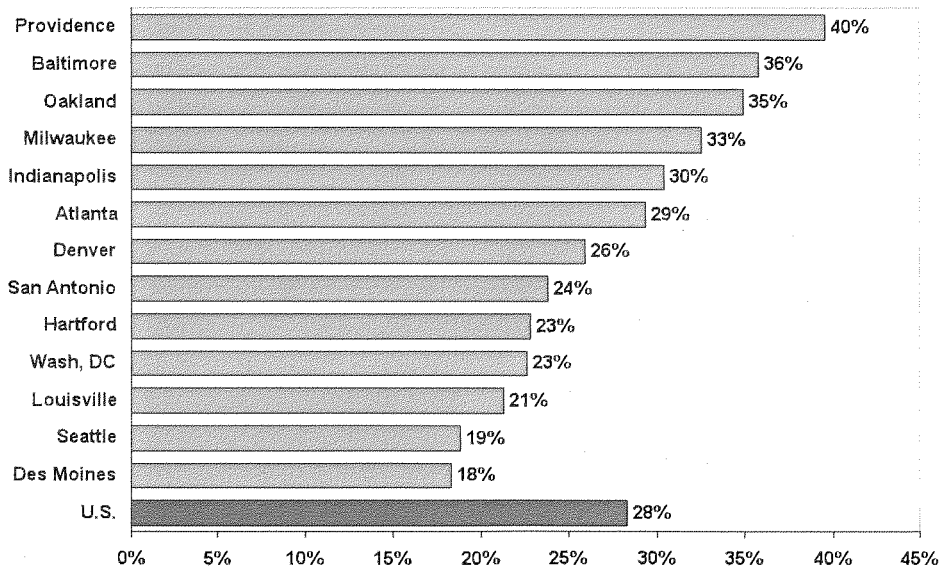
Difference in High-Cost Refinance Share from the Level in the Surrounding County



High-Cost Purchase Mortgage Shares in 2006 in Market Areas Studied



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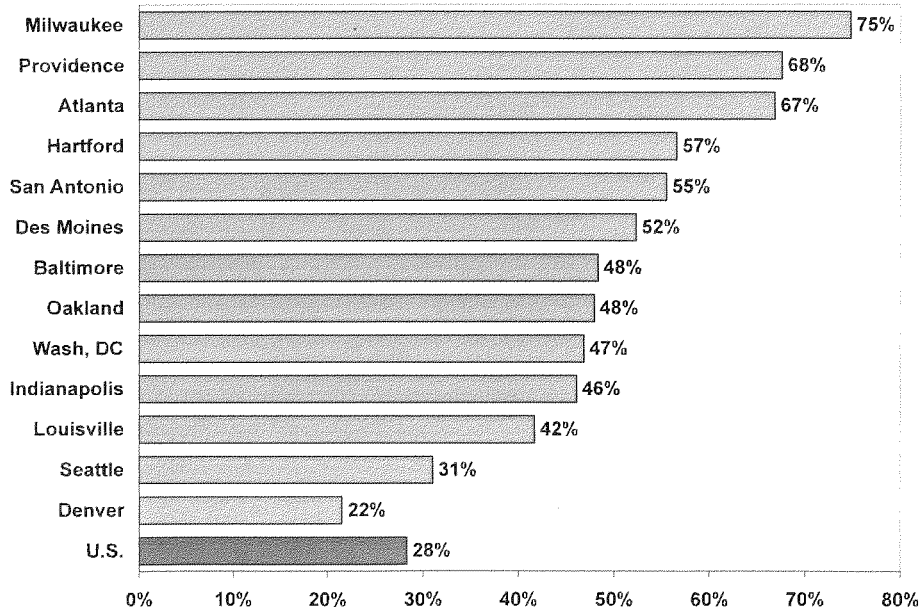
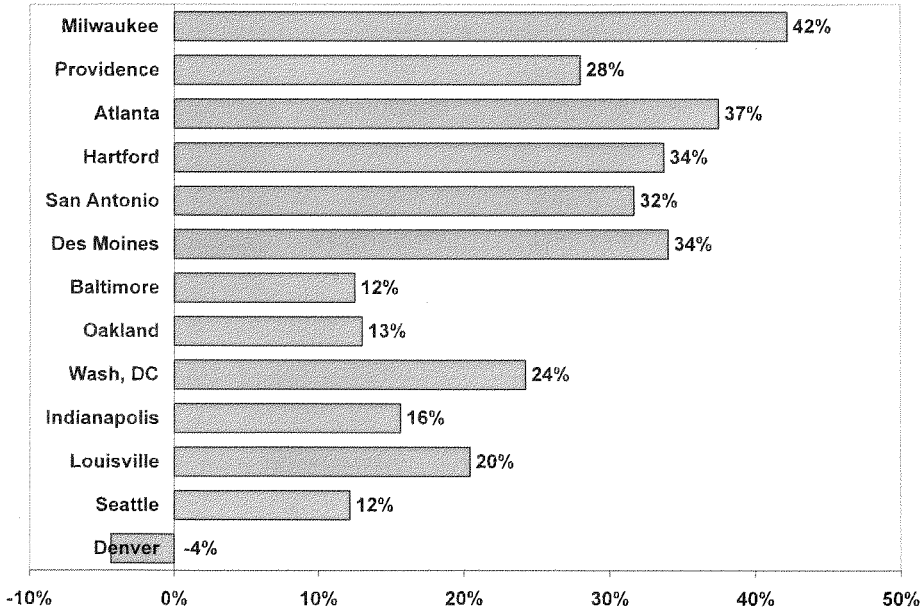
High-Cost Purchase Mortgage Shares in Making Connections Neighborhoods in 2006



Difference in High-Cost Purchase Share from the Level in the Surrounding County



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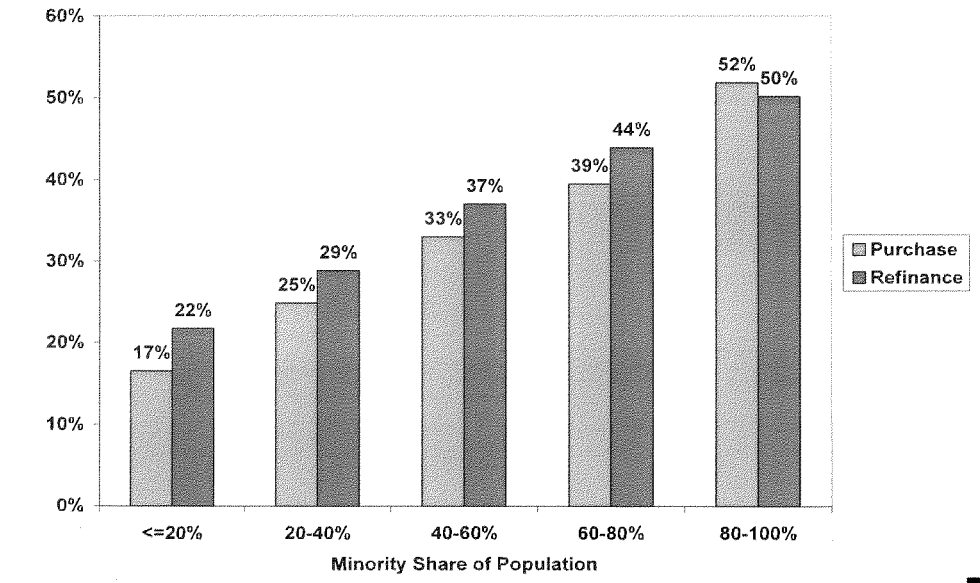
Summary of the Extent of High-Cost Lending in Making Connections Neighborhoods

High-Cost Refinance Mortgage Shares	High-Cost Purchase Mortgage Shares		
	Very High (>60%)	High (40-60%)	Mod/Low (<40%)
Very High (>60%)	Milwaukee	Baltimore Des Moines San Antonio	Louisville
High (40-60%)	Providence	Hartford Indianapolis Washington, DC	
Mod/Low (<40%)	Atlanta	Oakland	Denver Seattle

High-Cost Mortgage Shares Have a Strong Association with the Neighborhood Minority Population Share

Averages for All 13 Market Areas



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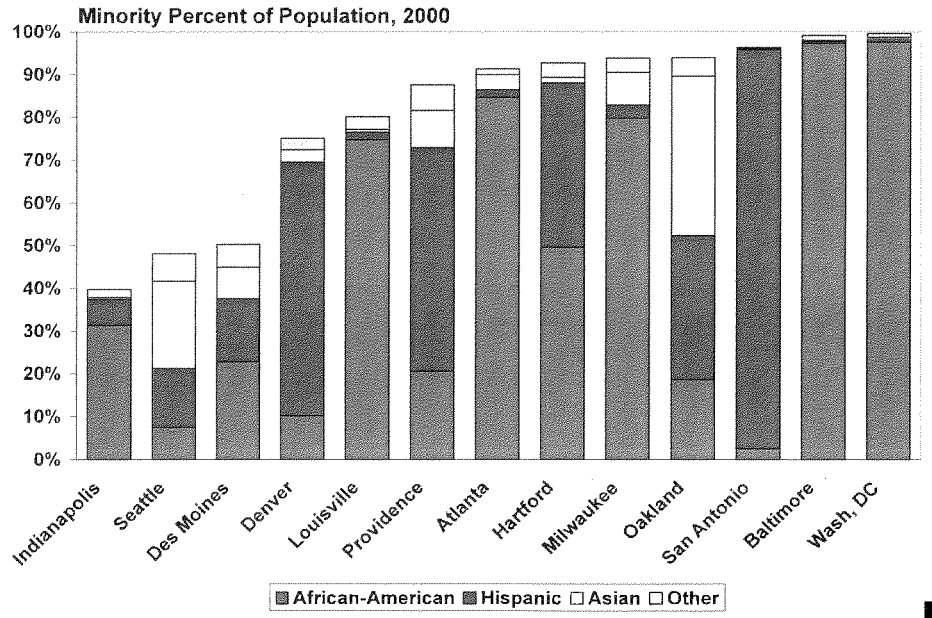
Most Making Connections Neighborhoods Are Predominantly Minority Communities



Making Connections Neighborhoods Do Exhibit Higher Levels of Mortgage Risk Factors Than Rest of County

Averages for All 13 Market Areas

	Making Connections Neighborhoods	Surrounding Counties	Percent Difference
Median Equivalency Credit Score	655	704	-7%
Median Household Income	23,287	43,693	-47%
Median House Value	79,839	147,050	-46%
Median Gross Rent	465	641	-27%
Capitalization Rate	0.74	0.57	30%
Homeownership Rate	36.0	55.6	-35%

Source: 2000 Decennial Census; 2006 Experian Equivalency Score.

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Summary of Regression Results

Number of Market Areas with Statistically Significant Results for Specific Variables

	Purchase	Refinance
Credit Score	11	12
Income	9	6
Capitalization Rate	9	10
Homeownership Rate	9	9
Share African-American	6	9
Share Hispanic	7	4
Share Asian	1	3

Coefficients also negative and significant on Share African-American in two markets for purchase mortgages, on share Hispanic in two markets for refinance mortgages, and on share Asian in one market for purchase mortgages.

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Estimating the Share of High Cost Lending Associated with Neighborhoods' Racial/Ethnic Composition

- Use regression models results to estimate what the high cost lending share would be in each neighborhood if:
  - Neighborhood had the same racial/ethnic composition as the surrounding county – *or* –
  - Neighborhood were entirely non-Hispanic white
- Otherwise, the neighborhood is still assumed to have other mortgage risk factors—income, credit scores, house prices, and homeownership rates
- Difference between actual high cost lending shares and those predicted by the model indicate potential magnitude of racial/ethnic disparities

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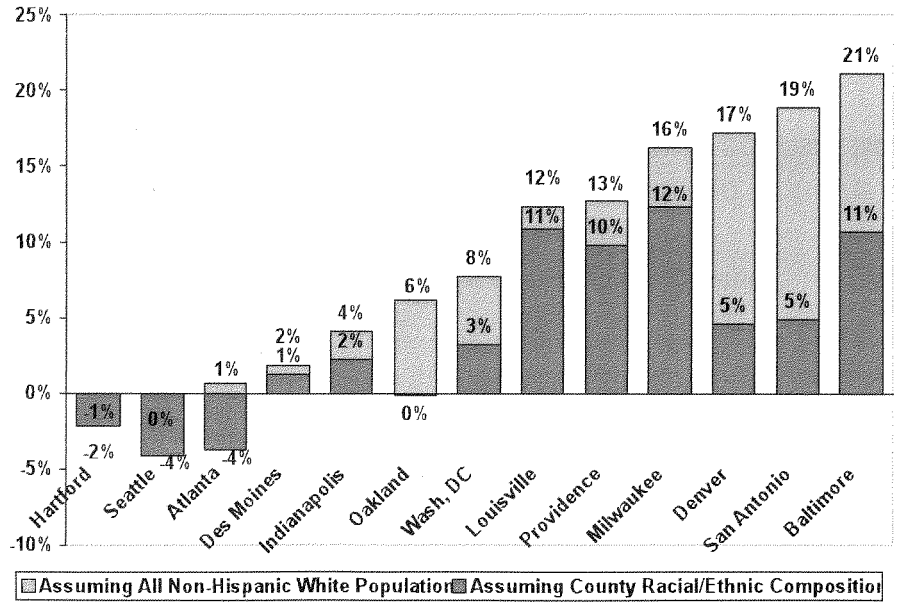
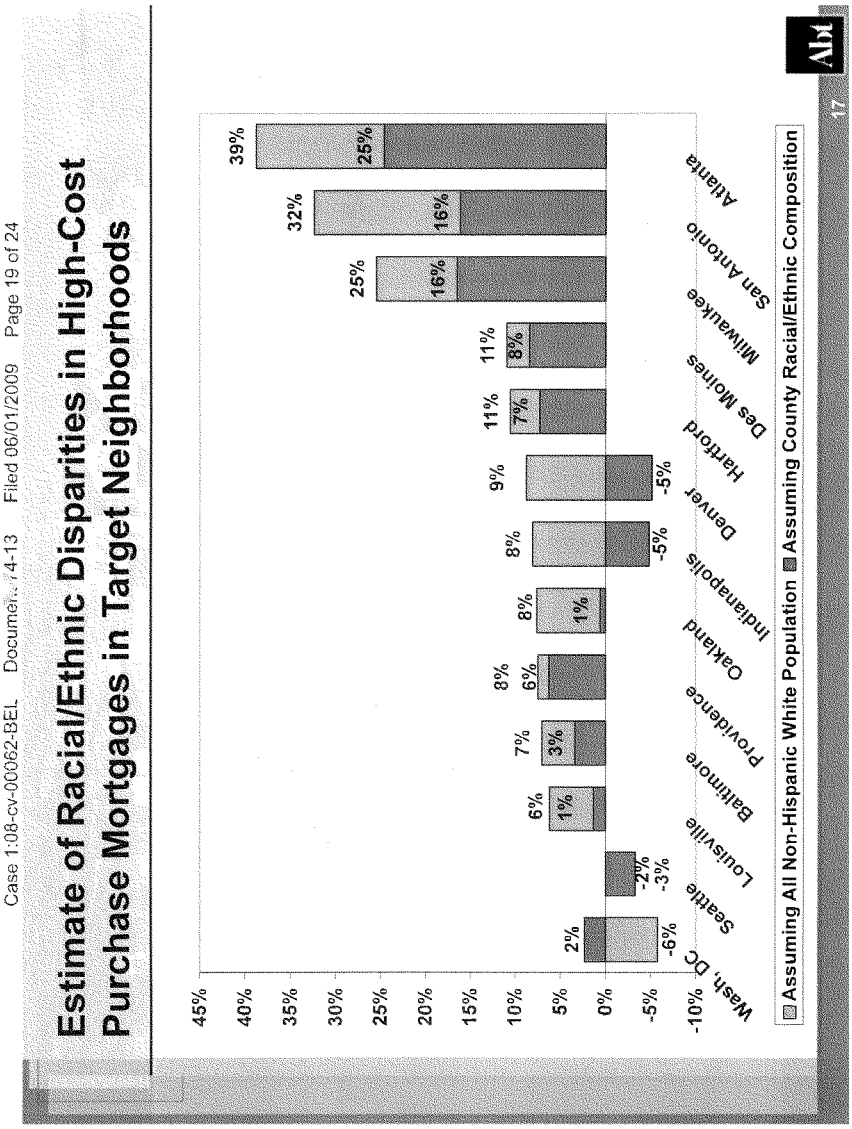
Estimate of Racial/Ethnic Disparities in High-Cost Refinance Mortgages in Target Neighborhoods




Estimate of Racial/Ethnic Disparities in High-Cost Purchase Mortgages in Target Neighborhoods
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
Wash, DC
Seattle
Louisville
Baltimore
Providence
Oakland
Indianapolis
Denver
Hartford
Des Moines
Milwaukee
San Antonio
Atlanta
2%
-2%
-3%
-6%
6%
1%
7%
3%
8%
6%
8%
1%
8%
-5%
9%
-5%
11%
7%
11%
8%
25%
16%
32%
16%
39%
25%
Assuming All Non-Hispanic White Population
Assuming County Racial/Ethnic Composition
17

Summary of the Findings on Extent of Potential Racial/ Ethnic Disparities in High-Cost Lending

Refinance	Purchase: Very High (>15%)	Purchase: High/Mod (5-15%)	Purchase: Low (<5%)
Very High (>15%)	Milwaukee San Antonio	Baltimore Denver	
High/Mod (5-15%)		Louisville Oakland Providence	Washington, DC*
Low (<5%)	Atlanta	Des Moines* Hartford Indianapolis	Seattle

* Racial/ethnic effect not statistically significant.

Identifying Lenders to Help Increase Prime Lending

- Examined lending activity in each market area using HMDA data to identify specific lenders that:
  - Originate a sizeable volume of prime mortgages in the county but made no loans in the Making Connections neighborhood
  - Are active in the Making Connections neighborhood but originate more high cost loans in the neighborhood than they do in the county overall
- ***But*** the original goal of identifying these lenders overtaken by the subprime market meltdown

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Example of List of Prime Lenders *Not Active* in Making Connections Neighborhood

Purchases

		Baltimore City		
	Lender Name	Originations	Subprime Loans	Share high-cost
1	SUNTRUST MORTGAGE, INC	344	31	9.0%
2	FIRST HOME MORTGAGE	194	24	12.4%
3	JPMORGAN CHASE BANK	154	10	6.5%
4	PROSPERITY MORTGAGE COMPANY	142	1	0.7%
5	PHH HOME LOANS	125	14	11.2%
6	WACHOVIA MORTGAGE	91	10	11.0%
7	FIRST MAGNUS FINANCIAL CORP	83	24	28.9%
8	CARROLLTON MORTGAGE SERVICES	74	9	12.2%
9	XPULTE MORTGAGE LLC	60	6	10.0%
10	CAPITAL MORTGAGE FINANCE CORP.	57	6	10.5%
11	K BANK	55	3	5.5%
12	GMAC BANK	53	7	13.2%

Refinances

		Baltimore City		
	Lender Name	Originations	Subprime Loans	Share high-cost
1	WACHOVIA BANK	313	20	6.4%
2	TAYLOR, BEAN & WHITAKER	167	0	0.0%
3	WASHINGTON MUTUAL BANK	122	9	7.4%
4	EQUITABLE TRUST MORTGAGE CORPO	81	3	3.7%
5	M&T MORTGAGE CORPORATION	77	6	7.8%
6	OHIO SAVINGS BANK	72	17	23.6%
7	FIRST HOME MORTGAGE	68	16	23.5%
8	AEGIS WHOLESALE CORPORATION	67	17	25.4%
9	CITIBANK, N.A.	63	2	3.2%
10	ABN AMRO MORTGAGE GROUP, INC.	56	1	1.8%
11	PREMIER MORTGAGE FUNDING, INC.	55	0	0.0%
12	MORTGAGEIT	54	15	27.8%

List of Most Active Lenders in Casey Foundation's Target Baltimore Neighborhood

Purchases

	Lender Name	Making Connections Neighborhoods: Total Originations	Making Connections Neighborhoods: Share high-cost	Baltimore City: Total Originations	Baltimore City: Share high-cost	Difference in high-cost shares
1	WELLS FARGO BANK, NA	11	63.6%	784	20.9%	42.7%
2	BANK OF AMERICA, N.A.	10	10.0%	732	3.7%	6.3%
3	COUNTRYWIDE HOME LOANS	9	77.8%	537	38.7%	39.0%
4	NATIONAL CITY BANK	8	25.0%	941	36.1%	-11.1%
5	1ST MARINER BANK	5	0.0%	356	7.6%	-7.6%
6	DECISION ONE MORTGAGE	3	100.0%			
7	FREMONT INVESTMENT & LOAN	3	100.0%	439	100.0%	0.0%
8	WMC MORTGAGE COMPANY	3	100.0%	272	96.7%	3.3%

Refinances

	Lender Name	Making Connections Neighborhoods: Total Originations	Making Connections Neighborhoods: Share high-cost	Baltimore City: Total Originations	Baltimore City: Share high-cost	Difference in high-cost shares
1	WELLS FARGO BANK, NA	11	54.5%	653	55.0%	-0.4%
2	FREMONT INVESTMENT & LOAN	8	100.0%	694	98.0%	2.0%
3	NEW CENTURY MORTGAGE CORPORATI	8	100.0%	433	95.8%	4.2%
4	LONG BEACH MORTGAGE CO.	5	100.0%	325	87.4%	12.6%
5	HFC COMPANY LLC	5	80.0%	184	77.7%	2.3%
6	DELTA FUNDING CORPORATION	4	75.0%	294	98.3%	-23.3%
7	NATIONSTAR MORTGAGE LLC	3	100.0%	115	93.0%	7.0%
8	COUNTRYWIDE HOME LOANS	3	66.7%	679	44.9%	21.7%
9	FLAGSTAR BANK	3	66.7%	222	9.9%	56.8%
10	WELLS FARGO FIN'L MARYLAND,INC	3	66.7%	129	86.8%	-20.2%
11	AMERICAN HOME MORTGAGE CORP.	3	33.3%	256	23.4%	9.9%

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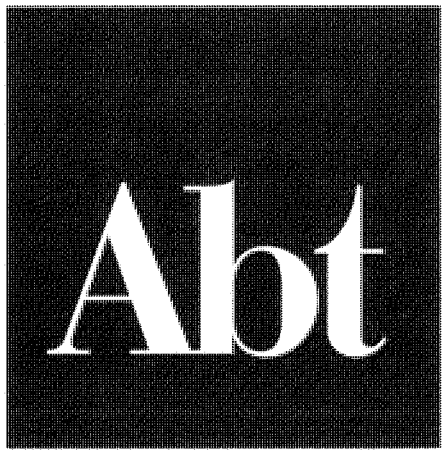

Abt Associates Inc.

ATTACHMENT K

Unequal Burden In Baltimore:

Income and Racial Disparities in Subprime Lending

May 2000

U.S. Department of Housing and Urban Development
Office of Policy Development and Research

UNEQUAL BURDEN IN BALTIMORE: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING

This study of subprime lending in Baltimore is part of a series that is constructing a national look at the growth in subprime lending[1]. Over the last decade, the amount of money available for home mortgages to borrowers with blemished or insufficient credit histories has grown at a tremendous rate. From 1993 to 1998, the number of subprime refinance loans reported under HMDA increased ten-fold – from 80,000 subprime refinance loans in 1993 to 790,000 in 1998. In 1994, the $35 billion in subprime mortgages represented less than 5 percent of all mortgage originations. By 1999, subprime lending had increased to $160 billion, almost 13 percent of the mortgage origination market.

The growth in subprime lending over the last several years has been a beneficial development for borrowers with impaired or limited credit histories. Subprime lenders have allowed such borrowers to access credit that they could not otherwise obtain in the prime credit market. However, there is a growing body of anecdotal evidence that a subset of these subprime lenders, who generally operate outside the federal regulatory structure, engage in abusive lending practices that strip borrowers' home equity and place them at increased risk of foreclosure. For this reason, this report examines patterns in subprime lending and foreclosures to understand where the risk and impact of predatory practices may be highest.

AN OVERVIEW

This study presents a preliminary analysis of mortgage originations in the Baltimore metropolitan area in 1998 using data reported under the Home Mortgage Disclosure Act (HMDA). Nationwide, the HMDA data demonstrate the rapid growth of subprime refinance lending during the 1990s and further, the disproportionate concentration of such lending in the nation's low-income and minority neighborhoods.[2] These same conclusions hold in the Baltimore metropolitan area.

By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending can and does serve a critical role in urban areas such as Baltimore. Some borrowers may have blemishes in their credit

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[1] For a national analysis, see the HUD report Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000. For similar analyses of the Atlanta, Los Angeles, and New York metropolitan areas, see the HUD reports: Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending, April 2000; Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending, May 2000; and Unequal Burden in New York: Income and Racial Disparities in Subprime Lending, May 2000.

[2] See the HUD report Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000.

record, insufficient credit history, or non-traditional credit sources. The subprime loan market offers these borrowers opportunities to obtain loans that they would be unable to realize in the prime loan market.

But there are two sides to this story. Since subprime lending often operates outside of the federal regulatory structure, it may be a fertile ground for predatory lending activities. Anecdotal evidence suggests that these practices may include imposing and financing excessive fees, bundling high-cost loans with lump-sum credit life insurance, and requiring prepayment penalties. Predatory lending can have disastrous consequences for less financially savvy borrowers. Equity may be stripped from their homes, and in more egregious cases, they may lose their homes altogether.

Some prime lenders have made significant progress in reaching underserved communities. A recent report for the Treasury Department showed that banks and thrifts increased the share of their mortgage originations to low-income borrowers and borrowers in low-income communities from 25 percent in 1993 to 28 percent in 1998.[3] However, as the evidence in this report suggests, there are many Baltimore neighborhoods that could benefit from increased competition from prime lenders in the home refinancing market. Such increased competition would give borrowers in these communities alternative options to lenders that may engage in abusive lending practices.

The first step to ensuring that subprime lending enhances the economic health of the borrowers' families without exposing them to predatory practices is to learn more about how and where it operates in America. To further understand geographic disparities, HUD has analyzed the problem nationwide and has now taken a look at the data on subprime lending in Baltimore.[4] In addition, this report also examines foreclosures in Baltimore City.

THE FINDINGS FOR BALTIMORE

In general, the analysis shows that subprime lending is more prevalent in lower-income and minority neighborhoods than in higher-income and white neighborhoods. This likely indicates that because of their lower incomes, lenders may consider these borrowers to be a higher credit risk, and these borrowers may therefore be less likely to qualify for prime loans. However, a lack of competition from prime lenders in these markets to find creditworthy borrowers may increase the chances that borrowers are exposed to the predatory practices of a subset of subprime lenders. There is also evidence

[3] Robert E. Litan, Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag, The Community Reinvestment Act After Financial Modernization: A Baseline Report, U.S. Department of Treasury, April 2000.

[4] HUD identifies subprime loans in HMDA using a list of lenders that primarily originate subprime loans. For the list of lenders and a discussion of the methodology, see Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

suggesting that after controlling for income, predominantly black neighborhoods may be comparatively underserved by prime lenders. Finally, the analysis finds that subprime lenders account for a high share of foreclosures in Baltimore City.

The importance of subprime lending to minorities and low-income Americans, which is documented in what follows, demonstrates how important it is to these communities that subprime lending not include any lenders engaging in predatory practices.

1. **As reported in HMDA, the number of subprime refinance loans originated in Baltimore increased over ten-fold between 1993 and 1998.** The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the Baltimore metropolitan area increased from 555 loans in 1993 to 8,268 in 1998.

2. **Subprime loans are seven times more likely in low-income neighborhoods in Baltimore than in upper-income neighborhoods.** In low-income neighborhoods, subprime loans accounted for 37 percent of all refinance loans originated during 1998 – compared with 5 percent in upper-income neighborhoods.[5]

3. **Subprime loans are six times more likely in predominantly black neighborhoods in Baltimore than in white neighborhoods.**[6] In predominantly black neighborhoods in Baltimore, subprime lending accounted for 49 percent of home refinance loans originated during 1998 - compared with only 8 percent in predominantly white neighborhoods.

4. **Homeowners in middle-income predominantly black neighborhoods in Baltimore are almost four times as likely as homeowners in middle-income white neighborhoods to have subprime loans.** In 1998, only 9 percent of borrowers in middle-income white neighborhoods obtained subprime refinance loans while 34 percent of borrowers in middle-income black neighborhoods refinanced in the subprime market. This percentage is

[5] The census tract income categories are as follows: low-income tracts have median incomes that are less than 80 percent of the metropolitan area median income (AMI); middle-income tracts, between 80 percent and 120 percent AMI, and upper-income tracts, greater than 120 percent AMI. These income categories are also used for analyses of borrower incomes relative to the area median income.

[6] This paper adopts the classification of tracts in the Woodstock Institute report, "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," Chicago, IL, November 1999. That is, predominantly white neighborhoods are tracts where the minority percentage is less than 15 percent; and predominantly black neighborhoods are tracts where blacks comprise at least 75 percent of the population. The racial composition of neighborhoods is based on 1990 census data; there may have been some changes in racial composition by 1998.

larger than the 25 percent of borrowers in low-income white neighborhoods who obtained subprime refinance loans.[7]

5. **The findings are similar when borrowers (rather than neighborhoods) throughout the Baltimore metropolitan area are examined.** In 1998, 45 percent of the refinance loans for low-income black borrowers throughout the Baltimore metropolitan area were subprime loans, compared with only 13 percent of loans for low-income white borrowers.

6. **Like originations, the subprime share of foreclosures is highest in low-income and predominantly black neighborhoods.** Subprime lenders accounted for 50 percent of mortgages being foreclosed in low-income census tracts in Baltimore City during the first three months of 1999. By comparison, the 1998 market share of subprime lenders in Baltimore City was 33 percent.[8] In predominantly black tracts, subprime lenders accounted for 57 percent of mortgages being foreclosed (compared with a subprime market share of 42 percent). The data also show that subprime loans were much quicker to foreclose than were conventional prime and FHA loans.

THE ANALYSIS

Subprime mortgage lending provides credit to borrowers with past credit problems, often at a higher cost or less favorable terms than loans available in the conventional prime market. In most cases, these lenders offer credit to borrowers who would not qualify for a loan in the prime market, thus expanding access to credit and helping more families to own their own homes. The higher costs of these loans may serve to offset the increased risk that these lenders assume in lending to these borrowers.[9]

In some cases, however, subprime lenders engage in abusive lending practices known as "predatory lending", which hits homeowners with excessive mortgage fees, interest rates, penalties and insurance charges that raise the cost of refinancing by thousands of dollars for individual families.

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[7] Of the predominantly black tracts in the Baltimore area, there were 79 low-income tracts and 11 middle-income tracts, but only one upper-income tract. Thus, this analysis of the Baltimore market is restricted to low-income and middle-income, predominantly black tracts. See HUD's Unequal Burden report (April 2000) for a separate analysis of upper-income predominantly black tracts at the national level.

[8] The Baltimore metropolitan area consists of 7 counties and includes Baltimore City. The subprime share of purchase and refinance loans in the Baltimore metropolitan area was 8 percent in 1998.

[9] However, there is evidence that the higher interest rates charged by subprime lenders cannot be fully explained solely as a function of the additional risks they bear. See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000.

HUD's study of subprime lending focuses mainly on subprime refinance lending, which accounts for nearly 80 percent of total (home purchase and refinance loans combined) subprime mortgage lending nationwide and for 83 percent of subprime lending in Baltimore.[10] HUD's study of subprime loans in the Baltimore metropolitan area found that:

1. **As reported in HMDA, the number of subprime refinance loans originated in Baltimore increased over ten-fold between 1993 and 1998.**

The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the Baltimore metropolitan area increased from 555 loans in 1993 to 8,268 loans in 1998. (See Figure 1.)

The magnitude and speed of the increase in subprime lending creates a critical need for greater scrutiny. The rapid growth of subprime lending may help expand credit access for more borrowers; however, some portion of subprime lending may be occurring with borrowers whose credit would qualify them for conventional loans. Subprime lending may expose borrowers to higher up-front fees and interest rates than they would bear if they had obtained prime loans.

2. **Subprime loans are seven times more likely in low-income neighborhoods in Baltimore than in upper-income neighborhoods.**

HUD's analysis reveals that subprime lending is being provided increasingly to low- and very low-income families and their communities. In Baltimore, 11 percent of all refinance mortgages in 1998 were subprime, but in low-income neighborhoods, the percentage of refinances in the subprime market was over three times as large -- 37 percent. (See Figure 2). In the poorest communities, where families make 50 percent or less of the area median income, subprime refinances accounted for almost 60 percent of all refinance loans. In middle-income neighborhoods, 11 percent of refinancing families relied on a subprime loan, as did only 5 percent in upper-income neighborhoods. According to HMDA data for 1993, only 3 percent of refinance mortgages in low-income neighborhoods and 1 percent in upper-income neighborhoods were subprime.

3. **Subprime loans are six times more likely in black neighborhoods in Baltimore than in white neighborhoods.**

In predominantly black neighborhoods in Baltimore, subprime lending accounted for 49 percent of home refinance loans in 1998 - compared with only 8 percent in predominantly white areas. Thus, while subprime refinance mortgages accounted for only one in twelve refinance loans originated in predominantly white neighborhoods, they accounted for one half the refinance loans originated in predominantly black

[10] Subprime lenders are also active in the home improvement market. Home improvement loans of subprime lenders were excluded from these comparisons.

neighborhoods. (See Figure 3.) Comparable 1993 figures reported by HMDA were 6 percent in black neighborhoods and 1 percent in white neighborhoods.

4. Homeowners in middle-income black neighborhoods in Baltimore are almost four times as likely as homeowners in middle-income white neighborhoods to have subprime loans.

Notably, even after controlling for differences in neighborhood income, homeowners in black communities are more likely than homeowners in white communities to refinance in the subprime market. (See Figure 4.) Among homeowners living in low-income black neighborhoods, 55 percent turned to subprime lenders, compared with 25 percent of homeowners living in low-income white neighborhoods. This disparity also existed in higher income neighborhoods. Among homeowners living in middle-income black neighborhoods, 34 percent turned to subprime lenders, compared with 9 percent of homeowners living in middle-income white neighborhoods. In fact, the subprime share (34 percent) for middle-income black neighborhoods is larger than the subprime share (25 percent) for lower-income white neighborhoods.

The map of the Baltimore metropolitan area summarizes the neighborhood concentration of subprime refinance loans. (See Figure 5.) In 1998, subprime mortgages accounted for at least 25 percent of all refinance mortgages in 156 (or 27 percent) of the 574 census tracts in the Baltimore metropolitan area refinance market. Census tracts where blacks comprised more than 30 percent of the population (black neighborhoods) accounted for 118 of these 156 census tracts. On a market share basis, black neighborhoods accounted for 13 percent of all refinances in the Baltimore metropolitan area but for 39 percent of all subprime refinances.

5. The findings are similar when borrowers (rather than neighborhoods) throughout the Baltimore metropolitan area are examined. In 1998, 45 percent of low-income black borrowers in the Baltimore metropolitan area relied upon subprime loans.

This section analyzes the Baltimore data by individual borrowers instead of entire neighborhoods; the impacts are similar. Subprime refinances accounted for 26 percent of all refinancing by low-income borrowers throughout the Baltimore metropolitan area; only 7 percent of upper income borrowers relied upon subprime refinancing. (See Figure 6.) The borrower data show that blacks in the Baltimore metropolitan area are also carrying a large proportion of subprime: in 1998, 25 percent of refinance mortgages for black borrowers were subprime, compared with only 8 percent for white borrowers.[11]

[11] It should be noted that borrower race and ethnicity data was not provided for 10,252 (14 percent) of the 75,889 refinance originations and for 2,818 (34 percent) of the 8,268 subprime refinance originations. Since the "not provided" data was a higher percentage of the subprime totals than of the market totals, and given that black borrowers account for a large percentage of subprime loans, any method of reallocating this "not provided" data would increase the presence of the subprime market among black borrowers. Income data was also not available for 17,202 (23 percent) of refinance originations; the missing income data was due almost entirely to FHA, which does not require borrowers to report their incomes when they are using

Combining data on the income and racial characteristics of the borrower shows large disparities between black and white borrowers with similar incomes. Subprime loans accounted for 45 percent of refinance loans originated for low-income black borrowers, compared with only 13 percent for low-income white borrowers. (See Figure 7.) Similarly, subprime loans accounted for 32 percent of refinance loans for middle-income black borrowers, compared with only 8 percent for middle-income white borrowers. In fact, upper-income black borrowers were more than twice as likely as middle-income white borrowers to rely on the subprime market (21 percent of upper-income blacks versus 8 percent of middle-income whites); and were also more likely than low-income white borrowers to rely upon the subprime market (21 percent for upper-income blacks versus 13 percent for low-income white borrowers).[12]

FORECLOSURES IN BALTIMORE CITY

This section describes an analyses of foreclosure petitions on homes in Baltimore City that were filed between January 1, 2000 and March 31, 2000.[13] The data on foreclosures included the petition and origination dates, the interest rate, product type (FHA, VA, conventional), the name of the lender, and the address of the property.[14] HUD used its subprime list of HMDA lenders to identify subprime lenders in Baltimore City. HUD also identified lenders that specialize in subprime lending but either do not report to HMDA or were not identified earlier by HUD. HUD's analysis was based on 1,251 petitions.[15]

FHA's streamline refinancing program. In this case, any method of reallocating the missing income data would reduce the subprime share among low-income borrowers.

[12] Hispanic borrowers had a relatively small presence in the Baltimore market, accounting for only 441 refinance originations during 1998.

[13] HUD obtained the data on foreclosure petitions in conjunction with the staff of the St. Ambrose Housing Aid Center. The data was obtained from the files of the Circuit Court for Baltimore City.

[14] Some of the lenders may be brokers. There was product information (e.g., adjustable-rate, balloon, wrap-around, purchase, refinance, home equity) for some petitions but the majority of petitions did not have these data so these fields are excluded from the analysis.

[15] The original file consisted of 1,889 cases. HUD excluded 14 foreclosure petitions from 1999, 51 that had missing petition dates, and 274 that had dates after March 31, 2000 -- leaving 1,550 foreclosure petitions. From these HUD excluded: 112 foreclosure petitions that had origination dates before 1990, 46 petitions in which the lender was missing, 65 petitions in which the lender was reported as the seller of the property or a realty company, and 76 petitions that either did not have geocode information or were not located in Baltimore City. FHA loans accounted for 17 percent of the petitions excluded from the analysis.

The results of the analysis of foreclosure petitions in Baltimore are similar to results from analyses of foreclosures in other cities. The critical findings are as follows[16]:

- **Subprime loans had a disproportionate share of foreclosures in Baltimore City's low-income neighborhoods.** Subprime loans accounted for 50 percent of foreclosure petitions in low-income Baltimore City neighborhoods compared to 24 percent for prime and 25 percent for FHA. The subprime share of purchase and refinance originations in low-income Baltimore City neighborhoods was 33 percent compared to 37 percent for prime and 27 percent for FHA. (See Figure 10.)

- **Subprime loans had a disproportionate share of foreclosures in Baltimore City's predominantly black neighborhoods.** Subprime loans accounted for 57 percent of foreclosures in predominantly black neighborhoods compared to 24 percent for prime and 18 percent for FHA. The subprime share of purchase and refinance originations in predominantly black Baltimore City neighborhoods was 42 percent compared to 36 percent for prime loans and 22 percent for FHA loans. (See Figure 11.)

- **Subprime loans resulted in foreclosure during a shorter period of time after origination than prime and FHA loans.** The mean lag between the origination date and the date that the foreclosure petition was filed was 1.8 years for subprime loans compared to 3.2 years for FHA and prime loans. Subprime loans originated in 1999 accounted for a large portion (28 percent) of all subprime foreclosure petitions.

- **The subprime share of foreclosures in Baltimore City was 45 percent, compared with shares of 23 percent for prime conventional loans and 30 percent for FHA loans.**

Other findings include:

- The subprime share of foreclosures is larger than the subprime share of originations. While subprime foreclosures accounted for 45 percent of the foreclosure petitions, the subprime share of home purchase and refinance originations in Baltimore City was 21 percent in 1998.[17]

[16] Abt Associates studied foreclosures in Atlanta and the National Training and Information Center studied foreclosures in Chicago. Abt Associates Inc., Analyzing Trends in Subprime Originations and Foreclosures: A Case Study of the Atlanta Metro Area, February 2000. National Training and Information Center, Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures, September 1999.

[17] The subprime share reported for 1998 may be the most useful share when comparing the subprime share of foreclosures with the subprime share of originations since 61 percent of subprime foreclosures in Baltimore City were for subprime loans originated since 1998. The subprime share of the market is derived from purchase and refinance loans that are reported to HMDA since the foreclosure data includes purchase and refinance loans. As noted earlier, the subprime origination shares reported in this section for home purchase and refinance loans in Baltimore City differ from the subprime share of purchase and refinance loans in the Baltimore metropolitan area.

- FHA accounted for 30 percent of all foreclosure petitions in Baltimore City during the first three months of 2000 and for 28 percent of mortgage originations during 1998. FHA's shares of foreclosures in low-income and predominantly black neighborhoods were also similar to its 1998 origination shares in these neighborhoods. FHA accounted for 25 percent (18 percent) of foreclosures in low-income (predominantly black) neighborhoods and for 27 percent (22 percent) of mortgage originations in these neighborhoods.

To summarize, this analysis of foreclosures in Baltimore shows that foreclosures on loans initiated by subprime lenders are concentrated in low-income and black neighborhoods.

CONCLUSIONS

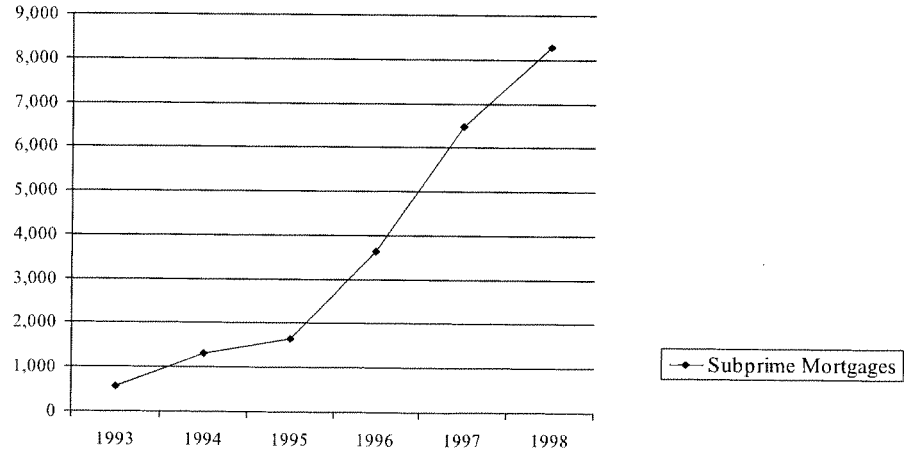
HUD's analysis of refinance mortgages originated in the Baltimore metropolitan area during 1998 clearly demonstrates the exponential growth in subprime lending and its growth for lower-income and, particularly, minority homeowners and communities. HUD analysis of foreclosures initiated in Baltimore City shows that foreclosures of subprime loans are concentrated in these same areas. While the growth in subprime lending has expanded access to credit for many borrowers with impaired or limited credit histories, these borrowers may also be vulnerable to predatory lending practices and possible loss of their homes.

Despite the progress made by prime lenders in reaching these markets, the growth of subprime lending in both lower-income and minority communities strongly suggests that much more can be done by both primary and secondary market participants to expand access to the prime lending market.

Figure 1

Growth in Subprime Refinance Lending
(Baltimore Metropolitan Area)

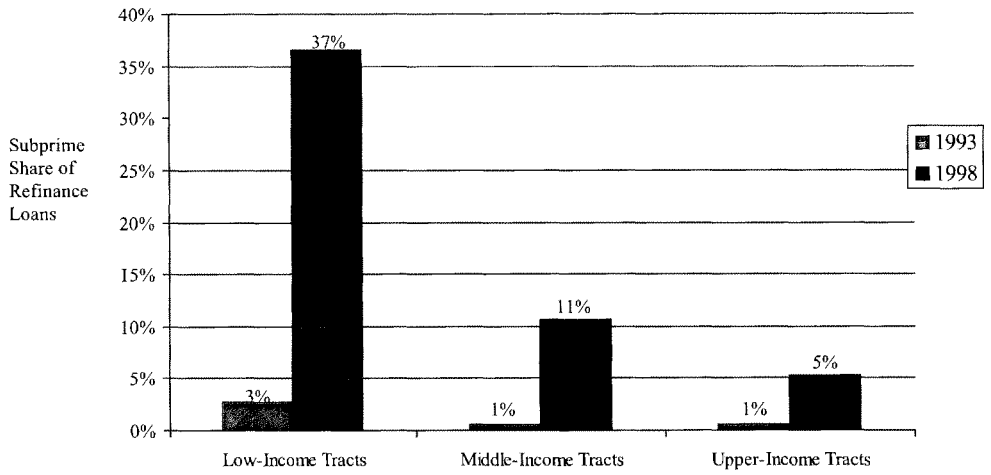
	1993	1994	1995	1996	1997	1998
Subprime Mortgages	555	1,311	1,651	3,648	6,464	8,268



Source: 1993-1998 HMDA Data

Figure 2

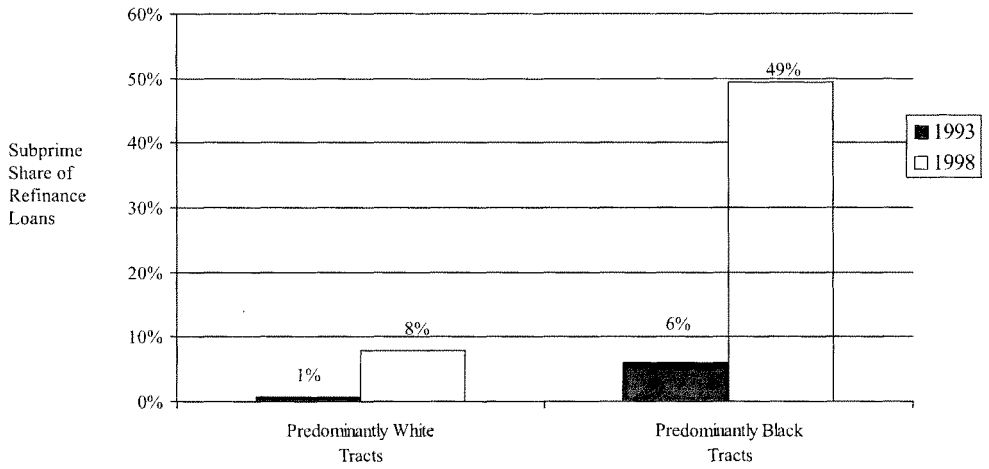
Subprime Share of Refinance Mortgages by Neighborhood Income
(Baltimore Metropolitan Area)



Note: Low-Income Tracts: Not More than 80% AMI; Middle-Income Tracts: 80-120% AMI; Upper-Income Tracts: More than 120% AMI.

Figure 3

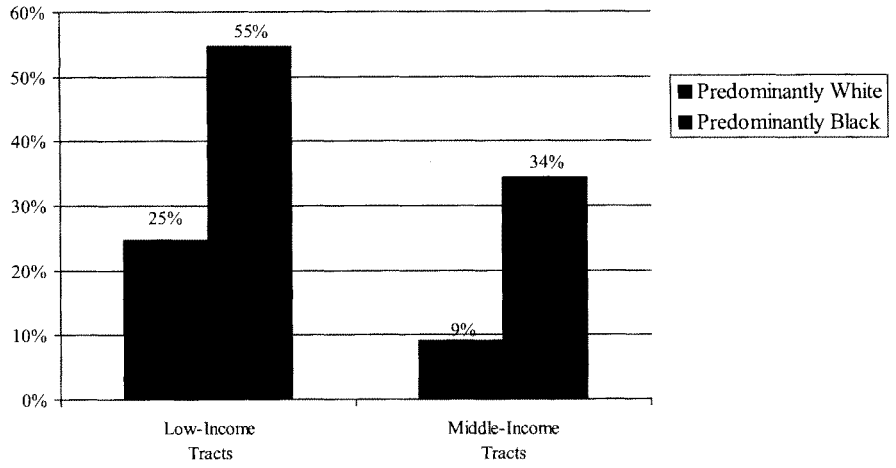
Subprime Share of Refinance Mortgages by Neighborhood Race
(Baltimore Metropolitan Area)



Note: Predominantly White Tracts: At least 85% White; Predominantly Black Tracts: At least 75% Black.

Figure 4

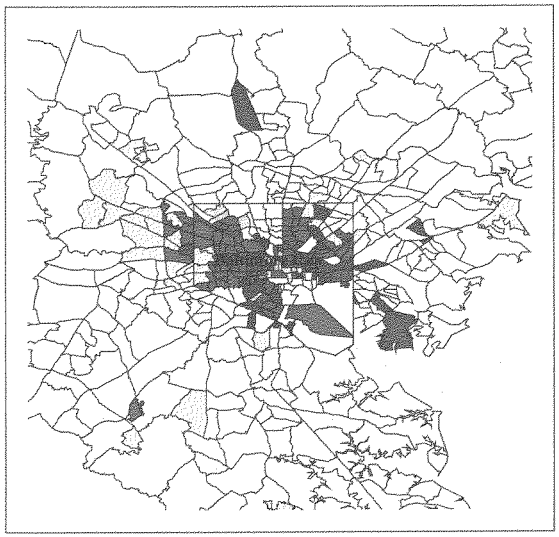
Subprime Share of 1998 Refinance Mortgages by Neighborhood Race and Income
(Baltimore Metropolitan Area)



Note: Predominantly White Tract: At least 85% White; Predominantly Black Tract: At least 75% Black.
Low-Income Tract: Not More than 80%; Middle-Income Tract: 80-120%.

Figure 5

Baltimore Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 156 (or 27 percent) of the 574 census tracts in the Baltimore metropolitan area refinance market.

Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 118 of these 156 subprime census tracts.

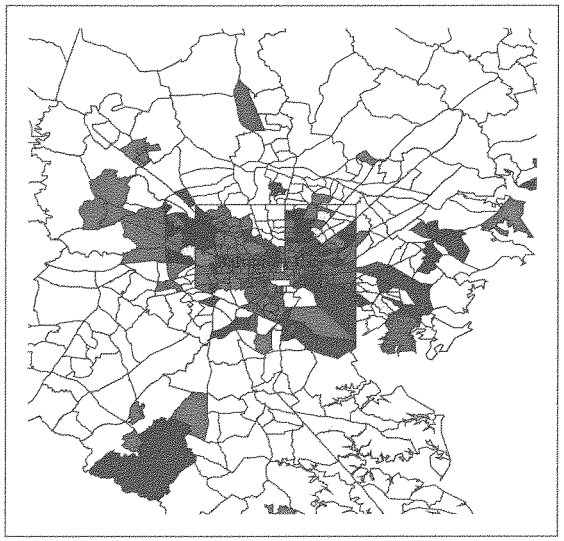
Black neighborhoods accounted for 13 percent of all refinances in the Baltimore metropolitan area but 36 percent of all subprime refinances.

Subprime and Black Neighborhoods
Other Subprime Neighborhoods
Other Black Neighborhoods

Source: 1998 HMDA Data

Figure 5

Baltimore, Maryland Metropolitan Area Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 156 (or 27 percent) of the 574 census tracts in the Baltimore metropolitan area refinance market.

Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 118 of these 156 subprime census tracts.

Black neighborhoods accounted for 13 percent of all refinances in the Baltimore metropolitan area but 36 percent of all subprime refinances.

- Subprime, Low-Income, and Black Neighborhoods
- Subprime and Black Neighborhoods
- Subprime and Low-Income Neighborhoods
- Subprime Neighborhoods
- Other Black and Low-Income Neighborhoods
- Other Black Neighborhoods
- Other Low-Income Neighborhoods

Source: 1998 HMDA Data

Figure 6

Subprime Share of 1998 Refinance Mortgages by Income and Race of Borrower
(Baltimore Metropolitan Area)

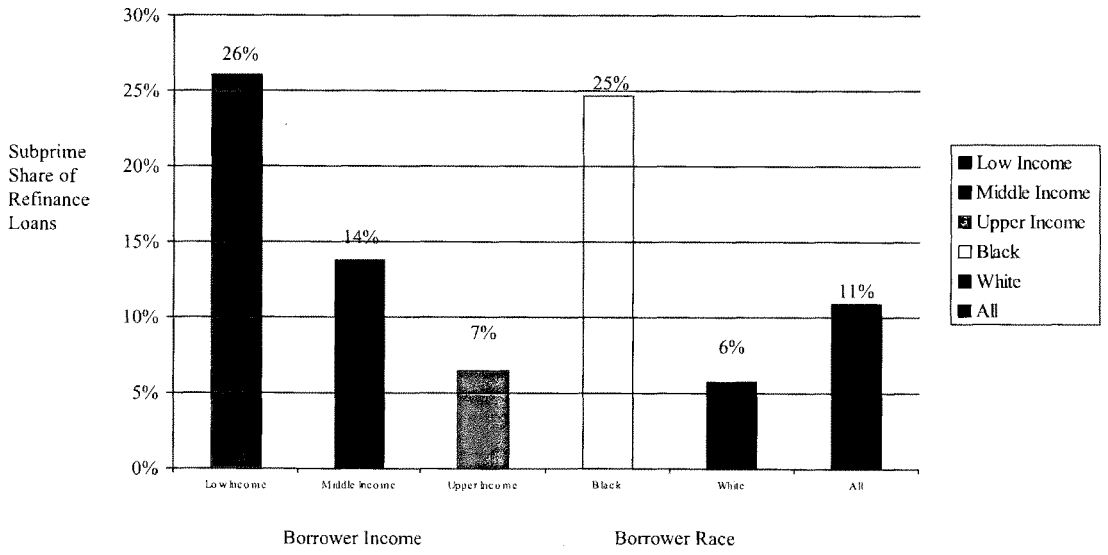
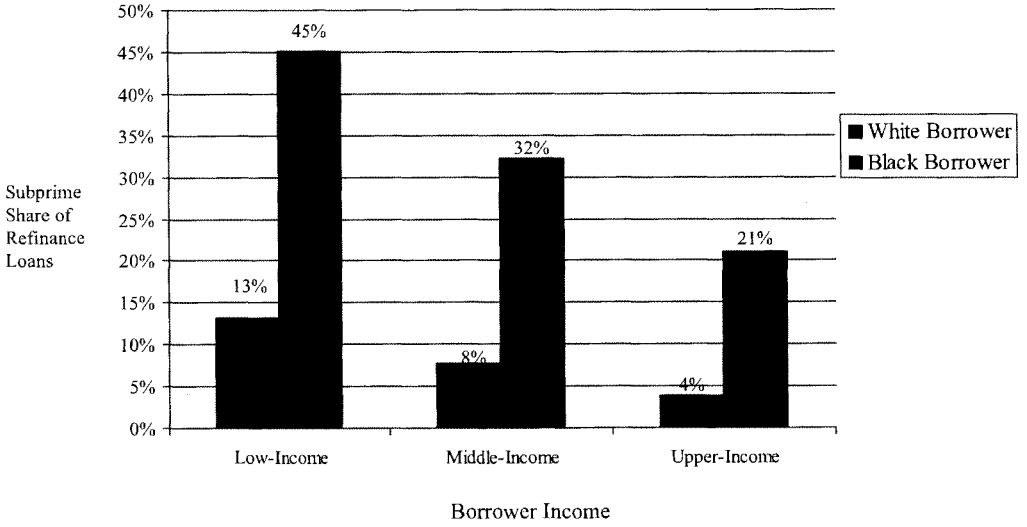


Figure 7

Subprime Share of 1998 Refinance Mortgages by Borrower Race and Income (Baltimore Metropolitan Area)



Note: Low-Income Borrower: Not More than 80% AMI; Middle-Income Borrower: 80-120% AMI; Upper-Income Borrower: 120% AMI.

Figure 8

Foreclosure Petitions for Baltimore City January - March 2000



Type of Loan
- Prime (289 loans)
- Subprime (561 loans)
- FHA (370 loans)
- VA (31 loans)

Minority Composition
- Other
- Predominantly Black (At least 75% Black)

Figure 9

Foreclosure Petitions for Baltimore City
January - March 2000



Figure 10

Subprime Share of Foreclosures and Originations in Low-Income Neighborhoods

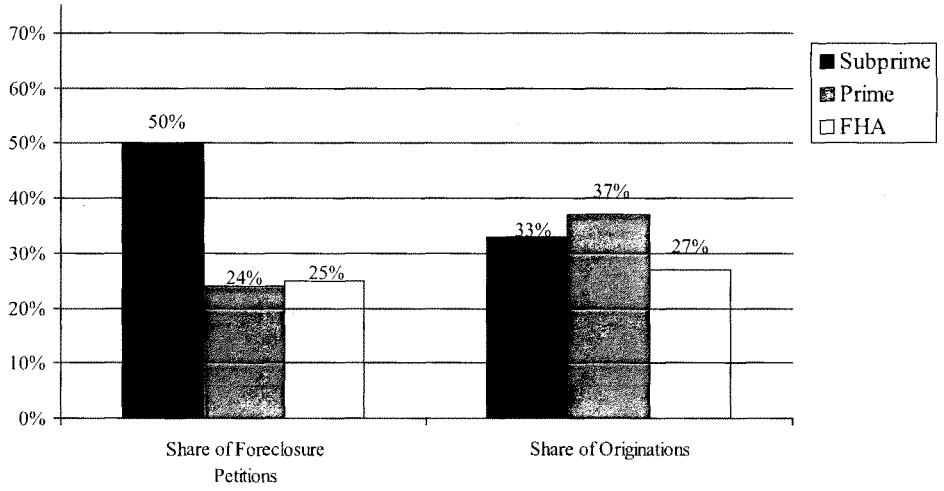
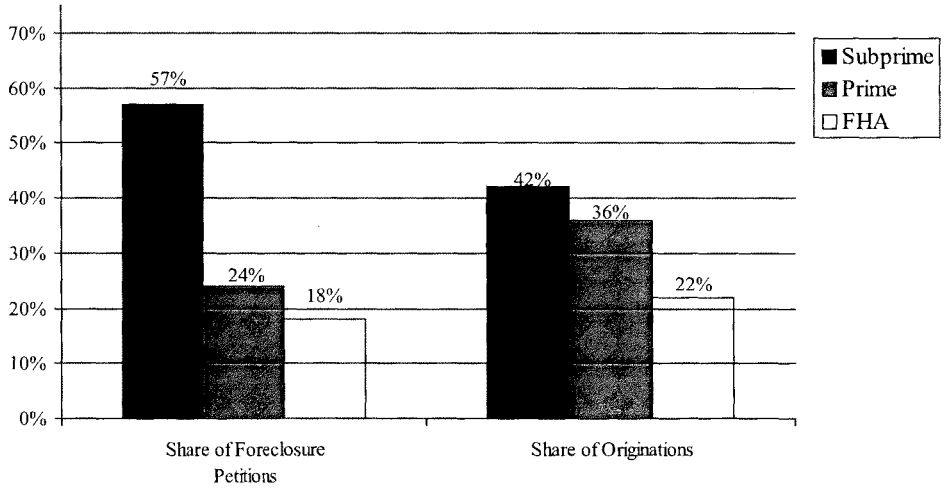


Figure 11

Subprime Share of Foreclosures and Originations in Predominantly Black Neighborhoods



ATTACHMENT L

CENTER FOR RESPONSIBLE LENDING

A Review of Wells Fargo's Subprime Lending

CRL Issue Paper April 2004

Wells Fargo & Company, a diversified financial services company, provides retail and business banking, insurance, investments, mortgages and consumer finance across the US. Its distribution system encompasses both traditional and non-traditional channels. Wall Street analysts praise Wells Fargo's revenue and sales growth, diversification, distribution/marketing prowess, and standout risk management.

Despite Wells Fargo's success, there appear to be serious trouble spots in its subprime mortgage lending, particularly the predatory practices of Wells Fargo Financial (WFF) that victimize low-wealth consumers. While these practices have been criticized by community groups since the mid-1990s, they apparently have been tolerated by Wells Fargo management because of the unit's profitability.

Background

A major money center bank, Wells Fargo operates approximately 3,000 bank branches, more than 750 home mortgage "stores," and about 1,200 consumer finance offices in the US, Canada, Latin America, and the Pacific Islands. Moody's has rated Wells Fargo's bank subsidiary AAA—the only bank with this rating—as a result of its consistent profits and conservative credit culture. In 2003, Wells Fargo's net income rose 14% to $6.3 billion, on revenue of $28.4 billion.

The company was formed through a $3.4B "merger of equals" between Norwest and Wells Fargo banks in 1998. Norwest was the surviving entity, but the new company adopted the Wells Fargo name. The merger combined one of the nation's most efficient banks with a strong revenue generator.

Under CEO Richard Kovacevich, Wells Fargo bank branches have become retail "stores" that push as much product as possible. Selling several products helps pay the high fixed cost of maintaining a branch, and also creates customer "loyalty" by making it hard for someone to leave the bank that has their checking account, home loan, insurance policy, credit card accounts, etc.

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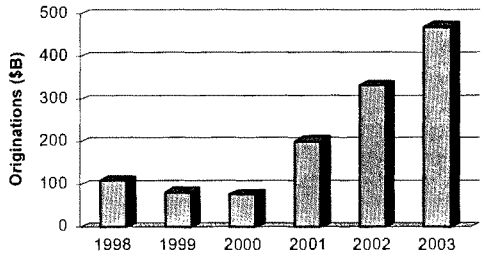
Wells Fargo Mortgage Lending

One of the biggest drivers in Wells Fargo Bank's steady income growth is its mortgage business, which contributes approximately one-third of the company's earnings year after year. Des Moines-based Wells Fargo Home Mortgage (WFHM) is one of the nation's largest mortgage originators and servicers. At the end of 2003, WFHM originations hit $470B and mortgage servicing reached a record $664B.

Wells Fargo Mortgage Originations, 1998-2003



Source: 2003 Mortgage Market Statistical Annual, Inside Mortgage Finance

	Originations ($B)	Market Share	Industry Rank
1998	$109.5*	7.7%	1
1999	$ 82.0*	6.4%	2
2000	$ 76.5	7.3%	1
2001	$202.0	8.8%	1
2002	$333.0	13.3%	1
2003	$470.0	12.5%	1

* Norwest Mortgage

According to Peter Wissinger, named president and chief operating officer of WFHM in 2000, the company's focus has been (and remains) increased efficiency, higher ancillary revenue, and new channels & partnerships. The first two items are especially important given Wells' higher reliance on retail originations compared with other major lenders.

Wells Fargo's "Two Channels" of Subprime Lending

Wells Fargo's subprime mortgage lending totaled $16.5B in 2003. While this is modest volume compared to Wells Fargo's prime mortgage originations, the company now ranks # 8 among B&C lenders and generally has been doubling its subprime volume each year since 2000.

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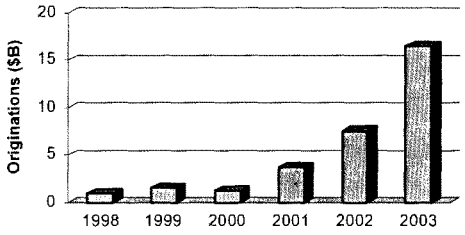
Wells Fargo Subprime Mortgage Originations, 1997-2003



Source: 2003 Mortgage Market Statistical Annual, Inside Mortgage Finance

	Subprime Mortgage Originations ($MM)	Market Share	Industry Rank
1997	$ 230	0.2%	N/A
1998	$ 884	0.6%	29
1999	$ 1,480	0.9%	22
2000	$ 1,184	0.9%	21
2001	$ 3,679	2.1%	12
2002	$ 7,547	3.5%	10
2003	$16,485	5.0%	8

Wells Fargo originates subprime loans through Wells Fargo Home Mortgage and Wells Fargo Financial. The two organizations got into subprime lending in different ways, and have completely separate (and often very different) sales forces, organizational cultures, and operating practices.

Channel #1: Wells Fargo Home Mortgage -- Subprime lending as product expansion

Wells Fargo—still Norwest at the time—was attracted by the profit potential in subprime lending: "[The Money Store] made 85% of our earnings on one-tenth the volume," stated a Norwest executive in 1998.[1] In addition, Norwest realized it had advantages over subprime finance companies because it could hold or sell loans and, as a depository, didn't have to rely on warehouse lending or the commercial debt market for capital.

Further, Norwest management realized that subprime lending as practiced by finance companies had serious flaws. It saw that lenders were originating loans at almost any cost, securitizing them and recording a significant gain on sale, but ultimately creating no real equity. (This point was missed by First Union, who acquired the Money Store for $2.1B in 1998 only to write off $1.7B its investment two years later.)

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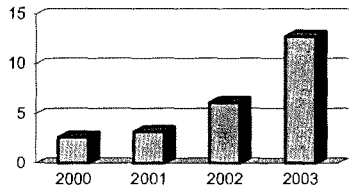
As a result, Norwest chose to create its subprime mortgage business internally. It purchased Directors Mortgage Loan Corp of California in 1995 to use as a subprime lending and servicing platform. Renamed Directors Acceptance, the unit opened its corporate headquarters in Carlsbad CA and began making loans in early 1997.

Directors original goal was to reach loan volume of $500MM in three years. Management believed it could achieve this by tapping Norwest customers who had been turned down for conventional loans—reportedly 30,000 denied applications in 1995 alone.

Using its large sales organization and branch network, WFHM has rapidly grown its subprime originations and industry position. Wells also set up a separate servicing site for subprime loans in Charlotte, NC, and created a specialized default management team. In 2000, Fitch gave Wells a RPS2 rating (the best) for its subprime servicing, citing the performance of collections and loss mitigation staff dedicated exclusively to subprime loans, and the performance of Wells' portfolio. By year-end 2003, Wells Fargo had a subprime portfolio of $12.7B.

Wells Fargo Subprime Servicing Portfolio ($B)



Source: Inside B&C Lending

Channel #2: Wells Fargo Financial – Unfettered consumer lending

Wells Fargo's consumer finance company, originally Dial Finance, was acquired by Norwest in 1982. At that time, Dial Finance had 460 stores in 38 states, and assets of $1.1 B.

From 1984-87, Dial/Norwest Financial was consistently the top performing business segment at Norwest Bank; in 1986 the unit generated 60% of the entire company's profits. In 1987, Duff & Phelps rated Norwest Financial the nation's premier consumer finance company, and one analyst later asserted that the unit's consistent profitability "was probably what spared Norwest from being taken over."[2]

In 1994, American Banker called Norwest Financial "the powerful profit engine [that] helped propel Kovacevich into the catbird seat on Wall Street."[3] At that time, Norwest stock was trading at 225% of book value, the highest multiple among nation's largest regional banks.

The same American Banker article described the Norwest Financial culture and profitability:

> *To step inside Norwest Financial is to enter a flexible, fast-paced world where federal regulation takes a backseat to competition and discipline...In most cases, the unit can open offices in any state without going through an elaborate approval process. There is no federal regulation and state lending laws are not onerous.*

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> *On average, first-year start-up costs for a new office are about $200K, versus $1mm for a de novo commercial bank branch. Most new units break even by the third year, versus five years for a new bank branch. As for why bank regulators keep their hands off: liability funding comes entirely from non-deposit sources and is composed of commercial paper and long term debt. Equity capitalization exceeds 20% of assets...And there are rewards to go with the risks: First Manhattan Co estimates Norwest Financial enjoyed an average 21% yield on receivables in 1993, versus an average 6.3% cost of funds.* [4]

Most of Norwest Financial's growth during the late 1980s and 1990s came via acquisitions of other consumer and auto financing companies. It also added a credit card business through two banking subsidiaries, insurance business lines, and a collection service. In addition, Norwest expanded beyond the US through acquisitions of Trans Canada Credit in 1992 and Island Finance (the largest consumer finance company in Puerto Rico) in 1995.

For further growth, Norwest Financial pursued vigorous cross selling campaigns with other Norwest divisions by, for example, providing lists of customers who were renters to Norwest Mortgage and targeting that unit's homeowners for financing purchases of furniture, appliances, etc. It took over Norwest bank's credit insurance operation and began cross-selling this to its customers and mortgage customers. The unit also relied on selling "new" loans to its existing customer base: in 1999, Norwest Financial reported that 60-65% of its volume came from borrowers who were already in debt to them.[5]

While the consumer finance unit grew and its name changed over time (ultimately to Wells Fargo Financial in 2000), its senior management has remained intact for years. David Woods, Norwest Financial's chairman and CEO until 2000, joined Dial Finance in 1970. Tom Shippee, current COO of Wells Fargo Financial, has been with the subsidiary for almost 30 years. Norwest/Wells Fargo top management sets profit goals for the unit and allowed it to operate with relatively little oversight of day-to-day operations. "From our perspective," said one executive "[this] is the only way to go. You cannot take a business that's been successful, managed away from a bank culture, and convert it and have it continue to be successful."[6]

The consumer finance company has its own system to support origination, funding, servicing, collections and reporting of subprime loans. According to public statements, Wells Fargo Financial does not use credit scoring but relies heavily on collateral-based underwriting on real-estate secured loans.[7] "The loan is only going to be as good as the appraisal value is low; [and] as long as the LTV is low, you keep the borrower paying because the amount of debt at stake is not worth losing a house over," according to one exec.[8]

In the late 1990s, Wells Fargo Financial continued to be profitable, but its growth was disappointing to Wells Fargo top management. Daniel Porter, previously a GE Capital executive, was hired to succeed David Woods in 1999, and implemented changes designed to reclaim the unit's double-digit profit growth. "I wanted to compete with the likes of Citifinancial...but they had a broader set of products and greater focus on real estate," he said.[9] These changes included (1) adding technology, (2) achieving greater scale and geographic distribution through acquisitions, (3) expanding real estate loan offerings to range from prime to "near-prime" to subprime, and (4) moving the credit card operation to Nevada and South

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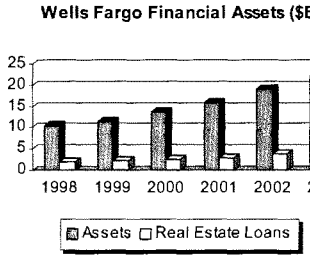
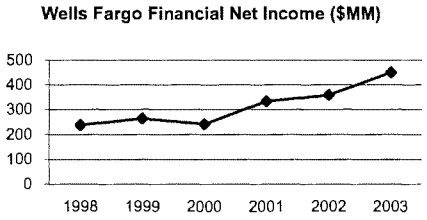
Carolina so it could charge higher rates and fees. The result was higher concentrations of real-estate secured loans, and higher profits.





Wells Fargo Financial ($MM)				
	Assets	**Revenue**	**Real-estate Secured Loans**	**Net Income**
1998	$10,516	$2,000	$1,889	$239
1999	$11,283	$2,184	$2,137	$265
2000	$13,576	$2,234	$2,507	$241
2001	$15,909	$2,623	$2,984	$334
2002	$18,988	$2,220	$3,732 est	$360
2003	$22,281	$2,689	$7,200 est	$451

Source: Wells Fargo earnings statements, Wells Fargo Financial 10-K/405, and 10-Q SEC filings. Real-estate secured loan estimates based on statements included in Wells Fargo earning releases

CRL Concerns with Wells Fargo Subprime Lending Practices

Getting a clear and complete picture of Wells Fargo's subprime lending is difficult, because the company originates loans through two units with sometimes very different operating practices. In addition, many standard methods of analyzing a lender's mortgage activity cannot be used with Wells Fargo because (1) a significant portion of Wells Fargo Financial's loans are not reported in its HMDA data, and (2) Wells Fargo Financial does not securitize its loans, so securities prospectuses describing loan terms are not available.

Nonetheless, we have seen Wells Fargo Financial embrace a host of practices that victimize low-wealth consumers, including excessive fees and high interest rates, deceptive marketing and customer steering, loan "flipping," overpriced insurance, and sham "open-end" loans and credit cards.

Many of these are long-standing practices, and community groups such as ACORN have complained about them for years. Others are newer, and appear to have been adopted at least in

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part to circumvent state anti-predatory lending laws. The major abuses identified by ACORN, the Center for Responsible Lending, and other organizations are described below:

- **Excessive Fees**: As recently as 2002, WFF had been regularly financing fees of 10% into refinanced first mortgages. To add insult to injury, they often labeled their fees "discount points," although borrowers also were charged very high interest rates. In response to growing public attention, WFF lowered its standard amount of fees to 7% of the loan amount in May 2003, and subsequently said they were limiting fees to 5%.[10]

  In a January 2004 meeting with CRL staff, WFF executives indicated that they now routinely charge customers, regardless of credit score, 4% in prepaid finance charges.

  Further, from Wells' description WFF underwriting procedures to the Federal Reserve, it is clear that WFF continues to make HOEPA loans, potentially including loans in excess of an 8 percent points-and-fee threshold (excluding prepayment penalties and yield spread premiums).[11] One possible explanation is that WFF's uses a limited definition of "points" that fails to adequately capture all of the points and fees a borrower pays on a loan.

- **Unfair and Inconsistent Pricing**: Wells Fargo subprime borrowers will not get the best loan possible, if their first contact is with WFF. As mentioned earlier, WFF executives have admitted that its customers get higher-priced loans compared to similar subprime customers at Wells Fargo Home Mortgage.

  And while WFHM now screens all borrowers through an "A-Filter" to identify the best interest rate they qualify for, WFF "does not classify credit as prime or subprime as a factor in setting APRs",[12] suggesting that there is room for wide variation in the terms offered clients. ACORN has identified several troubling examples of WFF borrowers with good credit receiving loans with excessive fees and high interest rates.

- **Prepayment Penalties**: As with WFHM loans, a large portion of WFF subprime loans contain prepayment penalties. ACORN found too that WFF borrowers frequently were unaware that their loans contained a prepayment penalty, because the loan officers never pointed it out or deliberately misled them.

  Wells Fargo does not publicly disclose the size of those fees, but we note that the vast majority of Wells Fargo Home Mortgage loans carry prepayment penalties of six months interest on 80 percent of the amount prepaid.[13] This equates to fees of approximately 3.5% of the loan amount or higher—an average of $5,300 on each loan. In most cases, this will be equity stripped directly from consumers' homes.

- **Mandatory Arbitration**: Historically, Wells Fargo loans carried a mandatory, pre-dispute arbitration clause that waived a borrower's right to access the courts and diverts cases to a costly private legal system that favors the lender. Borrowers were left with no choice but to waive these rights, because arbitration clauses are presented on a take-it-or-leave-it basis. WFHM recently ceased this practice, when Freddie Mac announced it

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would no longer purchase loans with mandatory arbitration clauses. However, we have seen no evidence that WFF, which holds all its loans in portfolio, has followed suit.

Mandatory arbitration almost always has several features that would make it difficult, if not impossible, for a WFF borrower to prevail in a dispute with the company, including high costs, limited discovery, inconvenient venue, prohibition of class actions, no public record, and limited judicial review. The National Consumer Law Center advocates believe these clauses are the single biggest threat to consumer rights in recent years.[14] Mandatory arbitration is expensive for consumers, denies them their rights under law, and, in the vast majority of cases, benefits only lenders. Public Citizen, a Washington consumer advocacy group, estimates that filing a claim on a loan of $75,000 can cost a borrower more than $2,000, plus thousands more in fees paid to the arbitrators who decide the case.[15]

- **Single-Premium Credit & Life Insurance**: Wells Fargo Financial regularly financed credit insurance policies into their home loans until October 2002, when the Federal Reserve changed regulations to discourage these policies. ACORN has found that WFF continues to sell single-premium life insurance to its borrowers, with the same financial impact on consumers that the Federal Reserve sought to outlaw. ACORN also found that these policies often were sold deceptively with high-pressure tactics.[16]

  It is interesting to note that insurance has been a trouble spot for WFF in the past. In 1998, Norwest Financial paid $870,000 to 3,000 Texas consumers to settle claims they had been misled into buying credit and collateral insurance on loans in what was called insurance "jamming."[17]

- **Refinancing without Benefit (flipping)**: Wells' loan officers frequently convince borrowers to refinance in transactions that provide little benefit to borrowers but generates profits for WFF from financed fees, increased interest revenues, and other terms that tack on extra costs. On the other hand, one community group has learned that WFF employees who leave the company are told that if at their next employer they refinance any Wells Fargo loans, they will be sued for $2000 for each loan.[18]

  According to its recently announced "Responsible Lending" practices, WFF now requires that refinances provide a "tangible benefit" to consumers. However, it defines this to include a loan that reduces a customer's current monthly debt payments by any amount. Based on this definition, WFF could charge over $17,000 in fees to a consumer to refinance $10,000 in 29% interest credit card debt, and still provide a "benefit."[19]

- **Hidden Variable Interest Rates**: WFF borrowers often were led to believe they were receiving fixed interest rates when their loans actually contained a variable rate, which could only go up. ACORN found that Wells Fargo Financial loans frequently contained variable interest rates that might start at 11% and have a ceiling of 17%. Structuring the loan with a variable interest rate also enabled Wells Fargo Financial avoid any restrictions in state law on the length or amount of prepayment penalties, under an interpretation of federal law by the federal Office of Thrift Supervision later reversed.

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- **Spurious Open-End Loans**: WFF sells consumers revolving lines of credit secured by their homes, in many cases systematically tacking on home-secured credit cards with high interest rates as junior mortgages which were never requested by the borrowers. WFF appears to be transforming what are closed-end loans in every other respect into open-end loans by adding an additional page into the loan documents setting out a credit limit. This enables WFF to evade reporting requirements and insulates the company from liability under state and federal consumer protection laws.

  But more important, these open-end credit cards or lines of credit harm consumers in a several ways: (1) the higher interest rates on the credit lines rack up large interest payments; (2) the home-secured debts inflate borrowers' loan-to-value ratios, making it more difficult for them to refinance out of their loans; and (3) borrowers often do not realize that the credit cards/lines are secured by their homes and thus are unaware of the real risk and costs of their Wells Fargo loans.[20]

  We believe that WFF used these open-end loans in order to evade a number of state and federal anti-predatory lending laws, many of which to date have tended not to include open-end loans in the scope of covered loans.

- **Live Checks**: To bring customers in, Wells often mails out unsolicited live checks to homeowners for a few thousand dollars. In reality, these are loans with interest rates of 25% or 30%, and are aimed at vulnerable homeowners who either do not understand what they are getting into and/or are confronting difficult personal situations. In sending out the live check, WFF's apparent goal is to get the homeowner to refinance their entire mortgage with them.

  Wells Fargo defends its use of live checks and relies upon disclosures to make the claim that borrowers understand that these are loan products.[21] However, the California Department of Corporations filed suit against Wells in January 2003 for $38.8 million in civil penalties for charging borrowers rates above those listed on the loan contracts, after Wells failed to correct the overcharges after an earlier notification.[22] We also wonder if consumers actually have read the disclosure "fine print", which indicates that borrowers who make a late payment will be in default on their loan, and may be required to pay the entire outstanding balance immediately.

- **HMDA Under-Reporting**: The Center for Responsible Lending's analysis of Wells Fargo home loans has revealed substantial discrepancies between courthouse records and data reported under the Home Mortgage Disclosure Act (HMDA), suggesting a pattern of under-reporting loans originated by Wells Fargo Financial. This has prevented regulators from fairly evaluating Wells Fargo's lending patterns by dramatically under-reporting lending activities by its subprime subsidiary.

  In 2002, courthouse records from 17 states revealed that WFF made 20,847 loans in these states. For that year, however, WFF only reported to the federal government that it made 4,770 loans in the same states. In other words, Wells Fargo underreported the number of

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loans made by its subprime unit in these states by more than 400%. In state after state, across every region of the country, WFF HMDA filings fail to match the number of subprime loans indicated by courthouse records.

While Wells Fargo has offered no convincing explanation for these discrepancies, we estimate that at least some are the result of WFF open-end loans discussed previously, since these are exempted from HMDA reporting requirements. We note that WFF reported significantly more HMDA loans in Georgia, a state with restrictions on open-end subprime loans.

Wells Fargo Financial
2002 Home Loans for Selected States

State	#WFF loans per courthouse records	#WFF loans reported under HMDA
Alabama	904	22
California	5,464	20
Colorado	1,636	1
Florida	2,956	1,599
Georgia	861	1,220
Illinois	1,311	0
Nebraska	358	620
New Jersey	666	1
New York	644	0
North Carolina	961	0
Ohio	1,300	876
Oregon	61	9
Rhode Island	61	9
South Carolina	378	0
Tennessee	1,454	0
Texas	1,194	0
Washington	697	402
TOTAL	**20,847**	**4,770**

Conclusion

Lulled by favorable analyst reports, Wells Fargo investors may not realize they are subsidizing a predatory lender. In addition, limited regulatory oversight and loopholes in regulations have enabled Wells Fargo Financial to hide predatory practices from federal regulators. Sadly, the people who see these problems most clearly are the unit's customers, who too often face the loss of their home or financial ruin as a result.

About the Center for Responsible Lending

The Center for Responsible Lending is dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is a national nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families.

For additional information, please visit our website at **www.responsiblelending.org**.

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Notes

[1] "Norwest Mortgage Exec Sees Opportunity in Subprime", National Mortgage News, 16 Nov 1998.
[2] "Norwest's Pitchman" Institutional Investor, Dec. 1, 1996
[3] "Norwest Racking Up Major Profits from Consumer Busines" American Banker, 28 March 1994
[4] Ibid.
[5] Wells Fargo Financial SEC 10-K filing, 12/31/98
[6] Subprime Credits Beckon to Banks", US Banker, 10 Oct 1995
[7] Ibid.
[8] Ibid.
[9] "Parting Thoughts from Wells Consumer Finance Exec", American Banker, 28 July 2003.
[10] "Wells Fargo Facing Tough Criticism," Los Angeles Times, March 2, 2003.
[11] Wells Fargo Aug. 11 Federal Reserve Response p. 33.
[12] Wells Fargo Aug. 11 Federal Reserve Response p. 33
[13] SEC 424b(5) filings available at www.sec.gov:
STRUCTURED ASSET INVESTMENT LOAN TRUST 2003-BC9 (August 23, 2003); ASSET BK FDG CORP ABFC MTG LN 03 WF1 (March 25, 2003); ASSET BACKED FUNDING CORP CERT SE 02 WF1 (March 28, 2002); ASSET BK FDG CORP ABFC MTG LN 02 WF2 (October 28, 2002).
[14] National Consumer Law Center < http://www.consumerlaw.org/initiatives/model/arbitration.shtml>
[15] Public Citizen <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID=7360>
[16] Stop the Stage Coach! Association of Community Organizations for Reform Now (ACORN). May 2003 http://www.acorn.org/index.php?id=64
[17] "Norwest subsidiary settles with 3,000 Texas consumers// $869,435 payment comes after claims the company misled customers about buying loan insurance." Austin American-Statesman. 30 September 1998.
[18] Inner City Press "Wells Fargo Watch" <www.innercitypress.org>
[19] Assumes WFF replaces 29% rate credit card debt with 10% mortgage loan. The related reduction in monthly payment would be $154. If $150 were added back to the mortgage (still providing a "benefit" of $4 per month to the consumer), this would increase the loan principal by $17,092.
[20] Wells Fargo credit card agreement includes the following text: "If there shall be any default in payment of any sums due under the Credit Card Account Agreement,...[we can] terminate the Credit Card Account Agreement and require you to pay the entire outstanding balance in one payment...and sell the land herein conveyed at public auction for cash."
[21] Wells Fargo Financial, "Wells Fargo Overall Response to ACORN's May 5, 2003 Report" at 11.
[22] "State Sues to Void 'Instant Loans' by Wells Fargo Unit," *Los Angeles Times*, by E. Scott Reckard, January 10, 2003.

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ATTACHMENT M

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

DECLARATION OF ELIZABETH M. JACOBSON

1. I, Elizabeth M. Jacobson, hereby attest that I am over the age of eighteen and I am competent to testify with respect to the matter below.

2. In 1998, I was hired by Wells Fargo Home Mortgage as a "Home Mortgage Consultant" or loan officer. I worked for Wells Fargo Home Mortgage ("Wells Fargo") until December, 2007. After a period of time, I was promoted to Sales Manager.

3. For much of the time that I worked for Wells Fargo my office was located in Federalsburg, Maryland. I worked directly with loan applicants to make subprime loans. The geographic area that I covered was known as Region 12. This area included Northern Virginia, Baltimore, and Prince George's County, among other places. Much of my business came from referrals from Wells Fargo loan officers who were on the prime

side of the business. That means that they dealt with prime loan customers. These loan officers were known as "A reps." Many of these referrals came to me over the telephone from the A reps. Once I got the referrals, I would work directly with the loan customer to get them a subprime loan.

4. I was very successful in making subprime loans. I received many awards from Wells Fargo for originating a very high volume of subprime loans. For several years I was the top subprime loan officer at the company. In 2004 I made more subprime loans than any other loan officer at Wells Fargo anywhere in the country. I was always one of the top three Wells Fargo subprime loan producers in the country.

5. Between 2003 and 2007 I completed approximately $50 million in subprime loans per year. This translated to about 180 loans per year.

6. My pay was based on commissions and fees I got from making these loans. Fees and commissions were based on the size of the loan and the interest rate. In 2004, I grossed more than $700,000 in sales commissions. In 2005 I grossed more than $550,000 in commissions and pay. I was happy to remain a sales manager and not move any higher up at Wells Fargo because I could make more money working directly with customers to originate loans.

7. Because of the high volume of subprime loans that I made and the length of time that I worked at Wells Fargo, I learned all of the "ins and outs" of the subprime loan process at the company. I used this knowledge to find ways to qualify customers for subprime loans.

8. The commission and referral system at Wells Fargo was set up in a way that made it more profitable for a loan officer to refer a prime customer for a subprime

loan than make the prime loan directly to the customer. The commission and fee structure gave the A rep a financial incentive to refer the loan to a subprime loan officer. Initially, subprime loan officers had to give 40% of the commission to the A rep who made the referral; later on A reps received 50 basis points of the available commission. Because commissions were higher on the more expensive subprime loans, in most situations the A rep made more money if he or she referred or steered the loan to a successful subprime loan officer like me. A reps knew about my success in qualifying customers for subprime loans; as a result, I received hundreds of referrals.

9. When I got the referrals, it was my job to figure out how to get the customer into a subprime loan. I knew that many of the referrals I received could qualify for a prime loan. If I had access to Wells Fargo's loan files right now and could review these files, I could point out exactly which of these customers who got a subprime loan could have qualified for a prime loan.

10. Because I worked on the subprime side of the business, once I got the referral the only loan products that I could offer the customer were subprime loans. My pay was based on the volume of loans that I completed. It was in my financial interest to figure out how to qualify referrals for subprime loans. Moreover, in order to keep my job, I had to make a set number of subprime loans per month.

11. Wells Fargo, like any other mortgage company, had written underwriting guidelines and pricing rules for prime and subprime loans. There was, however, more than enough discretion to allow A reps to steer prime loan customers to subprime loan officers like me. Likewise, the guidelines gave me enough discretion to figure out how to qualify most of the referrals for a subprime loan once I received the referral.

12. In many cases A reps used their discretion to steer prime loan customers to subprime loan officers by telling the customer, for example, that this was the only way for the loan to be processed quickly; that there would be less paperwork or documentation requirements; or that they would not have to put any money down. Customers were not told about the added costs, or advised about what was in their best interest.

13. Once I received a referral from an A rep, I had discretion to decide which subprime loan products to offer the applicant. Most of the subprime loans I made were 2/28s. A 2/28 loan allowed the borrower to pay a lower fixed rate of interest for the first two years of the loan (the "teaser rate") and then the interest would reset periodically with the market for the remaining 28 years of the loan. These loans typically included a prepayment penalty for two or three years which ultimately made it more difficult for the borrower to refinance later out of the loan. For those loans where the prepayment penalty extended beyond the teaser rate period, the borrower would be unable to refinance her loan even after her interest rate re-set because she could not afford to pay the prepayment penalty. I know that some loan officers encouraged customers to apply for these loans by telling them that they should not worry about the pre-payment penalty because it could be waived. This was not true – the pre-payment penalty could not be waived.

14. According to company policy, we were not supposed to solicit 2/28 customers for re-finance loans for two years after we made a 2/28 subprime loan. Wells Fargo reneged on that promise; my area manager told his subprime loan officers to ignore this rule and go ahead and solicit 2/28 customers within the two year period, even though this violated our agreement with secondary market investors. The result was that Wells

Fargo was able to cash in on the pre-payment penalty by convincing the subprime customer to re-finance his or her 2/28 loan within the initial two year period. I complained to senior managers about this practice. I am not aware of any corrective action that was taken.

15. In addition to 2/28 loans, we had at least three types of low or no document subprime loan products that we marketed to customers: (1) "stated income" loans; (2) no income, no asset loans; and (3) no ratio loans. Stated income loans were ones in which the customer did not have to show what his or her income was with verifying documentation, but could merely say he or she made a certain amount of money. No income, no asset loans did not require the customer to list any employment. For a no ratio loan, the loan officer only had to put down the borrower's job title and did not have to list any income or debt-to-income ratio. Although the underwriting guidelines with respect to these products changed from time to time, loan officers always had discretion to use different compensating factors to get the customer into one of these subprime loan products. If, for example, a customer had a high credit score that would make them a good candidate for a prime loan, it was a simple matter to get them qualified for a subprime loan by telling the underwriting department that the customer did not want to provide documentation for the loan, had no source or seasoned assets, or needed to get the loan closed quickly.

16. Wells Fargo loan officers encouraged loan applicants to apply for stated income loans, no income – no asset loans, and no ratio loans because these loans had higher interest rates and fees and would allow the loan officer to receive a higher commission. Wells Fargo qualified borrowers for subprime loans by underwriting all

adjustable rate mortgage (ARM) loans, including 2/28 loans, with the assumption that the borrower would pay the teaser rate for the full life of the loan even though this lower rate only applied during the first two or three years of the loan. Wells Fargo also did not require subprime borrowers to escrow for taxes and insurance and most subprime borrowers did not.

17. There were various techniques that were used to qualify the A rep referrals for subprime loans. Each of the techniques involved taking advantage of the discretion we had in applying the underwriting guidelines. One way was to tell customers not to put any money down on the loan and borrow the entire amount, even if they could afford a big enough down payment to qualify for a prime loan. As soon as the loan was submitted without a down payment, it would "flip" from prime to subprime and a subprime loan officer would be able to get the loan qualified as a subprime loan. Another technique would be to tell the customer that the only way to get the loan closed quickly would be to submit it as a subprime loan. A third technique would be to put a person into a "stated income" loan, even if they had a W-2 statement that verified their income. By doing this, the loan was flipped from a prime to a subprime loan. I know that through some of these techniques borrowers with credit scores as high as 780 were steered into expensive subprime loans with as many as four points, even though they could have qualified for a prime loan.

18. I also know that there were some loan officers who did more than just use the discretion that the system allowed to get customers into subprime loans. Some A reps actually falsified the loan applications in order to steer prime borrowers to subprime loan officers. These were loan applicants who either should not have been given loans or who

qualified for a prime loan. One means of falsifying loan applications that I learned of involved cutting and pasting credit reports from one applicant to another. I was aware of A reps who would "cut and paste" the credit report of a borrower who had already qualified for a loan into the file of an applicant who would not have qualified for a Wells Fargo subprime loan because of his or her credit history. I was also aware of subprime loan officers who would cut and paste W-2 forms. This deception by the subprime loan officer would artificially increase the creditworthiness of the applicant so that Wells Fargo's underwriters would approve the loan. I reported this conduct to management and was not aware of any action that was taken to correct the problem.

19. Prior to 2004, Wells Fargo did not make any effort to determine if subprime loans were being made to customers who qualified for prime loans. In 2004 a "filter" was put in place that was supposedly to help keep subprime loans from being made to prime customers. The filter did not work, and everyone knew it. There were lots of ways for loan officers to get around the filter because of the discretion that we had. If a subprime loan was flagged by the filter as one that had gone to a customer who qualified for a prime loan, the loan officer would simply give the underwriting department one of a set of stock responses, such as "the customer has no assets," or the customer's assets were not "sourced and seasoned." ("Sourced and seasoned" refers to verification of where the money comes from for the down payment and whether it has been in the customer's bank account long enough). These responses were widely used, and as soon as they were given to the underwriter, he or she would just override the filter and approve the subprime loan.

20. High ranking Wells Fargo managers knew that this practice was going on, because after about a year of these standby explanations being given, underwriters in the underwriting department were told to call the customers directly rather than contact the loan officer who was working with the customer. The loan officers quickly figured out how to work around this by warning customers that underwriters might call them and then coaching the customers about what to say. For example, customers were told that they should just tell the underwriter that they did not have much in the way of assets or documentation for their income, because otherwise the underwriter would deny their loan or force them to fill out additional paperwork to document their financials. The point was to get the customer to say whatever would allow them to qualify for a subprime loan, even if it was not true. The customers went along with this because they thought it would expedite the process of getting them the loan that they had been told was the right one for them.

21. Underwriters, like loan officers, had a financial incentive to approve subprime loans than, even if the customer could qualify for a prime loan, because they too got paid more if a subprime loan went through.

22. Wells Fargo charged higher interest rates and fees not only on its 2/28 and 3/27 subprime loans, but also on its subprime fixed-rate loans, than it did for prime loans. Subprime loan officers had discretion to decide what interest, points and fees to charge a borrower. For example, for approximately the first five years that I worked at Wells Fargo, I could charge as many points on a loan as I decided. Pricing sheets included different "add-ons" or fees that might be added to the price of the loan depending on the circumstances of the loan.

23. Federal Housing Administration (FHA) loans, like other government-insured loans, offered lower interest rates that are closer to prime rates. Subprime loan officers were required to have a subprime borrower sign a "Benefit to Borrower" Statement that stated that the borrower may qualify for a government-insured loan, but did not want it because it was too much paperwork. In fact, subprime loan officers were never trained in how to make FHA or government-insured loans. We asked for this training, but Wells Fargo refused to provide it.

24. For most of my employment, Wells Fargo did not restrict or regulate the fees that loan officers could charge. Only in 2007 did Wells Fargo begin to regulate and set the amount of fees such as processing fees and underwriting fees. Despite this regulation, subprime loan officers still had discretion to determine which fees to include as costs to the borrower and had a financial incentive to add fees because doing so increased their commission. There was always a big financial incentive to make a subprime loan wherever one could.

25. Once the subprime loan transaction with the customer was closed and we and Wells Fargo received our fees, closing costs and commissions, the loans were sold on the secondary market. This meant that Wells Fargo was no longer exposed to any risk of default or delinquency in payment on these subprime loans. In many cases, Wells Fargo continued to service these same subprime loans, and was paid a fee for doing that, but to my knowledge that did not expose the company to any risk beyond the first three months if the loans went bad. The risk of default rested with the companies that bought the loans from Wells Fargo, such as Fannie, Freddie, and Wall Street investment banks.

26. Many of the customers who were referred to me by A reps came from Prince George's County. Some came from Baltimore. I would estimate that a large majority of my customers were African American. Subprime managers joked that Prince George's County was the "subprime capitol of Maryland." I remember managers saying that they felt "so lucky to have P.G. County because it is the subprime capitol of Maryland."

27. I know that Wells Fargo Home Mortgage tried to market subprime loans to African Americans in Baltimore. I am aware from my own personal experience that one strategy used to target African-American customers was to focus on African-American churches. The Emerging Markets unit specifically targeted black churches. Wells Fargo had a program that provided a donation of $350 to the non-profit of the borrower's choice for every loan the borrower took out with Wells Fargo. Wells Fargo hoped to sell the African American pastor or church leader on the program because Wells Fargo believed that African American church leaders had a lot of influence over their ministry, and in this way would convince the congregation to take out subprime loans with Wells Fargo.

28. I remember being part of a conference call that took place in 2005 where Wells Fargo sales managers discussed the idea of going into black churches in Baltimore to do presentations about our subprime products. Everybody on that call was a subprime loan officer. Two of the individuals on the call were branch managers. On that call we were told that we "have to be of color" to come to the presentation. The idea was that since the churchgoers were black Wells Fargo wanted the loan officers to be black. I was

told that I could attend only if I "carried someone's bag." The point was clear to me: Wells Fargo wanted black potential borrowers talking to black loan officers.

29. Wells Fargo also targeted African Americans through special events in African-American communities called "wealth building" seminars. At some point in 2005 before the conference call discussed above, I remember preparing to participate in a wealth building seminar that was to be held in Greenbelt, Maryland. It was understood that the audience would be virtually all black. The point of the seminar was to get people to buy houses using Wells Fargo loans. At the seminar, the plan was to talk to attendees about "alternative lending." This was code language for subprime lending, but we were not supposed to use the word "subprime." I was supposed to be a speaker at this seminar, but was told by the Emerging Markets manager that I was "too white" to appear before the audience. I was offended by these statements and complained to several higher ranking managers about what had been said. The company did not respond to my complaints and no action was taken.

30. Subprime loan officers did not market or target white churches for subprime loans. When it came to marketing, any reference to "church" or "churches" was understood as a code for African-American or black churches.

31. I complained many times about what I thought were unethical or possibly predatory loan practices that Wells Fargo was engaged in. Managers never took any action to respond to my concerns. In my office we morbidly joked that we were "riding the stagecoach to Hell."

32. The culture at Wells Fargo was focused solely on making as much money as possible. Even as foreclosures were increasing in recent years, the company continued

MG

to lavish expensive trips and gifts on successful subprime loan officers. I attended all expense paid trips to Cancun, Orlando, Palm Springs, Vancouver and the Bahamas where we were entertained by Aerosmith, the Beach Boys, the Eagles, Cheryl Crow, Elton John, Jimmy Buffett and James Taylor. When we would return to our rooms at night we would find gifts of artwork, crystal platters, steak of the month club memberships and IPODs left for us.

33. Although I did not work in the part of the company known as Wells Fargo Financial ("Financial"), I am aware that Financial did mainly re-finances, not home purchase loans. Many of Financial's loans were extremely high priced with lots of points and fees. Wells Fargo management did not allow loan officers to solicit customers with high-priced Wells Fargo Financial loans for purposes of refinancing, even though this would have been in the borrower's best interest.

34. I left Wells Fargo in December 2007 because at that time the subprime market was contracting and I was getting fewer referrals. I wanted to move from Federalsburg to Easton, Maryland, but Wells Fargo said it wasn't opening any new offices. I gave my notice to the company at that point.

35. There are many other current and former Wells Fargo employees who have knowledge of the practices that I have discussed in this Declaration and, if compelled to testify, would, I believe, agree with what I have said. Many current and former Wells Fargo employees may well be reluctant to come forward voluntarily to tell what they know for fear of retaliation, reprisal or other actions that could adversely affect their future careers in the lending industry.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: April 20, 2009

BY: 
Elizabeth M. Jacobson

ATTACHMENT N

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

1. I, Tony Paschal, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. Between September, 1997 and September, 2007, during two separate periods of employment and for a total of eight years, I worked as a home mortgage consultant, or loan officer, in the Annandale, Virginia office of Wells Fargo Home Mortgage ("Wells Fargo").

3. My first period of employment with Wells Fargo was from September, 1997 to June, 1999. I was initially hired by Norwest Mortgage which merged with Wells Fargo in the middle of 1998. As a loan officer in Wells Fargo's Sales and Marketing section, my duties included contacting existing Wells Fargo borrowers in forty-eight (48) states to solicit them to refinance their home mortgage loan. Other Wells Fargo loan

officers also referred to me mortgage loan applicants that they were unable to qualify for "prime" loans because the applicants had blemished credit. I worked with these applicants to see if they would qualify for a prime conventional loan or a Federal Housing Administration ("FHA") loan. As loans insured by the federal government, FHA loans have interest rates that are a little higher than the prime rate, but are significantly less expensive than subprime loans.

4. I also worked during much of this period as a Community Development Representative. In this capacity, I contacted and worked with community groups with the goal of expanding Wells Fargo's business, particularly in minority communities. I am African American.

5. In June, 1999, I left Wells Fargo to take a position with Ardent Communication, a telecommunications business. I left Wells Fargo for two reasons. First, I was uncomfortable with how Wells Fargo treated its minority employees and customers. Wells Fargo's managers were almost entirely White and there was little to no opportunity for advancement for minorities. Wells Fargo also discriminated against minority loan applicants by advising them that the interest rate on their loan was "locked", when in fact, Wells Fargo had the ability to lower the interest rate for the applicant if the market rates dropped prior to the loan closing. I believe this was deceptive and discriminatory, particularly since Wells Fargo loan officers lowered interest rates for White loan applicants when market rates dropped after the application but prior to a loan closing. Even though I complained about this differential treatment of minorities to the branch manager, Jennifer Bowman, Wells Fargo did nothing to change

the practice. I also left Wells Fargo because Ardent Communications offered me a higher salary and more opportunities as a minority employee for advancement.

6. After Ardent Communications went out of business, in November 2001, I returned to work as a loan officer in the Sales and Marketing section of Wells Fargo's Annandale, Virginia office. Although I still had concerns about Wells Fargo's treatment of minority employees and customers, I thought that because there was a new branch manager, Dave Margeson, in the Annandale office, the working environment may have improved.

7. By the time I returned to Wells Fargo, the company was targeting existing customers for refinance loans to a much greater extent than it had during my first period of employment. As during my first period of employment, I contacted existing Wells Fargo borrowers nationally to solicit them to refinance their loans into a prime or FHA loan. When the borrower did not qualify for those loans, I would refer the borrower to the Mortgage Resource division, which is known by the acronym MORE and exclusively originates higher interest rate subprime loans. The employees working for MORE were located on the same floor as I was and I communicated with them every day.

8. In addition to taking referrals from other loan officers, MORE employees in the Annandale office targeted minority consumers for both purchase and refinance subprime loans. The MORE division targeted zip codes in Washington, D.C. east of the Anacostia River, Prince George's County, Maryland and the City of Baltimore with predominantly African-American populations. I heard employees in the MORE division comment that Howard County was not good for subprime loans because it has a predominantly White population. I also heard MORE employees on several occasions

mimic and make fun of their minority customers by using racial slurs. They referred to subprime loans made in minority communities as "ghetto loans" and minority customers as "those people have bad credit," "those people don't pay their bills," and "mud people."

9. In 2002, Dave Johnson, a former colleague with whom I had worked at Wells Fargo in 1997 and 1998, asked me if I could help him return to Wells Fargo. Mr. Johnson left Wells Fargo in 1998 to work at another mortgage lender. I spoke with Dave Margeson, my branch manager, and suggested that he hire Dave Johnson. Wells Fargo hired Mr. Johnson as a manager in the MORE division. Although I had also applied for a management position, Wells Fargo hired Mr. Johnson, who is White, instead of promoting me. I believe that Wells Fargo did not promote me for two reasons. First, Wells Fargo's management culture was White. Mr. Margeson is White and so is his immediate supervisor, area manager John Goulding. Indeed, I know of only one Wells Fargo African-American manager. Second, Wells Fargo management knew that I treated Wells Fargo customers well by offering to refinance them to prime and FHA loans when they qualified for those products. Wells Fargo management did not believe that I was doing enough to promote the subprime business, which was far more profitable because of the higher interest rates and fees. John Goulding told me that I was not doing enough to promote subprime loans and managers told me and others in the Sales and Marketing section that if we could not initially qualify a borrower for an FHA loan, we should refer them to the MORE division for a subprime loan even if with additional time or assistance the borrower would qualify a prime or an FHA loan.

10. Wells Fargo promoted its subprime business by targeting subprime loans to minorities. It did so in two ways, first, by sending marketing materials to minority

communities; second, by using minority subprime loan officers to solicit loans in those same communities. Wells Fargo targeted marketing materials to zip codes with predominantly minority populations. Wells Fargo's Annandale office targeted African American zip codes in Washington, D.C., Prince George's Country and Baltimore.

11. Wells Fargo even had software to generate marketing materials to minorities. For example, if a Wells Fargo loan officer anywhere in the United States wanted to send a flyer to consumers in an African-American neighborhood soliciting subprime loans, he could access software on his computer that would print out a flyer to persons speaking the language of "African American." I discovered this practice and attach a screen shot from my computer as an illustration of how a Wells Fargo employee could generate a flyer targeting African Americans. The document attached as Exhibit A is a true and accurate copy of the screen shot I printed on January 17, 2006. Only after I complained about this practice, did Wells Fargo agree to remove the African American option from the menu of languages.

12. Wells Fargo also marketed subprime loans to minorities by hiring minority employees to solicit these higher cost loans. Wells Fargo hired African-American loan officers exclusively from other subprime lenders. In the Annandale office, all the MORE loan officers were African-American, even though their two managers were White. In Silver Spring, Maryland, Wells Fargo had an "Affinity Group Marketing" section which consisted entirely of African-American employees. The Affinity Group targeted African-American churches and their members for loans. The Affinity Group Marketing section also hired an African-American employee specifically for the purpose of targeting African-American churches. Because the MORE group only had authority to make

subprime loans, they regularly originated subprime loans to African Americans and other minority borrowers who could have qualified for a lower cost prime loan or FHA loan. I had access to Wells Fargo customers' loan records and application files for my work in the Sales and Marketing division and regularly saw minority customers who had good credit scores and credit characteristics in subprime loans who should have qualified for prime or FHA loans.

13. Because Wells Fargo made a higher profit on subprime loans, the company put "bounties" on minority borrowers. By this I mean that loan officers received cash incentives to aggressively market subprime loans in minority communities. If a loan officer referred a borrower who should have qualified for a prime loan to a subprime loan, the loan officer would receive a bonus. Loan officers were able to do this because they had the discretion to decide which loan products to offer and to determine the interest rate and fees charged to the borrower. Since loan officers made more money when they charged higher interest rates and fees to borrowers, there was a great financial incentive to put as many minority borrowers as possible into subprime loans and to charge these borrowers higher rates and fees. I knew many loan officers who made more than $600,000 a year and a few who made more than $ 1 million.

14. Wells Fargo discriminated against minority loan applicants by not offering them its better or newer products which had lower fixed interest rates and fees. Instead, Wells Fargo offered its higher cost loan products, including its adjustable rate mortgage (ARM) loans to minority applicants. Wells Fargo's loan officers also discriminated against minority refinance applicants by encouraging them to take out more cash from their home equity. By taking out more cash, the borrower would unwittingly increase the

commission the loan officer received on the loan, while at the same time eliminating his ability to qualify for a prime or FHA loan. By encouraging the borrower to take out more cash, the loan officer knowingly increased the borrower's risk of foreclosure because of the higher loan amount.

15. In trainings, Wells Fargo loan officers were encouraged to omit pertinent information about a subprime loan in talks with applicants because discussing loan terms could cost a loan officer a sale. For example, it was implied in trainings that Wells Fargo loan officers should not mention that subprime loans included a prepayment penalty if the borrower paid off or refinanced his loan before the prepayment penalty period ended or that the monthly payments on ARM loans would substantially increase. When an applicant asked a loan officer about prepayment penalties or monthly payment increases, the loan officer would tell the applicant not to worry because Wells Fargo would later be able to refinance him into a prime or an FHA loan.

16. Wells Fargo's management also tolerated a culture of discrimination. In addition to being almost entirely White, the company promoted at least one manager who used racial slurs. Dave Zoldak, who succeeded Dave Margeson as my branch manager in 2005, used the word "nigger" at the office. Although Wells Fargo knew Mr. Zoldak used racial slurs, it promoted him to area manager after I complained about his discriminatory comments. On October 21, 2005, I complained by email to Mr. Zoldak directly about his use of the word "nigger" and speaking about how African Americans lived in "'hoods" and "slums." Mr. Zoldak replied that he had used the slurs in a humorous way, just as the African-American comedian Dave Chapelle did on television and thought that I would find the use of these terms humorous. I attach as Exhibit B a true and accurate

copy of my October 21, 2005 email to Mr. Zoldak and his response later the same day. On December 9, 2005, I complained by email to Joe Rogers, an Executive Vice President, and two Human relations employees at Wells Fargo about the use of the word "nigger" and other slurs by Wells Fargo employees. I also verbally informed Mr. Rogers's of Mr. Zoldak's racial slurs, including the use of the word "nigger." Although Mr. Rogers agreed with me by email that racial epithets were unacceptable, he questioned why I was raising the issue with him. I attach as Exhibit C a true and accurate copy of my December 9, 2005 email to Mr. Rogers and others, and his December 12, 2005 response. Despite these complaints, Wells Fargo promoted Mr. Zoldak.

17. Even the underwriting of subprime loans fostered their discriminatory impact on minorities. The subprime underwriting group was located in a different city than the prime underwriting group. The subprime underwriters were located initially in Baton Rouge, Louisiana and later Ft. Mill, South Carolina. Subprime loan officers with MORE and elsewhere within Wells Fargo pressured underwriters to approve subprime loans.

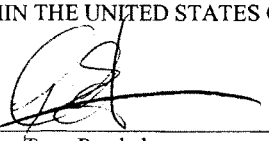
18. In late 2004 and early 2005, in response to the complaints of discrimination by such groups as ACORN (the Association of Community Organizations for Reform Now) and the Center for Responsible Lending, Wells Fargo implemented so-called "filters" in their lending programs that purportedly would discourage loan officers from steering minorities to subprime loans. Wells Fargo implemented these filters for public consumption only and not to actually restrict discriminatory practices. The filters were ineffective because they did not have any "teeth" (no punishment for violating) and because they were easy for loan officers to circumvent. I do not believe these filters had

any impact on steering because subprime loan officers continued to receive large financial incentives for making subprime loans to minority borrowers and were encouraged by their managers to do so because these loans were profitable. These filters also did not have an impact on steering because, notwithstanding any written rules, loan officers had discretion to make decisions about products and pricing.

19. Wells Fargo ultimately fired me in September, 2007 asserting that my loan production was low. My loan production was lower than many other loan officers because I tried to do the right thing by Wells Fargo customers by putting them in loans they could afford. If a customer did not qualify for a loan or could not afford an estimated monthly payment, I did not originate the loan. I was verbally reprimanded by John Goulding, my indirect supervisor, for placing too many customers in FHA loans, when the company wanted me to refer them to a subprime loan officer, for example in the MORE group, so that the company could make a greater profit on the loan.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED WITHIN THE UNITED STATES ON: April 9, 2009

BY: 

Tony Paschal

Exhibit A

Search for Items

Standard Search (* You must at least select a Type of Item or enter a Subject)

* What Type Of Item Are You Looking For?	Fast Flyer
* What Subject Are You Looking For?	
Personalized	Yes, Personalized
Strategy	Special Programs
Language	African American
Item Size	--Select One--
Item Color	--Select One--
Audience	--Select One--
Product / Program / Feature	--Select One--
High Trust Sales and Marketing	--Select One--
SALE ITEMS	--Select One--

Search

Searching Hints

Here are some helpful searching hints t
you find the items you're looking for.

> For the fastest results, if you know the
number, enter it in the Quick Search sect

> For best results using Standard Search
minimum, select a Type of Item AND a St
such as "FAST Flyer - Consumer" and "F
Homebuyer".

> For more targeted results, also include
search criteria as appropriate, such as st
language, etc. At a minimum, you must
either a Type of Item or enter a Subject.

Quick Search (Use This When You Know the Item ID)

Item ID (do not include NMFL#, etc.)

Search

Custom Requests

For custom design requests, click on the button below. Please note that custom requests are not tracked as orders through Easy O
should contact Ad Services directly at 515-213-4000 or by email at adservices@wellsfargo.com for questions regarding custom req

Custom Requests /Reviews

Exhibit B

Paschal, Tony

From: Zoldak, David
Sent: Friday, October 21, 2005 8:47 AM
To: Paschal, Tony
Subject: RE: Workflow

I'm only trying to provide you options to help lessen an obviously frustrating situation. I would rather suggest as many resources I know of to help you be proactive with your loans instead of making excuses to let these loans go to the wayside. As far as the rest of your comments are concerned, I believe you are referring to our many rehashings of the Dave Shappell(spelling) show , which, I assumed you enjoyed. If something I said had ever offended you, I'm sorry. They next time I say something that you feel is offensive to you or anyone, I would encourage you to address it at that time. I would like you to focus on working with me and our team in Ohio to resolve your loan problems instead of wasting your time and energy in some other direction.

David J. Zoldak
Branch Manager
Wells Fargo Home Mortgage
MAC M8602-031
7620 Little River Turnpike, Ste. 300
Annandale, VA 22003
703.333.5555 Tel
866.333.5540 ext. 5555 Toll Free
703.333.5590 Fax
david.zoldak@wellsfargo.com

For your protection, we remind you that this is an unsecured email service, which is not intended for sending confidential or sensitive information. Please do not include your social security number, account number, or any other personal or financial information in the content of the email. To see our privacy policy regarding how we use and protect customer information, please select the following link: http://www.wellsfargo.com/privacy/privacy.jhtml. To discontinue receiving all emails containing solicitation materials from Wells Fargo Bank N.A., including Wells Fargo Home Mortgage, please send an email to NoEmailRequest@wellsfargo.com with your name and email address.

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Wells Fargo Home Mortgage-2701 Wells Fargo Way-Minneapolis, MN 55467-8000

From: Paschal, Tony
Sent: Friday, October 21, 2005 6:49 AM
To: Zoldak, David
Subject: Workflow
Importance: High

As soon as my email functionality is restored I will forward the email I sent to Ms. Noble over a week ago informing her about my computer situation. If I were able to access the information she has been requesting in her email, (cell phone numbers, work numbers, etc) I would have used loan status not LIS to get that information. Since neither of those systems has been available on a consistent basis for the past two weeks, and since loans in apptaker are reciprocally linked to loan status, getting back to Ms. Noble has been difficult at best. I feel her emails have been returned in a timely fashion, however if this situation is being approached as Shirley Temple and Bill (Bojangles) Robinson we have a problem. Speaking of problems, since you were comfortable enough to use a quote in front of me several months ago using the word "nigger" you'll understand when I say that I am nobody's "nigger" and I do not live in anyone's "hood" and I am not from anyone's slums. If you have any questions feel free to contact me. Thank's

Tony Paschal
Home Mortgage Consultant
Wells Fargo Home Mortgage
M8602-031
7620 Little River Turnpike Suite 300
Annandale, Virginia 22003
703.333.5549 Office
866.333.5540 ext.5549 Toll Free

Exhibit C

Paschal, Tony
From: Rogers, Joe
Sent: Monday, December 12, 2005 10:34 AM
To: Paschal, Tony
Cc: White, Julie M. - HR; Williams, Mark S (HR)
Subject: RE:

Tony,

I believe all on this chain would agree with you. My question is one of context. What prompts you to ask that question at this time. While I would want to send an across the board agreement, questions like yours below, could be an example of the use of this word. In other words, indicating a totally unacceptable practice.

Joe Rogers
Ph: (410) 872-1935

-----Original Message-----
From: Paschal, Tony
Sent: Friday, December 09, 2005 4:03 PM
To: Rogers, Joe
Cc: White, Julie M. - HR; Williams, Mark S (HR)
Subject:
Importance: High

Is there any time when it is appropriate to use the word "Nigger" in the workplace? Is it ever appropriate to reference where an African American employee and his family live as the "slums" or the "hood"? This word is so vile and filthy that our email system will not allow it to leave our own network. After reading every employee handbook since Wells Fargo Home Mortgage was Norwest Mortgage, I cannot find any instance where any racial epithet is allowed at Wells Fargo. At least that what the handbook says.

Tony Paschal
Home Mortgage Consultant
Wells Fargo Home Mortgage
M8602-031
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tony.paschal@wellsfargo.com

For your protection, we remind you that this is an unsecured email service, which is not intended for sending confidential or sensitive information. Please do not include your social security number, account number, or any other personal or financial information in the content of the email. To see our privacy policy regarding how we use and protect customer information, please select the following link: http://www.wellsfargo.com/privacy/privacy.html. To discontinue receiving all emails containing solicitation materials from Wells Fargo Bank N.A., including Wells Fargo Home Mortgage, please send an email to NoEmailRequest@wellsfargo.com with your name and email address.

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Wells Fargo Home Mortgage-2701 Wells Fargo Way-Minneapolis, MN 55467-8300

ATTACHMENT O

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE,	)	
Plaintiff,	)	
v.	)	No. 1:08-cv-00062-BEL
WELLS FARGO BANK, N.A.	)	
and	)	
WELLS FARGO FINANCIAL LEASING, INC.,	)	
Defendants.	)	

DECLARATION OF IRA J. GOLDSTEIN

I, Ira J. Goldstein, hereby state as follows:

I am over the age of eighteen and am competent to make this Declaration. I have personal knowledge of the matters set forth below.

1. I hold a Ph.D. in Sociology from Temple University granted in 1986. My current position is that of Director of Policy and Information Services ("Policy") at an organization called The Reinvestment Fund ("TRF").

2. TRF is a Philadelphia-based community development financial institution whose mission is to alleviate poverty by building assets, wealth and opportunity for low- and moderate-

income communities and persons. TRF accomplishes its mission through the strategic use of capital, knowledge and market innovation.[1]

3. I am also a Guest Lecturer at the University of Pennsylvania where, for the last 20 years, I have taught an undergraduate course in statistics and research methods for the Urban Studies Program. For the last 5 years, I also have taught a graduate seminar in the uses of data and research methods to study issues related to urban redevelopment and blight; this course is offered in both the Urban Studies Program and the Department of City and Regional Planning.

4. In my position as Director of Policy for TRF, I am responsible for a number of grant and contract-related research projects. Among those projects have been a study of mortgage foreclosures in Baltimore for the Goldseker Foundation and other studies of mortgage foreclosures and predatory lending, including predatory lending in the City of Philadelphia under a grant funded by the Ford Foundation.

5. I also provided litigation support to the U.S. Attorney for the Eastern District of Pennsylvania on his predatory lending initiative and currently provide support to the Pennsylvania Human Relations Commission.

6. Prior to holding my position at TRF, I served at the United States Department of Housing and Urban Development ("HUD") as Director of Fair Housing and Equal Opportunity for the federal Mid-Atlantic Region, which includes Maryland. Among other duties, I was responsible for directing enforcement of the federal Fair Housing Act. At HUD, I developed analytical tools to measure racial disparities in mortgage lending. My publications include a number of articles, book chapters, and a book. In 2004, I wrote a paper presented at the Harvard University Joint Center for Housing Studies entitled "Bringing Subprime Mortgages to Market

[1] A complete description of TRF can be found at its website: www.trfund.com.

and the Effects on Lower-Income Borrowers."[2] I also coauthored a book, released in 2008 by Temple University Press, titled Restructuring the Philadelphia Region: Metropolitan Divisions and Inequality with Carolyn Adams, David Bartelt and David Elesh. I was recently appointed to a three-year term on the Federal Reserve Board's Consumer Advisory Council. My complete resume is attached as Attachment 1.

7. I have reviewed the data submitted by Mayor and City Council of Baltimore ("Baltimore") to the Court on April 6, 2009, and the data submitted by Wells Fargo Bank, N.A. and Wells Fargo Financial Leasing, Inc. (collectively, "Wells Fargo") to Baltimore on that date. I have been informed that, pursuant to the Court's Order, both sets of data concern properties that have been the subject of a foreclosure on a Wells Fargo loan between January 1, 2005, and December 31, 2008.

8. Based on my review of the data I have determined that the parties identified 379 properties subject to a Wells Fargo foreclosure filing. My colleague at TRF, Al Parker, precisely geocoded 374 to the census tract and block group. Geocoding is a process by which an address is translated into a set of spatial coordinates, which can then be identified with standard Census geographies. In the case where an address is incomplete or inaccurate, geocoding fails to occur; that was the case in five properties subject to a Wells Fargo foreclosure filing. Of those 374 geocoded properties, 203 (54.3%) are located in census tracts that are more than 80% African-American and 34 (9.1%) are located in census tracts that are between 60% and 80% African-American. Forty-five (12.0%) are located in tracts that are less than 20% African-American. The map attached as Attachment 2 reflects the locations of the 374 properties and the percentage of the population of each census tract in Baltimore that is African-American. The map

[2] A copy of the paper can be found at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-7.pdf.

demonstrates that the foreclosures are disproportionately located in census tracts with high African-American concentrations.

9. There is sufficient data on 375 of the 379 properties to determine whether they were vacant after the Wells Fargo loan was originated. The determination of vacancy was set forth in the data that I received, and described in paragraph 7 above. After reviewing data provided by Wells Fargo on the date of origination of the loans subject to the foreclosure filing along with data from other publicly available data sources referencing loan origination information, I determined that 222 of the 375 properties (59.2%) were in fact vacant after the Wells Fargo loan was originated. Mr. Parker then geocoded these 222 addresses and we determined that 132 (59.5%) are located in census tracts that are more than 80% African-American and 25 (11.3%) are located in census tracts that are between 60% and 80% African-American. The map attached as Attachment 3 reflects the locations of the 222 properties and the percentage of the population of each census tract in Baltimore that is African-American. The map demonstrates that the vacancies are disproportionately located in census tracts with high African-American concentrations.

10. The data I reviewed identified 107 of the properties as currently vacant. I determined that 69% of these are in neighborhoods that are at least 60% African-American while 16% are in neighborhoods that are at least 60% white.

11. I have also reviewed the data on the 379 properties in conjunction with data on Wells Fargo loan originations made public pursuant to the Home Mortgage Disclosure Act (HMDA) to determine the likelihood that a Wells Fargo loan in Baltimore has resulted in foreclosure. I have determined that 4.82% of Wells Fargo loans in neighborhoods that are more

than 60% African American have resulted in foreclosure, while 1.63% of its loans in neighborhoods that are over 60% White have resulted in foreclosure.

12. By analyzing HMDA data for the period 2004 through 2007 (the last year for which HMDA is available), I have also determined that Wells Fargo's high-cost loans in Baltimore are disproportionately located in neighborhoods that are more than 60% African American. The disparity is reflected on the map attached hereto as Attachment 4.

13. I have also determined based on my review of the data indicating the presence and amount of a tax lien, that 127 of the 379 Wells Fargo foreclosure properties (33.5%) were the subject of a tax lien sale between 2005 and 2008 after origination of the Wells Fargo loan, and that the median value of the tax lien for these 127 properties was $925.14. I have reviewed data released by Wells Fargo pursuant to the HMDA and determined that the median Wells Fargo mortgage loan in Baltimore between 2005 and 2007 (the 2008 HMDA data file is not yet available) was $112,000. Based on my years of experience working with municipalities, real estate attorneys and housing counselors, I do not believe that tax liens of the size at issue here are likely to play a significant role in causing borrowers to default on mortgages of this size.

14. Based on my review of HMDA data covering the years 2004 through 2007 reported by Wells Fargo, Wells Fargo made 38.7% of its mortgage loans in Baltimore in neighborhoods that are more than 60% African-American and 32.2% of its mortgage loans in neighborhoods that are less than 20% African-American.

15. I have been asked to identify the location and racial composition of the census tract/block group within which the following three properties are located:

500 N. Clinton Street, Baltimore, MD: Census tract/block group 2610.01
81.25% Black (2007 Claritas estimate)

2520 Shirley Avenue, Baltimore, MD: Census tract/block group 1513.02
95.14% Black (2007 Claritas estimate)

801 Arnold Court, Baltimore, MD: Census tract/block group 704.03
97.37% Black (2007 Claritas estimate)

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 29, 2009

BY:_____
Ira J. Goldstein

Attachment #1

Resume: Ira J. Goldstein

Resume

Name: Ira J. Goldstein

Address: 7203 Lincoln Drive
Philadelphia, PA 19119

Telephone: (215) 242-4824 (H) (215) 574-5827 (O)

E:Mail: Iralin@verizon.net (H)
Ira.goldstein@trfund.com (O)

Education: Ph.D. Sociology, Temple University (1/86) The Wrong Side of the Tracts: A Study of Residential Segregation in Philadelphia, 1930-1980
M.A. Sociology, Temple University (8/82)
B.A. Sociology, Temple University (5/79)

Reports, Publications & Reviews:

"USDA's Irrational Rationale." In The Philadelphia Inquirer Op-Ed, November, 2008 (with William Yancey).

"Subprime Lending, Mortgage Foreclosures and Race: How far have we come and how far have we to go?" (with Dan Urevick-Ackelsberg). The Ohio State University Kirwan Institue for the Study of Race and Ethnicity, 2008. (http://4909c99d35cada63e7f757471b7243be73e53e14.gripelements.com/pdfs/Goldstein_TRF_paper.pdf)

Restructuring the Philadelphia Region; metropolitan Divisions and Inequality (with Carolyn Adams, David Bartelt and David Elesh). Temple University Press, 2008.

"Estimating the Percentage of Students Income-Eligible for Free and Reduced Price Lunch." The Reinvestment Fund, 2007. A report prepared for the School District of Philadelphia. (http://www.trfund.com/resource/downloads/policypubs/SchoolLunchEligible_SDOP.pdf)

"One Industry's Risk is Another Community's Loss: The Impact of Clustered Mortgage Foreclosures on Neighborhood Property Values in Philadelphia" (with Richard Voith). Federal Reserve Bank of Philadelphia Discussion Paper, (forthcoming).

"Lost Values: A Study of Predatory Lending in Philadelphia" The Reinvestment Fund, 2007. (http://www.trfund.com/resource/downloads/policypubs/Lost_Values.pdf)

"The Economic Consequences of Predatory Lending: A Philadelphia Case Study." In Why the Poor Pay More: How to Stop Predatory Lending, Praeger Publishers, Squires, 2004.

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"Racial Barriers to Credit: Comment on Hula" (with Anne Shlay and David Bartelt). Urban Affairs Quarterly, 1992, Vol. 28, 1.

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Philadelphia: Neighborhoods, Division and Conflict in a Post-Industrial City (with Carolyn Adams, David Bartelt, David Elesh, Nancy Kleniewski and William Yancey). Temple University Press, 1991.

"Homeless With Children: African American Women In Philadelphia" (with Phyllis Ryan and David Bartelt). In The State of Black Philadelphia, Vol. IX, The Urban League of Philadelphia, October, 1990.

"Public Education In Philadelphia: A Demographic and Social Profile." In The State of Black Philadelphia, Vol. IX, The Urban League of Philadelphia, October, 1990.

"Homelessness: A Sign of the Times." Planners Network, 1990, 81, 3.

Race Relations In Philadelphia: A 1989 Perspective - A 1990 Opportunity (with Leah Gaskin White). A report prepared jointly with the Philadelphia Commission on Human Relations, January, 1990.

The Politics of Knowledge: Activist Movements in Medicine and Planning by Lily M. Hoffman. Book review for the American Journal of Sociology, 1990, Vol. 96, 1.

Homelessness in Philadelphia: Roots, Realities and Resolutions (with David Bartelt and Phyllis Ryan). A report prepared under a grant from the Thomas Skelton Foundation, October, 1989.

"There Isn't the Housing for the Homeless." In The Philadelphia Inquirer Op-Ed, September, 1989.

"An Analysis of the Real Estate Assessment Practices of the City of Philadelphia's Board of Revision of Taxes" (with Robert Beauregard and Arthur Lyons). A report commissioned by the City Council of Philadelphia, September, 1989.

"Local Tax Reform: Is It Good For Philadelphians?" Institute for Public Policy Studies; Working Paper Series, April, 1989.

"Neighborhood Disputes and Intergroup Tension Events" (with William Yancey). In The State of Intergroup Harmony - 1988, Philadelphia Commission on Human Relations, October, 1988.

"Getting the Credit We Deserve: An Analysis of Residential Lending in New Castle County, Delaware; 1984 - 1986" (with Anne B. Shlay). A report commissioned by the Delaware Community Reinvestment Action Council.

"North Philadelphia: A Social and Demographic Profile" (with William L. Yancey). Institute for Public Policy Studies; Working Paper Series, August, 1988.

Homelessness in Pennsylvania: How Can This Be? 1988 (with Phyllis Ryan and David Bartelt). A report prepared for the Coalition on Homelessness in Pennsylvania and the Pennsylvania State Legislature.

"Islands in the Stream: Neighborhoods in the Political Economy of Urban Areas" (with David Bartelt, David Elesh, George Leon, and William Yancey). In Human Behavior and the Environment, Plenum Publishers, Altman and Wandersman, 1987.

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"Projects, Blacks and Public Policy; The Historical Ecology of Public Housing in Philadelphia" (with William Yancey). In Housing Desegregation, Race, and Federal Policies, University of North Carolina Press, ed. John Goering, 1986.

"The Flow of Housing Capital in the Philadelphia Metropolitan Area, 1982-1984." Institute for Public Policy Studies; Working Paper #20, September, 1986.

"Suddenly, Racism Has Reawakened in the Delaware Valley." In Philadelphia Daily News Guest Opinion Column, August, 1986.

"The Ecology of Educational Outcomes: A Preliminary Report" (with William Yancey and Leo Rigsby). A report prepared for the Philadelphia School District, July, 1986.

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The Jewish Population of the Greater Philadelphia SMSA (with William Yancey). A report prepared for the Federation of Jewish Agencies, November 1984.

Paper Presentations and Speeches:

"Next Steps in Fair Housing: Where is "Affirmatively Furthering Fair Housing" in HUD's Neighborhood Stabilization Program?" Presented at the National Housing Law Project / Housing Justice Network Conference, Washington, DC, 2008.

"Subprime Lending, Mortgage Foreclosures and Race: How far have we come and how far have we to go?" Presented at The Ohio State University's Kirwan Institute for the Study of Race and Ethnicity Conference. Columbus, OH, 2008.

"CDFI Financing of Supermarkets in Underserved Communities: a case study." (with Lance Loethen, Cathy Califano and Edward Kako). Presented at The Community Development Financial Institutions Fund Research Conference. Washington, 2008.

"Mortgage Foreclosures and Subprime Lending: An Assessment of the Issues and Proposed Policy Solutions." Presented at the 29th Annual Research Conference of the Association for Public Policy Analysis and Management. November, 2007.

"Update On Philadelphia Market Value Analysis." Presented at the City of Philadelphia's Annual Developer's Breakfast. May, 2007.

"Trends In Homeownership Across the Commonwealth of Pennsylvania." Presented at the Commonwealth Housing Forum of the Pennsylvania Housing Finance Agency. April, 2007.

"Market Value Analysis: Understanding Where and How To Invest Limited Financial Resources." Federal Reserve Bank of St. Louis' Series on Neighborhood Revitalization. December, 2006.

"Mortgage Foreclosures In Baltimore, MD." Presented at the Baltimore Homeownership Preservation Conference. October, 2006.

"Mortgage Foreclosures and Predatory Lending In Philadelphia." Presented at the American Bar Association's National Legal Aid and Defender Association Conference. July, 2006.

"One Industry's Risk is Another Community's Loss: The Impact of Clustered Mortgage Foreclosures on Neighborhood Property Values in Philadelphia." Presented at the Federal Reserve Bank of Philadelphia's Reinventing Older Communities: People, Places, Markets. March, 2006.

"Approaches Used By Non-Auditors To Investigate and Report Complex Public Issues." Presented at the National Conference of State Legislators – National Legislative Program Evaluation Society. October, 2005.

"A Study of Mortgage Foreclosure Activity in Pennsylvania, 2000-2003." Presented at the Federal Reserve Board's Consumer Advisory Council. March, 2005.

"Reflections on the American Dream; Experiences in Pennsylvania." Presented at the FNMA Annual Conference on Fair Lending." September, 2004.

"Maintaining Economic Gains: Partnerships To Protect Low Income Families From Predatory Lending." Presented at the American Public Human Services Association Family and Economic Success Forum. May, 2004.

"Recent Subprime Analyses; Foreclosures and Race." Presented at the National Fair Housing and Fair Lending Research and Policy Forum. March, 2004.

"Does Predatory Lending Disproportionately Affect Protected Classes Under the Fair Housing Act: The Latest Research." Presented at the John Marshall Law School Fair Housing Legal Support Center Symposium on Fair Housing and Predatory Lending Law. September, 2003.

"The Disproportional Incidence of Subprime and Predatory Lending on Protected Classes: New Data." Presented at the National Consumer Law Center Symposium on Market Failures & Predatory Lending. May, 2003.

"Predatory Lending: Overview and Policy Implications for Human Rights Agencies." Presented at the 54th Annual Conference of the International Association of Human Rights Agencies. July, 2002.

"Leveraging Change: Gauging the Impacts of Neighborhood Investment" with David Bartelt. Presented at the Annual Meeting of the American Sociological Association, 2002.

"Predatory Lending: From the Kitchen Table to Wall Street." Presented at regional forums of Freddie Mac's Don't Borrow Trouble in TX, NY, and CA, 2002-2003.

Methods for Identifying Lenders for Systemic Investigation Under the Fair Housing Act." Presented at the Home Mortgage Lending and Discrimination Research and Enforcement Conference, Washington, D.C., 1993.

"Proving Disinvestment: The CRA Experience" (with Anne Shlay). Presented at the Annual Meetings of the American Sociological Association, Pittsburgh, 1992.

"Mortgage Lending Patterns in Philadelphia, 1987 - 1989." A speech delivered to the Philadelphia Commission on Human Relations' "Making Home Ownership a Reality - Not Just A Dream" Conference, Philadelphia, 1991.

"Mortgage Redlining in Philadelphia - An Empirical Analysis." A speech delivered to the Philadelphia Finance Association, Philadelphia, 1990.

"An Overview of Mortgage Redlining; Background, Data, Research Methods and Conclusions." A speech delivered at the HUD Region III FHAP Training Conference, Philadelphia, 1990.

"The Role of Statistics In the Proof of Housing Discrimination." A Speech delivered at the HUD Region III FHAP Training Conference, Philadelphia, 1990.

"Homelessness in Philadelphia." Public testimony delivered at the Affordable Housing Forum, University of Pennsylvania, Philadelphia, 1989.

"Homelessness in Philadelphia: Roots, Realities and Resolutions" (with Phyllis Ryan and David Bartelt). Presented at the Annual Meetings of the Society for the Study of Social Problems, Berkeley, 1989.

"Philadelphia's Ignored Homeless - Unemployed Minority Males." A speech delivered at the Annual Meeting of Philadelphia Committee for the Homeless, Philadelphia, 1989.

"Why Should There Be Intergroup Harmony?" A speech delivered at the Bi-annual Meeting of the Alliance for Intergroup Harmony, Philadelphia, 1989.

"The Role of Academics in CRA." A speech delivered at the U.S. Department of Housing and Urban Development Region III Fair Housing and Equal Opportunity Conference, Baltimore, 1989.

"GDI: A Gentrification/Displacement Detection System." Presented at the Annual Meetings of the American Sociological Association, Chicago, 1987.

"The Persistent Significance of Race; A City/Suburb Comparison of Mortgage Lending in the Philadelphia Metropolitan Area." Presented at the Annual Meetings of the Eastern Sociological Society, Boston, 1987.

"The Ecology of Health and Education Outcomes: An Analysis of Philadelphia Public Elementary Schools." Presented at the Brown II Commemorative Program, School District of Philadelphia, 1987.

"The Ecology of Educational Outcomes" (with William Yancey and Leo Rigsby). Presented at the Brown II Commemorative Program, School District of Philadelphia, 1986.

"Political Integration and Residential Segregation; A Case Study of Philadelphia Voter Turnout" (with Patrick Feeney). Presented at the Annual Meetings of the American Sociological Association, Washington, 1985.

"Neighborhoods and Schools: 30 Years of Urban Change" (with William Yancey). Presented at the Brown II Commemorative Program, School District of Philadelphia, Philadelphia, 1985.

"The Political Economy of Residential Segregation: A Study of Philadelphia Neighborhoods." Presented at the 15th Annual Meetings of the Urban Affairs Association, Norfolk, 1985.

"See No Evil, Speak No Evil: The New Right, The Civil Rights Commission and 1984" (with Patrick Feeney). Presented at the Annual Meetings of the American Sociological Association, San Antonio, 1984.

"Projects, Blacks, and Public Policy: The Historical Ecology of Public Housing in Philadelphia" (with William Yancey). Presented at the Annual Meetings of the American Sociological Association, Detroit, 1983.

"Social Indicators of Four Types of Homicide" (with Margaret Zahn). Presented at the 8th Annual World Congress of Social Psychiatry, Paris, 1982.

Teaching Experience:

University of Pennsylvania:

Introduction to Urban Research
Information, Public Policy and Distressed Cities
City Limits: The Impact of Urban Public Policy

Temple University:

Introduction to Sociology
Undergraduate Statistics
Society and Personality
Urban Affairs – Discrimination in Housing

Research/Employment Experience:

June 1999 to present:
Director, Policy and Information Services, The Reinvestment Fund

The Reinvestment Fund (TRF) is a regional community development financial institution that uses capital and technical expertise to build wealth and create economic opportunity for low wealth communities and low and moderate income individuals. TRF accomplishes its mission through its financial support of affordable housing development, charter schools, community facilities, commercial real estate, small businesses, and workforce development programs. Policy and Information Services ("Policy") is an office within TRF that designs and conducts research that evaluates TRF's progress toward meeting its goals with regard to the social impact of its investments. Policy also conducts research that relates to public policy issues that impact upon our core market constituency. This research supports the development of new policy to be introduced into the public forum for debate and implementation. Policy is also responsible for obtaining and administering grant-funded and contract research that relates to the Fund's core mission. A sampling of TRF's Policy government past and preset clients includes, but is not limited to: Pennsylvania Department of Banking, Pennsylvania Housing Finance Agency, City of Philadelphia, New Jersey Housing and Mortgage Finance Agency, New Jersey Department of Community Affairs, Federal Reserve Bank of Philadelphia, City of Baltimore, Delaware Department of Banking, School District of Philadelphia.

January 1998 to June 1999:
Director, Mid-Atlantic Hub, Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development, Pennsylvania State Office

The Hub Director is the highest ranking fair housing position in HUD's Mid-Atlantic area. My jurisdiction included the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia and the District of Columbia. I was responsible for directing the investigation and resolution of fair housing cases under several statutes, including the Federal Fair Housing Act. Where state or local agencies exist that offer rights and remedies that are "substantially equivalent" to the those afforded by HUD and the Fair Housing Act, I was responsible for insuring that these agencies processed cases of discrimination in a manner that is consistent with the dictates of the law. Under current delegations of authority, with the concurrence of Regional Counsel, I was responsible for deciding whether there was factual evidence sufficient to render a determination that one (or more) statutes have been violated. I managed a staff of approximately 30 people in

the PA State Office; another 20 people around the Mid-Atlantic reported to me as well. I reported directly to the Assistant Secretary and General Deputy Assistant Secretary. This position required frequent travel and public appearances. I spoke publicly before trade groups (e.g., Mortgage Bankers Association, Maryland Multi-Family Housing Organization) fair housing organizations, and had frequent contact with elected and appointed public officials (e.g., mayors, senators, governors, council members, solicitors). Finally, Congress makes available a pool of funds that are subject of an annual competition among groups involved in fair housing advocacy and enforcement. On several occasions, I was called upon by the Assistant Secretary to contribute to the decisions on granting these funds.

The management portion of this job entailed working with the union and staff to insure a working environment that is free of social and/or structural impediments to productivity. From February 1995 until January of 1998, the official date for position changes resulting from HUD's *Management 2020,* the position I held was that of Fair Housing Enforcement Center (FHEC) Director. The responsibility of the position as Hub Director completely subsumed that of the: (a) FHEC Director; (b) what was formerly known as the Program Operations and Compliance Center (POCC) Director; (c) all of the Directors of the HUD/FHEO Offices within the Mid-Atlantic.

June 1991 to January 1998:

Chief, Systemic Investigations Branch, U.S. Department of Housing and Urban Development, Philadelphia Regional Office

In this position I was responsible for enforcing the federal Fair Housing Act through investigation of housing discrimination complaints. The Systemic Investigations Branch investigates complaints of housing discrimination which have many victims, or the nature of the discrimination is such that it is reflective of a pattern or practice of institutional discrimination. As Chief, I was also responsible for conducting Secretary Initiated complaints, an enforcement tool new to the 1988 Amendments of the Fair Housing Act. This position required that I introduce to HUD's Fair Housing and Equal Opportunity Office the science of data and statistical analysis to the investigation of housing discrimination complaints. I developed and was the first in the country to receive Assistant Secretary approval to initiate a Secretary Initiated investigation of discrimination in mortgage lending in Philadelphia. The position included a full complement of administrative responsibilities. I supervised a staff of eight professional investigators and "outstanding scholar" interns.

For the last year that I held this position, I was detailed to the headquarters office in Washington, D.C. There, I worked in the Office of Regulatory Initiatives and Federal Coordination on a Task Force on Fair Lending that was constituted with representatives of all of the financial regulatory agencies as well as the Departments of Housing and Urban Development and Justice. Also, I was involved in developing a regulation to support the Fair Housing Act's prohibitions against mortgage lending discrimination. While on detail, together with a colleague, we developed a computer based system that produced reports using Home Mortgage Disclosure Act and Census data to be used by investigators across the country in the investigation of mortgage lending discrimination complaints.

August 1988 to June 1991:

Associate Director, Institute for Public Policy Studies (IPPS)

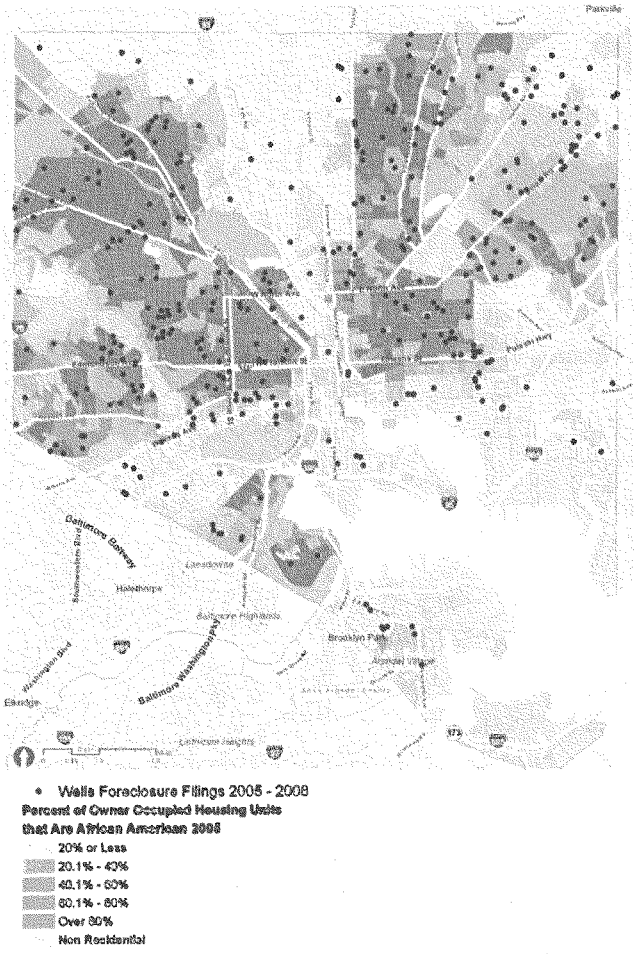
This position requires full administrative responsibility for departmental functions including staffing and budget. The acquisition and administration of departmental research and grants/contracts is an essential component. In this capacity, the Associate Director acts as liaison between funding sources, researchers, and university officials. The Associate Director is also responsible for carrying out empirically based policy research, and creating a forum in which policy researchers from a variety of backgrounds may meet and exchange ideas on issues of contemporary public policy importance. In 1989, IPPS became a Research Affiliate of the Pennsylvania State Data Center; the Associate Director is responsible for coordination of all related activities.

Professional Activities and Awards:

Recipient of the Consumer Credit Counseling Service of Delaware Valley's Peter F. Iacovini Credit to Greater Philadelphia Community Award
Committee Member, Pennsylvania Housing Advisory Committee (Gubernatorial Appointment)
Member, Federal Reserve Board Consumer Advisory Council (2009-2011)
Member, Research Advisory Group, Center for Responsible Lending
Referee, Urban Affairs Quarterly
Referee, Journal of Urban Affairs
Referee, Law and Social Policy

References Available Upon Request

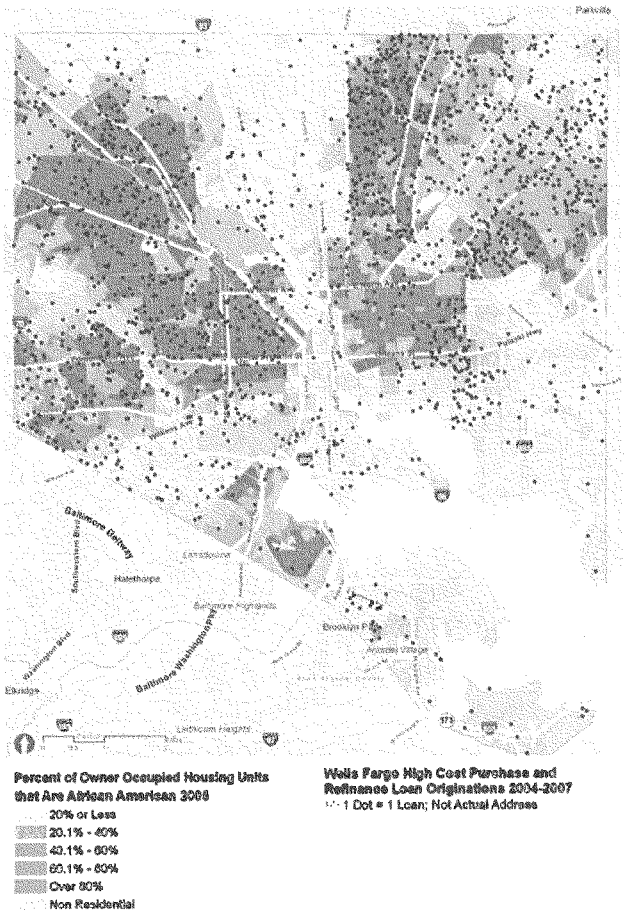
Attachment #2



Attachment #3



Attachment #4



ATTACHMENT P

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

1. I, Richard Faison, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. I reside at 2522 Shirley Avenue, Baltimore, MD 21215. I own my home, which is a row house located in northwestern Baltimore. I have lived in my home for more than 24 years.

3. My home is adjacent to another row house located at 2520 Shirley Avenue, Baltimore, Maryland 21215 ("the Property"), which is vacant and was recently boarded up in February, 2009.

4. The Property has caused problems for me and my family. For example, because the Property is rat infested, rats from the Property have come into our home and chewed holes in the walls. We have had to make repairs to those walls to try to keep the

rats out. Rats have come into both our basement and our kitchen from the Property. I had to put down one of my dogs because it got rabies from the rats.

5. Strangers go into the Property at all hours. I have called 911 on a few occasions because strangers are hanging out at the Property drinking. I also believe that people use the Property as a place to take drugs. Police have come to the Property at least twice because of the strangers who loiter there.

6. The Property has not been very well cared for. There is often trash on the front porch which attracts rats. A neighbor of mine who lives at 2518 Shirley Avenue, Brian Jefferson, has cut the grass in front of the Property on numerous occasions because it is so high and makes the whole block look bad.

7. There was also water buildup at the Property because the pipes burst. To prevent damage to my house, we had to call the City of Baltimore to come turn off the water and cap the pipes.

8. I know from viewing the inside of the Property that it is in bad structural condition because the floor and supports appear to be rotten. I am concerned that there may be additional damage to my home because of the condition of the Property. I am also concerned that the Property is a fire hazard. The Property has deteriorated even more over the last year.

9. The Property also has termite damage and I have to make repairs to my house to replace boards that have been damaged by termites.

10. The Property has hurt our neighborhood. People do not want to live in

my neighborhood because of the condition of the Property. I do not know who to get in touch with about the Property. I would like somebody responsible for the Property to repair it so that my neighbors and I no longer suffer from the problems described above.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 15, 2009

BY: Richard Faison
Richard Faison

ATTACHMENT P

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

1. I, Richard Faison, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. I reside at 2522 Shirley Avenue, Baltimore, MD 21215. I own my home, which is a row house located in northwestern Baltimore. I have lived in my home for more than 24 years.

3. My home is adjacent to another row house located at 2520 Shirley Avenue, Baltimore, Maryland 21215 ("the Property"), which is vacant and was recently boarded up in February, 2009.

4. The Property has caused problems for me and my family. For example, because the Property is rat infested, rats from the Property have come into our home and chewed holes in the walls. We have had to make repairs to those walls to try to keep the

rats out. Rats have come into both our basement and our kitchen from the Property. I had to put down one of my dogs because it got rabies from the rats.

5. Strangers go into the Property at all hours. I have called 911 on a few occasions because strangers are hanging out at the Property drinking. I also believe that people use the Property as a place to take drugs. Police have come to the Property at least twice because of the strangers who loiter there.

6. The Property has not been very well cared for. There is often trash on the front porch which attracts rats. A neighbor of mine who lives at 2518 Shirley Avenue, Brian Jefferson, has cut the grass in front of the Property on numerous occasions because it is so high and makes the whole block look bad.

7. There was also water buildup at the Property because the pipes burst. To prevent damage to my house, we had to call the City of Baltimore to come turn off the water and cap the pipes.

8. I know from viewing the inside of the Property that it is in bad structural condition because the floor and supports appear to be rotten. I am concerned that there may be additional damage to my home because of the condition of the Property. I am also concerned that the Property is a fire hazard. The Property has deteriorated even more over the last year.

9. The Property also has termite damage and I have to make repairs to my house to replace boards that have been damaged by termites.

10. The Property has hurt our neighborhood. People do not want to live in

my neighborhood because of the condition of the Property. I do not know who to get in touch with about the Property. I would like somebody responsible for the Property to repair it so that my neighbors and I no longer suffer from the problems described above.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 15, 2009

BY: Richard Faison
Richard Faison

ATTACHMENT Q

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

1. I, Stephen Faison, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. I reside at 2522 Shirley Avenue, Baltimore, MD 21215. I own my home, which is a row house located in northwestern Baltimore. I have lived in my home for more than 24 years.

3. My home is adjacent to another row house located at 2520 Shirley Avenue, Baltimore, Maryland 21215 ("the Property"), which is vacant and was recently boarded up in February, 2009.

4. The Property has caused problems for me and my family. Although I work during the day, I am at home at night. I live in my home with my father, Richard Faison, my mother, Denise Faison, and my brother, Devon Faison.

5. I leave for work in the morning at 5 a.m. I am worried each morning because there are strangers that loiter and sleep at the Property. I am concerned that someone may try to attack me. I have seen people drinking there both inside the Property and coming out of the Property. I also believe that people there are getting high on drugs.

6. There is also a smell that comes from the basement of the Property where trash has accumulated. I have seen trash in the basement of the Property that includes leftover food, plywood and old construction material. I have also seen an old gas stove in the Property and I am concerned that it could cause a fire

7. We also have had problems with the Property because of rats and termites that have spread from the Property and caused damage to our house. I have had to repair the walls in our basement and kitchen because of the damage. My dog, Redman, also got rabies from the rats that came over from the Property and I had to put him down in November, 2008.

8. People in our neighborhood talk all the time about the Property. We are bothered that the Property is in such bad shape. The Property also prevents me from fully enjoying my home. I cannot put my dogs out in the yard because I am concerned about the rats. We also cannot eat in our backyard because of the rats. My family cannot even hang clothing out to dry in our backyard because people who are loitering at the Property will steal it. We call this "clothes line shopping."

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 15, 2009

BY: Stephen Faison
Stephen Faison

ATTACHMENT R

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE,	)	
Plaintiff,	)	
v.	)	No. 1:08-cv-00062-BEL
WELLS FARGO BANK, N.A.	)	
and	)	
WELLS FARGO FINANCIAL LEASING, INC.,	)	
Defendants.	)	

1. I, Lisa Porter, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. I reside at 807 Arnold Court, Baltimore, MD 21205. I own my home, which is a row house located in East Baltimore. I have lived here since 1974.

3. My home is a few doors down from another row house located at 801 Arnold Court, Baltimore, Maryland 21205 ("the Property"), which has been vacant for at least a year.

4. Since becoming vacant, the Property has not been well maintained. It is a dumping ground for trash. There is usually trash scattered in both the front and back yard of the Property. The grass is also high around the Property. I would like the person who owns the Property to maintain it until someone can move in and take care of it.

5. Since the Property became vacant, I have also had an increased problem with rats in and around my home. Part of the inside of the Property' was "gutted" after it became vacant and this drove the rats to other homes nearby, including mine. When my grandchildren come to play in my front yard, they have to be careful not to step on or be bitten by the rats. I worry about their safety because of the rat infestation.

6. The Property also detracts from the appearance of my block. It has made my neighborhood a less attractive place to live.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 18, 2009

BY: _____
Lisa Porter

ATTACHMENT S

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, Plaintiff, v. WELLS FARGO BANK, N.A. and WELLS FARGO FINANCIAL LEASING, INC., Defendants.	No. 1:08-cv-00062-BEL

1. I, Bridget Ross, hereby attest that I am over the age of 18 years and that I am competent to testify with respect to the matter below.

2. I reside at 504 North Clinton, Baltimore, MD 21205. I own my home, which is a row house located in East Baltimore. I have lived in my home since 1995.

3. My home is two doors down from another row house located at 500 North Clinton, Baltimore, Maryland 21205 ("the Property"), which has been vacant for at least two years. After the Property became vacant, it was not boarded up for some time. During this period, people broke into the Property and vagrants stayed there. I noticed that the door was broken as well as some windows.

4. After becoming vacant, people stole plumbing from the Property. My neighbor Randy Taylor, who lives in a row house at 502 North Clinton, which is located

between the Property and my home, told me that he looked inside the Property after it became vacant and found that pipes were missing from the home and water was running from broken pipes inside the Property towards his home. Since the Property became vacant, my basement has flooded on more than one occasion on the side closest to the Property. Mr. Taylor told me that his basement has been flooded as well by water coming from the Property.

5. I called the City of Baltimore to complain about the Property. My neighbors told me they called the City as well to complain and within a few weeks the City boarded up the Property.

6. The Property has not been well maintained since becoming vacant. There is usually a large pile of garbage in the backyard and garbage scattered around the front yard. My neighbors and I sometimes clean up the front yard. The City has also come by to collect trash dumped in both the front and back yard of the Property.

7. I have noticed an increase in the rats around my home since the Property became vacant. There are rat holes in my backyard. I called the City to complain about the rats. In response to my call, the City took steps to exterminate the rats in and around my home, but there is still a rat problem on my block because of the garbage people dump in and around the Property.

8. I am concerned that the Property will become a drug house and increase crime in my neighborhood. I am also worried that children in the neighborhood could be injured if they play in or near the Property. The Property is already a hazard to the neighborhood.

9. The value of my home has gone down because of the Property. I have been unsuccessfully trying to sell my home for two years. I believe that having the vacant Property located so close to my home has made it difficult, if not impossible, for me to sell my home.

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

EXECUTED WITHIN THE UNITED STATES ON: May 25, 2009

BY: Bridget G Ross
Bridget Ross

CSi CENTER FOR SOCIAL INCLUSION

TESTIMONY BY THE CENTER FOR SOCIAL INCLUSION
House Committee on Oversight and Government Reform congressional hearing
"The Silent Depression: How are Minorities Faring in the Economic Downturn?"
September 23, 2009

The Center for Social Inclusion (CSI) thanks the House Committee on Oversight and Government Reform for holding this public hearing on "The Silent Depression: How are Minorities Faring in the Economic Downturn?" CSI is a national policy advocacy organization that works with communities to develop tools and strategies for creating opportunities in communities of color, which we believe fosters a more resilient society for us all. The interplay between policies and institutions over decades has created structural conditions that deny people of color adequate resources and equal opportunities to thrive. From housing and transit to healthcare and jobs, communities of color face daunting hurdles and carry the greatest burden as the economy falters. But ultimately these structurally rooted disparities harm everyone by under-funding public services, limiting economic growth, and undermining the social infrastructure we all rely on.

CSI has been conducting research on the relationships between policy, institutions, and the well-being of communities of color for the past seven years. When the financial markets crashed because of the mortgage industry, we began researching the impact of the crisis on communities of color.[i] In our 2009 report, *One Region: Promoting Prosperity across Race,* we reported on the disparate impact of the housing meltdown. Blacks and Latinos are more likely to have subprime mortgage loans, are disproportionately at risk of foreclosure, and often live in communities that lack jobs and sufficient public transit to job centers.

The nation needs a recovery that improves the well-being of all its residents. To ensure an effective recovery and a resilient economy for the 21st Century, everyone must be able to get a job and access fair credit. Congress and federal agencies administering American Recovery and Reinvestment Act must monitor and make transparent whether or not the recovery is reaching the most vulnerable in our nation to determine its effectiveness, ensure its fairness, and make course corrections when necessary.

UNEMPLOYMENT AND FORECLOSURE RATES ARE HIGH IN COMMUNITIES OF COLOR

The recession is hurting everyone. At the same time, it is critical that Congress, federal agencies, and state governments look for the communities that are hit hardest by this crisis. If we don't we risk a recovery that exists in name only for too many Americans. CSI's analysis of the latest economic data from the U.S. Census and the Bureau of Labor Statistics show that people of color are being hardest hit by the recession. Rising unemployment, falling wages, and widespread foreclosures are undermining recovery in communities of color, slowing the engine of America's struggling economy.[ii]

Black unemployment is up to 15.1% and Latino Unemployment is up to 13.0 % compared 9.7% for the total population. Young men of color have been hit especially hard. Unemployment for Black men ages 20-29 has skyrocketed to a devastating 26.5%, up more than 14 points. For young, Latino men, unemployment has increased to 14.2%, up more than 8 points. Young, White men have also been hit hard, but not as hard as Blacks and Latinos whose unemployment rate has risen to 11.7%, an increase of 6 points.[iii]

Not only are people of color losing jobs fastest, but even among those who are holding onto their jobs, incomes are falling dramatically. Communities of color are facing the greatest loss of purchasing power since the recession began. Latino incomes are down 5.6%, Asian incomes are down 4.4%, Black incomes are down 2.8%, while White incomes are down 2.6%.[iv]

The foreclosure crisis, which is at the heart of the recession, also disproportionately hurts communities of color. While national foreclosure rates by race are not available, research has shown that the concentration of subprime loans is a proxy for foreclosures.[v] In 2006, at the peak of the subprime boom, Black mortgage seekers were 2.3 times more likely, and Latino mortgage seekers twice as likely, to get subprime loans as Whites, even after controlling for loan size *and income*.[vi] It comes as no surprise then, that foreclosures are much more prevalent in communities of color. For example, in New York City, foreclosures are three times more likely in census tracts where Blacks and Latinos are the majority than in mostly-White areas.[vii]

RECOMMENDATIONS

The $787 American Recovery and Reinvestment Act (or "Stimulus") has created a tremendous opportunity for investment in communities that need it most, particularly in the area of infrastructure and job creation. Two key goals of the Act include (1) assisting those most impacted by the recession and (2) investing in infrastructure that will provide long-term economic benefits. These are laudable goals, and if done right, will speed an economic recovery and build a stronger nation over the long-term.

To reach these goals, we must be able to measure the Act's impact through data collection and transparency. Although Federal Civil Rights law requires that the Recovery Act reaches all communities, without sufficient data on race, gender, and disability, we cannot determine that all communities are benefiting. Further, the Stimulus represents a critical opportunity to bring investment to infrastructures in communities of color that have been historically neglected. The billions of dollars allocated through the Recovery Act to infrastructure projects for roads, mass transit, home weatherization, and broadband will not reach those most in need without federal oversight and support.

We suggest that the federal government take the following measures:

I. The Office of Management and Budget (OMB) must require that those receiving Stimulus collect and report data on those getting Stimulus jobs by race, ethnicity, gender, zip code, educational

attainment, household income, and disability status.[viii] **Data on the use of programs that ensure that Disadvantaged Business Enterprises (DBEs) are able to compete and the number of contracts or sub-contracts to DBEs must also be collected.**[ix] Although recipients of Recovery Act funds are required to comply with civil rights statutes such as the Civil Rights Act and the Americans with Disabilities Act, OMB does not require agencies or those who receive funding from agencies to collect and report the data necessary to demonstrate compliance with these acts. In addition to the above demographic data, collecting data on recipients of Stimulus jobs based on previous unemployment, whether or not they have been living in poverty the extent to which they are under "rent stress"[1] or "mortgage stress"[2] or whether or not they have recently suffered from home foreclosure, would further enable the government to demonstrate whether or not it has reached its goals through Stimulus.[x]

II. All federal agencies funding Stimulus jobs should fund quality jobs by collecting and reporting data per project on: wages, percentage of workers covered by employer-provided health insurance, occupational breakdown (managerial versus non-managerial), percentage of workers participating in apprenticeship programs, the existence of Community Benefit Agreements, and the existence of Project-Labor Agreements.[xi]

III. The Department of Transportation (DOT) must require that state, regional, and local transportation agencies and authorities collect and report data on jobs created by all programs in its agency recovery plan. This should include data collected from second and third-level sub-recipients.[3] This data must be broken down by race, ethnicity, gender, zip code, educational attainment, household income, disability status and other relevant categories and must be available in formats that are easy to analyze and interpret (e.g. .xml, .csv, .xls).

IV. The Federal Transit Authority (FTA), The Office of the Secretary of Transportation (OST) and the Federal Highway Administration (FHWA) must collect and publish comprehensive, high-quality data on transit and highway projects. At a minimum, FTA and OST data on transit projects must include: project location (census tracts and/or latitude/longitude), whether a project is an improvement of existing service or an expansion of service, the amount of Stimulus funds received, disability access, and total cost of the project. At a minimum, FHWA data on highway projects must include: project location (census tracts and/or latitude/longitude), whether a project is an improvement on existing highway or the creation of new highway, the amount of Stimulus funds received, and total cost of the project.

Agency data should identify the actual place where the project is sited—not the address of the local, regional, or state transportation agency--as the "project location." In addition, this data should be made

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[1] Spending 30% or more of income on gross rent.

[2] Spending 30% or more of income on mortgage payments.

[3] A sub-recipient is a non-Federal entity that expends Federal awards received from another entity to carry out a Federal program but does not include an individual who is a beneficiary of such a program. Currently, OMB Guidance only requires tracking of Stimulus dollars to first-level sub-recipients. Source: Office of Management and Budget, Memorandum for the Heads of Departments and Agencies. June 22, 2009 (pp 7-11)

available in formats that are readable by mapping programs (e.g. .shp, .kmz) and represent the shape of the project rather than a point.

V. The Department of Commerce and the Department of Agriculture must make data publicly available for each project funded through the Recovery Act, particularly through the $2.4 Billion Broadband Initiatives Program (BIP) and the $1.4 Billion Broadband Technology Opportunities Program (BTOP).[xii] Reported data must include: project location (census tracts and/or latitude/longitude), estimated number of homes the project will bring access to, estimated number of businesses the project will bring access to, speed of the broadband, status of the area as not served, underserved, or served, Stimulus funds received, and total cost of the project. Comprehensive data for each project that is awarded BTOP or BIP funding must also be made publicly available in formats that are easy to interpret and analyze, and posted on Recovery.gov and the Administration's overall Recovery web portal.

CONCLUSION

If we can get recovery right for those most hard hit by the recession, we can get it right for everyone. As we look ahead to future investments in the country's economic growth and infrastructure, we must build a recovery that will make us stronger than before by creating opportunities for us all to contribute to a growing economy. Making key data publicly available is a critical step toward a nation able to rebound in hard times and thrive in good times. Thank you again for the opportunity to testify and we look forward to working with you.

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[i] "One Region: Promoting Prosperity Across Race" The Center for Social Inclusion. March 2009.
[ii] "Race, the Job Market, and Economic Recovery: A Census Snapshot" The Center for Social Inclusion. September 2009.
[iii] "Current Population Survey" Bureau of Labor Statistics. September 2009.
[iv] "Income, Poverty and Health Insurance Coverage in The United States: 2008" U.S. Census. September 10, 2009.
[v] G. Thomas Kingsley, Robin E. Smith, David Price "The Impacts of Foreclosures on Families and Communities" The Urban Institute. May 01, 2009
[vi] Vikas Bajaj and Ford Fessenden "What's Behind the Race Gap?" The New York Times. November 4, 2007.
[vii] Michael Powell and Janet Roberts "Minorities Affected Most as New York Foreclosures Rise" The New York Times. May 15, 2009
[viii] "Fact Sheet - Ensuring Equal Opportunity in the Economic Recovery" Opportunity Agenda. August 2009.
[ix] "Assuring Equity In Recover Act Impacts" Good Jobs First. August 2009.
[x] *Id.*
[xi] *Id.*
[xii] Memo to the U.S. Department of Commerce regarding "Collection of Information Requirements—Broadband Technology Opportunities Program, RIN: 0660-ZA01." Center for Social Inclusion. August 31, 2009.

NCLR
NATIONAL COUNCIL OF LA RAZA

Laying the Foundation for Improved Access to Credit for Hispanic Families

Presented at:

"Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

Submitted to:

U.S. House of Representatives Committee on Financial Services

Submitted by:

Janet Murguía
President and CEO
National Council of La Raza
Raul Yzaguirre Building
1126 16th Street, NW
Washington, DC 20036

July 16, 2009

Good morning. My name is Janet Murguía. I am the President and CEO of NCLR (the National Council of La Raza)—the largest national Hispanic[1] civil rights and advocacy organization in the United States. For the last four decades, NCLR has been committed to improving opportunities for the nation's 47 million Latinos. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth. I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to participate in this timely and important hearing.

NCLR is deeply concerned that a generation of Latino wealth will be lost as a result of widespread failures of the banking systems and insufficient policy responses. Latinos have been historically marginalized from mainstream financial services, such as basic banking and checking accounts. Despite the many barriers, Latinos are entering the financial services market in record numbers. Unfortunately, these same barriers leave Hispanic borrowers vulnerable to abuse. As a leading voice for Latino consumers, NCLR has been warning corporations and governments for years that the financial markets do not serve Latino consumers well. Unprecedented foreclosures on homes and rising household debt from burdensome credit cards and car loans have exposed the system's weaknesses. We and our national network of Affiliates have been doing our part to ensure that potential Latino homeowners have access to safe and affordable credit and home loans, as well as high-quality financial advice. As a housing counseling intermediary, NCLR serves more than 38,000 homebuyers and homeowners every year. The NCLR Homeownership Network (NHN) has expanded beyond its traditional work in homeownership counseling to include foreclosure prevention, rental assistance, and financial planning. We understand what it takes to build sustainable wealth in Latino communities and have executed a successful strategy to do so.

Our national banking system is failing communities of color. Latino families are routinely steered toward inferior financial products designed to profit front-end originators, often resulting in default or burdensome debt. In contrast, a well-functioning system would put families on a path to financial security, building wealth for future generations. We applaud the administration and Congress, especially members of this committee, for taking on a bold regulatory reform agenda. We urge Congress and regulators to move swiftly to create a regulatory environment that promotes financial security for all communities, rather than quick profits for a few.

In my testimony today, I will discuss critical weaknesses in our banking system that have led to a two-tier financial system in which communities of color and other underserved populations routinely pay more for financial services and credit. I will also offer our analysis on the ways in which the administration's proposed overhaul addresses our concerns. I will close with a series of recommendations on how the proposed reforms can be strengthened.

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

Banking System Shortfalls

All Americans rely on financial products to help them buy homes and otherwise build wealth and financial security. Access to safe and affordable credit is an important means to this end for Latinos as they more fully integrate into the mainstream financial system and work to gain access to the American middle class. Yet, clear disparities exist between the quantity and quality of credit and banking products made available to low-income and minority consumers. These disparities perpetuate the wealth gap between minority and White households. Our banking oversight and regulatory systems are outdated, leaving consumers, investors, and even banking institutions themselves vulnerable to the consequences of failure. Congress must take this opportunity to modernize our banking oversight infrastructure with the goal of improving the quality and quantity of credit available to marginalized communities while also protecting consumers and investors.

Hispanic families are entering financial markets at a rapid rate, demonstrating a clear and growing demand for services. With their purchasing power to exceed 1.2 trillion by 2012,[2] it is no wonder that many financial institutions are looking for ways to capture the Hispanic market. However, the industry has taken few steps to develop or tailor products that meet their needs. Predatory lenders have been quick to fill the gaps between the needs and demands of consumers and the offerings available at banks and credit options. As a result, families waste hard-earned income on fees and high interest rates, rather than saving or paying down principal, and are at high risk for burdensome debt, foreclosure, and bankruptcy. There are numerous examples:

- **Lending:** Hispanic mortgage borrowers are more likely to have nontraditional profiles, resulting in rejection by automated underwriting. Even though the technology and business models exist to serve such a profile, originators often choose the more profitable route of steering families into subprime and exotic loans, even when their credit and income justify a prime product. As a result, Latino borrowers are more than twice as likely to receive a subprime home loan and are overrepresented among interest-only and negatively amortizing products.[3] In the case of auto lending, research has shown that Latino borrowers are more likely than White borrowers to receive an unnecessary markup in their interest rate, and the markup is typically higher for Latinos than Whites.[4]

- **Credit:** Hispanic families are less likely than others to have a credit card. Selective marketing tactics ensure that they only receive offers from the most expensive cards, which are characterized by terms and conditions that pile on fees and interest rate hikes. Latinos are nearly twice as likely as Whites to have a credit card interest rate over 20%.[5]

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[2] "Hispanics Are the Largest Minority in the U.S. with Purchasing Power Projected to Exceed...," *Reuters.com*, March 31, 2008, http://www.reuters.com/article/pressRelease/idUS124765+31-Mar-2008+BW20080331 (accessed January 9, 2009).

[3] Robert B. Avery, Kenneth P. Brevoort, and Glen Canner, "The 2007 HMDA Data," *Federal Reserve Bulletin* 94 (December 23, 2008).

[4] Mark A. Cohen, "Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation," Vanderbilt Law and Economics Research Paper no. 07-01 (December 14, 2006).

[5] Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* (New York, NY: Demos, 2007).

- **Banking:** Nearly one in six Latinos does not have a basic bank account. Two of the most commonly cited reasons for not having a transaction account by all those without one is that they do not like dealing with banks or the service fees are too high. When traditional banks do not meet their needs, consumers are driven to fringe financial providers that often charge high fees and do not encourage long-term savings.[6]

There is overwhelming evidence demonstrating that minority borrowers pay more to access credit than similarly situated White borrowers. This pattern of overpayment, abuse, and discrimination disrupts the financial stability of low-income and minority communities, and impedes their movement toward the middle class. There are four fundamental issues that characterize how the banking and financial services markets drain wealth rather than build it.

- **Shopping for credit is nearly impossible.** Many credit offers are not transparent. Credit card, auto loan, and mortgage borrowers are often unaware of the hidden costs included in their loans. Few shopping tools exist that can help borrowers create true apples-to-apples cost comparisons. As a result, some borrowers forgo shopping altogether while others rely on intermediaries, such as mortgage brokers or auto dealers, to shop on their behalf. Numerous studies and reports showing deception and hidden costs through these delivery channels demonstrate that brokers and dealers cannot be trusted consistently to operate in a manner that truly benefits the borrower. Furthermore, issuers of credit aggressively shop for their borrowers by trolling credit profiles and sending offers to their selected profile. This system guarantees opportunities for some and makes easy targets for high-cost products out of others.

- **Borrowers are steered toward expensive products regardless of creditworthiness.** Many low-income and minority borrowers have unique borrower profiles—such as thin credit files, multiple co-borrowers, or multiple sources of income—that are not easily processed through automated underwriting. Rather than taking the time to match these consumers with existing products that accurately measure their true risk, lenders err on the side of higher-risk and steer borrowers toward products that are easier to originate and highly profitable. Low-income and minority borrowers are more likely than similarly situated White borrowers to receive high-cost mortgage loans, even after controlling for income, co-applicant, and credit. The scenario is the same for credit cards and auto loans—Hispanic and African American borrowers are more likely than their White peers to get higher markups or pay higher interest rates. In fact, in auto and mortgage lending, brokers and dealers are paid kickbacks (known as Yield Spread Premiums in mortgage loans) for putting consumers in loans with higher interest rates than their credit warrants.

- **Creditors trap borrowers in cycles of debt.** For some subprime borrowers, excessive fees, high interest rates, and mounting debt effectively trap them in the subprime market. For example, many credit card customers find relief from a high interest rate card by transferring their balance to a credit card with a lower interest rate. Transferring balances from one card to another is not an option for consumers who carry high interest rates and

[6] Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 95 (February 12, 2009).

who are often rejected for credit. In the case of home loans, the pervasive use of loose underwriting criteria led to the origination of loans that homeowners could never afford to repay. The mortgage industry wagers that the value of home prices would continue to climb and clients would refinance if their mortgage product became too expensive. This practice led many families into a downward spiral of wealth-draining refinances that has contributed heavily to the current mortgage crisis.

- **Fraud and scams are rampant.** Compounding the impact of predatory lending and the gaps in consumer protections is the rise of fraud and scams targeting victims of burdensome debt and foreclosure. Research conducted by the Federal Trade Commission (FTC) shows that 14.3% of Hispanics are victims of fraud, compared to 6.4% of non-Hispanic Whites.[7] From fake credit cards claiming to help families build credit to foreclosure rescue scams claiming to help families save their home, fraud is on the rise. In fact, scammers are taking advantage of the industry's slow response to the administration's Making Home Affordable program by marketing quick access to loan modifications. Families are paying thousands of dollars in desperate attempts to reach their servicer and save their home.

Examining Proposed Reform

NCLR applauds the bold reforms proposed by the Obama administration. The market's breakdown in its service to communities of color, low-income families, the elderly, and other traditionally underserved populations has had a devastating impact that extends well beyond those initially harmed. Though we have not taken formal positions on every aspect of the proposed reforms, NCLR is actively engaged in Americans for Financial Reform (AFR), which has established positions on each segment of the administration's proposal.[8] In addition to offering general support, there are four areas of the proposed reforms that are of particular importance to communities of color and must be maintained as the proposal moves through the legislative process:

- **Housing the missions of promoting access to credit and protecting borrowers in the same regulatory agency.** In some cases, the failure of banks to serve the community has gone beyond poor service to include active disengagement from certain communities or populations and discrimination. In the meantime, some community banks, credit unions, and Community Development Financial Institutions (CDFIs) offer safe and fair credit and banking products, but are often beat in the marketplace by bigger banks or predators with large marketing budgets. For these reasons, we see the value of an independent agency to evaluate, test, and track the performance of financial products. Such evaluations must be conducted in light of the credit needs of diverse communities. Communities of color have long been cut off from mainstream banking institutions, often because banks do not offer products that meet their needs and borrower profiles. The proposed Consumer Financial Protection Agency (CFPA) would place value on promoting positive innovations in the market and limitations on new practices and products that would drain wealth and increase debt.

[7] "Consumer Fraud in the United States: An FTC Survey," Federal Trade Commission Staff Report (August 2004).
[8] For more information, visit Americans for Financial Reform at http://ourfinancialsecurity.org.

- **Holding all players in the market accountable.** Players throughout the banking system, from originators, brokers, and credit issuers to Wall Street investment firms, had a hand in manipulating a weak regulatory system to maximize short-term profit gains, leading to our current foreclosure crisis. Mortgage brokers earned profits at the closing table with no investment in the long-term performance of a home loan. Banks and mortgage finance companies routinely packaged and sold their loans within hours of the transaction. Investment firms heavily influenced the terms and types of credit cards, car loans, and mortgages available for consumers by establishing risk tolerances and directing capital to certain products. The proposed reforms would hold all of these players accountable for their role in extending credit by requiring banks to retain a portion of the credit risk on loans they originate and closing loopholes that allowed some finance companies and bank affiliates to evade compliance with more prudent state and federal laws.

- **Emphasizing simple, straightforward banking and credit products.** All too often, standard, safe mortgage and credit products were beat in the marketplace by those that were high risk and, thus, highly profitable. Compensation schemes guaranteed that brokers, originators, and card issuers would put forward their most expensive products first, wherever possible, and seek to further maximize profit by attaching expensive add-ons and kickbacks, such as Yield Spread Premiums. These compensation structures are at the root of predatory lending and steering. The Obama proposal promotes the creation and advancement of straightforward financial products that emphasize consumer safety and affordability, such as a classic 30-year fixed rate mortgage and automatic enrollment in employer-sponsored retirement accounts. NCLR encourages Congress to take this concept a step further by making the offering of such products the default option for originators before moving to more expensive and risky products.

- **Making enforcement a priority.** Much of the current foreclosure and household debt problem is attributable to gaps in consumer protections and an unwillingness to enforce current law. For example, despite widespread evidence of racial and ethnic steering and other violations of civil rights laws, bank regulatory agencies refused to take enforcement action against lenders. Individual borrowers struggled to make their case against brokers or financial institutions when their rights were violated. Legal resources for modest-income families are scarce and consumer complaints often go without a response. The administration's proposed reforms put an emphasis on enforcement by creating a meaningful system for analyzing consumer complaints, protecting private rights of action, and creating new tools for regulators to assess systemic risk.

It should also be noted that the concepts of promoting greater access to the financial mainstream and increasing protections for vulnerable consumers are not in conflict, though at times a healthy tension may exist. Financial industry lobbyists often attempt to paint commonsense regulation as cutting off access to credit for minority families. This is a false argument and a scare tactic. Throughout the country, credit unions, community banks, and nonprofit lenders are serving the community well by creating alternatives to payday loans, offering free checking accounts, and using nontraditional credit information to underwrite loans. They do it while holding to the highest standards of safety and soundness, and generally offer prime pricing. NCLR strongly

urges Congress and the CFPA to look to market leaders for innovative ways to expand all forms of credit and banking products to underserved communities, without sacrificing consumer protections.

Recommendations

NCLR welcomes the bold vision of the administration and many others who have contributed to the ideas and concepts within the proposal. Our current regulatory system has not kept pace with our expanding and dynamic financial markets. We need a regulatory system that is nimble and strong, and can respond to the complex demands of a global market as well as the individual circumstances of the consumers who make up one of their fundamental constituencies. In that spirit, we offer three recommendations for further strengthening the proposal.

- **Create an Office of Fair Lending Compliance and Enforcement within the CFPA.** Civil rights must be prioritized as a part of the agency's formal structure by establishing an office dedicated to promoting and enforcing fair housing and lending laws. This office should ensure that the CFPA itself operates in a manner that affirmatively furthers fair housing and that financial market players comply with fair lending statutes. It must have sufficient authority and resources to conduct fair lending examinations, engage in compliance activities, and write rules, and should be headed by a senior position who reports directly to the director of the CFPA.

- **Help consumers make smarter financial decisions.** The administration rightly proposes that the CFPA streamline disclosures and create standards that will simplify consumer shopping. However, these reforms stop short of improving borrowers' decision-making options. To achieve this, NCLR recommends that Congress go beyond general financial literacy and create a federally funded financial counseling program. Under such a program, nonprofits could provide objective, tailored advice to modest-income families to help them manage their personal finances, build credit, avoid unmanageable debt, plan for retirement, and spot scams.[9] In fact, this is the mainstream approach taken by families with the means to do so—they seek the advice of a professional financial planner or investment advisor. The CFPA can help give this same opportunity to lower-income families.

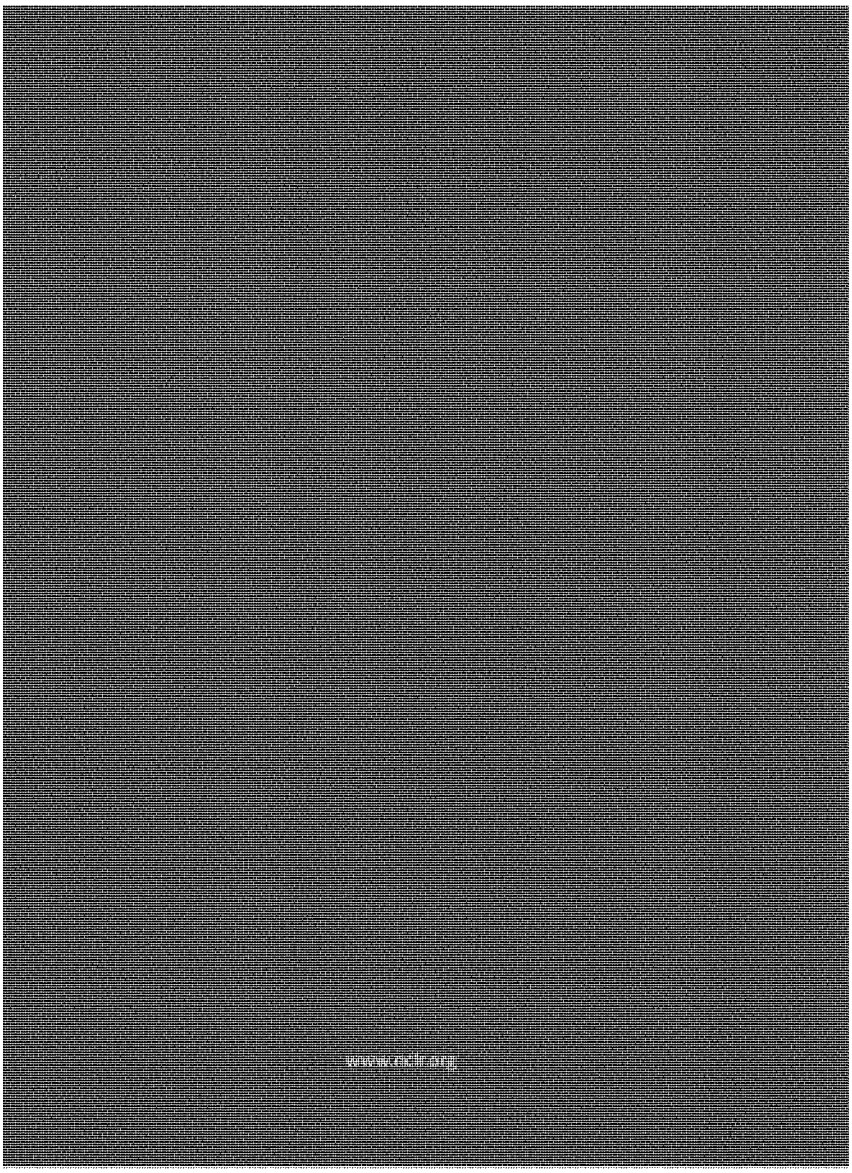
- **Improve data collection.** Publicly available data, such as those available under the Home Mortgage Disclosure Act (HMDA), have been valuable tools for holding financial institutions accountable. The administration's plan is unclear on the extent to which it would increase data collection and make data publicly available. NCLR recommends that data be collected, and publicly disseminated, on small business lending, credit cards, auto loans, and insurance products.

Conclusion

Communities of color have clearly been targeted by lenders for inferior products, even when they have high incomes and good credit. Hispanic borrowers continue to face real barriers to

[9] For a longer discussion on the creation of a community-based financial counseling program see House Committee on Financial Services Subcommittee on Financial Institutions, *Empowering Latino Consumers Through Financial Counseling*, 111th Cong., 1 sess., 2009.

accessing safe, fair, and affordable credit. Most of these families will not be able to move firmly into the middle class and achieve financial sustainability without access to credit and safe banking products. We need a strong regulatory system that will promote a well-functioning marketplace that allows borrowers fair and equal access to the banking system throughout their lifecycle. We look forward to working with Congress and the administration toward this end.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ARRESTED DEVELOPMENT: FORECLOSURES ERODING THE LATINO COMMUNITY

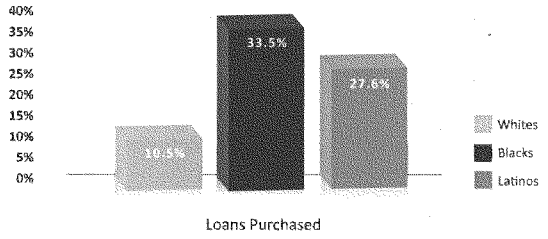
Introduction

Like many Americans, Latinos* have been deeply affected by the housing industry's meltdown.† They are particularly vulnerable, however, as 85% of the hardest-hit neighborhoods—where the default rate is at least double the regional average—are those in which the majority of homeowners are Black and Latino.[1] Few of these families have assets other than a home to rely on as a safety net. In fact, minority households hold only a fraction of the assets owned by White households, leaving them more vulnerable to economic distress.[2] More than 40% of Latino households are at risk of slipping out of the middle class due to the downturn, and they will encounter great difficulty in securing a nest egg or building a strong foundation for their children.[3]

Latinos were frequently caught in the mortgage trap as first-time homebuyers. During the lending boom of the past decade, Hispanic families pursued the American Dream of homeownership in record numbers. While significant progress was made toward reducing the gap between White and Hispanic homeownership rates, many Latino families were sold a risky and expensive mortgage to finance their home purchase.[4] Not only do such loans carry a higher risk of default and foreclosure, but they generally leave homebuyers with little equity to fall back on in hard times. This trend, along with other economic conditions, has contributed to a decline in Latino homeownership.[5]

Figure 1

HIGHER-PRICED LOANS IN SUBPRIME MARKET, 2007



Source: Rakesh Kochhar, Ana Gonzalez-Barrera, and Daniel Dockterman, *Through Boom and Bust: Minorities, Immigrants, and Homeownership* (Washington, DC: Pew Research Center, 2009).

* The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

† Contact Graciela Aponte at gaponte@nclr.org for more information.

Latinos were often steered into higher-cost loans even though they qualified for better subprime or prime loans. Market trends show a disparity in the distribution of products; minority applicants are disproportionately subjected to inflated interest rates and abusive terms. In 2006 and 2007, Hispanics were two and a half times as likely as Whites to receive a higher-priced loan (see Figure 1).[6] Even after controlling for legitimate risk factors, Latino families received higher-rate subprime loans at a frequency disproportionate to their White peers.[7] Many were sold adjustable rate mortgages with "teaser" rates, negative amortization loans, and other risky products that make default more likely—even when they had good credit.[8]

Hispanic neighborhoods have sustained comprehensive and lasting damage. In 2008, more than three in five (62%) Latino homeowners saw foreclosures in their neighborhoods.[9] Since January 1, 2006, banks have taken back 6.7 homes per 1,000 residents in counties where Hispanics account for more than 25% of the population, compared with 4.6 homes per 1,000 residents in all counties.[10] As homeowners are pushed out, crime often takes their place, causing rapid deterioration of neighborhoods and surrounding communities.[11]

The market plunge has resulted in substantial loss in wealth for Hispanic families. Home equity accounts for approximately two-thirds of Hispanic families' net wealth, and is likely to be the only appreciating asset a family owns.[12] Immigrant and minority populations are known to have more limited participation in financial markets than the general population.[13] This significantly impacts Latinos' options in developing assets or recovering through ventures.[14] Latinos have a difficult time rebuilding financial stability after foreclosure, especially since home loss is often coupled with job loss. Construction, for example, has been a mainstay for job growth among Hispanic workers, but the widespread discontinuation of current and future building projects has had a sweeping effect on the community. Hispanics lost nearly 250,000 jobs in 2008 alone because of the slump in the construction sector.[15]

Conclusion

From their jobs to their neighborhoods, Latinos have suffered severely from the foreclosure mess and have lost substantial wealth. A recent study projects that in 2009, more than 400,000 foreclosures will occur among Latino families alone.[16] While many Americans have an uphill battle ahead, the foreclosure crisis and its aftershocks have shaken Latino households to the foundation and will continue to threaten their financial stability.

Endnotes

[1] Michael Powell and Janet Roberts, "Minorities Affected Most as New York Foreclosures Rise," *The New York Times*, May 15, 2009, http://www.nytimes.com/2009/05/16/nyregion/16foreclose.html?hp (accessed May 16, 2009).

[2] Rakesh Kochhar, *The Wealth of Hispanic Households: 1996 to 2002* (Washington, DC: Pew Hispanic Center, 2004).

[3] Jennifer Wheary et al., *Economic (In)security: The Experience of the African-American and Latino Middle Classes* (New York, NY and Boston, MA: Dēmos and IASP, 2009), http://iasp.brandeis.edu/pdfs/byathreadlatino.pdf (accessed May 14, 2009).

[4] Allen Fishbein and Patrick Woodall, *Exotic or Toxic? An Examination of the Nontraditional Mortgage Market for Consumers and Lenders* (Washington, DC: Consumer Federation of America, May 2006), http://www.consumerfed.org/pdfs/Exotic_Toxic_Mortgage_Release052406.pdf (accessed May 20, 2009).

[5] For further discussion on trends in Latino homeownership, see the following: *Impacts of Changes in the Home Mortgage Market on Hispanic Homeowners in Pennsylvania and Delaware* (Washington, DC: The Reinvestment Fund, April 2009), http://www.trfund.com/misc/fhlbreport-draft.pdf; U.S. Bureau of the Census, *American Housing Survey*, Washington,

DC, 2003; Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market* (Washington, DC: National Council of La Raza, 2005); Chris Mayer and Karen Pence, *Subprime Mortgages: What, Where, and to Whom?*, in "Finance and Economics Discussion Series," for Divisions of Research & Statistics and Monetary Affairs (Washington, DC: Federal Reserve Board, 2008), http://www.federalreserve.gov/pubs/feds/2008/200829/200829pap.pdf.

[5] Rakesh Kochhar, Ana Gonzalez-Barrera, and Daniel Dockterman, *Through Boom and Bust: Minorities, Immigrants, and Homeownership* (Washington, DC: Pew Research Center, 2009), http://pewhispanic.org/files/reports/109.pdf (accessed May 19, 2009).

[7] Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Effect of Subprime Mortgages* (Washington, DC: Center for Responsible Lending, 2006), http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (accessed May 20, 2009).

[8] *Exotic or Toxic*.

[9] *Hispanics and the Economic Downturn*.

[10] Susan Schmidt and Maurice Tamman, "Housing Push for Hispanics Spawns Wave of Foreclosures," *The Wall Street Journal*, January 5, 2009, http://online.wsj.com/article/SB123110723683523O9.html (accessed May 20, 2009).

[11] "Minorities Affected Most."

[12] *The Wealth of Hispanic Households*.

[13] Una Okonkwo Osili and Anna Paulson, *Understanding Immigrant-Native Differences in Financial Market Participation, WP 2004-18* (Chicago, IL: Federal Reserve Bank of Chicago, December 2006).

[14] *Economic (In)security*.

[15] *Latino Labor Report 2008: Construction Reverses Job Growth for Latinos* (Washington, DC: Pew Hispanic Center, June, 2008), http://pewhispanic.org/reports/report.php?ReportID=88 (accessed January 30, 2009).

[16] *Projected Foreclosures to Latinos by State* (Durham, NC: Center for Responsible Lending, 2009).

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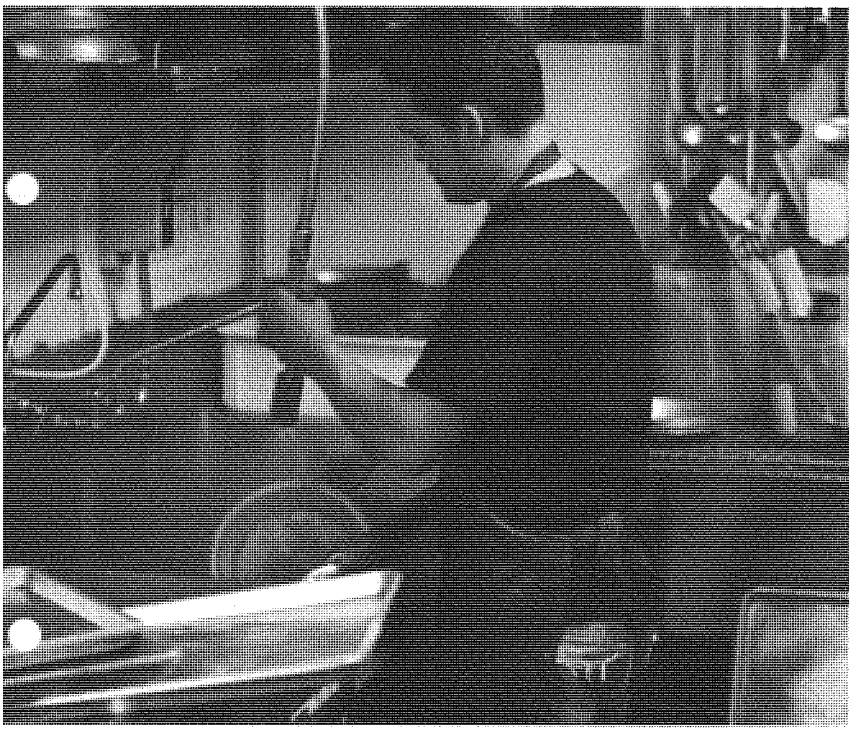
Chapter 3
Troubling Indicators of Job Quality



Although individual workers may value one aspect of their job over another, policymakers have generally prioritized wages, benefits, and working conditions as the core elements of job quality. Federal and state laws attempt to set the floor in these areas to protect them from the forces of competition (for more details, see Table 4.1). In general, by each of these three measures, Latinos are employed in low-quality jobs compared to White and Black workers. U.S.-born Hispanic workers fare considerably better than foreign-born Hispanic workers, but disparities remain. Moreover, since foreign-born workers compose more than half of all Latino workers, the experience of immigrant Hispanic workers heavily influences the status of the entire population.

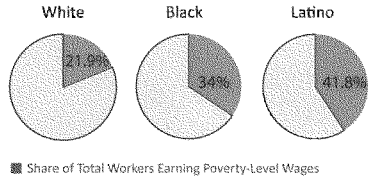
In general, Latino workers face major disparities in job quality compared to other workers, including:

- Low wages. Latinos are more likely than other workers to work in jobs that pay wages that are insufficient for raising a family of four above the poverty level.
- Fewer standard benefits. Compared to Whites and Blacks, Latinos have less access to health insurance and retirement plans at work.
- Less access to benefits such as disability and life insurance. While Latino workers need more life insurance due to having more dependents per worker and higher fatality rates on the job, they are unlikely to have access to life insurance at work.
- Low unionization rate. Latino workers benefit the most from unionization in terms of wages and benefits, yet Latinos are least likely to have unionized jobs.
- Highest workplace fatality rate. Every year, Latino workers, especially immigrant Latinos, consistently have the highest rate of fatal occupational injury of any group in the workforce.
- Underreported workplace injuries. Latino workers are concentrated in small businesses and other work arrangements where occupational injuries tend to be severely underreported.

WAGES

In 2007, more than two out of five (41.8%) Latino workers earned poverty-level wages, which were about $10.20 per hour to sustain a family of four. By comparison, 21.9% of White workers and 34% of Black workers earned poverty-level wages (see Figure 3.1).[1]

FIGURE 3.1
Workers Earning Poverty-Level Wages by Race/Ethnicity, 2007



Source: Lawrence Mishel, Jared Bernstein, and Heidi Shierholz, *The State of Working America 2008-2009* (Ithaca, NY: Cornell University Press, 2009).

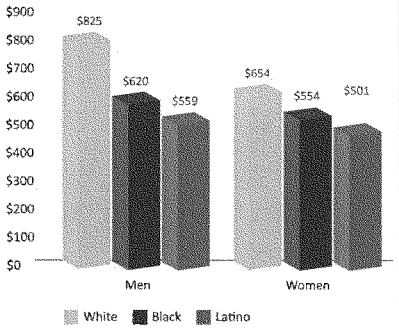
As discussed in Chapter 2, foreign-born Latino workers are overrepresented in jobs that require relatively low levels of education and skills certification. These jobs also tend to pay low wages. Figure 3.2 illustrates the wage disparities between Latinos and other workers. According to the latest Census Bureau data, Hispanic women have the lowest wages of any subgroup, earning a median of $501 per week, 30.5% less than White women and 10.6% less than Black women.[2] The occupational makeup of the Latino workforce as well as lower rates of unionization contribute significantly to these wage gaps.

EMPLOYER-BASED BENEFITS

Employers may elect to offer their employees benefits to supplement their income and provide economic security in emergency situations and into retirement. However, low-wage earners tend to have less access to health care and retirement plans, the two most common types of employer-based benefits. Latinos receive the least benefits compared to Whites and Blacks. While data regarding race and ethnicity are not readily available for recipients of other types of benefits, including disability insurance, life

insurance, and paid leave, it is likely that Latinos experience similar gaps in these areas due to their low earnings and occupational distribution.

FIGURE 3.2
Median Weekly Earnings by Race/Ethnicity and Gender, 2008



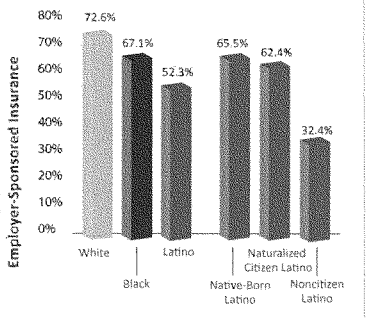
Source: U.S. Department of Labor, "37. Median weekly earnings of full-time wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat37.txt (accessed May 2009).

Health insurance. Overall, Latinos have the highest uninsurance rates of any racial or ethnic group in the country. Most insured Americans, including Latinos, obtain health insurance through their employers. However, in 2007, just over half (52.3%) of employed Latinos had employer-sponsored insurance (ESI), compared to 72.6% of non-Hispanic White and 67.1% of non-Hispanic Black workers.[3] As Figure 3.3 shows, U.S.-born Hispanic workers are more likely to have coverage (65.5%) than naturalized Hispanics (62.4%), and both groups are nearly twice as likely to be covered as noncitizen Hispanics (32.4%).[4]

A Commonwealth Fund study in 2001 found that ESI disparities persist within industries; only 38% of Latino workers in agriculture were offered ESI, compared to 67% of non-Hispanic White workers. Similar gaps exist in the construction and retail services. The share of Hispanics versus Whites with access to ESI in construction was 47% versus 67%. In retail services, 56.9% of Latinos versus 77.1% of Whites were offered ESI.[5]

The type of employment arrangement also affects the likelihood that workers will have employer-sponsored coverage. In the total labor force, only 25.7% of on-call workers and 8.3% of temporary help agency workers had ESI in 2005. Contract firm employees fared slightly better, but their 48.9% coverage rate was still much lower than that of the average worker.[6] Latinos' overrepresentation in these categories partially explains their low access to health plans, although other factors are also responsible.

FIGURE 3.3
Workers Receiving Employer-Sponsored Insurance by Race/Ethnicity and Nativity, 2007



Source: NCLR calculation using U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed September 2008).

Retirement plans. In 2006, 34.6% of Latino workers ages 21–64 had access to a retirement savings plan or pension through their employer, compared to 60.6% of their White peers and 52.9% of their Black peers.[7] Foreign-born Latinos had substantially lower access to a plan than their native-born peers; 49.1% of native-born Hispanics worked for an employer that offered a retirement plan, compared to only 25.7% of their immigrant counterparts.[8] Figure 3.4 illustrates these differences.

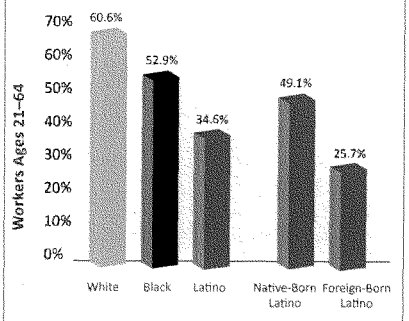
A worker's occupation and industry can determine his or her access to a retirement plan. A considerable portion of the Hispanic workforce is employed in low-coverage industries, such as agriculture, construction, wholesale, and retail. Latinos are also underrepresented in public sector jobs, where the pension coverage rate is higher than it is for private sector employees.[9] Similar to ESI coverage, pension coverage for nontraditional employees is significantly lower than for their counterparts in traditional arrangements. In 2005, only 2.6% of independent contractors, 33.2% of on-call workers, 8.9% of temporary help agency workers, and 42.6% of workers provided by contract firms were eligible for an employer-based pension plan.[10]

Disability insurance. In the event that an unforeseen accident or sickness prevents an individual from working, disability insurance provides replacement income. Short-term disability insurance provides income for a six- to 12-month period, after which long-term disability benefits take over. Participation in disability insurance plans is more common among employees in medium and large private establishments than those employed by small businesses (fewer than 100 employees) or state and local governments. Since Latinos are overrepresented in small businesses (see Chapter 2), it is probable that Latinos are less likely to participate in disability insurance plans.

Life insurance. If a worker dies, life insurance can protect his or her family and dependents from financial destitution by providing them with replacement income. Hispanic families tend to have more children than non-Hispanic families; on average, Latino families have 2.13 children

FIGURE 3.4

Workers with Access to Employer-Based Retirement Plans by Race/Ethnicity and Nativity, 2006



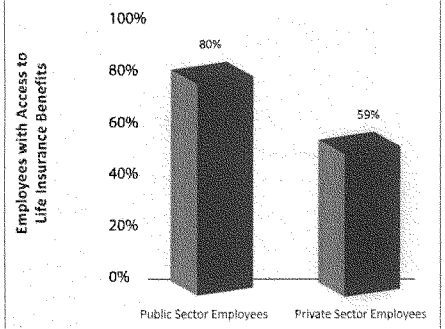
Source: Unpublished Employee Benefit Research Institute estimates from the U.S. Census Bureau's March 2007 *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2007.

under 18 years of age while other families have 1.78 children.[11] Hispanic workers also report having more financial dependents outside their households. Therefore, life insurance should be of critical importance to Latinos.[12]

Publicly employed workers have much greater access to employer-sponsored life insurance than private industry employees; their access rates are 80% and 59%, respectively (see Figure 3.5). Latinos are less likely to have the option of life insurance, given their underrepresentation in public sector jobs. Life insurance is more prevalent in occupational groups with low Latino presence—such as management and professional jobs, in which 78% of workers have access to insurance—and less prevalent in occupations where Latinos are concentrated, such as service jobs (42%) or natural resources, construction, and maintenance (60%). Furthermore, only four in ten workers who earn an average hourly wage between $10 and $25—a substantial portion of the Latino workforce—have access to life insurance plans.[13]

Paid leave. All workers have family and medical needs, but many workers may risk jeopardizing their employment if they take days off to attend to personal matters. Although federal law (specifically, the Family Medical Leave Act, discussed in Chapter 4), grants some workers unpaid leave without the risk of job loss, low-income workers are far less likely to be eligible for this benefit than higher-paid workers. In addition to losing critical wages, it is not uncommon for low-wage and contingent workers who miss days of work to risk immediate termination or disqualification from bonuses, overtime, and promotions.[14] Paid leave is even less common than unpaid leave; in 2008, only 37% of private industry workers had any paid personal leave. Research confirms that incidence of paid leave is dramatically lower among low-income workers, younger workers, workers with short job tenure, and those working for small businesses, all of which characterize Latino workers more so than White and Black workers.[15]

FIGURE 3.5
Access to Life Insurance, Public Sector vs. Private Sector, 2009



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Employee Benefits in the United States, March 2009," news release, July 28, 2009, http://www.bls.gov/news.release/pdf/ebs2.pdf (accessed May, 2009).

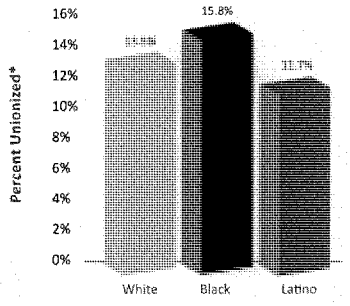
Latinos in Unions: A Significant Boost but a Long Way to Go

Belonging to a union or being covered by a collective bargaining agreement can boost low-skilled workers' wages and benefits.[16] The union wage premium for Hispanics is the highest of any racial or ethnic group; Hispanic men in unions earn 23.4% more than their nonunion and counterparts, and Hispanic women earn 18.7% more. By comparison, the union wage premium is 15% for White men, 9.1% for White women, 22.7% for Black men, and 14.5% for Black women. Low-wage Latino workers and immigrant workers benefit particularly well from unions.[17] In terms of health insurance coverage, low-wage Hispanic workers experience a 40.7% union premium. The union premium for pension coverage is 51.8%.[18] Union members also tend to have better access to disability and life insurance, as well as paid leave.[19]

In addition to increasing wages and benefits coverage for workers, unions play an important role as a watchdog to ensure that employers comply with laws governing minimum wage, overtime pay, and occupational health and safety. Armed with technical expertise about regulations, unions are uniquely poised to take action on behalf of concerned workers because they are relatively protected from the threat of adverse action from employers.[20]

However, despite the benefits unions bring to job quality, Hispanics are severely underrepresented in unions. As Figure 3.6 shows, in 2008, only about one in ten (11.7%) Latino workers belonged to a union, compared to 13.7% of White workers and 15.4% of Black workers.[21] Latino immigrants were even less likely to belong to a union. Between 2004 and 2007, the unionization rate for foreign-born Latinos averaged 8.5%, while the overall Hispanic unionization rate averaged 11.1%.[22]

FIGURE 3.6
Workers Represented by Unions by Race/Ethnicity, 2008



Source: U.S. Department of Labor, "40. Union affiliation of employed wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat40.txt (accessed May 2009).

* Percent unionized includes workers who are members of a union or whose jobs are covered by a union or an employee association contract.

HEALTH AND SAFETY

The impact of wages and benefits extends far beyond the workplace, affecting the economic security of workers and their families, as well as their social and physical well-being.[23] In addition to wages and benefits, the third element of job quality codified in law is the one with the most direct impact on workers themselves: the physical conditions under which they labor. In addition to the well-documented benefits of a healthy workforce, workplace health and safety standards exist primarily to protect workers from injury and illness. Ironically, the productivity of the U.S. in the global economy masks the fact that the typical American worker is at greater risk of death from a work-related injury than workers in many other "established market economies," including the United Kingdom, Germany, and France.[24] According to calculations based on International Labour Organization statistics, 5.6 out of every 100,000 U.S. workers were victims of fatal occupational injuries in 2006, compared to 0.8 in the United Kingdom, 3.6 in Germany, and 3.0 in France.[25]

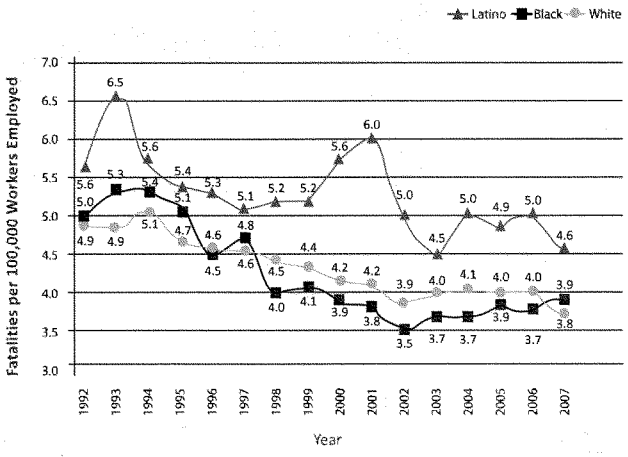
The U.S. Census of Fatal Occupational Injuries, the most comprehensive count of work-related fatal injuries in the U.S., calculates that in 2007, there were 3.8 workplace fatalities per every 100,000 U.S. workers.[26]

Fatal occupational injuries. Latino workers are more likely to die from an injury at work than White and Black workers. In 2007, 937 Latinos were killed by an injury at work, a fraction of the overall toll (see Figure 3.8). More often than not, Hispanic victims of fatal workplace injuries are immigrants, and the vast majority is male. Of the reported 937 Latino fatal injuries in 2007, 634 (67.7%) were injuries to immigrants and 894 (95.4%) were male.[27] The Hispanic occupational fatality rate was 21.1% higher than that of White workers and 17.9% higher than that of Black workers.[28] In fact, at 4.6 deaths per 100,000 workers, the Hispanic worker fatality rate surpasses that of many developing nations, as well as the U.S. fatality rate. As Figure 3.7 shows, these disparities match a trend spanning more than a decade in which Latinos have consistently seen higher rates of fatal workplace injuries than all other groups of workers. In contrast to the clear downward trend in fatal occupational injuries among White workers, the occupational fatality rate for Latinos has not declined consistently in recent years.

The concentration of Latinos in more hazardous jobs contributes to their relatively high risk of fatal injury. One study found that controlling for the major occupational groups significantly reduced Hispanic workers' risk of fatal injury, suggesting that Latinos' high presence in dangerous jobs accounts for most of the gap in fatality rates between Latinos and other racial and ethnic groups.[29] For example, public sector employees have a lower fatality rate (2.5 per 100,000) than employees in private industry (4.1 per 100,000). The overrepresentation of Blacks in public sector jobs, compared to Latinos' underrepresentation, may partially explain the lower fatality rate of Black workers.[30]

The causes of injuries to Latino workers are also telling of their occupational representation and the quality of jobs they hold. As Figure 3.9 shows, Latinos are far more likely than other workers to die from a fall (20.2% of Latino fatalities) or contact with

FIGURE 3.7
Fatal Occupational Injury Rate by Race/Ethnicity, 1992–2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007.* Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008).

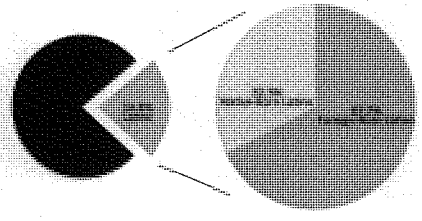
* Data from 2001 do not include fatalities from the September 11 terrorist attacks.

objects and equipment (21.3% of Latino fatalities). Conversely, transportation incidents, assaults, and violent acts make up a smaller share of the causes of fatal injury for Latinos compared to other workers.

Despite the obvious effects of labor market distribution on relative risk of fatal injury, some disparities between Latinos and other workers persist within occupations. Latino men face especially high risk compared to their peers when employed as equipment cleaners, helpers, and laborers; transportation workers and material movers; and farming, forestry, and fishing workers.[31] Several of the occupations listed in Table 3.1, which shows the deadliest occupations for Latinos, belong to these high risk categories.

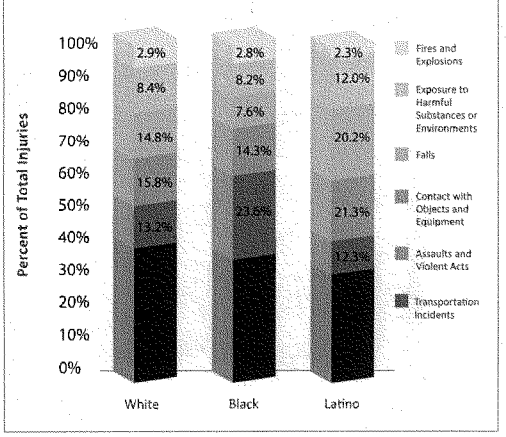
Table 3.2 details the typical tasks, work environment, education and training requirements, and wages of workers in occupations with the most Latino fatalities in 2007. The increased exposure to hazards tends not to be reflected in the wages of workers

FIGURE 3.8
Latino Share of Workplace Fatalities by Nativity, 2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007.* Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008); U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries to foreign-born Hispanic or Latino workers by selected characteristics, 2003–2007," *Census of Fatal Occupational Injuries,* unpublished data.

FIGURE 3.9
Causes of Fatal Occupational Injuries by Race/Ethnicity, 2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries by worker characteristics and event or exposure, All United States, 2007," *Census of Fatal Occupational Injuries, 2007.* Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cftb0229.pdf (accessed May 2009).

Table 3.1
Occupations with the Highest Latino Fatalities, 2007

	Construction Laborers*	Driver/ Sales Workers and Truck Drivers	Miscellaneous Agricultural Workers	Grounds Maintenance Workers	Hand Laborers and Freight, Stock, and Material Movers	Roofers	Installation, Maintenance, and Repair Occupations	Carpenters
Fatal Injuries to Latino Workers	141	118	54	54	36	29	29	29
Latino Share of Fatal Injury Victims	40.9%	12.1%	43.5%	33.8%	27.3%	36.7%	13.4%	26.6%

Sources: NCLR calculation using U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries to foreign-born Hispanic or Latino workers by selected characteristics, 2003–2007," *Census of Fatal Occupational Injuries*, unpublished data.

* Only occupations with more than 20 fatal injuries to Latinos and more than 30,000 Latinos employed in 2007 are shown.

employed in hazardous occupations. The tasks and work environments described give some indication of the conditions that could cause injury if workers are not protected. Evidence shows a shift in the organization of work—toward longer hours, inadequate rest, time pressures, and more repetitive tasks—has led to an overall increase in occupational injuries and illnesses.[32] The education and training levels of workers within each occupation varies, but on the whole, workers' earnings do not compensate for the exceptional risk of fatal injury that Latino workers face. The median wage for most of the occupations listed was below the national median wage in 2007 ($695).

Table 3.2
Descriptions of Occupations with the Highest Latino Fatalities, 2007

Occupation	Tasks[1]	Work Environment	Education and Training Requirements	Median Weekly Earnings[2]
Construction Laborers	Removal, cleaning, loading, digging Operating equipment Most workers do not specialize in a task Local competition gives preference to high-skilled workers with the ability to relocate	Repetitive motion Weather conditions Schedule varies depending on employer, weather, and opportunities for work Hazards: heights, exposure to harmful substances, machinery, noises, and odors (especially in confined spaces)	Entry-level, on-the-job training Some employers require trade-specific classroom instruction Formal apprenticeships Occupational Safety and Health Administration (OSHA) safety training	$514 The middle 50% earn between $9.95 and $17.31 per hour[3]
Driver/Sales Workers and Truck Drivers	Driving heavy trucks and tractor-trailers Driving light/delivery vehicles Workers may travel long distances, help unload, and sell goods	Some may engage in physical labor Long hours Hazards: fatigue, other drivers, and obstacles	Driver's license for all trucks Commercial driver's license required for large trucks Some states require additional training	$665 Median hourly earnings vary based on type of truck; restaurant drivers earn $7.11 per hour, while general freight truckers earn $18.38 per hour[4]
Miscellaneous Agricultural Workers	Varies widely Farmworkers: tending to crops, nurseries, greenhouses, ranch animals Operating equipment Grading and sorting	Repetitive motion (bending, stooping, lifting) Mostly outdoors Time pressures, especially during planting and harvest seasons Many seasonal and migrant workers Hazards: exposure to harmful substances (e.g., pesticides), machinery, animals; limited access to sanitation and drinking water; muscle strain	Most jobs require little education, short on-the-job training, especially in the crop production sector	$546 Median hourly wages vary greatly; farmworkers earn a median of $7.95 per hour while agricultural inspectors earn a median of $18.32 per hour
Grounds Maintenance Workers	Landscaping Grounds keeping Handling pesticides Trimming trees and pruning bushes	Repetitive motion (lifting, shoveling) Time pressures Often seasonal Usually outdoors Hazards: muscle strain and fatigue	Entry-level, on-the-job training Most workers have a high school education or less	$420 Median hourly earnings range from $9.82 for general workers to $17.93 for supervisors

Occupation	Tasks	Work Environment	Education and Training Requirements	Median Weekly Earnings
Hand Laborers and Freight, Stock, and Material Movers	Moving and loading freight, stock, and other materials onto docks, vehicles, ships, containers, and between work areas	Repetitive motion May be seasonal Some shifts are overnight Hazards: heights, weather conditions, harmful fumes, noises, materials, substances, machinery	Mostly on-the-job training OSHA safety training	$474 Median hourly earnings of $10.20 per hour
Roofers	Mostly repairing roofs and reroofing	Repetitive motion (lifting, climbing, bending) Seasonal in northern states Time pressures, especially before bad weather Hazards: slips, falls, burns, and extreme heat	Informal on-the-job training High school education helpful Formal education may include apprenticeships OSHA safety training	$550 The middle 50% earn between $12.12 and $20.79 per hour
Installation, Maintenance, and Repair Workers	Varies widely Repairing machines and appliances Maintenance Installing lines	Shift work is common Some workers on call Some long-distance travel Hazards: electrical shock, burns, and muscle strains	Much informal on-the-job training but some require technical training as well (e.g., heating, air conditioning, and refrigeration repair)	$618 Median hourly wage varies greatly; equipment wholesalers earn $20.53 per hour while vending machine operators earn $12.94 per hour
Carpenters	New construction Installation Repair 32% of workers are self-employed Workers may specialize in one or two tasks	Repetitive motion (climbing, bending, kneeling) May be exposed to weather conditions Time pressures Hazards: contact with tools and equipment, falls, muscle strain, and fatigue	Informal on-the-job training Formal training may require three to four years of on-site and classroom instruction Apprenticeships usually limited to union members employees of commercial and industrial building contractors	$615 The middle 50% earn between $13.55 and $23.85 per hour

[1] U.S. Department of Labor, *Occupational Outlook Handbook, 2008-09 Edition*, http://www.bls.gov/oco (accessed May 2009).

[2] Median weekly earnings listed are for 2007. U.S. Department of Labor, "39. Median weekly earnings of full-time wage and salary workers by detailed occupation and sex." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2007, ftp://ftp.bls.gov/pub/special.requests/lf/aa2007/aat39.txt (accessed September 2008).

[3] Hourly earnings are for 2006. U.S. Department of Labor, *Occupational Outlook Handbook, 2008-09 Edition*.

[4] Median hourly earnings are for 2006.

Underreported workplace injuries and illnesses. In addition to fatal injuries, serious injuries and illnesses are another indicator of occupational health and safety. However, there is a major discrepancy between fatal and nonfatal injury data for Latino workers. Compared to the dismal profile of workplace deaths, government records of serious injuries and illnesses are conspicuously low for Latinos. Evidence from employers, workers, and investigations makes it clear that underreporting—by employers and employees alike—is the main reason for these gaps.[33] National surveys, worker's compensation records, and medical records fail to account for between one-third and two-thirds of all workplace injuries, according to various estimates.[34] For instance, while the share of foreign-born and undocumented workers in poultry-processing occupations is rising, the rate of recorded musculoskeletal disorders has suspiciously declined from 88.3 for every 10,000 workers in 1996 to 20.8 for every 10,000 workers in 2006.[35]

Underreporting appears to be more prevalent among Latino workers and those who employ them, including businesses with fewer than ten workers, which employ 32% of the Hispanic workforce.[36] While available data often neglects to code for industry, investigations reveal that underreporting is especially prominent in areas of the labor market where Latinos are employed in high numbers, including construction, poultry processing, and agriculture.[37] In addition, several studies have reported considerably high rates of injury and illness among nontraditional workers and immigrant workers.[38]

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[2] U.S. Department of Labor, "37. Median weekly earnings of full-time wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat37.txt (accessed May 2009).

[3] NCLR calculation using data from U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed September 3, 2008).

[4] Ibid. For more information, see *Employer-Sponsored Health Insurance: Already Poor Access Further Dwindles for Working Latino Families* (Washington, DC: National Council of La Raza, 2008), http://www.nclr.org/content/publications/detail/50277 (accessed February 2008).

[5] Claudia L. Shur and Jacob Feldman, *Running in Place: How Job Characteristics, Immigrant Status, and Family Structure Keep Hispanics Uninsured* (Washington, DC: The Commonwealth Fund, 2001), http://www.cmwf.org/usr_doc/schur_running_453.pdf (accessed August 2007).

[6] U.S. Department of Labor, *Contingent and Alternative Work Arrangements, February 2005*. Conducted by the U.S. Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008), Table 9.

[7] Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006*, Issue Brief no. 311 (Washington, DC: Employee Benefit Research Institute, 2007), http://www.ebri.org/pdf/briefspdf/EBRI_IB_11-20074.pdf (accessed November 2007), Figure 2.

[8] Unpublished Employee Benefit Research Institute estimates from the U.S. Census Bureau's March 2007 *Current Population Survey*. For more information, see *Employer-Based Pension Plans: How Latinos Fare* (Washington, DC: National Council of La Raza, 2007), http://www.nclr.org/content/publications/download/50689 (accessed September 2008).

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[10] U.S. Department of Labor, *Contingent and Alternative Work Arrangements, February 2005*, Table 9.

[11] U.S. Census Bureau, "America's Families and Living Arrangements: 2007," *2007 Annual Social and Economic Supplement*. Housing and Household Economic Statistics Division, Fertility and Family Statistics Branch. Washington, DC, 2008, http://www.census.gov/population/www/socdemo/hh-fam/cps2007.html (accessed October 2008), Table AVG3.

[12] Nearly three in ten (29%) Latino workers surveyed in 2001 reported being financially responsible for three or more people other than themselves, while the same was true for 21% of all workers surveyed. Furthermore, more than one-third (34%) of Hispanic workers in 2001, compared to 15% of all workers, reported providing "significant" financial support for persons not living in their household. Mathew Greenwald and Associates, *2001 Minority Confidence Survey* (Washington, DC: Employee Benefit Research Institute, 2001).

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[17] Ibid., 201.

[18] Ibid., 202.

[19] U.S. Department of Labor, "Employee Benefits in the United States, March 2009."

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[22] Unpublished estimates from the Center for Economic and Policy Research.

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[25] Ibid.

[26] U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007*, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008). The Census of Fatal Occupational Injuries (CFOI) is a compilation of state and federal government collection and coding of data from a variety of sources, including death certificates, worker's compensation reports, federal agencies such as the Occupational Safety and Health Administration (OSHA), Employment Standards Administration (ESA), and Mine Safety and Health Administration (MSHA). See U.S. Department of Labor, Bureau of Labor Statistics, *BLS Handbook of Methods*. Washington, DC, September 2008, http://www.bls.gov/opub/hom/pdf/homch9.pdf (accessed June 2009).

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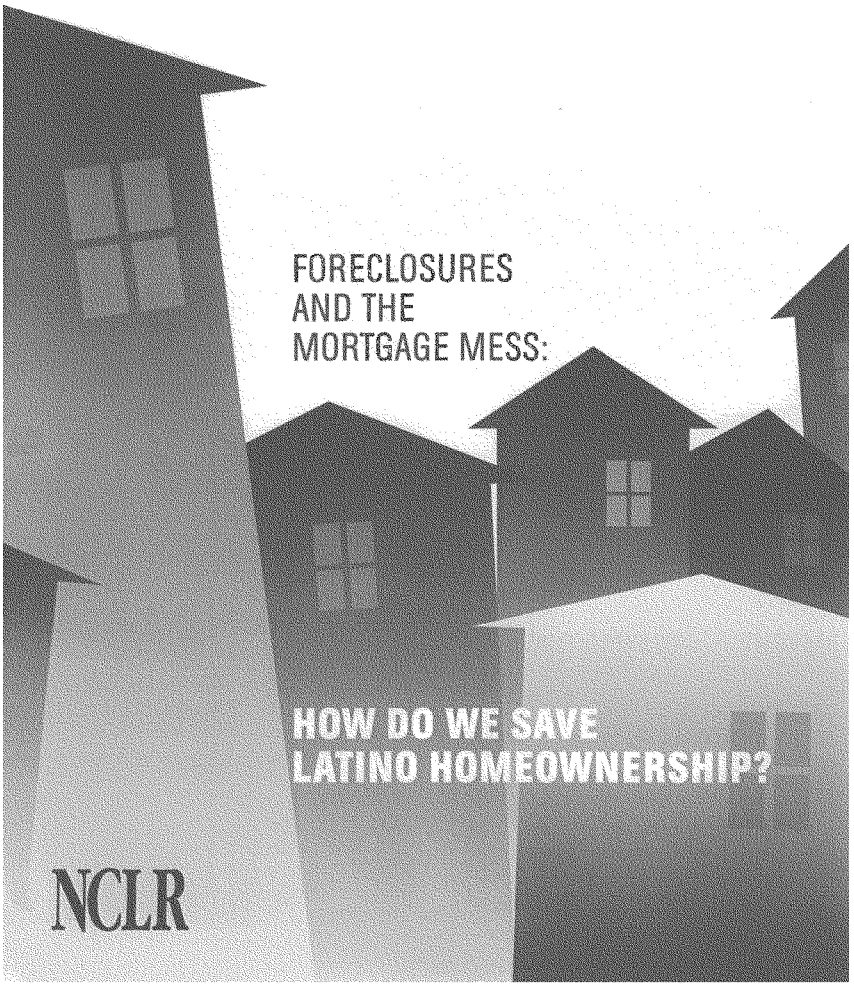
FORECLOSURES
AND THE
MORTGAGE MESS:
HOW DO WE SAVE
LATINO HOMEOWNERSHIP?
NCLR



The National Council of La Raza (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300 affiliated community-based organizations (CBOs), NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families.

Founded in 1968, NCLR is a private, nonprofit, nonpartisan, tax-exempt organization headquartered in Washington, DC. NCLR serves all Hispanic subgroups in all regions of the country and has operations in Atlanta, Chicago, Los Angeles, New York, Phoenix, Sacramento, San Antonio, and San Juan, Puerto Rico.

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NCLR



Foreclosures and the Mortgage Mess: How Do We Save Latino Homeownership?

Transcript of a Town Hall at the 2008 NCLR Annual Conference
Monday, July 14, 2008

Moderator
Evy Ramos

Panelists
Alan Fisher
Martin Gruenberg
Secretary Rosario Marin
Carol Ornelas



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Foreword

Homeownership has long represented stability. Traditionally, it has been the primary means for low- and moderate-income families to acquire assets, provide for their children's education, and build their own retirement. Unfortunately, the "perfect storm" of an overinflated mortgage market, the mainstreaming of predatory lending practices, and inadequate regulation has severely shaken the foundation of homeownership. Families are losing generations of wealth because their seemingly secure investment has been badly compromised at best, and too often lost entirely.

The mortgage crisis has unmasked weaknesses throughout the nation's entire financial system, and low-income and Latino families are among those most affected. If this is to be a year of recovery, we must make building up the assets of families who have lost, or may lose, their homes a top priority. This is not just a matter of helping those families recover: it's an essential element of any strategy to help all families, and the nation's ailing economy, get back on their feet.

In July 2008, NCLR held a town hall discussion to confront the challenges of a retracting housing market. In this discussion, experts from a variety of perspectives analyze the causes of the problem and ways to salvage household finances, and suggest innovative approaches to weathering the economic fallout. Although the panelists come from diverse perspectives, there appeared to be a strong consensus that any effective response to the housing crisis must include certain essential elements—systemic loan modifications, greater transparency, and increased accountability for financial institutions that accept public support. I'm pleased that at least the initial proposals from the new administration and Congress appear to include these components.

I hope that readers find this discussion helpful as they shape, design, and implement real solutions to the housing foreclosure crisis.

Janet Murguía

Janet Murguía
President and CEO
NCLR

Acknowledgments

This town hall, "Foreclosures and the Mortgage Mess: How Do We Save Latino Homeownership?," was coordinated by Janis Bowdler, Associate Director of the Wealth-Building Policy Project, National Council of La Raza (NCLR). Nancy Wilberg Ricks, Policy Analyst, Wealth-Building Policy Project, prepared the transcript for publication. Eric Rodriguez, Vice President of NCLR's Office of Research, Advocacy, and Legislation, provided guidance and feedback. Jennifer Kadis, Director of Quality Control; Kari Nye, Assistant Editor; Karen Nava, Director of Graphics and Publications; and Rodrigo Alvarez, Production Assistant and Graphic Designer, prepared the report for publication.

We thank Evy Ramos, Reporter, Digital Correspondent, *10News* ABC (San Diego), who served as the panel moderator, and we extend a very special thank-you to the panel participants, including:

Alan Fisher, Executive Director, California Reinvestment Coalition

Martin Gruenberg, Vice Chairman, Federal Deposit Insurance Corporation

Rosario Marin, Secretary of State and Consumer Services Agency, State of California

Carol Ornelas, Executive Director, Visionary Home Builders of California

We also thank the Ford Foundation for its support of NCLR's work in wealth-building, as well as Freddie Mac, title sponsor of the event, and Fannie Mae, event cosponsor.

The discussion and conclusions included in this transcript are those of the panel speakers alone and do not necessarily reflect the opinions of the Ford Foundation or the event sponsors.

All panel participants had an opportunity to review the transcript for clarification, but did not materially or substantively alter their comments.



Executive Summary

On July 14, 2008, the National Council of La Raza (NCLR) convened a Town Hall at the 2008 NCLR Annual Conference in San Diego, California titled "Foreclosures and the Mortgage Mess: How Do We Save Latino Homeownership?" Panelists discussed their work in the field of homeownership and foreclosure and specifically discussed:

- How and why high-interest subprime loans continue to disproportionately affect low-income and Latino communities
- Whether homeowners, lenders, or regulators are responsible for the foreclosure fallout
- Policy recommendations on the national and state levels to stop the current bleeding and to prevent recurrence
- Approaches to counseling homeowners on how to avoid risky and predatory loans

There was consensus among the panelists about various aspects of the foreclosure crisis. First, they agreed that there is no magic bullet. From the needs of individual communities to the challenges on a national scale, solutions should not be applied with sweeping strokes. Second, the onus of homeownership should sit on the shoulders of lenders and not just homeowners. Loan securitization plucked lender accountability from the mortgage process. This allowed bad loans to propagate at an alarming rate, with severe and lasting consequences. Third, while low-income and Latino communities are unevenly affected by the current wave of foreclosures, all Americans are impacted by the reckless activity of the mortgage industry. Everyone has a stake in finding ways to repair this utter loss. Finally, all participants agreed that industry practices need an overhaul. Consumers need greater protections against fraudulent loans, and once wealth is established within a community, more effective measures should be taken to secure it.



Opening Remarks

Announcer Voiceover: Now, please give a warm welcome to NCLR Board Treasurer and Executive Director of La Casa de Esperanza, Mr. Anselmo Villarreal.

Mr. Anselmo Villarreal: On behalf of the Board of Directors of the National Council of La Raza, it is my pleasure to welcome you today to this great town hall meeting. As we all know, homeownership is the American Dream, a dream that has clearly become a nightmare. We also know that [many] Latinos and Latinas who obtained a mortgage during 2005 and 2006 are in foreclosure right now. And in 2008, it is expected that about two million homes are going to be in foreclosure.

To address this key issue that affects our Latino community in particular—because it's also no secret that the Latino community has been targeted by predatory lending—the National Council of La Raza has put together a great panel of very talented people who are going to try to identify strategies and solutions to this foreclosure and mortgage mess. So again, it's my pleasure to welcome all of you, and also I want to thank you for taking the time to attend this important workshop because as you also know, housing counseling is a top priority of the National Council of La Raza. So thank you to our panel and thank you for attending this workshop.

Announcer Voiceover: Thank you, Mr. Villarreal. And now, providing a few opening remarks, please welcome Senior Vice President of Corporate Relations and Housing Outreach from Freddie Mac, Mr. Dwight Robinson.

Mr. Dwight Robinson: Good afternoon. It's really a pleasure for me to be here this afternoon to have this opportunity to welcome the discussion of this very important topic. It's also important for us to be here to recognize the fact that Freddie Mac and GSEs [government-sponsored enterprises]—given the issues that have been in the press over the last couple of days—are sound and moving forward to help America with the important mission that we have. We want to thank NCLR for their support, and we want you to know that we'll be moving forward into the future to continue with our mission.

Now, the topic for today's discussion is very [relevant] in the sense that none of us want to end in a circumstance where we have not provided enough Americans with the American Dream...we may have found ourselves in the situation where we have, in fact, [created] the American nightmare. Too many American families—Latino families and others—are suffering because they either unwittingly or, in other circumstances, simply found themselves in a lending or mortgage circumstance that does not allow for them to be successful with the American Dream. At Freddie Mac, we want you to know that we believe that the issue at hand is to help more and more Americans find success with homeownership, and not simply find homeownership a burden for families where they ultimately turn in the keys to their dream. We are interested in continuing over the long term.

It's important for us to note, however, that there are a couple of key pieces that need to be dealt with, and this discussion this afternoon takes us down that road. Certainly, families—Latino families and others—need to understand that there are options that they can engage with and avail themselves to in terms of preventing homeownership from slipping away. We at Freddie Mac are very proud of our financial literacy programs, all of which are not only available prior to purchase but certainly also post-purchase. And we've beefed up that program to focus on helping people to maintain their homeownership and be successful in it. We are proud that we're partnering with NCLR to make certain that this is made available in the Hispanic community and around the country.

But beyond that, we need to focus—as I'm sure that this panel will focus—on the issues that suggest that as we return to more traditional underwriting, to tightening the credit standards, to enhancing the down payment requirement, that we don't end up throwing the baby out with the bathwater—that we don't find ourselves in a situation where we're closing down the available credit to Black and Brown communities, to low-income communities, to underserved communities. It's important that we, both in the long run and as we deal with the crisis, understand that access to credit, access to the American Dream, to achieve homeownership are universal needs.

So we at Freddie Mac applaud NCLR for not only focusing on this issue but bringing together this group of individuals to discuss how to support families as they work their way through this—what may have turned into a nightmare. So let me end by saying thank you for your support of Freddie Mac and that we are certainly pleased and proud to be a partner with NCLR in this effort; we think that this discussion is a critical one. Thank you.

Announcer Voiceover: Thank you, Mr. Robinson. Now, let's welcome our moderator for this afternoon's town hall. She is San Diego's own *10News* ABC anchor, Ms. Evy Ramos.

Ms. Evy Ramos: I'm definitely honored to be here with you today and to discuss such an important topic that's affecting nearly every American. I'd like to see a show of hands if any of you have experienced foreclosure, or a family member, a friend, or even if a house in your neighborhood may have foreclosed. How many of you have experienced that? Okay, a large majority of you.

We can see that this is a big national problem. Experts say that 1.5 million homes began foreclosure in 2007, and they're expecting 2.5 million homes to begin foreclosure this year. These are large numbers. We're talking millions and millions of people. Experts go on to predict that foreclosures will continue in 2009, and [while] we're hopeful, they're saying that not until 2010 will we really start to see any progress in this area.

Clearly, it's an important topic. I'm so glad to be sharing the stage right now with some distinguished guests, and it's my honor to introduce each of them to you. I'll start over here to my far left.

We have Martin Gruenberg, who is the Vice Chairman of the Federal Deposit Insurance Corporation, or the FDIC, Board of Directors. The FDIC is an independent agency created by the Congress that maintains the stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions, and managing receiverships. Mr. Gruenberg joined the FDIC Board after broad congressional experience in the financial services and regulatory areas. Thank you for being here with us.

Next, we have Carol Ornelas. For the past 20 years, she has been the Chief Executive Officer for Visionary Home Builders, formally ACLC—a nonprofit residential development company headquartered in Stockton, California. Carol is a licensed general contractor and an expert in her field. Her strength is in building and creating partnerships with citizens of the community and collaborating with local, city, and state officials and other agencies to provide quality affordable housing for the communities she serves.

Next over here to my far right, we have Mr. Alan Fisher who is Executive Director of the California Reinvestment Coalition [CRC]. CRC is a statewide membership organization of more than 250 nonprofit organizations and public agencies that advocate for the right of low-income communities and communities of color to have fair and equal access to banking and other financial services. CRC's goals are equal access to finance for all Californians and an end to the two-tier lending system that causes lower-income people to pay more for financial access. Thank you, Mr. Fisher.

And last, but not least, we have Secretary Rosario Marin. She's the Secretary of the State and Consumer Services Agency here in California. She oversees the state's civil rights enforcement, consumer protection, improving access to state government, and charged with greening the state. Early in her career, she served in the Huntington Park City Council and later became the 41st Treasurer of the United States. In early 2007, she released her autobiography titled, *Leading Between Two Worlds: Lessons from the First Mexican-Born Treasurer of the United States*, which details her journey and provides insight for all of us working to improve our community. Thank you.

And I think that's why we're all here. We're all here because we want to improve our communities and to improve America, and so let's get right to it. I'm going to give a brief guideline. Each of our panelists will have



five minutes to discuss the mortgage crisis from their perspective and what their respective agencies and organizations are doing to try to come up with solutions to this problem.

Then we will have a discussion. I will ask questions and the four panelists will discuss them. And then, lastly, and perhaps most importantly, we're going to open it up for audience questions as well, so all of you will have an opportunity to ask questions of whichever panelist you would like to ask.

So we're going to start with Secretary Marin, and as I mentioned, each of them will have five minutes to discuss.

Panelist Introductory Remarks

Secretary Rosario Marin: Thank you, Evy. I am delighted to be here with all of you. The state of California, as many of you know, is probably the hardest-hit state when it comes to the housing crisis. We have about 25 percent of all of the subprime loans throughout the nation; 25 percent of that is here in California. So clearly we are disproportionately affected when all of these loans are going down the drain. We have been severely impacted by that.

Consequently, when we started seeing—and the governor, to his credit, back in April of last year, he created a task force that I'm part of. And he said, "We need to do something about this." We started doing town hall meetings back in May of last year. And interestingly enough—it gives me the chills—at one point in time we had one in Bakersfield, and it was a Thursday night and it was raining. And guess what happened? Two hundred people showed up, and that foretold, at least to me, that we had a very significant problem way back then. When you have 200 people at night, on a Thursday night, raining, show up, that's a problem.

And so the governor took very significant steps. He met with bankers. He met with loan servicers and said, "We need you to really try to modify some of these loans." He took the lead, and eventually the federal government said, "That makes sense. Why don't we do that too?" We held town hall meetings. We put town halls in a box, and so any assemblymember or senator who wanted to conduct a town hall could. They could bring in the servicers, bankers, and consumers and try to work with the loans.

Then the governor said, "You know what? We have some problems here in California because some of the people that wanted to buy a home, they can't afford the high interest rate. The amount of money that Fannie Mae and Freddie Mac have does not cover us because our home values are much higher." So he asked the federal government, and lo and behold, the federal government said, "Yes, that makes sense, so we're going to increase the loan limit so that you in California can actually be able to buy homes at a cheaper rate." That helped a lot, and I'll explain to you why.

The governor has taken tremendous steps. Just last Monday he signed SB 1137. That did three things that I believe were very crucial. Senator [Don Richard] Perata [D–CA, 9th] ... offered that bill. The number one thing that it does is it requires banks or loan servicers, or whoever owns the loan right now, before they go into foreclosure proceedings, it requires them to sit down and talk to the loan holder and see if they can modify that loan.

Why is that important? Because up until now, it's been up to the ... [homeowner] to try to get the bank to talk to them and see if they can modify the loan. This changes that completely. It now puts the onus on the banks and/or whoever owns the loan to sit down with the people and say, "Let's see if we can work with you." That's really crucial, and I would hope that many of you from different states would ... have that same law passed in your state, because now it's no longer on the individuals. The onus is not on the individuals.

Number two—I think this is important for many of you to know. The renters, up until now, they had only three days to move out of the foreclosed home. This bill gives them 60 days, and I think there's another one, but I can tell you, those are steps that California has taken. We're very, very

happy. We're not there yet, but I think these are steps that mitigate the situation where we are.

Ms. Ramos: Thank you, Secretary Marin. Carol, we'll give you the opportunity now to discuss what you've done.

Ms. Carol Ornelas: I'm going to put this into proper context and begin with a little bit of information of where the foreclosure crisis is today. Today, cities throughout the state of California continue to show some of the highest foreclosure activity in the nation. Statistics show that one out of 204 homes [is] in foreclosure. I am from Stockton, California which is in the Central Valley, and the problem is a lot worse there. In Stockton, one in 26 homes is in foreclosure. Let me assure you, everyone knows someone in that predicament.

Last December, our congressman held a foreclosure event. Usually, December is a month of celebration, but outside the event center the scene was far from celebratory as the line wrapped around the building. When I walked into the event, I took a look at the sea of people, and I remember looking over to one of my colleagues from the City of Stockton and saying, "There is a chill in this room. Take a look at the fine example of predatory lending." Ninety-eight percent of the people that were there that day were Latinos, Blacks, Asians, and seniors. By the end of the day, I knew this problem was huge because all the families I had worked with that day did not qualify for their initial loan, and now their payments were going up and their incomes remained the same.

Today, we do not see the light at the end of the tunnel. We know that in July and November, we will be hit with another surge of resets. Keep in mind that these homeowners' homes will not even be in foreclosure or on the auction block for another six months. This problem is not going away soon and has had a domino effect on other aspects of society. Local governments are faced with lack of revenue from property taxes, and yet they still need to operate or many cities will find themselves in line with Vallejo in bankruptcy court.

The blight and vandalism in neighborhoods will only increase. Our property values will even further deteriorate. We must not forget that many investors who have bought homes and rented them to families have lost their investments, and many of these renters have been caught off guard, paid their rent, and the sheriff knocks on the door and tells them they must leave.

Current efforts today, including those within the industry and the government, are not working. My counselors face an uphill battle every time they work with the families struggling to keep their homes. You have read stories about our troops being sent to battle without proper equipment to fight the war. Well, our counselors have also been sent into this battle without the proper equipment.

We were told that banks and mortgage companies would work with us, yet somewhere along the way servicers and loan mitigation officers failed to come through. Wouldn't it be nice to read in the *Wall Street Journal* tomorrow morning that the government and banks are here to help you keep your home? After all, many have paid taxes for years and would like the government to give us a hand in this time of need.

What we need is a local community-based response to this foreclosure crisis because each company struggles in its unique way. We cannot yet quantify the impact that this will have on our Latino community. Today, it's our home and our tax base, but down the road we're talking about people's ability to pay for their kids' education and secure retirement.

Yesterday I worked in the home clinic here at the convention center. I met a family that had a loan they could not afford. They would do just about anything to keep that home. They were upside-down. His wife told me to take a look at his hands. They were blotchy and had bumps. His wife said they were from stress. He worries about how to pay for his home and bills, knowing that his net income is not enough each month to cover his expenses. We talked about the financial health of his family. They had no medical insurance or retirement fund. This is only the beginning for this family; there will be



many more problems down the road. If we don't act now, the Latino community will lose a generation of wealth.

Ms. Ramos: Thank you. Marty, I'd like to turn the time over to you. You have five minutes to respond.

Mr. Martin Gruenberg: Thank you, Evy. Let me say at the beginning what a privilege it is for me to be here. As you mentioned in your kind introduction, I worked for many years on the staff of the Senate Banking Committee for Senator [Paul S.] Sarbanes [D–MD], and certainly one of our great allies and advocates for fairness and opportunity for all Americans, particularly in the area of access to credit, is NCLR. We worked very closely with them, and it's a particular privilege for me to have the opportunity to be here today and speak to you.

This is a profound national crisis that we're confronting. In its most fundamental sense it's a moral issue for the hundreds of thousands of homeowners and their families who are being put at risk of losing their home and, for many of them, their most significant financial asset. It's also a crisis for the neighborhoods in which those families live, because when a home goes into foreclosure it's not just the family that's impacted, but every homeowner in that community is impacted in terms of the value of their home.

And at the end of the day this crisis is a national economic crisis, and until we can get some stability to the housing market in the United States, we're going to have great difficulty addressing the broader issues of financial stability that we're confronting today. So this really is a compelling issue to address on many levels.

The fundamental point that the FDIC has tried to make is that, given the scale of this problem, it is essential that we develop large-scale systemic responses. We have to use every tool available, but given the dimensions, it has to be more than a case-by-case response. We really need broad-scale systemic responses. The FDIC initially advocated, and our Chairman Sheila Bair advocated, broad-scale modifications by the servicers, by the private-sector holders of these mortgages, and made a simple proposal. That proposal was that for these subprime mortgages that have these reset points—as you understand, after two or three years, it is initially a low starter interest rate and then these mortgages adjust sharply upward. For homeowners who have been making their payments at the starter rate but can't afford the adjusted rate, simply freeze the rate at the starter rate so that you know the homeowner can continue to make payments. That's going to be in the homeowner's interest and it's going to be in the interest of the holder of that mortgage as well. And in fact, the FDIC had an agreement with Governor Schwarzenegger in which that proposal was put forward in the state of California and it had some positive response.

But it's clear at this point that the scale of the problem is so great that simple voluntary private-sector modifications are probably not going to be sufficient really to make an impact.

There's legislation pending in Congress now that probably is near enactment that would use the Federal Housing Administration to facilitate long-term modifications of these mortgages so that these homeowners can stay in their homes. Very simply, it would require a write-down of the current value of these homes to 85 percent of their current worth so that the homeowner could afford the payments. And if the owner and holder of the mortgage are willing to do that, the mortgage would be restructured with an FHA guarantee and the holder of the mortgage would be taken out.

We hope this is sufficient incentive to get the owners of these mortgages to participate and use the FHA to make possible what we hope will be large scale and very importantly, long-term modifications—so it's not a quick fix—modifications that will allow people to stay in their homes.

There's an additional proposal that the FDIC has put forward. I see my time is almost up, so I can come back to that in the next round. Thank you very much.

Ms. Ramos: We will. Thank you. Alan?

Mr. Alan Fisher: Yes. It's a great honor to be here. We have great sadness at our organization about the size of this crisis. Beginning toward the end of the last decade, we started saying to the regulators and the banks, "There are real dangers here. It's the opposite of homeownership." Yet, very little was done. The Federal Reserve did not step in, and when you all raised your hands—I don't know if you could see each other—but almost every hand was up. When I checked in and got my badge today, the woman told me she wished she could get some reinvestment because she had just lost her house.

But I think the crisis, as we're seeing from how widespread it is, is even bigger than just housing, and I think that we shouldn't be deceived, like sometimes happens in the media, into talking about the greedy investor or the greedy homeowner but that these were real. To me, there was a conspiracy of greed without responsibility: the realtor made money, the broker made money, the lender, the packager, Wall Street. Meanwhile, the Federal Reserve, Alan Greenspan, and others stood by and did nothing. And I think it's a very scary thing—small businesses that relied on equity lines.

There's a prediction that maybe 75 or more banks may go under, not just IndyMac. Neighborhoods are going down; cities are going down. As we talked about, kids are having to transfer out of their schools. There are mental health problems. It's something that all of us need to come together on, and I know NCLR has done good work around this.

But I think the first solution is really not to see it as the problem of the borrower, but to see it as an economic crisis, as Marty is saying, and to really react to it in that way. And to me, the housing boom really hid the greater gap in society between the rich and the poor, and how working people were making less and less, and that there are some major problems that we all need to address and not bury our heads in the sand. From our point of view, from our organization, there may be five critical pieces, and I'll just go through them quickly.

One has been mentioned: the tenant who pays regularly and one day gets a notice he or she has to be out. Now, with SB 1137 that has passed recently in California at least, they have 60 days, but still, they did nothing wrong. No banks are making an effort to keep people in those homes.

The second is counseling and legal services. Much of what occurred was fraudulent, the loans that were done. There's some federal money; it's very bureaucratic, but at least it's beginning to happen.

Servicing, the mortgage servicers, as we've been talking about up here, they're critical. They can make a decision to modify a loan, but they're not doing it. We did a study that just came out a few weeks ago that I think is available somewhere here, where we found that the most common thing in California—out of 42 counseling agencies and 12,000 or 15,000 people counseled—the most common outcome was still foreclosure, despite having someone who might work a day or more trying to fix it for you, and loan modifications were very uncommon. When the loan modifications happened, they were perhaps for one year. That was the most common thing. Now, no one can think that one year is enough to fix the situation of the income or the housing prices.

Another is that there's a lot of repossessed property out there that's going vacant. Slum lords are buying some of it, but a lot of it's just vacant and all the things that happen out of vacant properties and neighborhoods. I was in Stockton. One of Carol's staff took me around, and here were these houses, every other one, for auction, for sale, foreclosure, and in between and across the street were these gorgeous houses. The lawns were perfect, the homes were perfect, people who probably sacrificed tremendously to be in those homes, and the neighborhood gets hurt by this. There needs to be a program for repossessed homes to get to community organizations, so they can keep the neighborhoods alive and keep the neighborhoods in good shape.

And the last is regulation and legislation. Our state legislature has passed one bill, 1137. That's good, but many others—including ones that would make the people



who do these loans responsible for what happens—were voted down. Those things need to change.

And just in closing, we need real regulation to be sure this doesn't happen again. We had the savings and loan disaster. Now we have this. If no one is watching, if the market is supposed to fix it, this will happen again. Thank you.

Discussion

Ms. Ramos: Thank you. So first, let's start from the beginning and try to see where this all started, how this whole mortgage crisis began. Now, during the first quarter—and you mentioned some numbers, Carol—but during the first quarter of this year, nationwide, one in every 194 U.S. households received a foreclosure filing. That's a lot of households, one in every 194. So how did we get here? And I'd like it, Marty, if you could kick us off in this discussion on how we arrived at this day.

Mr. Gruenberg: Well, the short answer, particularly if you're talking about the subprime mortgage crisis, was that you had a complete collapse of underwriting standards within the subprime mortgage market that really has ultimately led to the foreclosure crisis that we're seeing today. And underlying that was a remarkable transformation that's taken place really over the last few years in the U.S. housing market.

As recently as 2001, more than 80 percent of home mortgages in the United States were the traditional long-term, fixed rate mortgage. By 2006, only 55 percent of home mortgages in the United States were fixed rate. The other 45 percent were adjustable rate mortgages [ARMs]. Most of those, the so-called nontraditional mortgages, the option ARMs, the interest only, and within that universe, you had the very rapid growth of the subprime mortgages.

In 2001, subprime mortgages accounted for only 5 percent of mortgage originations in the United States. By 2006, they had grown to 20 percent. And not only was there rapid growth, but you had within that subprime market the development of these—and you may have heard of them; some of you know them too well—the so-called 2/28 and 3/27 mortgages. The "2" stands for the first two years of the mortgage; the "28" stands for the next 28 years.

And the way these mortgages worked, the first two years was at a relatively low starter rate— not that low. Actually, most of them were at or near prime, but low enough that people could afford them, but after the first two years, they would adjust sharply upward, 3 or 4 more percent. So you would have a 6 percent or 7 percent loan and then it would go to 10 percent or 11 percent. And these mortgages were being underwritten only on the basis of the borrower's ability to pay the starter rate.

So you had hundreds of thousands of mortgages being given out, not based on the borrower's ability to pay the mortgage. These lenders knew these mortgages would adjust upward, and they knew the borrowers couldn't pay. They assumed that these borrowers could refinance out of the mortgage, and the reason they thought that was they assumed that the home values would continue to appreciate. It was a reasonable expectation because in the post-World War II period, that had always been the experience until last year.

Last year, home values in the United States declined by more than 4.5 percent, really the first time since World War II. This year, home prices are declining even more rapidly. In April, in the top 20 cities, there was a 15 percent decline in home values. Well, that undercut the fundamental assumptions underlying all of this mortgage lending. Folks could not refinance and they could not pay, and they were stuck—hundreds of thousands, millions of homeowners. And as you well know, this lending is heavily concentrated in the Hispanic community, in the African American community, and in the low- and moderate-income communities of our country. So we have a national crisis on our hands, and that is really the story of how it came about.

Ms. Ramos: Thank you. Now, do any of our panelists have comments? You segued into what I'd like to discuss. This has been all over the media; in every paper you pick up,

every news program you watch, every radio station you listen to, you hear about the victims—the real victims of this whole collapse.

And Alan, recently, the CRC released a multistate analysis that indicated that concentrations of the high-interest subprime loans have, and will continue to have, a disproportionate effect on the lower-income and Latino communities. Can you tell us a little bit about the study and maybe why that is?

Mr. Fisher: We see that neighborhoods of color and low-income neighborhoods were targeted. There often aren't bank branches in those neighborhoods, people feel uncomfortable with the regular lenders, and there was, I think, nine times as much subprime lending to people of color in Los Angeles.

I think another reason is that there are predators who speak other languages than English in those neighborhoods. They go out in those neighborhoods and talk to folks and convince them that they can get a good loan, and many times the paperwork is in English, even though all of the conversations have happened in Spanish and Tagalog, or whatever. And I think they found a vulnerable population, and I think we all have built into us this American Dream that we'll own a home, and people were led on by that belief.

Ms. Ramos: You have some people that say a home is one of the biggest investments a person will ever make. And a lot of people have questioned how somebody can go into that and not fully understand what they're putting their money into. Carol, I know that you work within the community. How do you respond to those who ask, "Why should we help those that got into something that was way over their heads?"

Ms. Ornelas: What I feel about this whole situation is that the consumers were led onto this train; it was going full speed, and there were absolutely no brakes. You had all these folks pressuring you [to think] that they can make it work. There was a fiduciary responsibility from everyone that they've talked and worked with. The real estate laws are very, very clear when you sell real estate or are a lender. You have a fiduciary responsibility to that client. That client paid every one of those persons dollars to get them into those loans. They all went away with money. The consumer went away with their home, but they received a product that they truly did not understand or could not afford. Where is the breakdown? That breakdown has been there for years and is a result of a lack of understanding from the buyers of what the numbers mean. Realtors and lenders who are motivated by money and greed recognize an ill-informed buyer's situation and thus took advantage and exploited these buyers.

It is ideally assumed that when financing the purchase of a home, most have an idea of what is going on. Unfortunately, this is not the case. You glance at the paperwork to realize that it is complicated and simply beyond the understanding of most. In reality, most prospective buyers arranging financing put their trust in a loan officer and [leave] it to them to arrange everything. The loan officer then presents to the buyer a vague yet ideal scenario of the situation and asks them to sign on the dotted lines.

We see foreclosures happening and families are losing their homes and it is devastating. It is devastating because we see that these families are employed and are no longer able to afford these homes. I don't know many employers who give $10,000 increases [in pay to employees] annually. Most people receive maybe a $1 increase per hour. That pay increase would not meet the needs of the increase of their new payment.

And I know Rosario has talked about future training and literacy of homeownership, but that's the future. We're dealing with today and we need those solutions. I'm glad. I keep waiting for that bill to pass, and every day I read the *Wall Street Journal* to see if we're going to get it. We already know that the President [George W. Bush] is talking about vetoing it. So that solution is not quite in the making.

And we need real solutions, and it really means that each one of you, you know someone or you've been in that



predicament. We need to get on the phone, and we need to start calling our local congressmen and putting on the heat and the pressure, as well as the President to sign that bill and put it out in the street. Just as quick as we could say, Freddie Mac and Fannie Mae, we need to do the same thing for our people. We are the strength. We are the backbone of our country—homeownership is too. We do not need a lot of investors coming into our community and turning our single-family housing stock into rental property.

Ms. Ramos: Well, you mentioned briefly—we were talking about the housing bill and that's more on a national level, but what about on the local, state level? What role should the state be playing? Secretary Marin, if we can touch on the work that is currently being done on the state level and what you think is the max a state can do. Do you need help on the national level and from the community level?

Secretary Marin: Yes. Well, thank you, Evy. You know, there is no easy solution. There is not one bill that is going to fix all of the problems. This is a big, big crisis that we have that is touching on a lot of people's lives. And while we are looking at this problem as well, if we had done what we need to do now for the future, if we had done this five years ago, ten years ago, we wouldn't be in the situation that we are today.

So we need to, while we're fixing the problem, while we let the legislatures fix it, I think everybody here can help us go out there and try to educate our community. Financial literacy must happen, should have happened a long time ago. It's not happening. It needs to happen now and it needs to happen in the future.

Let me tell you, when I was the Treasurer of the United States, I went around the country and talked about why we needed to have financial literacy, and I'm sure there are many efforts [in] the states right now and around the nation, but we need people to understand what they're signing. We need to make sure that they understand.

We're making some changes here in the law. Right now there's going to be one sheet of paper that tells people this is how much [their] mortgage payment is right now, and this is how high it could be. It's very important, because if that piece of paper would have been part of that ton of paperwork that families need to sign when they're getting their mortgage, maybe people would not have signed them, but they didn't even know. They didn't even know that their loans were going to be so high, that their payments were going to be so high. So we need to do that.

The other thing with the law, and let me just share this with you because I didn't share the other one—the law that the governor just signed, 1137, it also deals—it makes the loan holder, the bank—it requires them to maintain the property, and I think that will be a welcomed thing especially in the areas so hard hit as Stockton and San Diego. There are some areas that are very, very hard hit. And what happens is that the people leave and the houses just go absolutely —not just vacant. It would be great if they're just vacant, but they are unkempt; drug dealing takes place; gangs take them over. Then, all of a sudden, you have entire neighborhoods absolutely decimated.

So now, this bill holds the loan holder, the person responsible, the bank or the loan servicer, or whoever owns the loan, it makes them responsible and that's really, really a welcome development. I know you like that a lot and so that's important.

What I want from all of you is to help us for the future. There are some things we need to do. There is legislation that is going to pass right now, but in the future we need to take people by the hand and educate them.

But the other thing is our community. My God, it pains me. They won't report that they were the subject of fraud. Why? [*Porque fue el compadre. Fue mi amigo. Fue la hija de la comadre.*] So we're not going to do that like—[*verdad que si?*] Yes? You know that? Right? Because they were our friends. But friends don't do that to friends. I cannot tell you how many times I listened to these horror stories and I said, "You know what? I have somebody here from the Department of Real Estate. Right now, you put that as a complaint and we'll deal with them." "No, no [*señora es que es mi amigo*]." So would you please help

me and tell people when somebody did you wrong, file a complaint? Make me busy, okay? I want to be busy that way.

Ms. Ramos: We'll let Carol answer. We want to definitely leave time, though, for audience questions as well. So go ahead, Carol.

Ms. Ornelas: You asked what communities can do. Foreclosures are a big issue, and as we heard today there is no easy answer, but going into the future, especially in the state of California, we have what is called the housing element. That housing element is supposed to be the blueprint for communities as to how they're going to deal with their housing issues.

I can only speak for my community, but from what I have seen in the report, housing that was proposed was not being built for those in our community. I want to make it really clear here today, that this crisis did not only affect low-income people, it affected our moderate-income people also, and the working class of America. All these groups were sucked into this subprime lending.

Those housing elements are so important because we should be building housing affordable to everybody at any income level. That's where it started to crumble in California because we thought we should just build for above moderate-income families and we forgot the working poor; we forgot the working middle class. We totally forgot about them because everybody has failed to implement a strong housing element in the state of California.

There are very few communities that can say they have a document that worked. And guess what? It's because, like many things, it does not have teeth. Somebody on the legislative level needs to say, "We don't like it because it's not going to make people accountable and we shouldn't have to approve it."

Well, to you, and all of you out there, what did this market do to us? We always depend on the market. I think we need to stop looking at the market and stop depending on it so much. We should focus on what is best for our community.

Ms. Ramos: Thank you, Carol. I know, Marty, you had a comment.

Mr. Gruenberg: There is one point I wanted to make in terms of understanding this issue, particularly on this question of responsibility and somehow whether the homeowners are responsible for the circumstances. It's important to understand that for these subprime mortgages, a majority of the subprime mortgages that were made were refinancing of existing home loans.

What that meant was that these were people who were already in their homes with fixed rate mortgages they could afford and they were encouraged to refinance their mortgages. Why did they do that? Well, this is what they were told. They were told, "Look, we can lower your mortgage payment. We can let you pull out some of the equity so that you can fix up your home or the roof or whatever else and it will cost you less money." They didn't tell you that this lower interest rate was only good for two or three years. They didn't tell you that they weren't including the escrow for taxes and insurances.

So it sounded too good to be true and it was too good to be true, but did the people really understand it? No. Were these people speculators? No. These were folks who were living in their homes, wanting to try to address some of their financial needs and were persuaded by people that they could get a better deal. And it wasn't true.

And this was done on a very large scale and we're now trying to cope with the repercussions.

Ms. Ramos: Thank you very much.

Mr. Fisher: Just quickly, I just want to emphasize again what Carol was saying, that the housing element is part of how the city decides about housing, but our legislators at the state level are talking about getting together to do another bill that'll help about this. You should be sure you call them in California and across the country. The Congress people have been futzing around with this thing, making a lot of noise, and not doing anything. It's not really moved forward. It gets weakened all the time. You are the electorate. You should be speaking up and



saying to them, "These things need to change. You need to do something." Every day in California—well, every 45 seconds or so in California—someone loses their home. This is happening all across the country.

Ms. Ramos: Thank you very much. We are now going to turn time over to you in the audience for questions. We have, I believe, two mikes going around. So if we can start with the gentleman in the back. He's had his hand—oh, okay, after the lady right here.

Questions from the Audience

Q: Thank you. My name is Aracely Panameño. I'm with the Center for Responsible Lending in Washington, DC and this question is to you, Martin. Unfortunately, you are the only one here representing the regulators, so I'm going to direct my question to you and ask you to speak on behalf of regulators in general and not just the FDIC.

At the Center for Responsible Lending, we certainly do a great deal of research about the performance of the market, and we've talked about refinancing, but 45 percent of Latinos who bought a home in 2006 did so with a subprime loan. More than 60 percent of them actually qualified for prime, and the rest of them qualified for better subprime terms.

You just covered IndyMac and that was a depository institution and the reports have shown that many other depository institutions, as well as other mortgage lending institutions, have engaged in predatory practices. Will you release a report regarding the performance of IndyMac as you move forward, and also what will you do regarding other banking institutions in your supervisory role? Because obviously somebody fell asleep at the helm.

Mr. Gruenberg: Well, in regard to IndyMac, obviously, the priority now is the ongoing operation of the institution and assuring all the depositors and account holders in that institution that they can continue doing business as usual, and that's the priority. But you raised a set of very important issues in terms of the regulation of the mortgage-lending market generally and the subprime mortgage-lending market in particular.

Now, let me just—if I could comment briefly on that. The essential issue here in terms of regulation was the failure of the lenders to underwrite these loans based on the borrower's ability to pay. And so the two dimensions of this issue are, one, going forward, fixing the regulations so this doesn't occur again. And two, what we've been talking about, which is the most urgent and compelling part perhaps, is dealing with the folks who are holding these mortgages and are at risk. But let me talk for a second about the first part.

We need, going forward, to address the regulatory standards. At a minimum, these subprime mortgage loans, they have to be underwritten based on the borrower's ability to pay and on the full index rate for these mortgages that adjust upward. We need to address the practice of not including escrow for taxes and insurance in the underwriting of these loans and the utilization of so-called low-doc or no-documentation loans. These are some of the critical abusive practices that produced this issue.

If I can take a second—I've been told to stop. I will stop if you want me to, but there are actions that could be taken, both further actions by the regulators—the Federal Reserve has broad authority in this area, and today they just actually issued a final regulation that at the minimum, I think, will address these three issues of underwriting based on the borrower's ability to pay, the escrow of taxes and insurance, and the no- or low-documentation lending. So that's very important. And there's also legislation pending in Congress. Whether it's this year or next year, we probably should address this in the statute to be sure it doesn't happen again.

Ms. Ramos: Yes, the gentleman in the back.

Q: Thank you very much for participating today. My name is Mike Aguirre. I'm the City Attorney here in San Diego. Many of us believe that we can't rely on Washington for a solution for a lot of different reasons, and so we are preparing to take action ourselves here in San Diego to stop all foreclosures that were based upon unfair violations

of the law under our state law. And my question to you is will you help us provide technical support and information from the FDIC and from many of the others of you to make this a reality? We think that if we can do this here in San Diego, perhaps we can do it elsewhere. And the reason we've lost confidence is people like Senator Sarbanes, who was on notice that the SEC Chairman Chris Cox had been himself involved in prime lending fraud as an attorney, and held no hearings, no background, rubber-stamped his appointment. And had he done his job and regulated, instead of looked the other way, we wouldn't be here today.

So the question is will you help those of us in local government who are prepared to take action, who believe that foreclosure should not be an option as a result of fraudulent, unlawful, and unfair business practices?

Ms. Ornelas: I think that's yours, Marty. (laughter)

Mr. Gruenberg: I'm not quite sure how to respond to that. I have to say, if you're talking about private legal action at the local level, you can bring lawsuits using state or federal unfair and deceptive practices. That's certainly something that's within your power to do.

And I guess an important point to make is that it seems to me—and this was mentioned before—there's no one solution to this issue, and that from my perspective every home is important. So whether it's a community group providing counseling to homeowners to deal with their foreclosure situation, or whether it's an action by local or state officials, or whether it's an action by a legal services attorney bringing a suit against a lender that's been engaged in unfair practices, or whether it's an action at the federal level, either by regulation or congressional response, these are all resources we should try to bring to bear to deal with what I really believe is a compelling issue for millions of Americans.

Ms. Ramos: We have the lady up in front.

Q: Thank you for giving me the opportunity to speak before you, and thank you, all of you. I'm Myrna Reyes and I'm the past president of the Filipino-American Chamber of Commerce. I'm also a certified HUD counselor, and what I'd like for all of you to know is that we're taking actions here in San Diego ourselves.

I have been an escrow officer for 27 years and I'm very passionate about this issue because I've seen a lot of them. So I'm also inviting some of you on July 23rd from eight o'clock to 12:00, there is a meeting with the Law Enforcement Group in San Diego. It pertains to eviction and it will be at 4305—write it down—University Avenue in San Diego. I will be outside and I will take your names later if you want to come with me.

Ms. Ramos: Okay, thank you. We have the gentleman right here in the middle.

Q: Hello. My name is Freddy. I'm from Los Angeles. I thought it was a very important point that our young friend here made about IndyMac. This is the second-largest collapse of a bank in the history of this country. I recently heard a report that Fannie Mae and Freddie Mac are also about to go under, and we might have to have the federal government step it [up]. If that were to happen, that [would] add on $5 trillion to the already existing debt that we have in the country.

My main concern is that everything that's been proposed from Ben Bernanke to Barney Frank, Chris Dodd, and even the presumptive presidential candidates, it still seems somewhat of a short-term solution. I think Marty hit the nail on the head when he said that this was a systemic problem.

Now, throughout the country, you've had city councils and state legislators support a legislation known as the "Homeowners and Bank Protection Act." This was put together by economists and Democrat Lyndon LaRouche. He specifically calls for—to address the systemic crisis—you address it by declaring a moratorium on foreclosures, not for an extended amount of time.

Second, he's calling for a top-down reorganization of the banking system, the way that Franklin Roosevelt had



discussed and, frankly, penalizes speculators. It's going to require much more than that—excuse me. I'm sorry. I'm (inaudible).

So my question is what type of actions are the members here on the panel and the members of NCLR willing to take? It's very clear. We were jacked by the speculators and we need action on a federal level, not on a local level. This has to be addressed on a national scale. And at this point, the only alternative seen throughout this country to be most effective is the "Homeowners and Bank Protection Act" by Lyndon LaRouche.

I'm curious as to what stance you guys are ready to take. Are we going to continue talking about just a short-term solution, or are we really going to wage a political fight this year, because, like I said, this is big. We're not talking about a two-month crisis.

Ms. Ramos: Thank you.

Secretary Marin: Well, I think that there is no perfect solution. I think that what you're going to see is a number of different solutions. Some of them might be small, some of them might be big, but there is not one perfect solution. I think that what we're looking for is at both the federal level and the state level. We want a number of options.

It's just like financial services. The subprime loans are one of many services. They obviously were abused, and we need to have a whole bunch of procedures as it is a systemic problem. So we need to have a number of different solutions. Some of them are going to deal with the bankers and the lenders. Some of them are going to deal with the mortgage brokers. Some of them are going to deal with financial literacy. Some of them are going to deal with a number of things. Some of them may deal with the plan, the housing plan, but it's going to take a number of them.

And for anybody that is looking for the one piece of legislation that will be a cure-all, it's probably not very realistic, but I am very hopeful—and I represent a governor who's extremely optimistic. He feels that it took both lenders and borrowers to get us where we are right now, and it's going to take both lenders and borrowers to get us out of it. So I believe we will.

Ms. Ornelas: I'd like to also add I've had this conversation with those in our community. It really is about dialogue. There's not this one brush that we all can use to paint the same picture. We need to take a look at the problem, but we need the lenders at the table and for them to stop saying, "We can't do it." There are laws, but guess what? Laws can be changed and they should not take forever to change. And so to me, to personalize this more in your own community, you need to open up dialogue and get people behind a cause to move this forward.

Today, Freddie Mac was here, right? And I said why can't we keep people inside their homes, letting them pay rent while solutions are happening? (applause) I think it's better than receiving no money at all, or having a vacant house that's being vandalized. And they said, "Well, it can't work." Well, why can't it work? Those are the types of dialogues that need to be happening.

We should be telling Freddie Mac, this is the way we want to do it because it is our community. Those homes are sitting in our community vacant and vandalized and increasing problems for us as a whole.

Ms. Ramos: Thank you. Right over here.

Q: Okay. Hi, thank you for joining us today. I think this is a very important discussion that needs to continue. Everyone had very valid input into what's going on. I think that Mr. Gruenberg hit the nail on the head in terms of looking at FHA as part of the solution. I think that FHA has always historically been the answer to stabilizing the market.

And I think that the points that you've given are very important and crucial to making sure that the real estate market really doesn't bottom out, and if you have a situation where you're doing a moratorium on foreclosures, there is a very big chance that it will bottom

out and affect the economy even more negatively.

My question is regarding a regulation of servicing providers. It seems that most of the leg work that's been done already and the accomplishments have been on the side of origination in terms of modernizing the Truth in Lending [Act] and the Real Estate Settlement Procedures Act.

What is really being done to make sure that we have some uniformity on the side of servicing agents? Because I'm on the frontlines dealing with people that are losing their houses. When they're finding themselves in trouble, they're calling the lenders. The lenders are saying, "You might want to think about defaulting on your payment so that we can help you because we can't help you now." And when they do, they're saying, "Well, you've defaulted, so we really can't help you now either."

And so people are finding [themselves] in a place where there's no regulation behind what servicers can do to help them. And the process is being brought about for seven, eight, nine months and to the point where they're in despair. And regulations such as SB 1137 may help, but that's almost at the end, where you're already facing foreclosure and people are outside.

So my question is, what is being done on the side of regulating servicing agents?

Secretary Marin: Yes, I'm going to say something because one of the things that is very, very clear, and there was a lot of confusion because there were a number of different things that both the federal government was doing, and at one point in time it was like, "Well, we're going to try to help the people that are going through foreclosure proceeding. So if in fact you have not gone into foreclosure, don't even call us. Go into foreclosure before we can help you."

Then there was another program that started back in December of last year, where it was like, "No, if you anticipate that you're not going to be able to make your payments and your loan is going to be resetting, come and talk to us right now," and so forth.

I think that there has been some massive confusion out there, where people don't know, when can I go and get help? I can tell you right here, and right now, it is in the best interest of the banks that homes do not foreclose. The market is saturated with foreclosed homes. It is not in their best interest to continue to grow that stock. They lose money.

So they are pretty much—and we've held a lot of workshops, and personally I have attended quite a few of them—they are very willing to sit down and talk with the people so that they don't go into foreclosure proceedings. And now with the law in California, they have to sit down before they actually go into foreclosure proceedings.

There is a lot being done. There is some confusion out there. The most important thing that we can ask people is to go in and talk to their banks. I know some people say it takes too long, it's too much, and so forth. Some people are not seeing the responses, but I can tell you, banks do not want to have more and more foreclosures.

Ms. Ramos: Alan, I know that CRC—you mentioned it briefly—recently did a survey. Can you talk about this as well?

Mr. Fisher: Right, and we actually called for a six-month moratorium about a year and a quarter ago. The institutions didn't listen to us for some reason, but we had a number of meetings and what I heard was what Rosario was saying, and we felt hopeful that maybe there was a solution.

But what we see and hear over and over again is that the servicers, not necessarily the banks, but many of these things are in big investment blocks—10,000 loans. The people who service them are not fixing it, and actually it may be that the people who service them make more money foreclosing than they make on fixing the loan. So I think there are tremendous problems with what we call this regulation or whatever we call this, where they're just going ahead, and meanwhile whole neighborhoods are emptying out.



And I think we really need to do something about that and the service—while there are all these nice things being said here—I don't mean here by Rosario, but by the banks, that they were going to solve this. They have no interest. The reality is that there are foreclosures all the time that the servicers are not responding to. And whatever reason for that may be it's not happening, and maybe they're making more money that way, just like they made more money doing this in the first place.

Ms. Ramos: I guess—what's the suggestion then for those facing foreclosure? If somebody's out there and they call a lender and the lender's not listening to him? They're not helping them. What are they supposed to do at that point?

Mr. Fisher: There are many counselors, like Visionary Home Builders. The HUD website has a listing of HUD-certified counselors. There are others. There's the Hope Now phone line, but I think the other thing is to turn to people like Governor Schwarzenegger and say, "You've talked with these servicers. We're still not seeing what we should see." Or, in your states or the federal government, "Let's solve this for us because we have a $14 billion deficit for next year in the state of California." That's what's happening across the country. If this doesn't get solved, it's more than the banks that are in trouble.

Ms. Ramos: Right. Thank you. We have a question in the back. Where is the microphone? There it is.

Q: Thank you. Hi, my name is Erdena. I'm from Los Angeles. It's a true point that you make about 50 percent of the annual banking assets are mortgage-backed or related to the mortgage industry in some way or another.

Now, my question is, obviously, the banks are going to do what's in the interest of the banks, and I find it ironic that a part of what was made, and part of the points that were made in the presentation earlier, is that the pending legislation on the Hill right now was authored by the banks—Credit Suisse being among the banks that authored the legislation.

So obviously, it's not being done from the standpoint of having the interest of the people and the lower 80 percent in mind. Now my question is, today, yesterday, all the discussions were always leading back to this question of deregulation and speculation. Why don't we just come out full force and say, "Hey, NAFTA, free trade, these economic policies have proved to be inefficient in the past 40 years since we've been practicing them."

Today— just one quick thing—John McCain—I was in a luncheon today. He brought up the fact that he was a staunch supporter of free trade, a staunch supporter of NAFTA and the free markets. And I thought that it was extremely audacious, considering the fact that all these issues, the mortgage issue, the health care issue, the border issues have to do with free trade policies that have been decimating not only the United States but the Third World as well.

So my question is, why aren't we—at this conference and in general—willing to stand up and say, "We talk about it at home. Free trade doesn't work. We know it doesn't work." Let's start to become a producer-oriented economy again. Infrastructure—talk about it. Why aren't you talking about it?

Ms. Ramos: Would anybody like to tackle that question. Was there maybe a more direct question for a specific panelist?

Q: (Off mike)—free trade, people think that there is no alternative. That's not true. It's only been in place since 1971, that's it. All the successes we've had in U.S. history under FDR.

Ms. Ramos: Yes, I understand that, but if you can just have a direct question for one of the panelists, not a general—

Q: (Off mike) How will they have the audacity to speak here and talk about legislation (off mike) authored by the banks and—(off mike).

Mr. Gruenberg: I think—and I understand the point you're making. I think the issue here is trying to find

responses that we think might be effective. And I think the proposal being put forward is viewed by many community advocates, as well as others, as a possibly effective response and utilizing FHA to facilitate substantial write-down of principal on the current value of these mortgage loans, so that people can afford to pay them and then utilizing FHA to guarantee the restructured loan, structured in a way that the homeowner can pay it for the long term is a sensible thing to do, whatever the origin of that idea. So I'm not sure we want to get hung up on that, for what it's worth.

I want to come back just to address this—one of the complications. And I want to be sure people understand when they talk about the role of the servicers as opposed to the lenders because I'm not sure if everybody understands.

One of the big changes that's happened in the mortgage market in the United States over the last five years, it used to be when a lender made a loan, made a mortgage, the lender held on to that mortgage, and so when people ran into difficulty they'd go to their lender and try to work it out. And that's what lenders do. It's part of their business and they want to maintain relationships with their customers. So they had a capacity to do a workout so that people can stay in the homes because, as was pointed out, by and large it's in the interest of the lender as well as the homeowner to avoid the foreclosure.

One of the big changes we've had in the mortgage market, and particularly in the subprime market just over the last five years, was this thing that happened, which the lenders started selling off these mortgages to investors, the so-called securitization of these mortgages, where they would sell the mortgages to Wall Street firms, who would then package these mortgages into a—it was called a mortgage-backed security—and sell them off to investors around the country and, frankly, around the world.

And then they would have these financial companies that are called intermediaries or servicers between the investors and the homeowner collecting the payments from the homeowner and passing it along to the investor. And these servicers were not in the lending business and they were not used to dealing with homeowners, with borrowers, and not used to doing workouts when people got into difficulty. And we've got this really difficult problem and the servicers are poorly equipped and it's not clear, as Alan said, that the incentive system is right for these people to deal with.

It's been a big part of the problem. It's not an excuse, but it's one of the difficulties and challenges we faced in trying to address this problem.

Ms. Ramos: All right. Can we have the next question right over here? Sorry, I can't see where you are. Oh, okay, in the front.

Q: Good afternoon. With this experience that we have gone through—and I know that one of the ladies mentioned about the regulations that are taking place—is it possible that we could have stricter educational requirements for the professionals that are working in this field because, at this moment, it is so easy to get a real estate license and make $100,000. And so you get a flood of a lot of people who don't know what they're doing and they're entering into this market just because they have the connections.

My mom, my uncle, whoever—they're all being impacted. So is it possible—is there some way that this—there could be stronger requirements, some way to make sure that we have actual professionals that are in this field, as opposed to amateurs? That would be my question.

Secretary Marin: You want me to try it? I'll try it. I personally do not oversee the Department of Real Estate, but we—as I understand—in California, it's actually not as easy to get a real estate license. There are many, many people that actually flunk the test. So it's not easy. But what I think you're saying has real value.

I think that there needs to be—of course, there are probably mortgage brokers here and real estate agents here. They will disagree with you that it's easy. It's not that easy, but can we do more to ensure that? What we



cannot do is legislate integrity. There are some people that have taken advantage, that have taken advantage of the trust that people had put in them. And it's a little bit more difficult to legislate integrity and honesty. We can pull their licenses, if we know that they wronged somebody.

The problem—and I go back to what I said before. There are people that do not want to file complaints. So if we knew for a fact that somebody has actually wronged somebody that defrauded them, that told them one thing and it was something else, they can file complaints. The problem, especially within our community—and I get very, very upset about that—... people will not file complaints. I would—I can tell you, we'll take care of them. You give me the people that should be—that their licenses should be pulled, we'll go through the process. We'll be very happy to pull their licenses.

Conclusion

Ms. Ramos: Thank you. Unfortunately, we don't have time for any other questions. We do, however, have surveys on your seats. If you have any questions, comments, concerns, or just comments about the town hall discussion, we would love for you to fill those out.

We do want to thank our panelists for being here with us today and giving us their time. Hopefully, we can take these solutions and take them to our local, state—and to Washington—and hopefully we can come up with some help for those that are suffering in this massive foreclosure crisis. Thank you very much.

Panelist and Speaker Bios



Alan Fisher

Alan Fisher is Executive Director of the California Reinvestment Coalition (CRC). CRC is a statewide membership organization of more than 250 nonprofit organizations and public agencies that advocates with financial institutions for increased lending, investment, and financial services for low-income and minority communities. CRC's goals are equal access to finance for all Californians and an end to the two-tier lending system that causes lower-income people to pay more for financial access.

CRC has Community Reinvestment Act (CRA) agreements with major California financial institutions, including Bank of America, Wachovia Bank, Comerica Bank, Union Bank of California, Wells Fargo Bank, U.S. Bank, and Washington Mutual Bank. CRC members meet with these institutions regularly for dialogue to expand products and services available to low-income and minority communities that also offer positive opportunities for the institutions. In addition, CRC negotiates with insurance companies and other entities in the consolidating financial sector to increase their investments and services to underserved communities. CRC also works on the issues of payday, subprime mortgage, and tax refund lending.

Mr. Fisher has experience as a labor and community activist, writer, small-business person, management consultant, electronic repairman, researcher, college lecturer, and foundation staffer. He has written or contributed to CRC reports on small business lending, payday lending, affordable housing, mortgage redlining, small business technical assistance, and other community issues. Mr. Fisher is on the Board of Directors of the National Community Reinvestment Coalition, Bernal Heights Housing Corporation, and Centro del Pueblo. He has an MBA from the University of California at Los Angeles and a BA from the University of California at Santa Cruz.



Martin J. Gruenberg

Martin J. Gruenberg was sworn in as Vice Chairman of the FDIC Board of Directors on August 22, 2005. Upon the resignation of Chairman Donald Powell, he served as Acting Chairman from November 15, 2005 to June 26, 2006. On November 2, 2007, Mr. Gruenberg was named Chairman of the Executive Council and President of the International Association of Deposit Insurers (IADI).

Mr. Gruenberg joined the FDIC Board after broad congressional experience in the financial services and regulatory areas. He served as Senior Counsel to Senator Paul S. Sarbanes (D–MD) on the staff of the Senate Committee on Banking, Housing, and Urban Affairs from 1993 to 2005. Mr. Gruenberg advised the senator on issues of domestic and international financial regulation, monetary policy, and trade. He also served as Staff Director of the Banking Committee's Subcommittee on International Finance and Monetary Policy from 1987 to 1992. Major legislation in which Mr. Gruenberg played an active role during his service on the Committee includes the Financial Institution Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the Gramm-Leach-Bliley Act, and the Sarbanes-Oxley Act of 2002. Mr. Gruenberg holds a JD from Case Western Reserve Law School and an AB from Princeton University, Woodrow Wilson School of Public and International Affairs



Secretary Rosario Marin

Rosario Marin is a trusted advisor to California Governor Arnold Schwarzenegger and an inspiration to many. Early in her career she served on the Huntington Park City Council and was later appointed by President George W. Bush and unanimously confirmed by the United States Senate to be the 41st Treasurer of the United States. In her current

role as Secretary of the Sate and Consumer Services Agency, she oversees California's civil rights enforcement, consumer protection, improvement of access to state government, and the "greening" of the state. In 2008, Secretary Marin was honored by the U.S. Citizenship and Immigration Services and received the "Outstanding American by Choice" Award, which recognizes the outstanding achievements of naturalized U.S. citizens.

In early 2007, she released her autobiography titled, *Leading Between Two Worlds: Lessons from the First Mexican-Born Treasurer of the United States*, which details her journey and provides valuable insight for anyone working to improve the Latino community. Secretary Marin is the recipient of four honorary doctorate degrees from the following universities: California State University, Los Angeles; Whittier College; University of St. Francis; and Woodbury College. Today, Secretary Marin is not only a trailblazer, she is a devoted wife, mother, public servant, and tireless mentor.



Carol Ornelas

Carol Ornelas is a licensed general contractor and an expert in the field of affordable housing. For the past 20 years, she has been the Chief Executive Officer for Visionary Home Builders of California (formerly ACLC, Inc.), a nonprofit residential development company headquartered in Stockton, California. Ms. Ornelas has brought in more than $150 million in grants and private dollars to develop quality and affordable housing for families in the San Joaquin Valley. She also serves with distinction as the only female housing developer in the area.

Under Ms. Ornelas's direct leadership, Visionary Home Builders has built or rehabilitated more than 1,000 units of rental housing and more than 350 residential homes for first-time homebuyers. Ms. Ornelas also worked with San Joaquin County to develop the Valle del Sol community of 76 housing units for farmworker families. This community includes child care with an emphasis on early development, social services, and a medical clinic. The project was recently awarded "Best Affordable Housing Project" in its category in the nation by *Affordable Housing Finance* magazine.



Evy Ramos

Evy Ramos is currently the morning anchor for KGTV *10News* and works as a reporter covering issues affecting the Latino community in San Diego. From politics to health care and family, she shares the stories of the culturally diverse Latino community.

Ms. Ramos graduated from the University of Southern California (USC) with a degree in broadcast journalism and a minor in communication and the entertainment industry. Upon graduating, she worked at *E! True Hollywood Story* in Los Angeles before heading to Fresno where she worked as a reporter/anchor for two years.

Ms. Ramos was born the eldest of seven children in Ciudad Obregon, Sonora, Mexico. When she was three years old, her family moved to Southern California where they currently reside. She graduated from the Thatcher School in Ojai before continuing her studies at USC. While in school, she was involved in the school news program Annenberg TV News, dramatic arts, musical theater, soccer, volleyball, piano, and voice. She is bilingual (English and Spanish).



Dwight P. Robinson

Dwight P. Robinson currently serves as Senior Vice President of Corporate Relations and Housing Outreach of Freddie Mac. In 1998, he was named Vice President of Industry Relations, where he was responsible for coordinating the corporation's relationships with trade associations and other key industry groups. Prior to joining Freddie Mac in 1998, Mr. Robinson was Deputy Secretary of the U.S. Department of Housing and Urban Development (HUD), functioning as Chief Operating Officer and handling the

agency's day-to-day operations, coordinating seven HUD operating entities. Before assuming the Deputy Secretary position at HUD, he was President of Ginnie Mae, a wholly owned government association that serves low- to moderate-income homebuyers. As President, Robinson was responsible for all major policy decisions affecting Ginnie Mae's issuers and purchasers worldwide.

Before joining Ginnie Mae in 1993, Mr. Robinson was Director of Freddie Mac's Affordable Housing unit where he was a key figure in establishing corporate affordable housing policies, programs, and mortgage offerings. Prior to his time at Freddie Mac, he was Deputy Executive Director and Chief Loan Underwriter of the Michigan State Housing Development Authority, managing 360 employees and an annual budget of $27 million. He also held several senior management positions with the Authority. Mr. Robinson holds a BS in urban planning and community development from Michigan State University.

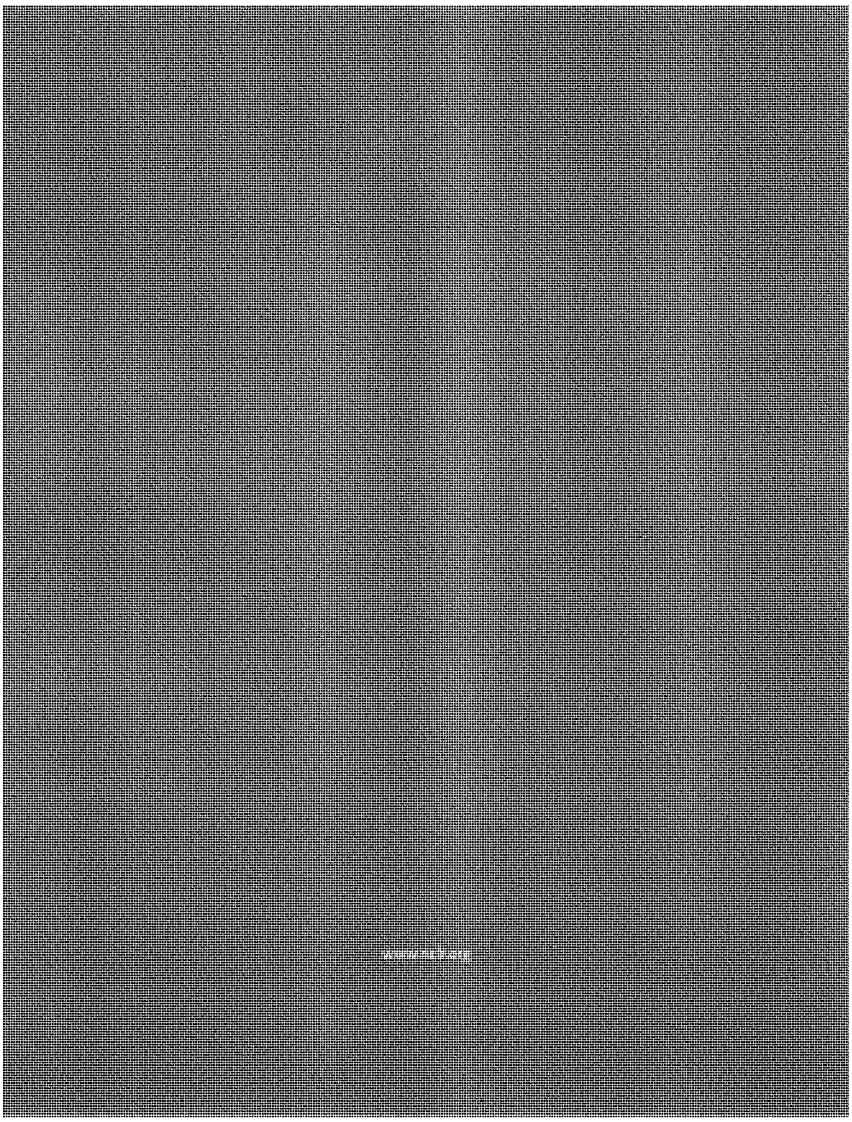


Anselmo Villarreal

Anselmo Villarreal is the President and CEO of La Casa de Esperanza, a community-based organization dedicated to serving Waukesha, Wisconsin's low-income and Latino populations since 1966. With 18 years of experience in nonprofit management, his primary responsibility is to provide strategic vision, planning, and direction for the organization under the guidance of the Board of Directors and in line with the organizational mission.

Dedicated to advancing the well-being of Latinos and building stronger communities, Mr. Villarreal is a member of several local and national organizations including the Waukesha Area Chamber of Commerce, Workforce Development Board, Mexican and American Solidarity Foundation, the Federal Home Loan Bank of Chicago Advisory Board, National Rural Housing Action Coalition, Southeastern Wisconsin Regional Planning Commission, NCLR's Board of Directors, and the American Lung Association, among others. Mr. Villarreal is the Wisconsin Representative of the Advisory Council of the Institute of Mexicans Abroad and recently completed his term on the Consumer Advisory Council of the Federal Reserve Board.

He began his career in the federal government of Mexico, the country of his birth and college education. After graduating from the Instituto Tecnologico y de Estudios Superiores de Monterrey in Mexico, he came to the United States to advance his career by earning an MA in economics from the University of Wisconsin, Milwaukee in 1986.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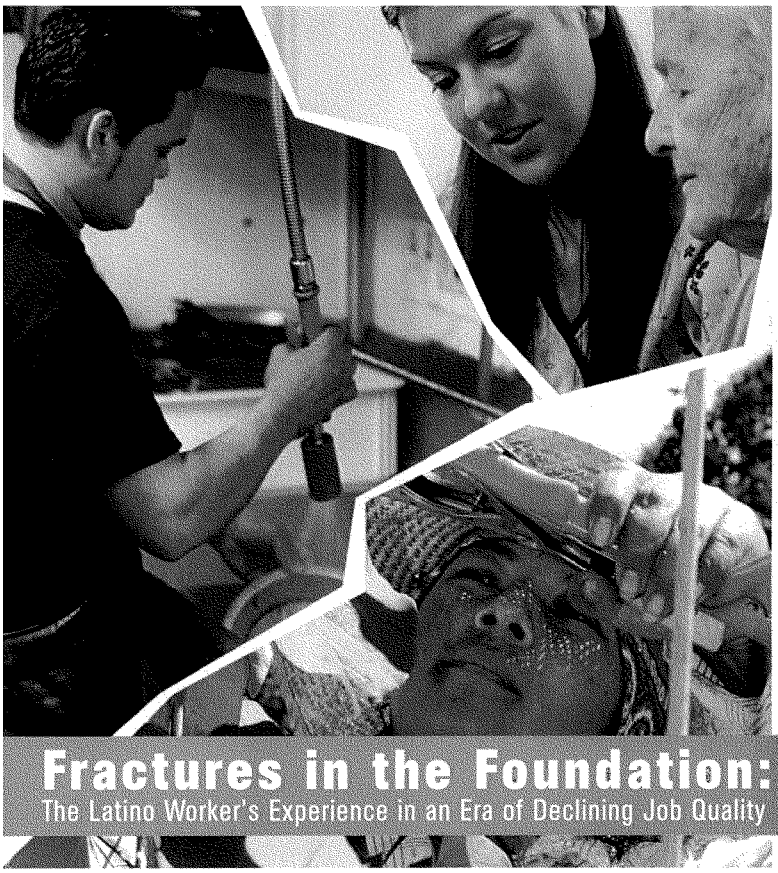

Fractures in the Foundation:

The Latino Worker's Experience in an Era of Declining Job Quality

NCLR

NATIONAL COUNCIL OF LA RAZA

The National Council of La Raza (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300 affiliated community-based organizations (CBOs), NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families.

Founded in 1968, NCLR is a private, nonprofit, nonpartisan, tax-exempt organization headquartered in Washington, DC. NCLR serves all Hispanic subgroups in all regions of the country and has operations in Atlanta, Chicago, Long Beach, Los Angeles, New York, Phoenix, Sacramento, San Antonio, and San Juan, Puerto Rico.

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NCLR
NATIONAL COUNCIL OF LA RAZA

Fractures in the Foundation:

The Latino Worker's Experience in an Era of Declining Job Quality

By Catherine Singley

NCLR

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NCLR

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Foreword

This Labor Day, we find ourselves in the midst of the worst recession since the Great Depression. More than 6.7 million workers have lost their jobs, and countless others have also lost their health insurance, their retirement savings, and even their homes. Suddenly, millions of Americans are scrambling to find a job—any job—that will keep their families afloat.

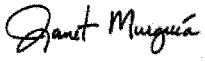
In this environment, many workers will enter the low-wage labor market for the first time ever. There they will encounter daily threats to health and safety: pressure to do repetitive work at speeds that cripple limbs, exposure to toxic chemicals, use of dangerous machinery without proper training, sweltering conditions with no breaks, and the constant fear of getting fired and blacklisted if they dare to stand up for their rights.

For some Americans, these unthinkable conditions will be something to be endured temporarily until the economy recovers. But for millions of workers, they are a permanent reality. In too many industries, workers are paying the price for the neglect and sometimes official disregard of basic labor protections that most of us take for granted. The foundation that we built as a nation to ensure that workers are safe on the job and paid fairly for their work is badly fractured.

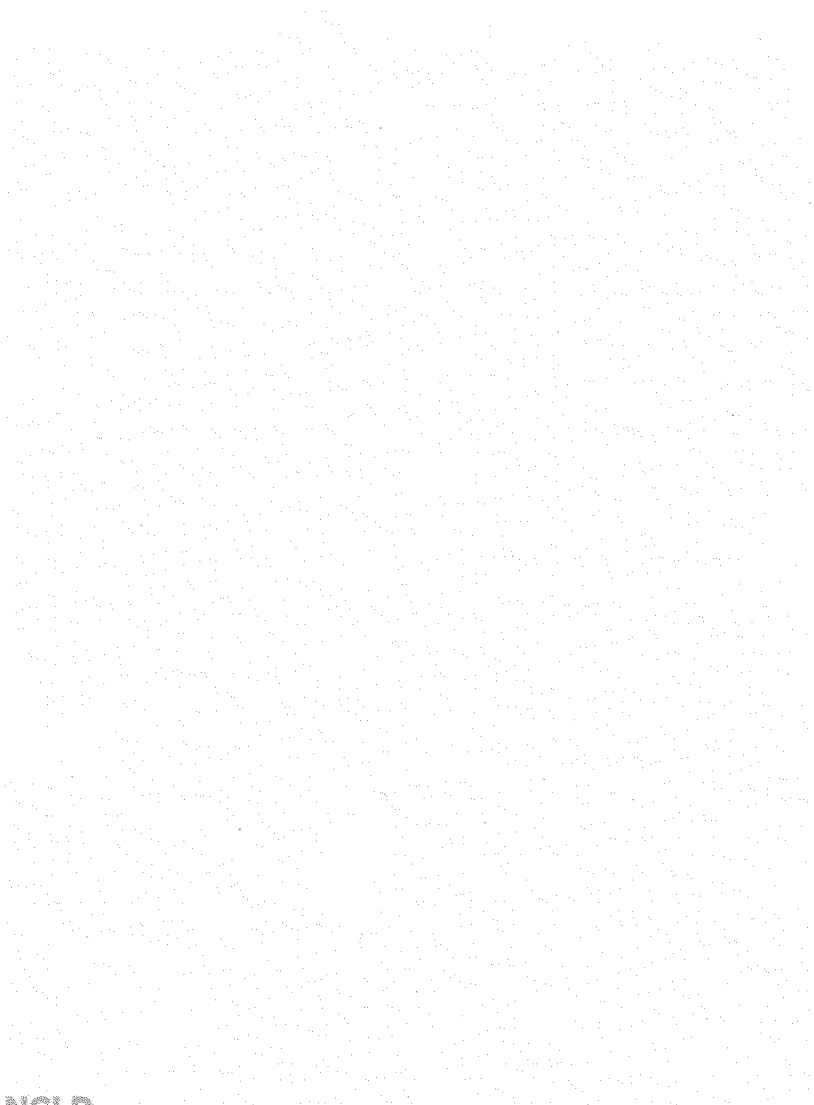
Numerous reports have focused on the economic causes and consequences of our nation's growing low-wage labor market. By contrast, this report focuses on the conditions workers in those jobs face on a daily basis, and their human cost. Hispanic Americans have the highest rate of occupational death of any demographic group. Latino workers' determination to provide for their families in their pursuit of the American Dream—too often under dangerous conditions—motivates us to find ways to restore basic standards to the workplace.

This is an issue of fundamental concern for everyone. On a moral level, no one in this country should be forced to risk life and limb unnecessarily, just to make a life for their family. On an economic level, our society pays huge, if often hidden, costs for labor law violations and workers' deaths, in the form of skewed competition, lost productivity, and rising health care bills. And on a practical level, in a tough job market, an increasing number of workers will experience the effects of the decades-long deterioration of job quality that millions of workers have endured for too long.

We hope this report serves as a starting point for a dialogue that will help to rebuild a strong foundation of job quality for all workers. It is a challenge that we, as a country, cannot afford to ignore.



Janet Murguía
President and CEO
National Council of La Raza
Labor Day 2009



Executive Summary

As we struggle with the task of rebuilding our economy, it is important to do as any architect would: we must examine not only the structural flaws, but also the condition of the foundation. Recognizing early on that the strength of the economy depends on the strength of its workers, ordinary Americans and public leaders constructed a foundation of laws and standards to ensure that workers are protected from harm and can reap the fruits of their labor. In the last century, policymakers set a minimum wage, capped the number of hours an individual could be compelled to work, restricted the employment of children, granted workers the right to organize, and established workplace health and safety standards.

Workers, employers, and the government all play a role in maintaining these standards, especially through the turbulence of a changing economy and a dynamic workforce. In recent decades, however, employers and government have not upheld their end of the bargain—and workers are paying the price. The most alarming indicator of this fact is that thousands of workers die on the job every year from preventable incidents. That Hispanic Americans consistently have the highest rates of fatal occupational injuries of any group compelled the National Council of La Raza (NCLR) to take a closer look at the state of workplace standards. This report provides an in-depth analysis of those standards, and it exposes serious weaknesses in the foundation of job quality.

NCLR has found that death is only one indicator of neglect for basic worker protections. Cases of workers who are never paid, who are denied basic benefits because their employer misclassified them as independent contractors, who are never compensated for a disabling workplace injury, or who are never trained on how to avoid job site hazards are a daily reality in nearly every American industry. The majority of these violations occur in low-wage jobs. Therefore, while millions of Latinos are solidly in the middle class, the focus of this report is on essential workers in less-skilled industries, such as production, food preparation and service, construction, farming, and maintenance—where more than one in every five workers is Latino.

Public opinion polls consistently find that Latinos believe strongly that opportunity comes from personal effort. The issues raised in this report prevent responsible, hardworking people from achieving the American Dream, but they are all amenable to policy change. Better enforcement of the laws on the books, modernized protections for a modern workforce, and investment in community-based strategies are essential first steps to restoring dignity to the workplace. At this unique moment of economic turmoil and anticipation for what lies ahead, a decision must be made about whether to take on these policy challenges or continue to chip away at the foundation of job quality. Workers' lives hang in the balance.

Major findings of this report include the following:

The experience of Latino workers sounds the alarm for what is happening to the quality of American jobs.

- Latino workers are more likely to die from an injury at work than White and Black workers. In 2007, 937 Latinos, the majority of them immigrants, were killed by an injury at work. The occupational fatality rate for Latinos has remained the highest in the nation for 15 years. The Latino death toll lays bare the state of decay in American workplace health and safety standards; in all, 5,657 workers died on the job in 2007.
- Two in five Latino workers do not earn sufficient wages to keep their families out of poverty. In 2007, 41.8% of Latino workers earned poverty-level wages, which were about $10.20 per hour, to sustain a family of four.

- While millions of Americans worry about losing their health insurance and retirement benefits, a significant portion of working Latinos is already living those fears. In 2007, just over half (52.3%) of employed Latinos had health insurance through their employers, compared to 72.6% of White and 67.1% of Black workers. An even smaller share of Latinos (34.6%) had access to a retirement plan through their employers.

Many employers evade their legal responsibility to pay their workers and keep their work sites safe.

- For employers who break the law, the chances of getting caught are slim and the penalties are low. Employers who allow dangerous conditions to persist even after a worker becomes injured or is killed have little chance of facing penalties against them. Consequently, many employers have come to treat compliance with labor laws as optional and fines for noncompliance as merely a cost of doing business.

- Some employers legally sidestep accountability for their workers' well-being. For instance, the IRS code provides a "safe harbor" from penalties for employers who misclassify workers as independent contractors as long as they can prove that the misclassification is a common practice in their industry, which is often the case in industries with high Latino representation. An estimated one-third of businesses misclassify workers, robbing them of the benefits, retirement security, and health and safety protections they deserve.

- Employers who take advantage of vulnerable workers drive down standards for all workers. The enactment of the Immigration Reform and Control Act of 1986 made the workplace the frontier of immigration enforcement and shifted the balance of power heavily in favor of employers. Unscrupulous employers who cut corners and threaten workers with deportation if they complain are granted an unfair advantage over employers who follow the law.

Ongoing divestment and government inaction undermine basic labor standards and devalue the contributions of workers.

- The enforcement capacity of the Department of Labor is severely constrained. A typical full-time Occupational Health and Safety Administration (OSHA) employee has four times the caseload that an OSHA employee had in 1975. Employers' active discouragement of worker complaints and other causes of underreporting often misdirect these limited resources away from high-risk workplaces.

- Millions of workers are without legal protection. Millions of workers are excluded from basic protections simply based on the kind of work they do. Antiquated labor laws that exclude agricultural workers and domestic workers from coverage are especially damaging to Latinos, who represent 45.1% and 37.5% of these occupations, respectively. Additionally, since the 1970s, the shifting U.S. economy has crowded less-skilled workers—including many Latinos—out of high-quality manufacturing jobs and into lower-quality service jobs. Federal labor policies have lagged behind these changes, leaving wide segments of the workforce to labor in largely unregulated work arrangements, often for low pay and no benefits.

NCLR recommends the following steps to restore basic worker protections:

Reassert the federal government's role as workplace watchdog.

- Make the punishment fit the crime for employers who break the law. The penalties for employers who fail to uphold basic wage and safety standards must be sufficient deterrents against the tendency of unscrupulous employers to cut corners, which harms their workers and their competitors. Long-overdue increases in fines and elevated legal consequences for repeat and egregious violations—especially those resulting in a worker's death—are essential first steps.

- Restore funding for government outreach and enforcement efforts, with emphasis on high-risk and emerging industries. In order to keep pace with an increasingly complex labor market, Congress must devote adequate federal funds to the Department of Labor's Wage and Hour Division and OSHA. Targeted programs that reach low-wage workers, subcontractors, workers on multiple job sites, and limited-English-proficient workers should be prioritized.

- Support community-based organizing structures for nonunionized and nontraditional workers. In addition to working to open union jobs to Latinos, who are currently underrepresented in unions, the Department of Labor should partner with community-based organizations to pilot models for disseminating culturally competent and linguistically appropriate training and "know your rights" information to immigrant and low-wage workers. Community-based organizations can also help identify high-risk workplaces that traditional enforcement entities may miss.

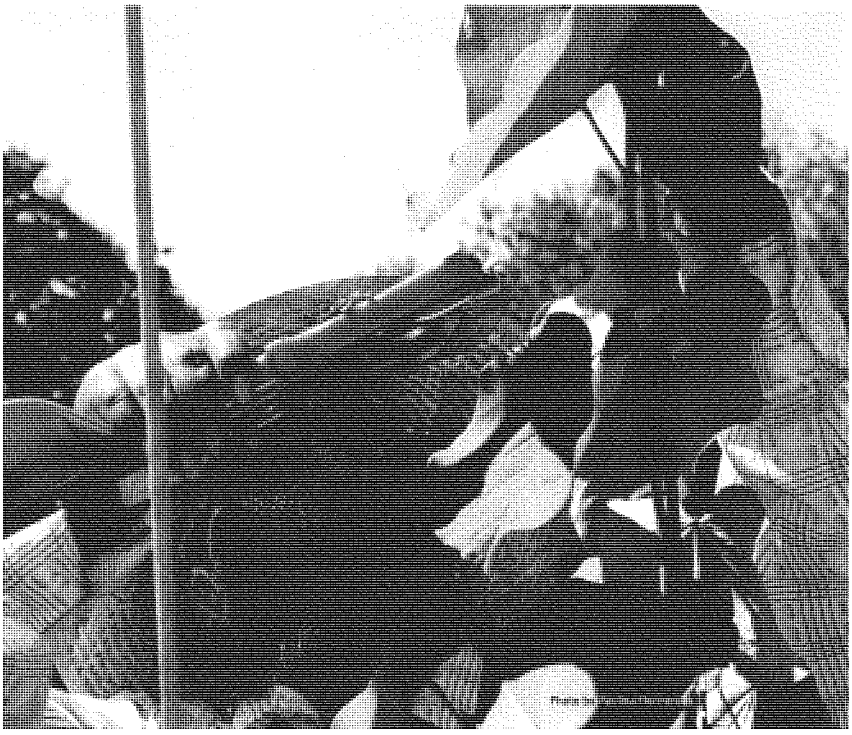
Empower workers to defend themselves against exploitation.

- Correct historical inequities in wage and hour laws. The rampant exploitation of farmworkers and domestic workers could be significantly reduced by eliminating outdated legal exclusions in laws that set a floor on wages and a ceiling on hours.

- Strengthen policies to protect workers in nontraditional arrangements. Congress should pass legislation to close tax loopholes and crack down on industry norms that allow employers to legally evade accountability for these workers.

- Uphold the rights of all workers through comprehensive immigration reform. More than ten million American workers, 81% of whom are from Latin American countries, work without legal authorization because our immigration system does not offer sufficient legal channels for immigrants. The culture of fear that exists in many workplaces enables employers to escape punishment for actively subverting workers' complaints. As a result, job quality declines for all workers. The first step toward leveling the playing field in the labor market is to fix the nation's broken immigration system. Comprehensive immigration reform requires a plan to make immigration policy more responsive to labor market needs, unclog naturalization backlogs, and incorporate stronger workplace protections.

Chapter 1
Today's Latino Workforce: Diverse and Growing



Nearly 21.8 million Latinos* are at work in the United States, representing 14.2% of the labor force.[1] Between 2000 and 2007 alone, the U.S.-born Hispanic labor force grew by 34.2% and the foreign-born Hispanic labor force grew by 53.7%.[2] Despite the economic recession, 395,000 Latinos joined the workforce in 2008, accounting for over half (54%) of the new labor force entrants. As the Hispanic workforce continues to grow, their labor market contributions become increasingly important to the economy as a whole; by 2050, it is expected that one in three working Americans will be Latino.[3]

Several characteristics distinguish Latinos from the rest of the workforce:

- **Fast growth.** As in the population overall, Latinos are the fastest-growing segment of the American workforce.
- **Relative youth.** Latino workers, especially immigrants, are significantly younger than the workforce overall.
- **High rate of participation.** Hispanic men are more likely to be working or actively searching for a job than any other group in the labor force.
- **Large foreign-born population.** Many indicators of job quality look quite different for Latinos born in the U.S. and those born abroad. More than half of Latino workers are foreign-born.
- **Lower educational attainment and English proficiency.** These challenges are more profound for immigrant Latinos, although they also limit the job opportunities of many U.S.-born Latinos.

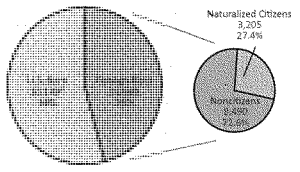
DEMOGRAPHIC CHARACTERISTICS

As a group, Latino workers tend to be younger and are more likely to be foreign-born than their peers. Yet much like the Hispanic population as a whole, the Latino workforce itself is quite diverse. A Latino worker's experience in the labor market can depend on differences in a number of factors:

Age. Latino workers tend to be younger than Black and White workers. The average age among Hispanic adult civilian workers is 37, versus 40 for Blacks and 42 for Whites. Naturalized Latino workers tend to be older than Hispanic noncitizen workers. The average ages for these two subgroups are 44 and 36, respectively.[4]

Nativity. In 2008, more than 10.1 million Latino workers were U.S.-born, while more than 11.7 million were foreign-born, as seen in Figure 1.1.[5] Immigrants and their children are projected to drive the growth of the Latino workforce in the coming decades.[6]

FIGURE 1.1
Hispanic Adult Labor Force by Nativity, 2008



Source: NCLR calculation using U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed June 2009).

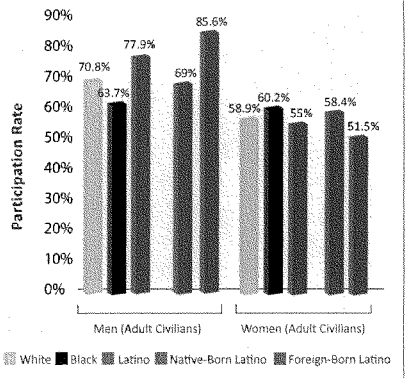
*Numbers are in thousands.

* The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

Gender. Hispanic men and women have the highest and lowest participation rates in the overall U.S. labor force, respectively (individuals who are actively searching for a job, as well as individuals who are currently employed, are counted as participants in the labor force). Only four in ten Hispanic workers are female. As seen in Figure 1.2, more than three-quarters (77.9%) of working-age Latino men are in the labor force versus 70.8% of non-Hispanic White men and 63.7% of non-Hispanic Black men. Foreign-born Latino men are even more active in the workforce, participating at a rate of 85.6%. By contrast, foreign-born Hispanic women are less likely to participate in the workforce than their native-born counterparts. Slightly more than half (51.5%) of immigrant Latinas are in the workforce, compared to 58.4% of native-born Latinas. Overall, 55% of Hispanic women of working age participate in the workforce, compared to 58.9% of White women and 60.2% of Black women.[7]

Immigration status. Of the 11.7 million adult Hispanic immigrant workers, 3.2 million are naturalized citizens while 8.5 million are not U.S. citizens. Noncitizens include legal permanent residents (LPRs), refugees and asylees, undocumented workers, and those who are in the process of naturalizing or adjusting their immigration status. During the past decade, a shift occurred in the composition of incoming immigrants from Mexico and Latin America, changing from a majority undocumented to a majority legal.[8] Nevertheless, these areas were still the most common origins of the undocumented population in the U.S.; in 2008, an estimated seven million undocumented individuals residing in the U.S. were from Mexico, 1.35 million were from Central America, 775,000 were from South America, and 500,000 were from the Caribbean. In all, an estimated 8.3 million undocumented immigrants were in the U.S. labor force in 2008.[9]

FIGURE 1.2
Labor Force Participation Rate by Race/Ethnicity, Nativity, and Gender, 2008



Source: NCLR calculation using U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed June 2009).

HUMAN CAPITAL

In addition to demographic factors, human capital can shape the types of jobs available to Latinos in the labor market.[10] Employment qualifications frequently differ between native-born, naturalized, and noncitizen workers. For instance, Latino immigrants are more likely to have difficulty speaking English as well as fewer years of formal education; when combined, these factors can substantially limit a worker's employment options.

Educational attainment. Education is indisputably tied to success in the job market. In addition to opening doors to higher-paying jobs, educational attainment also affects workers' upward employment mobility between and within generations. In general, Latino workers tend to have lower levels of education than Black and White workers. As Figure 1.3 shows, in 2008, only 67.1% of adult Latino workers

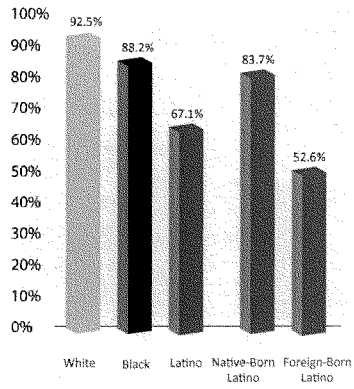
had completed high school or postsecondary education, compared to 92.5% of White workers and 88.2% of Black workers. Educational disparities narrow considerably when immigrants are excluded from the comparison; 83.7% of U.S.-born Latino adults have attained a high school education or higher.[11]

Among Latino workers, the share of immigrants who have completed high school or college has risen over the past five years, although immigrants still trail native-born workers in their educational attainment. In 2008, 72.9% of naturalized Latino immigrants had at least a high school education, compared to 63.5% in 2003.[12] The portion of noncitizen Latinos with a high school education has also grown, from 42.3% in 2003 to 45% in 2008. Although fewer in number, Hispanic women in the workforce have significantly higher levels of education than their male counterparts; 74% of Latina workers have a high school degree or higher, compared to 62.3% of Hispanic men.

English language proficiency. Limited proficiency in English is a major impediment for a significant portion of Latino workers. Within the Hispanic adult population, limited-English-proficient (LEP) individuals are predominantly, though not exclusively, foreign-born; in 2006, 13.4% of native-born and 73% of foreign-born Hispanics of working age spoke English less than "very well."[13] LEP workers tend to also have low levels of education, which often bars access to higher-wage jobs. In the 2000 Census, 83% of foreign-born workers with less than a 9th grade education were LEP, and 84% of low-wage immigrants at that education level were LEP.[14]

Difficulties with English can also block the path to well-paying jobs for highly educated or highly skilled workers. Highly skilled LEP workers are twice as likely as English-proficient individuals to work in unskilled occupations that require only "modest on-the-job training."[15] Despite these challenges, progress in English acquisition is evident between first-generation Latinos and their children. While only 23% of first-generation Latinos speak English very well, 88% of second-generation Latinos do. Among the third generation, English language proficiency improves significantly to 94%.[16]

FIGURE 1.3
Adult Civilians Who have Completed High School or Higher by Race/Ethnicity and Nativity, 2008



Source: NCLR calculation using U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed June 2009).

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[3] Jeffrey J. Passel and D'Vera Cohn, *U.S. Population Projections: 2005-2050* (Washington, DC: Pew Research Center, 2008), http://pewhispanic.org/files/reports/85.pdf (accessed March 2008). Not all working-age adults are in the labor force.

[4] U.S. Bureau of the Census, "CPS Table Creator."

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[14] Randolph Capps et al., *A Profile of the Low-Wage Immigrant Workforce* (Washington, DC: Urban Institute, 2003), http://www.urban.org/url.cfm?ID=310880 (accessed April 2008).

[15] Jeanne Batalova, Michael Fix, and Peter Creticos, *The Employment Pathways of Skilled Immigrants in the United States* (Washington, DC: Migration Policy Institute, 2008), http://www.migrationpolicy.org/pubs/BrainWasteOct08.pdf (accessed November 2008).

[16] Shirin Hakimzadeh and D'Vera Cohn, *English Usage Among Hispanics in the United States* (Washington, DC: Pew Hispanic Center, 2007), http://pewhispanic.org/reports/report.php?ReportID=82 (accessed May 12, 2008).

Chapter 2
Bedrock of the Economy, Bottom of the Labor Market



Broadly speaking, Latinos have the highest labor force participation rate of any racial or ethnic group, which means they are more likely to be employed or actively searching for work than other groups. In 2008, 68.5% of Latinos over age 16 were in the labor market, compared to 66.3% of Whites and 63.7% of Blacks. Not only are Hispanic workers more likely than other groups to be part of the labor force, they are also more likely to be employed.[1] Although they have a robust presence in the labor force, Latinos are concentrated in jobs that require low levels of formal education and skills, often with insecure attachment to their employers.

A snapshot of Latinos in the labor force shows heavy representation in:

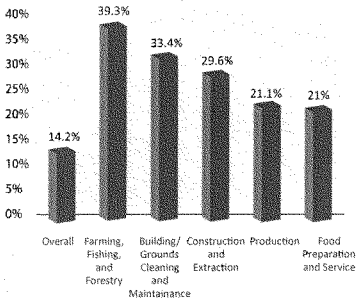
- **Low-paying jobs.** Latino workers are overrepresented in low-wage jobs with low requirements for education and experience. The education and wages of native-born Latino workers are significantly higher than those of their foreign-born peers.
- **Small businesses.** More than Black and White workers, Latinos are likely to work in firms with fewer than 25 employees.
- **Contingent and nontraditional jobs.** Compared to full-time, permanent jobs, these arrangements are usually less secure.

LABOR MARKET DISTRIBUTION

Latinos form the bedrock of several major occupation groups. As Figure 2.1 shows, Hispanic workers make up more than one in five employees in the following categories: farming, fishing, and forestry (39.3%); building/grounds cleaning and maintenance (33.4%); construction and extraction (29.6%); production (21.1%); and food preparation and service (21%).

Industry characteristics. Similar to the overall workforce, most Latinos work in the private sector. By contrast, Latinos are underrepresented in public jobs compared to other workers. Citizenship requirements bar many Hispanics from employment in government jobs; only 9.5% of Hispanics work for the government, compared to 19.5% of Blacks and 14.1% of Whites. Latinos are overrepresented among employees in private households. Although the total number of Hispanic domestic workers—officially 302,000, which is likely a conservative estimate—is small compared to the entire population of workers, this particular industry merits attention due to its unique set of job quality issues, discussed in Chapter 5.[2]

FIGURE 2.1
Occupational Groups with High Latino Representation, 2008



Source: U.S. Department of Labor, "11. Employed persons by detailed occupation, sex, race, and Hispanic or Latino ethnicity." *Current Population Survey.* Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, http://www.bls.gov/cps/cpsaat11.pdf (accessed September 2008).

Latinos also make up the highest share of workers employed in service occupations relative to their group's overall employment. While Latinos compose only 14% of employed adults, they represent 20.2% of employees in the service sector.[3] Less-skilled workers in the service sector tend to earn lower wages compared to their counterparts in the manufacturing sector. The service sector also has a higher incidence of short-term employment, which can jeopardize eligibility for employer-sponsored benefits.[4]

Occupational distribution. Figure 2.2 shows the occupational distribution of Latinos in the labor market. Using a socioeconomic index score developed by Toussaint-Comeau et al. to compare occupational groups,[5] it is clear that Latinos are disproportionately employed in jobs that pay low wages and have low human capital requirements (see Table 2.1). In fact, more than half of the Latino workforce is employed in the eight major occupation groups with the lowest socioeconomic index scores: farming, fishing, and forestry; food preparation and service; building/grounds cleaning and maintenance; personal care and service; health care support; transportation and material moving; production; and construction and extraction.

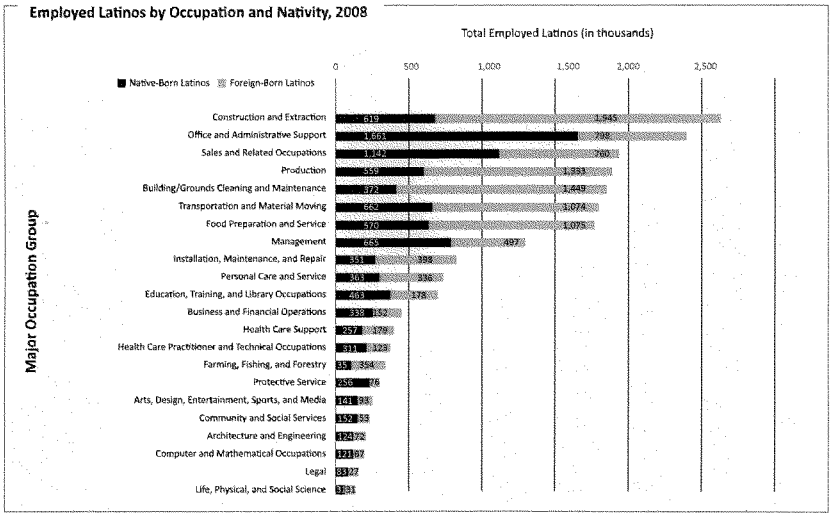
Figure 2.2 illustrates that the vast majority of Latinos are employed in occupations with socioeconomic index scores below 50. With the exception of health care support, foreign-born Latinos have a larger presence in these low-scoring occupations than in the overall workforce. Meanwhile, native-born Latinos are more concentrated in jobs with higher pay and higher human capital requirements, such as office support, sales, management, education and library occupations, business and financial operations, and health care practitioners. This confirms the expectation that Hispanic immigrants tend to work in jobs requiring relatively few formal credentials or barriers to entry.

TYPES OF EMPLOYMENT

Latino workers are overrepresented in small businesses compared to their overall presence in the workforce. As will be discussed in Chapter 5, firm size is another fault line for job quality, since small businesses are often exempt from complying with worker protection laws. In different ways, employers of those who work on a contingent

FIGURE 2.2

Employed Latinos by Occupation and Nativity, 2008



Source: U.S. Bureau of Labor Statistics, "1. Employed and experienced unemployed persons by detailed occupation, sex, race, and Hispanic or Latino ethnicity," *Current Population Survey* (unpublished data). Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008.

or nonpermanent basis, often in nontraditional work arrangements such as day laborers, also leave workers open to low wages, poor benefits, and dangerous working conditions.

Small businesses. Latinos are more likely to be employed by small firms—those with fewer than 25 employees—than Blacks and Whites. In 2007, 36.2% of the Latino workforce was employed in small businesses, versus 29.1% of the White workforce and 21.4% of the Black workforce. Figure 2.3 demonstrates the unique "bottom-heavy" distribution of the Latino workforce according to firm size. In fact, 17.6% of small business employees are Latino, which represents a larger portion than their overall presence in the workforce (14.2%).

Contingent and nontraditional arrangements. In 2005, 2.5 million Latinos considered themselves to be contingent workers, meaning that they did not expect their jobs to last. The same year, approximately 1.7 million Latinos were employed in nontraditional arrangements (also called "alternative" and "nonstandard" employment arrangements by the U.S. Census Bureau). Figure 2.4 shows the distribution of Latinos employed in nontraditional arrangements. These categories of workers are noteworthy because contingent and nontraditional workers usually face uncertain job security compared to traditional workers. Furthermore, as discussed in the next chapter, these workers are less likely to be covered by employer-sponsored benefits, and some face increased risk of occupational injury and exploitation.

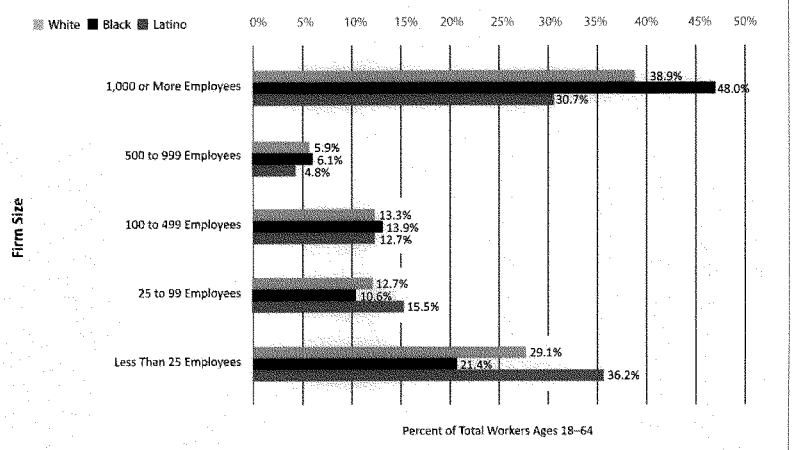
TABLE 2.1
Employed Latinos by Major Occupation Group and Socioeconomic Index Score, 2008

Occupation Group	Distribution of Latino Workforce	Socioeconomic Index Score*
Construction and Extraction	12.6%	27
Office and Administrative Support	12.1%	30
Sales and Related Occupations	9.3%	39
Production	9.3%	26
Building/Grounds Cleaning and Maintenance	9.0%	18
Transportation and Material Moving	8.5%	24
Food Preparation and Service	8.1%	17
Management	5.7%	54
Installation, Maintenance, and Repair	3.7%	33
Personal Care and Service	3.4%	22
Education, Training, and Library Occupations	3.2%	61
Business and Financial Operations	2.4%	52
Health Care Support	2.1%	24
Health Care Practitioner and Technical Occupations	2.1%	36
Farming, Fishing, and Forestry	1.9%	14
Protective Service	1.6%	37
Arts, Design, Entertainment, Sports, and Media	1.2%	37
Community and Social Services	1.0%	44
Architecture and Engineering	1.0%	45
Computer and Mathematical Occupations	0.9%	49
Legal	0.5%	51
Life, Physical, and Social Science	0.3%	42

Source: NCLR calculation using U.S. Department of Labor, Bureau of Labor Statistics, "Contingent and Alternative Work Arrangements, February 2005," news release, July 27, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008).

*Socioeconomic index score ranges on a scale of 0 to 100, with the best score being 100. The scale is derived from several regression analyses of occupations based on wages and human capital requirements, in terms of education and experience. Only major occupational groups are listed.

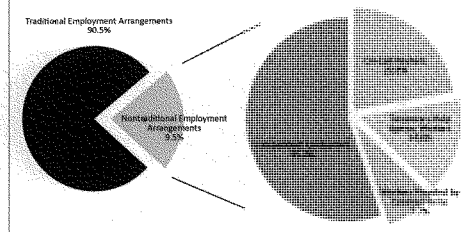
FIGURE 2.3
Workers Grouped by Race/Ethnicity and Firm Size, 2007



Source: NCLR calculation using U.S. Bureau of the Census, "2008 Annual Social and Economic Supplement," *Current Population Survey.* Washington, DC, 2008, http://pubdb3.census.gov/macro/032008/health/h01_000.htm (accessed September 2008), Table HI01.

In 2005, the Latino portion of on-call workers (without a set work schedule or notice of a project), workers employed by temporary help agencies, and workers provided by contract firms was greater than the Latino portion of workers employed in traditional arrangements. For example, 15.7% of on-call workers, including day laborers, were Hispanic, compared to 13.1% of traditional workers.[6] The largest major survey of day laborers found that immigrants dominate this subcategory; on a given day, 59% of those looking for work are immigrants from Mexico, 28% come from Central America, and 7% are U.S.-born.[7] Workers provided by temporary help agencies and contract firms are also more likely to be Latino than their counterparts in traditional arrangements.

FIGURE 2.4
Latinos Employed in Nontraditional Work Arrangements, 2005



Source: NCLR calculation using U.S. Department of Labor, Bureau of Labor Statistics, "Contingent and Alternative Work Arrangements, February 2005," news release, July 27, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008), Table 5.

Endnotes

[1] U.S. Department of Labor, "3. Employment status of the civilian noninstitutional population by age, sex, and race" and "4. Employment status of the Hispanic or Latino population by age and sex." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat3.txt and ftp://ftp.bls.gov/pub/special.requests/lf/aat4.txt (accessed May 2009).

[2] U.S. Department of Labor, "12. Employed persons by sex, occupation, class of worker, full- or part-time status, and race" and "13. Employed Hispanic or Latino workers by sex, occupation, class of worker, full- or part-time status, and detailed ethnic group." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, http://www.bls.gov/cps/cpsaat12.pdf and http://www.bls.gov/cps/cpsaat13.pdf (accessed September 2008). For more information, see Luisa Grillo-Chope and Carlos Ramos, *Domestic Workers Working Hard to Sustain American Families, Compromising Their Social Security* (Washington, DC: National Council of La Raza, 2006), http://www.nclr.org/content/publications/detail/41906 (accessed September 2007).

[3] NCLR calculation using U.S. Department of Labor, "11. Employed persons by detailed occupation, sex, race, and Hispanic or Latino ethnicity." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics, Washington, DC, 2008, http://www.bls.gov/cps/cpsaat11.pdf (accessed September 2008).

[4] Lawrence Mishel, Jared Bernstein, and Heidi Shierholz, *The State of Working America 2008-2009* (Ithaca, NY: Cornell University Press, 2009).

[5] Maude Toussaint-Comeau, Thomas Smith, and Ludovic Comeau Jr., *Occupational Attainment and Mobility of Hispanics in a Changing Economy* (Washington, DC: report to the Pew Hispanic Center, 2005), http://pewhispanic.org/files/reports/59.1.pdf (accessed September 2008).

[6] U.S. Department of Labor, Bureau of Labor Statistics, "Contingent and Alternative Work Arrangements, February 2005," news release, July 27, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008), Table 5.

[7] Abel Valenzuela Jr. et al., *On the Corner: Day Labor in the United States* (Los Angeles, CA: UCLA Center for the Study of Urban Poverty, 2006), http://www.sscnet.ucla.edu/issr/csup/uploaded_files/Natl_DayLabor-On_the_Corner1.pdf (accessed September 2007).

Chapter 3
Troubling Indicators of Job Quality



Although individual workers may value one aspect of their job over another, policymakers have generally prioritized wages, benefits, and working conditions as the core elements of job quality. Federal and state laws attempt to set the floor in these areas to protect them from the forces of competition (for more details, see Table 4.1). In general, by each of these three measures, Latinos are employed in low-quality jobs compared to White and Black workers. U.S.-born Hispanic workers fare considerably better than foreign-born Hispanic workers, but disparities remain. Moreover, since foreign-born workers compose more than half of all Latino workers, the experience of immigrant Hispanic workers heavily influences the status of the entire population.

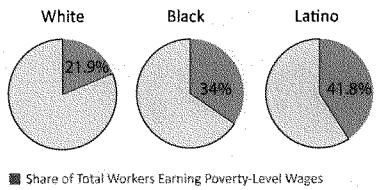
In general, Latino workers face major disparities in job quality compared to other workers, including:

- Low wages. Latinos are more likely than other workers to work in jobs that pay wages that are insufficient for raising a family of four above the poverty level.
- Fewer standard benefits. Compared to Whites and Blacks, Latinos have less access to health insurance and retirement plans at work.
- Less access to benefits such as disability and life insurance. While Latino workers need more life insurance due to having more dependents per worker and higher fatality rates on the job, they are unlikely to have access to life insurance at work.
- Low unionization rate. Latino workers benefit the most from unionization in terms of wages and benefits, yet Latinos are least likely to have unionized jobs.
- Highest workplace fatality rate. Every year, Latino workers, especially immigrant Latinos, consistently have the highest rate of fatal occupational injury of any group in the workforce.
- Underreported workplace injuries. Latino workers are concentrated in small businesses and other work arrangements where occupational injuries tend to be severely underreported.

WAGES

In 2007, more than two out of five (41.8%) Latino workers earned poverty-level wages, which were about $10.20 per hour to sustain a family of four. By comparison, 21.9% of White workers and 34% of Black workers earned poverty-level wages (see Figure 3.1).[1]

FIGURE 3.1
Workers Earning Poverty-Level Wages by Race/Ethnicity, 2007



Source: Lawrence Mishel, Jared Bernstein, and Heidi Shierholz, *The State of Working America 2008-2009* (Ithaca, NY: Cornell University Press, 2009).

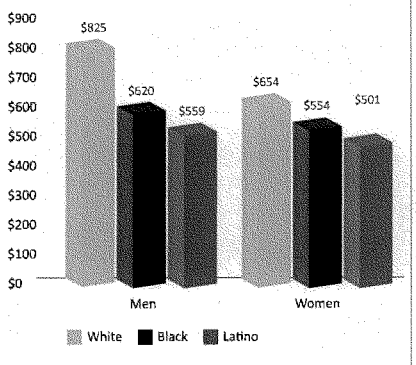
As discussed in Chapter 2, foreign-born Latino workers are overrepresented in jobs that require relatively low levels of education and skills certification. These jobs also tend to pay low wages. Figure 3.2 illustrates the wage disparities between Latinos and other workers. According to the latest Census Bureau data, Hispanic women have the lowest wages of any subgroup, earning a median of $501 per week, 30.5% less than White women and 10.6% less than Black women.[2] The occupational makeup of the Latino workforce as well as lower rates of unionization contribute significantly to these wage gaps.

EMPLOYER-BASED BENEFITS

Employers may elect to offer their employees benefits to supplement their income and provide economic security in emergency situations and into retirement. However, low-wage earners tend to have less access to health care and retirement plans, the two most common types of employer-based benefits. Latinos receive the least benefits compared to Whites and Blacks. While data regarding race and ethnicity are not readily available for recipients of other types of benefits, including disability insurance, life

insurance, and paid leave, it is likely that Latinos experience similar gaps in these areas due to their low earnings and occupational distribution.

FIGURE 3.2
Median Weekly Earnings by Race/Ethnicity and Gender, 2008



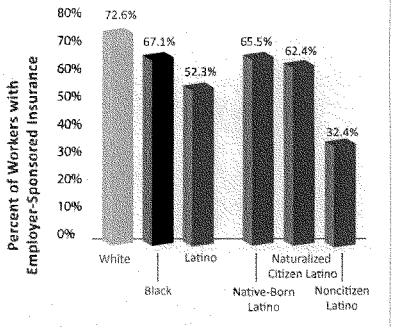
Source: U.S. Department of Labor, "37. Median weekly earnings of full-time wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat37.txt (accessed May 2009).

Health insurance. Overall, Latinos have the highest uninsurance rates of any racial or ethnic group in the country. Most insured Americans, including Latinos, obtain health insurance through their employers. However, in 2007, just over half (52.3%) of employed Latinos had employer-sponsored insurance (ESI), compared to 72.6% of non-Hispanic White and 67.1% of non-Hispanic Black workers.[3] As Figure 3.3 shows, U.S.-born Hispanic workers are more likely to have coverage (65.5%) than naturalized Hispanics (62.4%), and both groups are nearly twice as likely to be covered as noncitizen Hispanics (32.4%).[4]

A Commonwealth Fund study in 2001 found that ESI disparities persist within industries; only 38% of Latino workers in agriculture were offered ESI, compared to 67% of non-Hispanic White workers. Similar gaps exist in the construction and retail services. The share of Hispanics versus Whites with access to ESI in construction was 47% versus 67%. In retail services, 56.9% of Latinos versus 77.1% of Whites were offered ESI.[5]

The type of employment arrangement also affects the likelihood that workers will have employer-sponsored coverage. In the total labor force, only 25.7% of on-call workers and 8.3% of temporary help agency workers had ESI in 2005. Contract firm employees fared slightly better, but their 48.9% coverage rate was still much lower than that of the average worker.[6] Latinos' overrepresentation in these categories partially explains their low access to health plans, although other factors are also responsible.

FIGURE 3.3
Workers Receiving Employer-Sponsored Insurance by Race/Ethnicity and Nativity, 2007

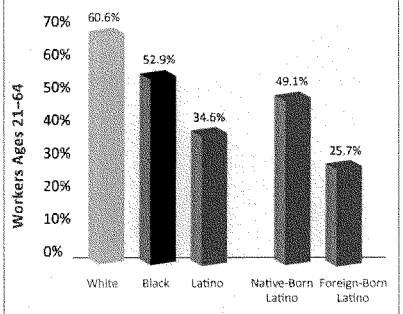


Source: NCLR calculation using U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed September 2008).

Retirement plans. In 2006, 34.6% of Latino workers ages 21–64 had access to a retirement savings plan or pension through their employer, compared to 60.6% of their White peers and 52.9% of their Black peers.[7] Foreign-born Latinos had substantially lower access to a plan than their native-born peers; 49.1% of native-born Hispanics worked for an employer that offered a retirement plan, compared to only 25.7% of their immigrant counterparts.[8] Figure 3.4 illustrates these differences.

A worker's occupation and industry can determine his or her access to a retirement plan. A considerable portion of the Hispanic workforce is employed in low-coverage industries, such as agriculture, construction, wholesale, and retail. Latinos are also underrepresented in public sector jobs, where the pension coverage rate is higher than it is for private sector employees.[9] Similar to ESI coverage, pension coverage for nontraditional employees is significantly lower than for their counterparts in traditional arrangements. In 2005, only 2.6% of independent contractors, 33.2% of on-call workers, 8.9% of temporary help agency workers, and 42.6% of workers provided by contract firms were eligible for an employer-based pension plan.[10]

FIGURE 3.4
Workers with Access to Employer-Based Retirement Plans by Race/Ethnicity and Nativity, 2006



Source: Unpublished Employee Benefit Research Institute estimates from the U.S. Census Bureau's March 2007 *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2007.

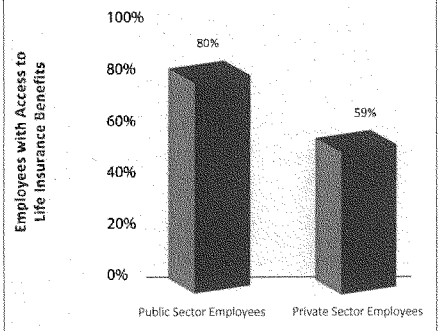
Disability insurance. In the event that an unforeseen accident or sickness prevents an individual from working, disability insurance provides replacement income. Short-term disability insurance provides income for a six- to 12-month period, after which long-term disability benefits take over. Participation in disability insurance plans is more common among employees in medium and large private establishments than those employed by small businesses (fewer than 100 employees) or state and local governments. Since Latinos are overrepresented in small businesses (see Chapter 2), it is probable that Latinos are less likely to participate in disability insurance plans.

Life insurance. If a worker dies, life insurance can protect his or her family and dependents from financial destitution by providing them with replacement income. Hispanic families tend to have more children than non-Hispanic families; on average, Latino families have 2.13 children under 18 years of age while other families have 1.78 children.[11] Hispanic workers also report having more financial dependents outside their households. Therefore, life insurance should be of critical importance to Latinos.[12]

Publicly employed workers have much greater access to employer-sponsored life insurance than private industry employees; their access rates are 80% and 59%, respectively (see Figure 3.5). Latinos are less likely to have the option of life insurance, given their underrepresentation in public sector jobs. Life insurance is more prevalent in occupational groups with low Latino presence—such as management and professional jobs, in which 78% of workers have access to insurance—and less prevalent in occupations where Latinos are concentrated, such as service jobs (42%) or natural resources, construction, and maintenance (60%). Furthermore, only four in ten workers who earn an average hourly wage between $10 and $25—a substantial portion of the Latino workforce—have access to life insurance plans.[13]

Paid leave. All workers have family and medical needs, but many workers may risk jeopardizing their employment if they take days off to attend to personal matters. Although federal law (specifically, the Family Medical Leave Act, discussed in Chapter 4), grants some workers unpaid leave without the risk of job loss, low-income workers are far less likely to be eligible for this benefit than higher-paid workers. In addition to losing critical wages, it is not uncommon for low-wage and contingent workers who miss days of work to risk immediate termination or disqualification from bonuses, overtime, and promotions.[14] Paid leave is even less common than unpaid leave; in 2008, only 37% of private industry workers had any paid personal leave. Research confirms that incidence of paid leave is dramatically lower among low-income workers, younger workers, workers with short job tenure, and those working for small businesses, all of which characterize Latino workers more so than White and Black workers.[15]

FIGURE 3.5
Access to Life Insurance, Public Sector vs. Private Sector, 2009



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Employee Benefits in the United States, March 2009," news release, July 28, 2009, http://www.bls.gov/news.release/pdf/ebs2.pdf (accessed May, 2009).

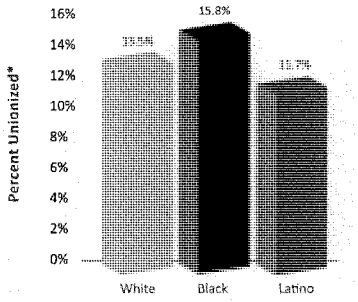
Latinos in Unions:
A Significant Boost but a Long Way to Go

Belonging to a union or being covered by a collective bargaining agreement can boost [illegible] workers' wages and benefits.[1] The union wage premium for Hispanics is the highest of any racial or ethnic group. Hispanic men in unions earn 21.4% more than their nonunionized counterparts, and Hispanic women earn 18.7% more. By comparison, the union wage premium is 15% for White men, 8.1% for White women, 22.7% for Black men, and 14.5% for Black women. Low-wage Latino workers and immigrant workers benefit particularly well from unions.[2] In terms of health insurance coverage, low-wage Hispanic workers experience a 30.7% union premium. The union premium for pension coverage is 53.9%.[3] Union members also tend to have better access to disability and life insurance, as well as paid leave.[4]

In addition to increasing wages and benefits coverage for workers, unions play an important role as a watchdog to ensure that employers comply with laws governing minimum wage, overtime pay, and occupational health and safety. Armed with technical expertise about regulations, unions are uniquely poised to take action on behalf of concerned workers because they are relatively protected from the threat of reprisal action from employers.[5]

However, despite the benefits unions bring to job quality, Hispanics are severely underrepresented in unions. As figure 3.6 shows, in 2008, only about one in ten (11.7%) Latino workers belonged to a union, compared to 13.5% of White workers and 13.8% of Black workers.[6] Latino immigrants were even less likely to belong to a union: between 2004 and 2007, the unionization rate for foreign-born Latinos averaged 8.5% while the overall Hispanic unionization rate averaged 11.6%.[7]

FIGURE 3.6
Workers Represented by Unions by Race/Ethnicity, 2008



Source: U.S. Department of Labor, "40. Union affiliation of employed wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat40.txt (accessed May 2009).

* Percent unionized includes workers who are members of a union or whose jobs are covered by a union or an employee association contract.

HEALTH AND SAFETY

The impact of wages and benefits extends far beyond the workplace, affecting the economic security of workers and their families, as well as their social and physical well-being.[23] In addition to wages and benefits, the third element of job quality codified in law is the one with the most direct impact on workers themselves: the physical conditions under which they labor. In addition to the well-documented benefits of a healthy workforce, workplace health and safety standards exist primarily to protect workers from injury and illness. Ironically, the productivity of the U.S. in the global economy masks the fact that the typical American worker is at greater risk of death from a work-related injury than workers in many other "established market economies," including the United Kingdom, Germany, and France.[24] According to calculations based on International Labour Organization statistics, 5.6 out of every 100,000 U.S. workers were victims of fatal occupational injuries in 2006, compared to 0.8 in the United Kingdom, 3.6 in Germany, and 3.0 in France.[25]

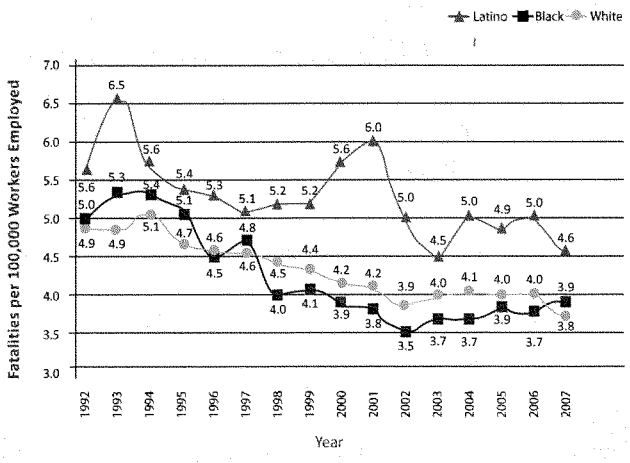
The U.S. Census of Fatal Occupational Injuries, the most comprehensive count of work-related fatal injuries in the U.S., calculates that in 2007, there were 3.8 workplace fatalities per every 100,000 U.S. workers.[26]

Fatal occupational injuries. Latino workers are more likely to die from an injury at work than White and Black workers. In 2007, 937 Latinos were killed by an injury at work, a fraction of the overall toll (see Figure 3.8). More often than not, Hispanic victims of fatal workplace injuries are immigrants, and the vast majority is male. Of the reported 937 Latino fatal injuries in 2007, 634 (67.7%) were injuries to immigrants and 894 (95.4%) were male.[27] The Hispanic occupational fatality rate was 21.1% higher than that of White workers and 17.9% higher than that of Black workers.[28] In fact, at 4.6 deaths per 100,000 workers, the Hispanic worker fatality rate surpasses that of many developing nations, as well as the U.S. fatality rate. As Figure 3.7 shows, these disparities match a trend spanning more than a decade in which Latinos have consistently seen higher rates of fatal workplace injuries than all other groups of workers. In contrast to the clear downward trend in fatal occupational injuries among White workers, the occupational fatality rate for Latinos has not declined consistently in recent years.

The concentration of Latinos in more hazardous jobs contributes to their relatively high risk of fatal injury. One study found that controlling for the major occupational groups significantly reduced Hispanic workers' risk of fatal injury, suggesting that Latinos' high presence in dangerous jobs accounts for most of the gap in fatality rates between Latinos and other racial and ethnic groups.[29] For example, public sector employees have a lower fatality rate (2.5 per 100,000) than employees in private industry (4.1 per 100,000). The overrepresentation of Blacks in public sector jobs, compared to Latinos' underrepresentation, may partially explain the lower fatality rate of Black workers.[30]

The causes of injuries to Latino workers are also telling of their occupational representation and the quality of jobs they hold. As Figure 3.9 shows, Latinos are far more likely than other workers to die from a fall (20.2% of Latino fatalities) or contact with

FIGURE 3.7
Fatal Occupational Injury Rate by Race/Ethnicity, 1992–2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007*. Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008).

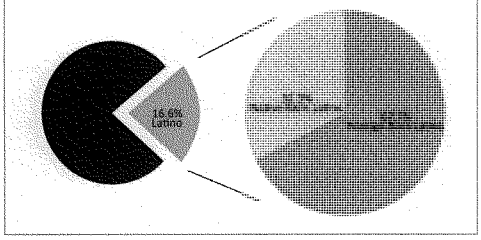
* Data from 2001 do not include fatalities from the September 11 terrorist attacks.

objects and equipment (21.3% of Latino fatalities). Conversely, transportation incidents, assaults, and violent acts make up a smaller share of the causes of fatal injury for Latinos compared to other workers.

Despite the obvious effects of labor market distribution on relative risk of fatal injury, some disparities between Latinos and other workers persist within occupations. Latino men face especially high risk compared to their peers when employed as equipment cleaners, helpers, and laborers; transportation workers and material movers; and farming, forestry, and fishing workers.[31] Several of the occupations listed in Table 3.1, which shows the deadliest occupations for Latinos, belong to these high risk categories.

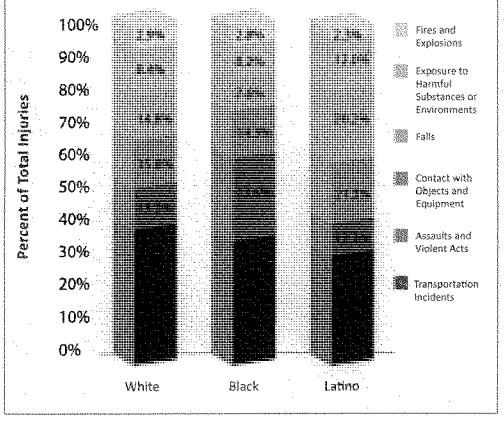
Table 3.2 details the typical tasks, work environment, education and training requirements, and wages of workers in occupations with the most Latino fatalities in 2007. The increased exposure to hazards tends not to be reflected in the wages of workers

FIGURE 3.8
Latino Share of Workplace Fatalities by Nativity, 2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007*. Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008); U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries to foreign-born Hispanic or Latino workers by selected characteristics, 2003–2007," *Census of Fatal Occupational Injuries*, unpublished data.

FIGURE 3.9
Causes of Fatal Occupational Injuries by Race/Ethnicity, 2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries by worker characteristics and event or exposure, All United States, 2007," *Census of Fatal Occupational Injuries, 2007*. Washington, DC, 2009, http://www.bls.gov/iif/oshwc/cfoi/cftb0229.pdf (accessed May 2009).

Table 3.1
Occupations with the Highest Latino Fatalities, 2007

	Construction Laborers*	Driver/ Sales Workers and Truck Drivers	Miscellaneous Agricultural Workers	Grounds Maintenance Workers	Hand Laborers and Freight, Stock, and Material Movers	Roofers	Installation, Maintenance, and Repair Occupations	Carpenters
Fatal Injuries to Latino Workers	141	118	54	54	36	29	29	29
Latino Share of Fatal Injury Victims	40.9%	12.1%	43.5%	33.8%	27.3%	36.7%	13.4%	26.6%

Sources: NCLR calculation using U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries to foreign-born Hispanic or Latino workers by selected characteristics, 2003–2007," *Census of Fatal Occupational Injuries*, unpublished data.

* Only occupations with more than 20 fatal injuries to Latinos and more than 30,000 Latinos employed in 2007 are shown.

employed in hazardous occupations. The tasks and work environments described give some indication of the conditions that could cause injury if workers are not protected. Evidence shows a shift in the organization of work—toward longer hours, inadequate rest, time pressures, and more repetitive tasks—has led to an overall increase in occupational injuries and illnesses.[32] The education and training levels of workers within each occupation varies, but on the whole, workers' earnings do not compensate for the exceptional risk of fatal injury that Latino workers face. The median wage for most of the occupations listed was below the national median wage in 2007 ($695).

Table 3.2
Descriptions of Occupations with the Highest Latino Fatalities, 2007

Occupation	Tasks[1]	Work Environment	Education and Training Requirements	Median Weekly Earnings[2]
Construction Laborers	Removal, cleaning, loading, digging Operating equipment Most workers do not specialize in a task Local competition gives preference to high-skilled workers with the ability to relocate	Repetitive motion Weather conditions Schedule varies depending on employer, weather, and opportunities for work Hazards: heights, exposure to harmful substances, machinery, noises, and odors (especially in confined spaces)	Entry-level, on-the-job training Some employers require trade-specific classroom instruction Formal apprenticeships Occupational Safety and Health Administration (OSHA) safety training	$514 The middle 50% earn between $9.95 and $17.31 per hour[3]
Driver/Sales Workers and Truck Drivers	Driving heavy trucks and tractor-trailers Driving light/delivery vehicles Workers may travel long distances, help unload, and sell goods	Some may engage in physical labor Long hours Hazards: fatigue, other drivers, and obstacles	Driver's license for all trucks Commercial driver's license required for large trucks Some states require additional training	$665 Median hourly earnings vary based on type of truck; restaurant drivers earn $7.11 per hour, while general freight truckers earn $18.38 per hour[4]
Miscellaneous Agricultural Workers	Varies widely Farmworkers: tending to crops, nurseries, greenhouses, ranch animals Operating equipment Grading and sorting	Repetitive motion (bending, stooping, lifting) Mostly outdoors Time pressures, especially during planting and harvest seasons Many seasonal and migrant workers Hazards: exposure to harmful substances (e.g., pesticides), machinery, animals; limited access to sanitation and drinking water; muscle strain	Most jobs require little education, short on-the-job training, especially in the crop production sector	$546 Median hourly wages vary greatly; farmworkers earn a median of $7.95 per hour while agricultural inspectors earn a median of $18.32 per hour
Grounds Maintenance Workers	Landscaping Grounds keeping Handling pesticides Trimming trees and pruning bushes	Repetitive motion (lifting, shoveling) Time pressures Often seasonal Usually outdoors Hazards: muscle strain and fatigue	Entry-level, on-the-job training Most workers have a high school education or less	$420 Median hourly earnings range from $9.82 for general workers to $17.93 for supervisors

Occupation	Tasks	Work Environment	Education and Training Requirements	Median Weekly Earnings
Hand Laborers and Freight, Stock, and Material Movers	Moving and loading freight, stock, and other materials onto docks, vehicles, ships, containers, and between work areas	Repetitive motion May be seasonal Some shifts are overnight Hazards: heights, weather conditions, harmful fumes, noises, materials, substances, machinery	Mostly on-the-job training OSHA safety training	$474 Median hourly earnings of $10.20 per hour
Roofers	Mostly repairing roofs and reroofing	Repetitive motion (lifting, climbing, bending) Seasonal in northern states Time pressures, especially before bad weather Hazards: slips, falls, burns, and extreme heat	Informal on-the-job training High school education helpful Formal education may include apprenticeships OSHA safety training	$550 The middle 50% earn between $12.12 and $20.79 per hour
Installation, Maintenance, and Repair Workers	Varies widely Repairing machines and appliances Maintenance Installing lines	Shift work is common Some workers on call Some long-distance travel Hazards: electrical shock, burns, and muscle strains	Much informal on-the-job training but some require technical training as well (e.g., heating, air conditioning, and refrigeration repair)	$618 Median hourly wage varies greatly; equipment wholesalers earn $20.53 per hour while vending machine operators earn $12.94 per hour
Carpenters	New construction Installation Repair 32% of workers are self-employed Workers may specialize in one or two tasks	Repetitive motion (climbing, bending, kneeling) May be exposed to weather conditions Time pressures Hazards: contact with tools and equipment, falls, muscle strain, and fatigue	Informal on-the-job training Formal training may require three to four years of on-site and classroom instruction Apprenticeships usually limited to union members employees of commercial and industrial building contractors	$615 The middle 50% earn between $13.55 and $23.85 per hour

[1] U.S. Department of Labor, *Occupational Outlook Handbook, 2008-09 Edition*, http://www.bls.gov/oco (accessed May 2009).

[2] Median weekly earnings listed are for 2007. U.S. Department of Labor, "39. Median weekly earnings of full-time wage and salary workers by detailed occupation and sex." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2007, ftp://ftp.bls.gov/pub/special.requests/lf/aa2007/aat39.txt (accessed September 2008).

[3] Hourly earnings are for 2006. U.S. Department of Labor, *Occupational Outlook Handbook, 2008-09 Edition*.

[4] Median hourly earnings are for 2006.

Underreported workplace injuries and illnesses. In addition to fatal injuries, serious injuries and illnesses are another indicator of occupational health and safety. However, there is a major discrepancy between fatal and nonfatal injury data for Latino workers. Compared to the dismal profile of workplace deaths, government records of serious injuries and illnesses are conspicuously low for Latinos. Evidence from employers, workers, and investigations makes it clear that underreporting—by employers and employees alike—is the main reason for these gaps.[33] National surveys, worker's compensation records, and medical records fail to account for between one-third and two-thirds of all workplace injuries, according to various estimates.[34] For instance, while the share of foreign-born and undocumented workers in poultry-processing occupations is rising, the rate of recorded musculoskeletal disorders has suspiciously declined from 88.3 for every 10,000 workers in 1996 to 20.8 for every 10,000 workers in 2006.[35]

Underreporting appears to be more prevalent among Latino workers and those who employ them, including businesses with fewer than ten workers, which employ 32% of the Hispanic workforce.[36] While available data often neglects to code for industry, investigations reveal that underreporting is especially prominent in areas of the labor market where Latinos are employed in high numbers, including construction, poultry processing, and agriculture.[37] In addition, several studies have reported considerably high rates of injury and illness among nontraditional workers and immigrant workers.[38]

Endnotes

[1] Lawrence Mishel, Jared Bernstein, and Heidi Shierholz, *The State of Working America 2008-2009* (Ithaca, NY: Cornell University Press, 2009).

[2] U.S. Department of Labor, "37. Median weekly earnings of full-time wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat37.txt (accessed May 2009).

[3] NCLR calculation using data from U.S. Bureau of the Census, "Current Population Survey (CPS) Table Creator." Housing and Household Economics Statistics Division. Washington, DC, 2008, http://www.census.gov/hhes/www/cpstc/cps_table_creator.html (accessed September 3, 2008).

[4] Ibid. For more information, see *Employer-Sponsored Health Insurance: Already Poor Access Further Dwindles for Working Latino Families* (Washington, DC: National Council of La Raza, 2008), http://www.nclr.org/content/publications/detail/50277 (accessed February 2008).

[5] Claudia L. Shur and Jacob Feldman, *Running in Place: How Job Characteristics, Immigrant Status, and Family Structure Keep Hispanics Uninsured* (Washington, DC: The Commonwealth Fund, 2001), http://www.cmwf.org/usr_doc/schur_running_453.pdf (accessed August 2007).

[6] U.S. Department of Labor, *Contingent and Alternative Work Arrangements, February 2005*. Conducted by the U.S. Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008), Table 9.

[7] Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006*, Issue Brief no. 311 (Washington, DC: Employee Benefit Research Institute, 2007), http://www.ebri.org/pdf/briefspdf/EBRI_IB_11-20074.pdf (accessed November 2007), Figure 2.

[8] Unpublished Employee Benefit Research Institute estimates from the U.S. Census Bureau's March 2007 *Current Population Survey*. For more information, see *Employer-Based Pension Plans: How Latinos Fare* (Washington, DC: National Council of La Raza, 2007), http://www.nclr.org/content/publications/download/50689 (accessed September 2008).

[9] Teresa Ghilarducci, Karen Richman, and Wei Sun, *Causes of Latinos' Low Pension Coverage* (Notre Dame, IN: University of Notre Dame du Lac, Institute for Latino Studies, 2007), http://latinostudies.nd.edu/pubs/pubs/Low_Pension_Coverage.pdf (accessed June 2009).

[10] U.S. Department of Labor, *Contingent and Alternative Work Arrangements, February 2005*, Table 9.

[11] U.S. Census Bureau, "America's Families and Living Arrangements: 2007," *2007 Annual Social and Economic Supplement*. Housing and Household Economic Statistics Division, Fertility and Family Statistics Branch. Washington, DC, 2008, http://www.census.gov/population/www/socdemo/hh-fam/cps2007.html (accessed October 2008), Table AVG3.

[12] Nearly three in ten (29%) Latino workers surveyed in 2001 reported being financially responsible for three or more people other than themselves, while the same was true for 21% of all workers surveyed. Furthermore, more than one-third (34%) of Hispanic workers in 2001, compared to 15% of all workers, reported providing "significant" financial support for persons not living in their household. Mathew Greenwald and Associates, *2001 Minority Confidence Survey* (Washington, DC: Employee Benefit Research Institute, 2001).

[13] U.S. Department of Labor, "Employee Benefits in the United States, March 2009," news release, July 28, 2009, http://www.bls.gov/news.release/pdf/ebs2.pdf (accessed November 2008).

[14] Lenore S. Azaroff, Charles Levenstein, and David H. Wegman, "Occupational Injury and Illness Surveillance: Conceptual Filters Explain Underreporting," *American Journal of Public Health* 92 (2002): 1421–1429, http://www.ajph.org/cgi/reprint/92/9/1421.pdf (accessed June 2008).

[15] Katherin Ross Phillips, *Getting Time Off: Access to Leave Among Working Parents* (Washington, DC: Urban Institute, 2004), http://paidsickdays.nationalpartnership.org/site/DocServer/Getting_Time_Off_-_Access_to_Leave_Among_Working_Parents.pdf?docID=365 (accessed November 2008).

[16] These premiums prevail when age, education, region, industry, occupation, and marital status are held constant. Lawrence Mishel, Jared Bernstein, and Heidi Shierholz, *The State of Working America 2008-2009* (Ithaca, NY: Cornell University Press, 2009), 201.

[17] Ibid., 201.

[18] Ibid., 202.

[19] U.S. Department of Labor, "Employee Benefits in the United States, March 2009."

[20] Cynthia Estlund, "Rebuilding the Law of the Workplace in an Era of Self-Regulation," *Columbia Law Review* 105, no. 2 (2005): 364.

[21] U.S. Department of Labor, "40. Union affiliation of employed wage and salary workers by selected characteristics." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat40.txt (accessed May 2009).

[22] Unpublished estimates from the Center for Economic and Policy Research.

[23] Elizabeth Lower-Basch, *Opportunity at Work: Improving Job Quality* (Washington, DC: Center for Law and Social Policy, 2007), http://www.clasp.org/publications/qaw_paper1_full.pdf (accessed September 2008).

[24] Päivi Hämäläinen, Jukka Takala, and Kaija Leena Saarela, "Global estimates of occupational accidents," *Safety Science* 44 (2006): 145, http://www.ilo.org/public/english/protection/safework/accidis/est_method.pdf (accessed September 2008).

[25] Ibid.

[26] U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007," *Census of Fatal Occupational Injuries, 2007*, http://www.bls.gov/iif/oshwc/cfoi/cfoi_rates_2007.pdf (accessed June 2008). The Census of Fatal Occupational Injuries (CFOI) is a compilation of state and federal government collection and coding of data from a variety of sources, including death certificates, worker's compensation reports, federal agencies such as the Occupational Safety and Health Administration (OSHA), Employment Standards Administration (ESA), and Mine Safety and Health Administration (MSHA). See U.S. Department of Labor, Bureau of Labor Statistics, *BLS Handbook of Methods*. Washington, DC, September 2008, http://www.bls.gov/opub/hom/pdf/homch9.pdf (accessed June 2009).

[27] U.S. Department of Labor, Bureau of Labor Statistics, "Fatal occupational injuries to foreign-born Hispanic or Latino workers by selected characteristics, 2003–2007," *Census of Fatal Occupational Injuries*, unpublished data.

[28] NCLR calculation using U.S. Department of Labor, "Fatal occupational injuries, employment, and rates of occupational injuries by selected worker characteristics, occupations, and industries, 2007."

[29] Scott Richardson, John Ruser, and Peggy Suarez, *Hispanic Workers in the United States: An Analysis of Employment Distributions, Fatal Occupational Injuries, and Non-fatal Occupational Injuries and Illnesses* (Washington, DC: National Academies Press, 2003), http://books.nap.edu/openbook.php?record_id=10641&page=43 (accessed September 2008).

[30] See Chapter 2 of this report.

[31] Scott Richardson, John Ruser, and Peggy Suarez, *Hispanic Workers in the United States: An Analysis*, 58.

[32] Javier Hernandez, "Until Sudden Death, an Immigrant Worker Toiled Six Days a Week," *New York Times*, June 12, 2008, http://www.nytimes.com/2008/06/12/nyregion/12worker.html?emc=tnt&tntemail1=y (accessed June 2008).

[33] Underreporting likely occurs in cases involving fatal work-related injuries. X. Dong and J. Platner, "Occupational fatalities of Hispanic construction workers from 1992 to 200," *American Journal of Industrial Medicine* 45 (2004): 45–54.

[34] Kenneth Rosenman et al., "How Much Work-Related Injury and Illness is Missed by the Current National Surveillance System?" *American College of Occupational and Environmental Medicine* 48 (2006); J. P. Leigh, J. P. Marcin, and T. R. Miller, "An estimate of the U.S. government's undercount of nonfatal occupational injuries," *Journal of Occupational and Environmental Medicine* 46 (2004); Lenore S. Azaroff, Charles Levenstein, and David H. Wegman, "Occupational Injury and Illness Surveillance."

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[36] *The Construction Chart Book* (Silver Spring, MD: The Center for Construction Research and Training, 2008), 33.

[37] Lenore S. Azaroff, Charles Levenstein, and David H. Wegman, "Occupational Injury and Illness Surveillance."

[38] Ibid.; Abel Valenzuela Jr. et al., *On the Corner: Day Labor in the United States*, (Los Angeles, CA: University of California, Los Angeles, Center for the Study of Urban Poverty, 2006), http://www.sscnet.ucla.edu/issr/csup/index.php (accessed September 2007); Chirag Mehta et. al., *Workplace Safety in Atlanta's Construction Industry: Institutional Failure in Temporary Staffing Arrangements* (Chicago, IL: University of Illinois at Chicago, Center for Urban Economic Development, 2003), 13, http://www.uic.edu/cuppa/uicued/npublications/recent/natlanta.htm (accessed April 2008).

Chapter 4

The Erosion of Job Quality: An Historic Perspective



As Chapter 3 demonstrates, Latinos face wide gaps in job quality compared to many White and Black workers. Disparities in wages, benefits, and working conditions are even more pronounced for Hispanic immigrants, who make up 53.8% of the Latino workforce. In order to address the current issues contributing to low job quality for Latinos, it is important to consider the history behind these issues, especially with regard to:

- Labor market restructuring. **Since the 1970s, many Latinos and less-skilled workers have been crowded out of relatively high-quality manufacturing jobs and moved into lower-paying service occupations and nontraditional employment arrangements.**
- Immigration policy. **Many foreign-born Latinos have been left without secure legal footing in the workplace, which has taken a toll on job quality for all workers.**
- Federal labor laws. **A final consideration is the deep-seated reluctance of Congress and federal agencies to adopt—and adapt—policies to protect workers in the changing economy.**

LABOR MARKET RESTRUCTURING

Beginning in the late 1970s, the U.S. economy began to shed goods-producing jobs in favor of service-providing jobs, which are more difficult to "export." Many U.S. businesses shifted their labor-intensive operations to developing countries where they could pay workers lower wages, profoundly altering the composition of the U.S. labor market and producing downward pressure on job quality. Altogether, between 1979 and 2007, the economy lost 7.2 million manufacturing workers, while employment in the service sector grew by 14.2 million workers. Among other factors, these changes were driven by a new world financial system, advances in technology, and intensified international trade.

Shift to lower-paying service jobs. The industrial shifts in the second half of the 20th century produced a bifurcated American workforce of high-skilled and low-skilled workers. Likewise, the labor market distribution of Hispanic and non-Hispanic workers has become increasingly dissimilar. Latinos have been simultaneously crowded out of the remaining well-paying jobs from the older manufacturing economy and locked into lower-paying jobs in the new service economy.

By contrast, broad educational progress has enabled a significant number of Whites to advance out of low- and middle-skilled jobs and into professional and technical jobs.[1] Latinos have tended to fill low- to middle-skilled jobs left open by workers with advanced skills. For example, White men reduced their presence in farming by 99,500 between 1990 and 2000 while the number of Hispanic men grew in the farming sector by 84,800. Equally important is that Latinos played a major role in filling out the emerging service sector, where demand for less-skilled labor skyrocketed during the same period in response to changing consumer preferences. For example, Hispanic men filled 110,903 jobs that were added in the building and grounds cleaning category, which reflects the growing popularity of commercial landscaping.[2] Between 1990 and 2000, service employment grew by 373,055 for Hispanic men; 28.8% of that growth change was attributable to industrial shift, but 69.7% was caused by job growth.

Increase in nontraditional work arrangements. Many labor market experts have been documenting a growing trend among employers to reconfigure their workforce to avoid the costs of compensating and insuring traditional wage-and-salary employees. One such practice is to hire workers on a contingent basis (described in Chapter 2) rather than through the use of a time-delimited contract.[3] The Hispanic share of the contingent workforce has grown to surpass their overall share in the labor force; between 1995 and 2005, the Latino presence among contingent workers jumped from 12.7% to 21.4%.[4] Yet in 2005, more than half (55.3%) of contingent workers reported that they would have preferred a permanent job.[5] This preference is likely a reaction to the high job insecurity that characterizes contingent work. Contingent status is often closely associated with low job quality. Contingent workers are much less likely than noncontingent workers to be covered by employer-sponsored benefits,[6] to receive extensive training,[7] or to belong to a union.[8]

Growth of subcontracting. Most contingent workers are employed in nontraditional

arrangements. Since the majority of Latinos in alternative arrangements are employed as independent contractors (see Figure 2.4), Latino workers have been acutely and disproportionately impacted by the growing prevalence, complexity, and abuse of subcontracting arrangements. Subcontracting includes practices such as outsourcing of production or the provision of services, hiring independent or self-employed contractors, and procuring workers through labor intermediaries such as contractors, temporary help agencies, and employee leasing companies.[9] Many employers use subcontracting arrangements to evade responsibility for upholding standards of job quality and fair treatment of workers (described in greater detail in Chapter 5). Latino workers involved in subcontracting arrangements tend to be employed in building and grounds cleaning occupations, food preparation and processing, home health care, and construction.[10]

IMMIGRATION POLICY

Many of the factors responsible for poor job quality are rooted in U.S. immigration policies that fail to provide sufficient legal channels for willing workers to enter the country, thereby promoting a cycle of illegality that leaves all workers vulnerable to exploitation. The number of employment-based visas issued by the U.S. government falls far short of employer demands. However, despite the shortage of legal options for entry, jobs continue to draw foreign-born workers, forcing many U.S. industries to become dependent on undocumented individuals. This trend has nearly paralyzed the labor market potential of millions of Latinos, who make up the majority of new immigrants. Furthermore, as Chapter 5 explains, these flawed policies ultimately drive down job quality for all workers who work side by side with undocumented immigrants, including legal immigrants and U.S.-born workers.

Supply and demand for immigrant labor. Historically, public sentiment toward immigrants—and ultimately, government restrictions on legal entry—has fluctuated with the health of the U.S. economy.[11] Yet in contrast to restrictions on Chinese and European immigration (through the Chinese Exclusion Act of 1882 and the Quota Acts of 1921 and 1924), enforcement of immigration laws against Hispanic immigrants was relatively lax in the early 20th century, with some notable exceptions. The unique treatment of Latinos was largely a product of their protracted attachment to the U.S. labor market: for more than a century, U.S. employers depended on Mexican workers, recruiting willing migrants to fill seasonal labor shortages as farmers, loggers, and miners in the 19th century Southwest. Consequently, when the creation of a Border Patrol in 1924 disrupted the steady supply of labor, U.S. farmers and ranchers lobbied Congress to preserve legal pathways for Mexican agricultural workers.

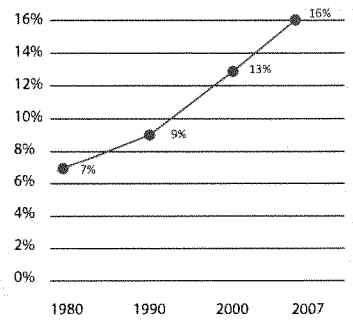
However, subsequent policy efforts to meet employers' demand for less-skilled labor, such as the *Bracero* program (1942–1964), failed to do so. More importantly, the program's porous labor standards and weak enforcement left workers extremely vulnerable to abuse. The 4.5 million workers who passed through the *Bracero* system regularly endured wage theft, deplorable living conditions, and a hazardous work environment—and they were essentially bound to their employers.[12] Many of these abuses continue in modern guest worker programs that have replaced the *Bracero* program. For instance, despite the requirement to pay H-2B (unskilled nonagricultural) guest workers the "prevailing wage" in an occupation to eliminate unfair competition against employers who hire U.S. workers, a 15-state study of H-2B workers found that in most cases, H-2B workers were paid well below the prevailing wage as reported by the Department of Labor.[13]

Restrictions on legal entry. The restructuring of the U.S. economy and advances in the human capital of U.S.-born workers created shortages of low-skilled labor that spread from the agricultural industry to other essential economic sectors, including construction, wholesale and retail trade, health care, manufacturing, and food processing.[14] During that same period, more foreign-born workers a growing portion of whom were Hispanic—entered the U.S. labor market, shown in Figure 4.1. As demand for less-skilled workers grew, restrictions on employment-based immigration visas tightened, as Figure 4.2

illustrates. Today, most permits for entry favor highly skilled immigrants. With the exception of the Immigration Reform and Control Act (IRCA) of 1986, which legalized approximately 2.7 million individuals already living and working in the U.S., Congress has not made significant adjustments in visa levels to meet labor market demand.[15]

It should be noted that not all undocumented workers enter the U.S. illegally; rather, many enter through legal channels and remain in the country after their visas expire. Between 4.5 and six million undocumented immigrants residing in the U.S. in 2006 entered the country legally at a border and overstayed visas that were not intended for permanent immigration.[16]

FIGURE 4.1
Foreign-Born Workers in the U.S. Labor Force, 1980–2007



Source: Migration Policy Institute, "Foreign Born as a Percentage of the Total Population and of the Civilian Labor Force by State, 1980 to 2007," MPI Data Hub, http://www.migrationinformation.org/datahub/charts/laborforce.2.shtml (accessed September 2008).

Few Legal Pathways for Low-Skilled Immigrants

While experts are not in agreement on how to measure labor shortages, most agree that the number of U.S. workers in the labor market will decline significantly as baby boomers retire. It is estimated that in order to maintain the current level of 2% annual growth in GDP, the workforce will need to add about one million workers per year between now and 2050.[17] To do so will require hiring new immigrant workers.

Despite growing demand for workers from abroad, current legal avenues for immigrants seeking to work in the U.S. are extremely limited, which promotes illegality. Indeed, from 2003 to 2008, the share of undocumented workers in the U.S. labor force increased from 4.3% to 5.4%.[18] Legal pathways are especially limited for less skilled workers. In 2007, only 5,000 unskilled immigrants were granted lawful permanent residence ("green cards") by the U.S. government. Temporary residency options are more numerous, but guest workers must be sponsored by a specific employer. Temporary visa categories for seasonal agricultural workers (H-2A), seasonal nonagricultural workers (H-2B) totaled 173,000 in 2008. Each year, the United States Citizenship and Immigration Services branch of the Department of Homeland Security receives far more employer applications for temporary workers than are accepted; the annual cap is usually reached within a week of the open application process.[19]

Barriers to naturalization. Even immigrants who obtain legal permanent residency face difficulties becoming naturalized citizens, which can limit their opportunities to advance in the job market, fully participate in the civic process, and improve their quality of life. One major obstacle to naturalization is the government backlog of citizenship applications. At the end of fiscal year 2008, 1,046,539 persons were naturalized, and decisions on 480,000 cases were pending.[20] Another 121,283 naturalization applications were denied.[21]

Limited English proficiency is another obstacle to naturalization for many Latinos, since proficiency in English is required for individuals to pass the citizenship exam. On October 1, 2008, U.S. Citizenship and Immigration Services (USCIS) began administering the redesigned naturalization exam.[22] It is possible that this change will prompt new misconceptions about the test and the citizenship process, creating an additional impediment for many prospective applicants.

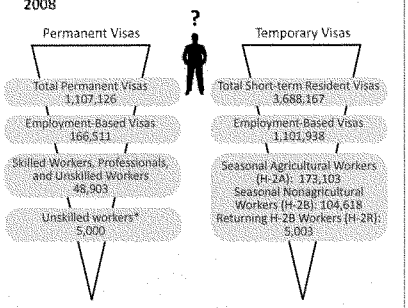
Finally, the application fee is prohibitively high for many low-wage earners, which reduces the likelihood that they will naturalize. On July 30, 2007, the cost for processing naturalization applications (form N-400) rose 80%, from $330 to $595.[23] Individuals applying for citizenship must also pay an additional $80 biometric fee, bringing the total cost of applying for naturalization to $675.

Employment verification. The job quality of many immigrant and foreign-born Latinos has been compromised by the tumultuous evolution of policies that restrict the hiring of undocumented workers. The passage of IRCA in 1986 was the first time Congress made it unlawful to hire undocumented workers. IRCA required employers to check the validity of the now ubiquitous I-9 form of all newly hired employees. IRCA threatened to penalize any employer who was found to "knowingly hire" an unauthorized worker (these penalties are known as "employer sanctions"). Rather than preventing the employment of undocumented workers, IRCA led to unintended consequences. It established a thriving fraudulent document industry and set in motion widespread discrimination against Latinos and other workers who are perceived to be "foreign." Both were products of the fact that workers and employers were forced to find ways to work around a system that did nothing to widen legal channels to address the magnet of available jobs and the flow of willing workers.[24]

In response to criticism from civil rights and worker advocates, as well as from employers who demanded clarity in order to avoid sanctions, Congress has sought to come up with a system that allows employers to automatically verify whether newly hired employees are eligible to work in the U.S. For more than two decades, employers have tested several versions of an electronic employment verification system (EEVS) designed to check newly hired employees' I-9 form against Social Security and immigration records held in government databases.

However, since EEVS was never intended to match a worker's identity with the information provided in their employment documents, the system has not fulfilled its purpose of preventing the hiring of undocumented workers. Furthermore, serious flaws in the system due to database errors and rampant employer misuse and abuse of EEVS have come at a major cost to job quality, disproportionately impacting U.S. citizens and legal residents with "foreign" last names. These issues

FIGURE 4.2
Permanent and Temporary Employment-Based Visas, 2008



Source: U.S. Department of Homeland Security, *Yearbook of Immigration Statistics: 2008*. Office of Immigration Statistics. Washington, DC, 2009, http://www.dhs.gov/files/statistics/publications/LPR08.shtm (accessed June 2009).

* The federal government caps the number of visas available for unskilled workers at 10,000 per year, with 5,000 reserved for the Nicaraguan Adjustment and Central American Relief Act (NACARA) of 1997. U.S. Department of State, *Report of the Viso Office 2003*. Washington, DC, 2003, http://travel.state.gov/pdf/FY2003%20AppA.pdf (accessed January 2008), Appendix A.

are described at length in Chapter 5. Although only about 4% of newly hired employees are verified electronically under the current system, called E-Verify, about 4,000 employers are registering for the program each month.[25] Thus, the problems with the current system could spread rapidly as E-Verify expands, to the detriment of job quality for both U.S. citizens and foreign-born workers. Essential protections for workers in an employment verification system are addressed in Chapter 6.

FEDERAL LABOR PROTECTIONS

By and large, federal policymaking has lagged significantly behind trends in the U.S. labor market. In fact, major federal legislative and regulatory activity concerning labor issues has been relatively dormant since the mid-1990s (see Table 4.1). As a result, the institutional framework for protecting workers has become increasingly porous.

Table 4.1
Major Federal Labor Laws

Law	Purpose	Year Enacted
Clayton Act[1]	Protects organized labor from penalty under antitrust laws.	1914
Davis Bacon Act[2]	Requires individuals contracted for construction work by, or with the assistance of, the federal government to be paid no less than the local prevailing wage.	1931
National Labor Relations Act (NLRA/Wagner Act)[3]	Gives workers the right to organize unions and choose their representatives, and protects them from certain employer retaliation. The law also establishes the National Labor Relations Board (NLRB) to arbitrate union elections.	1935, amended in 1947 by the Taft-Hartley Act
Fair Labor Standards Act (FLSA)	Sets the federal minimum wage, mandates the payment of overtime wages for workers earning below a certain income level, requires employers to keep records of employees' hours, and sets limits on the hours and types of jobs young people can work. Domestic workers and farmworkers are excluded from most protections under FLSA.[4]	1938; notable amendments include the Equal Pay Act of 1963, modest expansion in 1966 to extend some protections for certain farmworkers, and the 1993 Family and Medical Leave Act
Labor-Management Relations Act (Taft-Hartley Act)	Prohibits the "closed shop," excludes "supervisory" employees from protections under the Wagner Act, and prohibits and restricts certain union actions.	1947; additions and clarifications to unlawful union practices added in the Labor-Management Reporting and Disclosure Act (Landrum-Griffin Act) of 1959[5]
Immigration and Nationality Act (INA)[6]	Consolidates the provisions of several guest worker programs regarding the recruitment, certification, and hiring of workers.	1952
Equal Pay Act[7]	Prohibits discriminatory pay for men and women in the same establishment who experience and labor under the same working conditions.	1963
Civil Rights Act, Title VII[8]	Bans employment discrimination on the basis of race, color, religion, sex, and national origin, with exceptions for certain types of employers. Establishes the Equal Employment Opportunity Commission (EEOC) to enforce Title VII.	1964

Law	Purpose	Year Enacted
Occupational Safety and Health Act (OSH Act)[9]	Holds employers responsible for providing a safe and healthy workplace. Establishes the Occupational Health and Safety Administration (OSHA) to create and enforce health and safety regulations in the workplace, to research, educate, and train workers and the public, and to provide assistance to states to carry out similar tasks. OSHA's enforcement tools include monetary fines, and in cases involving worker deaths, criminal penalties.	1970
Employee Retirement Income Security Act (ERISA)[10]	Protects employees' pension benefits by establishing rules about disclosure, vesting, participation, and funding.	1974
Migrant and Seasonal Agricultural Worker Protection Act (AWPA)[11]	Extends certain protections to migrant and seasonal farmworkers regarding recordkeeping, wages, supplies, housing, and working conditions.	1983
Immigration Reform and Control Act (IRCA)[12]	Establishes a national worker verification system and sanctions against employers who knowingly hire undocumented workers.	1986
Family and Medical Leave Act (FMLA)[13]	Requires certain employers to offer their employees up to 12 weeks of unpaid leave during a 12-month period for certain family and medical conditions without penalty in wages, benefits, or position. All public employers, as well as private-sector employers of at least 50 employees in certain industries, are covered by the act.	1993

[1] *Clayton Act, U.S. Code*, (1914), Title 15 § 12.
[2] *Davis-Bacon Act*, Public Law 107-217 (August 21, 2002, as amended).
[3] *National Labor Relations Act, U.S. Code* (1935), Title 29 §§ 151–169.
[4] *Fair Labor Standards Act, U.S. Code* (1938), Title 29 §§ 201–219.
[5] Labor-*Management Relations Act, U.S. Code* (1947), Title 29 §§ 141–187.
[6] Immigration and Nationality Act, *U.S. Code* (1952), Title 8 §§ 1101–1778.
[7] Equal *Pay Act of 1963, U.S. Code* (1962), Title 9 § 206d.
[8] *Civil Rights Act, U.S. Code* (1964), Title 42 §§ 2000e–2000e-7.
[9] *Occupational Safety and Health Act* (1970), Title 29 §§ 651–678.
[10] *Employee Retirement Income Security Act, U.S. Code* (1974), Title 29 §§ 1001–1461.
[11] *Migrant and Seasonal Agricultural Worker Protection Act, U.S. Code* (1983), Title 29 §§ 1801–1872.
[12] *Immigration Reform and Control Act, U.S. Code* (1986), Title 8 § 1324.
[13] *Family and Medical Leave Act, U.S. Code* (1993), Title 29 §§ 2601–2654.

Legislative slowdown. Since the enactment of major labor laws in the early 20th century, the work environment and the structure of the labor market have changed dramatically; yet there has been no sweeping federal legislation to strengthen workers' rights in more than 15 years.[26] Early laws were intended to preserve private negotiation between workers (acting through unions) and employers, but when it became clear that unions were not always successful in their efforts—and many workers were altogether excluded from union membership—policymakers sought to establish basic labor standards through the force of law. The Federal Labor Standards Act of 1938 set the floor on wages and the hours and conditions under which youth could work. The Occupational Health and Safety Act was the landmark legislation meant to protect workers' physical well-being on the job by requiring all employers to follow health and safety laws. Today's workplace continues to be regulated by these laws.

Stalled rulemaking. Regulatory activity around workplace standards has also slowed considerably. Historically, the rulemaking process within the Occupational Health and Safety Administration (OSHA) has been heavily influenced by corporations and organized labor, with input from experts, other employee advocates, and scientists from the public and private sectors.[27] Throughout its nearly 40-year history, however, the vast majority of rules issued by OSHA have never been finalized. Particularly in the last decade, rulemaking and finalization has stalled; only seven major final rules were issued between 1997 and 2007, compared to approximately 26 final rules in the previous decade.[28] Of the standards that were finalized between 1971 and 1996, evidence suggests that the majority has generally favored the interests of business rather than those of workers.[29] Among other factors, the decline of the labor movement and the rise of multinational corporations have limited the capacity of workers, unions, and advocates to advance and defend pro-worker standards.

Endnotes

[1] Maude Toussaint-Cameau, Thomas Smith, and Ludovic Comeau Jr., *Occupational Attainment and Mobility of Hispanics in a Changing Economy* (Washington, DC: Report to the Pew Hispanic Center, 2005), http://pewhispanic.org/files/reports/59.1.pdf (accessed September 2008), 48.

[2] Ibid.

[3] In reaction to growing global competition and soaring health insurance premiums, many businesses have cut costs by eliminating benefits for their employees. However, there is debate about whether contingent workers actually do cost less than their permanent counterparts. *Employer Health Insurance Costs and Worker Compensation* (Menlo Park, CA: Kaiser Family Foundation, 2008), http://www.kff.org/insurance/snapshot/chcm030808oth.cfm (accessed May 2008); Kathleen Barker and Kathleen Christensen, *Contingent Work: American Employment Relations in Transition* (Ithaca, NY: Cornell University Press, 1998).

[4] U.S. Department of Labor, Bureau of Labor Statistics, "Contingent and Alternative Work Arrangements, February 2005," news release, July 27, 2005, http://www.bls.gov/news.release/pdf/conemp.pdf (accessed September 2008); U.S. Department of Labor, Bureau of Labor Statistics, "Contingent Worker and Alternative Employment Supplement, 1995." *Current Population Survey*. Conducted by the U.S. Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 1995, http://www.bls.census.gov/cps/contwkr/1995/sdata.htm.

[5] U.S. Department of Labor, "Contingent and Alternative Work Arrangements."

[6] Only 9.4% of contingent workers had employer-provided health insurance in 2005, and only 4.6% were included in an employment-based retirement plan. U.S. Department of Labor, Bureau of Labor Statistics, "Contingent and Alternative Work Arrangements," Table 9.

[7] T. A. Kochan, M. Smith, J. C. Wells, and J. B. Rebitzer, "Human resource strategies and contingent workers: The case of safety and health in the petrochemical industry," *Human Resource Management* 33 (1994): 55–77.

[8] In 1999, just 5.9% of contingent workers were unionized, compared to 14.8% of noncontingent workers. There is notable variation between industries, however. Construction unions have successfully organized contingent workers at a rate of 22.6%, perhaps due to workers' reliance on unions for stability in a job market that is traditionally transient. Steven Hipple, "Contingent work in the late-1990s," *Monthly Labor Review* (2001), http://www.bls.gov/opub/mlr/2001/03/art1full.pdf (accessed September 2008).

[9] In addition to the economic incentives for employers to contract out work, the growth of subcontracting has also been fueled by new technologies and decentralized production chains, which make virtual and multisite operations possible. Thus, subcontracting arrangements are not limited to less-skilled occupations but rather have taken hold in higher-skilled, higher-pay occupations such as computer technicians. Catherine Ruckelshaus and Bruce Goldstein, *From Orchards to the Internet: Confronting Contingent Work Abuse* (New York, NY: National Employment Law Project, 2002), http://www.bls.gov/opub/mlr/2001/03/art1full.pdf (accessed September 2008).

[10] Planmatics, Inc. for the U.S. Department of Labor, *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs* (Rockville, MD: 2000), 51, http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf (accessed September 2008).

[11] T. J. Espenshade and K. Hempstead, "Contemporary American Attitudes toward U.S. Immigration," *International Migration Review* 30 (1996).

[12] Center for History and New Media, "Bracero History Archive," George Mason University, Smithsonian National Museum of American History, Brown University, and the Institute of Oral History at the University of Texas at El Paso, http://braceroarchive.org (accessed July 2009).

[13] Denice Velez, "Wages for H-2B workers set lower than the prevailing wage" (Washington, DC: Economic Policy Institute, 2008), http://www.epi.org/economic_snapshots/entry/webfeatures_snapshots_20080813 (accessed August 2008).

[14] The Essential Worker Immigration Coalition (EWIC) is a coalition of businesses, trade associations, and other organizations from across the industry spectrum concerned with the shortage of both lesser skilled and unskilled ("essential worker") labor. EWIC, "The Essential Worker Immigration Coalition," http://www.ewic.org//index.php (accessed August 2008).

[15] *Immigration Reform and Control Act, U.S. Code* (1986), Title 8 § 1324.

[16] *Modes of Entry for the Unauthorized Migrant Population* (Washington, DC: Pew Hispanic Center, 2006), http://pewhispanic.org/files/factsheets/19.pdf (accessed September 2008).

[17] Ray Marshall, *Immigration for Shared Prosperity: A Framework for Comprehensive Reform* (Washington, DC: Economic Policy Institute, 2009), 26.

[18] Jeffrey Passel and D'Vera Cohn, *A Portrait of Unauthorized Immigrants in the United States* (Washington, DC: Pew Hispanic Center, 2009), 15, http://pewhispanic.org/files/reports/107.pdf (accessed April 2009).

[19] U.S. Citizenship and Immigration Services, "USCIS Reaches H-2B Cap for Second Half of Fiscal Year 2009," news release, January 8, 2009, http://www.uscis.gov/files/article/h2b_8jan09.pdf (accessed January 2009).

[20] James Lee and Nancy Rytina, *Naturalizations in the United States: 2008*. U.S. Department of Homeland Security Office of Immigration Statistics. Washington, DC, 2009, http://www.dhs.gov/xlibrary/assets/statistics/publications/natz_fr_2008.pdf (accessed July 2009).

[21] *Yearbook of Immigration Statistics: 2008*. U.S. Department of Homeland Security. Washington, DC, 2008, Table 20, www.dhs.gov/xlibrary/assets/statistics/yearbook/2008/table20.xls (accessed July 2009).

[22] Applicants who file a naturalization application on or after October 1, 2008 and those who are scheduled for a naturalization interview on or after October 1, 2009 will take the new test. U.S. Department of Homeland Security, "New Naturalization Test," U.S. Citizenship and Immigration Services, http://www.uscis.gov/newtest (accessed July 2009).

[23] U.S. Department of Homeland Security, "Adjustments of Immigration and Naturalization Benefit Application and Petition Fee Schedule." Final Rule 8 CFR Part 103, Docket No. USCIS 2006-0044. U.S. Citizenship and Immigration Services. Washington, DC, 2006, http://www.uscis.gov/files/nativedocuments/FinalRule.pdf (accessed July 2009).

[24] Charles A. Bowsher, *Immigration Reform: Employer Sanctions and the Question of Discrimination*, Statement before the Committee on the Judiciary, March 30, 1990, U.S. General Accounting Office, T-GGD-90-31, http://archive.gao.gov/d38t12/141005.pdf (accessed April 2009).

[25] Estimates from U.S. Citizenship and Immigration Services in U.S. House of Representatives Committee on the Judiciary, Subcommittee on Immigration, Citizenship, Refugees, Border Security, and International Law, *Employment Verification: Challenges Exist in Implementing a Mandatory Electronic Employment Verification System*, Statement of Richard Stana, 111th Cong., 2nd sess., 2008, http://www.gao.gov/new.items/d08895t.pdf (accessed June 2008).

[26] One important exception is the increase in the federal minimum wage in 2007, which increased to $7.25 per hour on July 24, 2009, the last in a three-phase increase since 2007, when the Fair Labor Standards Act was amended to increase the minimum wage from $5.15 per hour. The latest increase gave approximately 4.5 million workers a raise. Kai Filion, *Minimum Wage Issue Guide* (Washington, DC: Economic Policy Institute, 2009), http://epi.3cdn.net/9f5a60cec02393cbe4_a4m6b5t1v.pdf (accessed July 2009).

[27] In fact, the OSH Act created the National Institute of Occupational Safety and Health (NIOSH) to provide scientific guidance on standards.

[28] *Death on the Job: The Toll of Neglect* (Washington, DC: AFL-CIO, 2009), "Major OSHA Health Standards Since 1971," http://www.aflcio.org/issues/safety/memorial/upload/_24.pdf (accessed April 2009), 41.

[29] Ana-Maria Wahl and Steven Gunkel, "Due Process, Resource Mobilization, and the Occupational Safety and Health Administration, 1971-1996: The Politics of Social Regulation in Historical Perspective," *Social Problems* 46, no. 4 (1999): 591–616.

Chapter 5
Major Issues Affecting Job Quality for Latinos



Absent effective, responsive immigration policy or significant strengthening of workers' rights at the federal level, the structural changes in the economy and employers' growing reliance on less-skilled—often immigrant—workers have eroded the quality of U.S. jobs. While millions of workers have been negatively impacted by these trends, Latinos have emerged as the workers who are most likely to hold jobs with low wages, insufficient benefits, and dangerous working conditions. This chapter explores the major issues that help explain the quality disparity Latinos face on the job. These issues can be grouped into three categories:

- Labor law violations. Latinos are concentrated in occupations with where labor law violations are prevalent.
- Gaps in legal protections. Many Latinos are partially or fully excluded from coverage under laws designed to protect workers.
- Inadequate government outreach and enforcement. Latinos bear a disproportionate burden of the federal government's failure to enforce fundamental labor laws.

LABOR LAW VIOLATIONS

Several low-wage industries are plagued by violations of the major federal labor laws that are outlined in Table 4.1. Anecdotal and empirical evidence suggests that the majority of the Latino workforce is employed in workplaces where wage, benefit, and working condition regulations are not met. The industries in bold in Table 5.1 are those with a high frequency of labor law violations. The most common types of violations and the affected industries are listed in Table 5.2.

The Occupational Health and Safety Administration (OSHA) has documented a 6.4% rise in violations of standards and regulations since 2003, including a rise in "willful" violations in which employers knowingly violate the law.[1] While OSHA credits these increases with better oversight and reporting, the rising toll of Latino worker deaths raises the probability that the incidence—not just the discovery—of willful violations is on the rise. At the heart of this trend is that the penalties for violating labor laws are generally too low to offset the financial incentives for unscrupulous employers to cut corners. In order to avoid detection, many employers fail to report serious workplace injuries and illnesses, allowing substandard conditions to persist.

Table 5.1
Employed Latino Workers by Industry, 2008

Industry	Percent of Total Employed Who Are Latino*	Latino Workers (in thousands)†
Manufacturing	**14.6%**	**2,323**
Education and Health Services	15.0%	3,040
Wholesale and Retail Trade	**13.8%**	**2,831**
Construction	**24.6%**	**2,701**
Leisure and Hospitality	**18.5%**	**5,664**
Professional and Business Activities	10.5%	2,144
Other Services	9.0%	1,197
Transportation and Utilities	14.6%	1,155
Financial Activities	10.6%	1,083
Public Administration	3.1%	631
Information	1.6%	317
Mining	0.6%	127

*NCLR calculation using U.S. Department of Labor, "14. Employed persons in nonagricultural industries by age, sex, race, and Hispanic or Latino ethnicity." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat14.txt (accessed September 2008).
†U.S. Department of Labor, "14. Employed persons in nonagricultural industries."

Absent adequate health and safety training or the presence of a union, many Latino workers have little recourse in the face of widespread violations. The issue of employer noncompliance acutely affects workers employed in nontraditional arrangements, who often find it difficult to hold a single employer responsible.

Weak civil and monetary penalties. Depending on the laws that apply to certain categories of employees, an employer may be obligated to pay for an employee's salary, benefits, and personal protective equipment and training.[2] In many cases, however, the civil penalties for violating these laws are too weak to compel employers to fulfill their legal

Table 5.2
Most Common Labor Law Violations

Violation	Commonly Affected Industries
Wage theft. Employers' failure to pay workers their wages has serious implications for those who already earn low wages and are likely to be paid on an hourly basis. Refusing to provide any compensation and failing to pay minimum wage or overtime are all potential violations of the Fair Labor Standards Act (FLSA) and, for certain agricultural employees, the Migrant and Seasonal Agricultural Worker Protection Act (AWPA).	Agriculture
Poor recordkeeping. An employer who neglects to record all hours an employee works as required by the FLSA and the AWPA is likely to underpay the employee. While some recordkeeping errors are accidental, a common practice in the construction industry is to fail to record hours worked as overtime for employees who perform various tasks within one week for the same employer.	Construction
Youth employment violations. In addition to the standards of the FLSA and the AWPA, youth are subject to different employment restrictions depending on their age. One of the most common violations of youth employment law is to exceed the permissible number of hours a young person is allowed to work. According to a compliance survey of restaurants by the U.S. Wage and Hour Division, 47% of 14- and 15-year-olds employed in full-service restaurants were in violation of youth employment laws, most of them working more hours than permitted.[1]	Leisure and hospitality
Misclassification of employees as independent contractors. In 2005, 957,000 Latino workers identified themselves as independent contractors,[2] but due to the growing practice among employers to misclassify actual employees as independent contractors, this number is likely much higher. Misclassification, described in greater detail below, has serious consequences for workers who remain unaware of their tax obligations and legal vulnerability as self-employed workers.	Manufacturing
Inadequate sanitation, housing, and transportation. Several case studies have revealed the high incidence of violations of the AWPA and the Occupational Health and Safety Act (OSH Act), which require adequate drinking water and sanitation in the fields, among employers of migrant and seasonal farmworkers.	Agriculture
Scaffolding hazards. Occupational Health and Safety Administration regulations require that scaffolding be properly constructed to support workers on temporary elevated surfaces. In 2007, however, 88 workers died due to a fall from scaffolding. In fact, scaffolding standards were the most frequently cited rule violations in OSHA inspections during the fiscal year 2008 (October 2007 through September 2008).[3]	Construction, especially masonry, drywall, and insulation work
Inadequate fall protection. This was OSHA's second most frequently cited workplace safety violation in fiscal year 2008.[4] Based on 2006 fatal occupational injury data, Latinos are more likely than other workers to be killed by a fall on the job; 20.2% of Latino fatalities were caused by falls, compared to 14.8% of White fatalities and 7.6% of Black fatalities (see Figure 4.9).	Carpentry Construction, especially roofing, siding, and sheet metal work
Insufficient hazard communication. OSHA's hazard communication standard requires employers to provide clearly accessible information (such as labels and descriptions) about chemicals in the workplace and their hazards. Failure to appropriately warn workers about hazardous chemical substance was OSHA's third most frequently cited safety violation in fiscal year 2008.[5]	Construction, especially masonry, painting, and paper hanging

[1] NCLR calculation using U.S. Department of Labor, "14. Employed persons in nonagricultural industries by age, sex, race, and Hispanic or Latino ethnicity." *Current Population Survey*. Conducted by the Bureau of the Census for the Bureau of Labor Statistics. Washington, DC, 2008, ftp://ftp.bls.gov/pub/special.requests/lf/aat14.txt (accessed September 2008).

[2] U.S. Department of Labor, "14. Employed persons in nonagricultural industries."

[3] U.S. Department of Labor, "Most Frequently Cited Standards," Occupational Health and Safety Administration (OSHA), http://www.osha.gov/dcsp/compliance_assistance/frequent_standards.html (accessed January 2009).

[4] Ibid.

[5] Ibid.

obligations. For instance, employers found guilty of violating the FLSA are required to pay back wages to unpaid or underpaid workers—in other words, no more than the amount rightly due to the worker.[3] Fines for OSHA violations have not increased in nearly two decades. Even in the most egregious case—"willful" violations that result in a worker's death—the maximum fine is $70,000, far below fines leveraged for violations in other areas, such as environmental law.[4]

OSHA logs reveal that employers are not likely to pay the full fine levied against them. In fact, the median reduction in willful violations that result in a worker fatality is 58%, or $40,600. This is partially by design: OSHA guidance instructs investigators to reduce fines for certain types of employers, including small businesses.[5] Furthermore, since a willful violation is considered a Class B misdemeanor—with lower penalties than mail fraud—criminal charges are very rarely pursued. Between 2003 and 2008, OSHA deemed 237 fatality cases willful violations, but in only ten cases were employers prosecuted by the Department of Justice.[6] The main obstacles to court action are the low classification of violations, a general lack of evidence in fatality cases, and employers' tendency to seek alternative methods of making reparations to avoid public repudiation for being responsible for a worker's death.[7]

Employee intimidation and underreporting. Abnormally high rates of injury or illness can drive up an employer's workers' compensation premiums and can affect a business' chance of winning certain government contracts.[8] These considerations, coupled with the weak penalties discussed above, cause many employers to evade their legal obligation to accurately report serious incidents. Accounts from low-wage workplaces have exposed a wide range of tactics employers use to prevent workers' complaints from reaching supervisors and government enforcement agencies. These include blatant violations of whistleblower protections—such as firing an employee who disputes a paycheck—to low-level disciplinary tactics that are more difficult to detect, such as verbal harassment, assigning workers undesirable tasks or schedules, and passing up workers for bonuses and promotions.[9]

Even practices that appear to make positive investments in workers can inadvertently or deliberately discourage workers from issuing complaints. For example, employers who excessively reward "accident-free" workers with prizes or bonuses can maintain popularity with employees while still discouraging honest reporting. Another trend is to provide in-house medical care to workers who get sick or injured on the job. Especially in larger businesses, such as poultry-processing and meatpacking plants, some employers have instructed their in-house medical staff to downplay the severity of work-related injuries.[10] Since only injuries serious enough to merit "lost work time" show up on OSHA logs and nationwide surveys, this practice distorts the accuracy of official injury reports and blocks workers from accessing the workers compensation process.

Ineffective delivery and content of health and safety training. By law, employers are obligated to create a safe and healthy workplace. In addition to minimizing and eliminating hazards, it is their responsibility to train workers to protect themselves from injury and illness. However, many employers provide low-wage workers with little to no safety training. For instance, in a survey of restaurant employees in New York City, 52% of workers said they had not received any health and safety training.[11] When workers do receive training, it is often minimal, low-quality, or not delivered in a language or manner that enables them to fully comprehend it. In fact, several investigations into several cases of Hispanic worker deaths have concluded that inadequate training is a major cause of preventable deaths.

Language barriers often compromise the quality of vital safety training to Hispanic workers, particularly the foreign-born. Non-Spanish-speaking employers often fail to provide culturally and linguistically appropriate training to Spanish-speaking workers, in violation of their legal obligation to provide quality training.[12] OSHA

Workplace Discrimination and Harmful Employment Verification Measures

A discussion of Latinos' experience in the labor market cannot leave out the negative impact of racial, ethnic, and national origin discrimination on employment opportunities and job quality for Hispanic workers. Discrimination can be detrimental to all three core components of job quality: wages, benefits, and working conditions. One study found that "differential treatment explains one-fourth of the wage gap between foreign-born Latinas and white women even when human capital, broad occupational controls and neighborhood characteristics are included."[20] The failure of occupational distribution to fully explain disparities in workplace fatality rates may be partially explained by differential treatment of workers in the same occupation.[21] For instance, Latino or immigrant workers may be assigned inferior and more dangerous tasks than other workers with the same job title.

The proposed expansion of a flawed employment verification system threatens to reverse years of progress in combating workplace discrimination.[22] Decades after a congressionally mandated General Accounting Office* report found that employment discrimination spiked in areas with Latino and Asian populations following the enactment of the Immigration Reform and Control Act (IRCA) in 1986, these groups continue to be more likely than others to be harmed by employer misuse and abuse of the system, or by database errors that prevent authorized individuals from being automatically confirmed to work.[23]

According to evaluations of the latest electronic employment verification system, E-Verify, U.S.-born and foreign-born workers with "foreign-sounding" surnames, foreign-born workers who are naturalized U.S. citizens, and other lawfully present foreign-born workers are more likely than U.S.-citizens to be incorrectly denied automatic confirmation due to errors in government databases. These workers face greater risk of adverse actions from their employers. In violation of the rules of E-Verify, 31% of employers screened job applicants and new hires before issuing their first paycheck, 21.6% restricted work assignments, 16% delayed on-the-job training, and 2% reduced pay of workers who were not immediately confirmed to have work authorization.[24] In other cases of abuse, some employers demand extra or "better" documents than legally required from people they believe to be immigrants. Others implement unlawful "citizen-only" policies to avoid a potentially longer and more costly verification for these "error-prone" workers.[25]

* Now the Government Accountability Office.

has developed extensive compliance assistance resources in Spanish. However, public health models have shown that the effectiveness of these materials rests on the quality of delivery of information. Evidence shows that such outreach materials are often impractical, instructing employees on practices irrelevant to their occupation, or insensitive to cultural differences.[13] Many employers remain unaware that limited-English-proficient (LEP) workers have not fully understood or benefited from training since soliciting employee feedback is rare. Instead, they may incorrectly assume that LEP workers understand safety instructions as long as they receive them in Spanish.[14] This assumption further excludes workers for whom Spanish is not their primary language, or for whom low literacy is a barrier.

The high incidence of violations of E-Verify rules, coupled with persistent error rates in the Social Security and U.S. Citizenship and Immigration Services (USCIS) databases, come at a significant cost to all workers, especially Latinos. Expanding such a system through a mandate on all U.S. employers would drive up workplace discrimination, further deteriorating job quality.

Declining union presence. Compared to 1973, when nearly one in three workers was covered by a collective bargaining agreement,[21] only 12.4% of workers were unionized in 2007.[22] The decline of unions eliminated an important watchdog figure in the workplace, leaving workers more exposed to

employer violations. In the midst of disappearing union jobs, several court interpretations of labor laws have further restricted workers' right to organize.[23] Furthermore, since the 1970s, there has been a documented rise in employer tactics to discourage workers from joining unions and recruit employees from outside the unionized workforce.[24] These efforts have succeeded in many industries, abetted by delays in union outreach to workers employed in the service sector. Although some unions have made progress recruiting immigrant and non-English-speaking workers, they continue to face challenges presented by complex contractor and subcontractor relationships, multisite operations, and nontraditional work arrangements.[25]

Job Quality Comes Full Circle: The Case of Meatpacking

The evolution of the meatpacking industry is one example of how changes in workplace governance have affected the employment and job quality of Latino workers. At the turn of the 20th century, the business of slaughtering, processing, and packing beef employed predominantly immigrant workers at poverty-level wages and under extremely hazardous conditions.[i] Upton Sinclair's 1906 novel *The Jungle* exposed the deplorable conditions experienced by meatpacking employees both at work and at home. Aroused like Sinclair's reader public consciousness about the problems facing workers, which led lawmakers to set some industry standards affecting the packing process and working conditions. Significant progress was made between 1940 and 1960, when two unions—the Amalgamated Meat Cutters and the United Packinghouse Workers of America (UPWA)—successfully organized 93% of the hourly workers in plants throughout the Great Lakes region. Workers' wages rose dramatically during this time, despite the fact that the industry was dominated by only four companies. In 1947, meatpackers' average hourly wages were about 4% higher than hourly earnings of workers in nondurable goods, but by 1960 they were 26% higher.

In 1968, Iowa Beef Packers (IBP) entered the meatpacking market with a new product: boxed beef. This method of packing enabled IBP to lower its costs by locating its plants closer to the livestock in rural areas. In order to fill labor shortages in these locales, IBP and other large businesses began recruiting Hispanics and Asians, many of whom were immigrants, to work in the packing plants. In the meat products industry, Hispanics' share of workers increased from 9% in 1978 to 21% in 1990.[ii] Immigrants, women, and minorities were all groups that unions had found difficult to organize.[iii] Together with other reversals to strikes and other union activities, IBP and a few other new entrants to the industry pressured unions to make major concessions on workers' wages. As wages declined in the 1980s, the rate of job-related injury increased, eventually coming to resemble the unregulated, nonunionized poultry processing industry of the 1960s.[iv] In fact, in 1987, OSHA sought $2.6 million in fines against IBP for deliberately concealing the high incidence of occupational injuries and illnesses at its plant in Dakota City, Nebraska.[v]

Since the late 1980s, employers in meatpacking have continued to drive down wages. The average hourly wage in meatpacking declined from $11.12 in 1982 to $10.81 in 1986, while the disparity between meatpacking and manufacturing wages grew.[vi] Meanwhile, in 2008, the U.S. beef industry was worth about $76 billion.[vii] A relatively slim profit margin has prompted producers to implement other cost-cutting measures, such as faster production line speeds and longer hours, which have contributed to some of the highest serious occupational injury rates of any job in the country.[viii] These conditions lead to extremely high employee turnover in meatpacking, often exceeding 100% per year.[ix] Union activity has centered in the meat, poultry, and packing industries, often with the intent of organizing minority and immigrant workers to demand better wages and working conditions. However, heavy resistance from employers has slowed this process in many places, such as the Smithfield Packing slaughterhouse in Tar Heel, North Carolina, which voted for a union in December 2008 after 15 years of organizing activities.[x] The uncertain future of job quality in meatpacking is especially critical to Latinos, who now represent 18.4% of butchers and other meat, poultry, and fish processing workers.[xi]

Exploitation of independent contractors. One of the most prevalent and harmful practices affecting the quality of work at nearly every level of the pay scale is the misclassification of legitimate employees as independent contractors. True independent contractors are considered self-employed and are thus required to purchase their own equipment and benefits and pay their own payroll taxes. Employers are not responsible for paying workers compensation payments if an independent contractor is injured on the job. While many employers hire legitimate independent contractors, misclassification of regular employees as independent contractors is a practice that is spreading among employers seeking to avoid the responsibility and costs of employing workers. A study commissioned by the U.S. Department of Labor estimated in 2000 that 30% of businesses misclassify their workers as independent contractors.[37] Although misclassification happens across occupations, it is best documented among construction and extraction workers. In New York, for example, an estimated 14.8% of construction workers, about 45,474 individuals, are misclassified each year.[38] The costs of misclassification are widespread. Workers who are misclassified face a host of potential problems that tend to surface only when they seek to exercise their rights as legitimate employees. Data from the Internal Revenue Service (IRS) suggest that a significant portion of independent contractors are unaware of their tax obligations. As a result, workers lose out on a significant portion of their expected contributions to Social Security and state and federal governments lose significant tax revenue.[39] It is also likely that misclassified workers are unaware that they are excluded from rights under the FLSA, the OSH Act, the Employee Retirement Income Security Act (ERISA), the Family and Medical Leave Act (FMLA), and the Civil Rights Act of 1964. Even legitimate independent contractors may face confusion as to their status under the law, since different labor laws define independent contractor in different ways.[40]

Tackling the issue of misclassification is challenging because the practice is permitted under current law in certain circumstances. For instance, the IRS code provides a "safe harbor" for employers who misclassify workers as independent contractors, disqualifying employers from penalty for misclassification if this is a common practice in their industry.[41] The complexity of employer-contractor relationships adds to the difficulty of cracking down on employers who deliberately misclassify workers. For instance, as is the case with many of the violations listed in Table 5.2, the practice of misclassification is especially common in nontraditional employment arrangements and small businesses, where the lines of accountability between employees and employers are often obscured. The joint supervision of a contractor by multiple employers, rather than a single employer who takes sole responsibility for its workers, further complicates the problem. Recent attempts to regulate these types of arrangements, including the "hot goods" provision of the FLSA, which authorizes the Department of Labor to seize goods produced under substandard working conditions, have had some success. The intent of this regulation is to hold all employers in a production chain accountable for their labor practices.[42]

GAPS IN LEGAL PROTECTIONS

Millions of Latinos work without the full protection of federal labor laws.[43] Explicit exclusions in the law affect broad segments of the Latino workforce, including the 7.6 million Latino small business employees. Specific occupations, such as domestic workers, are also singled out for exemption, leaving hundreds of thousands of workers exposed to exploitation on the job. The following groups of workers risk working in low-quality jobs because they are not fully covered by the nation's labor protections.

Small business employees. Due to their higher representation as small business employees, Latinos are more likely than Blacks and Whites to be excluded from federal labor laws. In 2007, 36.2% of the Hispanic nonelderly labor force (about 7.6 million Latinos, native-born and foreign-born alike) worked for a firm employing fewer than 25 employees, compared to 29.1% of Whites and 21.4% of Blacks.[44] Minimum establishment size is a common measure of eligibility for coverage under federal labor laws.

For instance, Title VII of the Civil Rights Act only applies to establishments employing 15 workers or more. The FMLA is even narrower, applying only to federal contractors and subcontractors with at least 50 employees working within 75 miles of each other.

While these exemptions are designed to prevent small businesses from experiencing undue burdens in hiring workers, it is also a common practice to deliberately contract out work in order to remain small enough to be exempt from occupational health and safety regulations, antidiscrimination laws, and record-keeping requirements.[45] Multiple layers of contractors also tend to blur the lines of accountability between employer and employee, leaving some workers without any protections under federal labor laws.

Agricultural workers. Another segment of the Latino workforce that is explicitly excluded from legal protections is the 426,000 Latinos who work in agriculture, the majority of whom are immigrants. In 2008, Latinos composed nearly half (45.1%) of miscellaneous agricultural workers, or farmworkers.[46] Legal exclusions of agricultural workers have their roots in the New Deal era, when conservative Southern Democrats in Congress refused to extend the protections of the FLSA to domestic workers and farmworkers, who were predominantly Black.[47] Although the FLSA was amended in 1966 to expand minimum wage requirements to some farmworkers, the law continues to exclude farmworkers from overtime pay provisions and full protections for young workers. Furthermore, many farmworkers, particularly those on small farms, work without any minimum wage requirements. Under the National Labor Relations Act (NLRA), agricultural workers are not protected from employers who retaliate against workers who attempt to organize unions. Many states also exempt agricultural employers from paying workers' compensation.[48]

Domestic/household workers. Approximately 302,000 Latinos, the majority of them foreign-born, are employed in private households, usually as nannies, butlers, gardeners, and caretakers. In fact, Latinos make up 37.5% of domestic workers, which is likely to be an underestimate since many households fail to report employing individuals in their homes.[49] All domestic workers are explicitly excluded from the standards and whistleblower protections of the OSH Act and the NLRA. Despite the stability of the domestic workforce, the FLSA excludes "casual" babysitters and "companions" who care for the sick or elderly, which disadvantages workers whose hours and wages are not properly recorded by their employers. A study of New York City's domestic work industry found that 8% earn below minimum wage, 67% sometimes or never receive overtime pay (despite the fact that about half work overtime), and 33% have experienced abusive treatment by their employers, including verbal and physical abuse. The majority (59%) of workers interviewed were the primary earners for their families.[50]

Undocumented workers. In 2008, an estimated 8.3 million undocumented immigrants worked in the U.S., representing 5.4% of the labor force.[51] In 2009, the Pew Hispanic Center estimated that undocumented workers represent the following shares of these occupation groups:

- Farmworkers (25%)*
- Buildings, grounds keeping, and maintenance (19%)
- Construction (17%)
- Food preparation and service (12%)
- Production (10%)
- Transportation and material moving (7%)

*The National Agricultural Workers Survey estimates that 53% of farmworkers are undocumented. U.S. Department of Labor, Bureau of Labor Statistics, "Figure 1.4 U.S. Employment Eligibility," *National Agricultural Workers Survey*. Washington, DC, 2003, http://www.doleta.gov/agworker/report9/toc.cfm (accessed August 2009).

In 2006, more than 25% of workers in the following occupations were estimated to be undocumented:[52]

- Drywall installers, ceiling tile installers, and tapers
- Construction trade helpers
- Butchers and other meat, poultry, and fish processing workers
- Pressers of textiles, garments, and related materials
- Grounds maintenance workers
- Construction laborers
- Brick masons, block masons, and stonemasons

Although federal laws do not take into account a worker's legal status, recent legal developments have cast a shadow of uncertainty on whether workers with insecure immigration status are conferred the full rights and protections of labor laws. The 2002, the Supreme Court's decision in *Hoffman Plastic Compounds Inc. v. NLRB* denied back pay—virtually the only recourse for illegal employer retaliation under the NLRA and the FLSA—to undocumented workers.[53] Not only has the *Hoffman* decision produced confusion among employers and workers, it has also opened the door to a wave of legal efforts to deny all rights to undocumented workers, including compensation for discrimination and work-related injuries and illnesses. Although the outcomes of the cases have been mixed, the movement to deny certain protections to workers based on immigration status has created a hostile environment for all workers seeking to exercise their rights.[54]

Case Study:

Bosbely, a car wash worker, was fired after reporting dangerous working conditions to OSHA.

Bosbely worked at Vermont Hand Wash for nearly two years as a dryer and detailer. Bosbely and many of his coworkers suffered health effects from using acids and other toxic chemicals without protective gear such as goggles or gloves.

Bosbely reported the dangerous working conditions at the car wash to the California Division of Occupational Safety and Health and answered questions from the press when other workers were afraid to do so. He also joined his coworkers in taking legal action against the owners of the car wash for not paying minimum wage or overtime pay and not allowing workers to take meal and rest breaks.

Bosbely was one of the most outspoken union supporters in the car wash and took great personal risks to try to improve conditions for all workers there. In October 2008, management at Vermont Hand Wash fired Bosbely.

Source: Carwash Workers Organizing Committee, "Meet the Workers," Clean Car Wash Campaign, http://www.cleancarwashla.org/index.cfm?action=cat&categoryID=12d390a7-5282-4de5-b76b-bc6dc4a3b06a (accessed August 2009).

GOVERNMENT OUTREACH AND ENFORCEMENT

Government both assists employees and plays an enforcement role in protecting workers' rights to basic standards of job quality. The evidence is clear that labor law enforcement activities, whether planned or complaint-based, do in fact induce employers to correct violations.[55] Under certain conditions, employers seeking to avoid violations and proactively comply with the law are actually guaranteed protection from penalties for violations discovered by compliance assistance officers. Nevertheless, federal efforts to appropriately target high-risk industries and vulnerable worker populations have been met with significant obstacles. By and large, Latinos have not been well-served by government outreach and enforcement efforts in the workplace.

Insufficient resources for federal outreach and enforcement. The primary barrier to effective outreach and enforcement activities is declining funding for OSHA and the Wage and Hour Division

Case Study:

Guadalupe, a poultry worker, was encouraged by her company to lie to the doctor about her workplace injury. Then she was fired.

Guadalupe worked at the poultry processing plant where she was assigned to cut the breast bone and wings from chickens as they came through the line on hooks. It took a lot of effort to hook and remove the chickens with one hand because they came through the line so fast. The chickens were quite high, and she would have to coordinate up a step stool to reach them. Her arm started to get numb and she had stabbing pains across her chest.

The company sent her to the hospital to have the pains checked out, and the doctor ordered 14 weeks of disability. She was diagnosed with a repetitive motion injury in her elbow and the doctor ordered that she was not supposed to lift more than five pounds. The company's human resources department told her that she could not work with that restriction and that she should go back to the doctor and report that she had no longer had pain. She went back to the doctor, who refused to discharge her. The company fired her.

Now Guadalupe can hardly sleep from the pain—she can not lift her arm. She has trouble caring for her children because she cannot lift them. Without two incomes, her family is having difficulty paying bills.

Source: Guadalupe [last name withheld], interview by Julia A. Dunn, Jr., 2012. Note: Name changed to protect privacy. Similar stories of workplace intimidation and retaliation have been found in studies of poultry workers. See, e.g., Human Rights Watch, Cruelty Behind Bars: Abuses Against Immigrants in Alabama's Private Prisons (2011); Human Rights Watch, Blood, Sweat, and Fear: Workers' Rights in U.S. Meat and Poultry Plants (2005); Human Rights Watch, Cultivating Fear: The Vulnerability of Immigrant Farmworkers in the U.S. to Sexual Violence and Sexual Harassment (2012); Human Rights Watch, Blood, Sweat, and Fear: Workers' Rights in U.S. Meat and Poultry Plants (2005); Human Rights Watch, Cruelty Behind Bars: Abuses Against Immigrants in Alabama's Private Prisons (2011

Conflicts with immigration enforcement activities. Over the past decade, immigration raids at workplaces throughout the country have served as evidence of the elevated presence of the Immigration and Customs Enforcement arm of the U.S. Department of Homeland Security in the workplace. In many cases, these raids have occurred at workplaces where the Department of Labor is conducting investigations of possible labor standards violations. In several cases, raids have disrupted these investigations by removing potential witnesses through the swift detention and prosecution of undocumented workers and, in some cases, U.S. citizens. Among the many consequences of immigration raids is the heightened fear among immigrant workers to report even serious employer violations to the government. In one particularly egregious case, in a raid at Seymour Johnson Air Force Base, Immigration Customs and Enforcement posed as OSHA officials to lure workers to a mandatory "safety meeting," where they arrested 48 workers.[64] Incidents like these breed worker distrust of all government entities and give employers greater leverage to pressure undocumented workers not to complain about violations. Finally, while raids have had a negligible effect on the size of the undocumented population, they have been widely criticized for harming individuals, their families, and their communities.[65]

Inaccessible grievance process. In addition to employer efforts and government intervention, workers themselves play an important role in maintaining a safe and healthy workplace, reporting work-related injuries and illnesses and issuing complaints to the government about violations of the law. Even with adequate information and training, however, significant portions of the Hispanic workforce do not have full access to the complaint-driven process that governs the workplace.

Immigrants in particular may be unfamiliar with the fundamental labor laws regarding wages, benefits, and working conditions.[66] For instance, the underrepresentation of Latinos in workers' compensation claims suggests that workers may view pain or injury as a personal cost of working in a hazardous job rather than a cause for redress.[67] Furthermore, even in cases in which workers successfully contact the Department of Labor, officials report that the quality of complaints—in terms of accuracy and adequate descriptions of the problems—is often lacking.[68]

Workers who are prepared to know what to look for and report violations are more likely to use government resources effectively. However, legal recourse for workers who are victims of unlawful employer retaliation can be an unrealistic option for Latinos with limited access to affordable, culturally and linguistically appropriate legal resources.

Case Study:

Gonzolo, a residential construction worker, was not paid for two months of hard work.

Gonzolo worked for a Minneapolis contractor to remodel a house. He worked six days a week, from 7:00 a.m. until 9:00 p.m., for two months gutting the home, painting it, doing tile work, and laying cement. This is Gonzolo's story:

"My employer kept promising to pay us later. 'I'll pay you tomorrow, Tuesday, Thursday...' I ended up being paid $300 total. He owes me $7,500—that's how much he stole from me.

"I took him to court. On the first court date, my employer didn't show up. He came to the second court date and told the judge that I hadn't worked the hours I claimed. The judge ruled in his favor since I didn't have paperwork to prove my case.

"When you are forced into poverty, you have to get used to it. We've had to buy a little bit less to eat. Can you imagine what it's like to do all this work and come home penniless?

Source: Gonzolo (last name withheld), interview by Ted Smukler, Interfaith Worker Justice, translated by Brian Payne, at Gonzolo's home in Minneapolis, August 2008.

Case Study

Candelario, Armenio, and other foreign workers who are legally present in the U.S. on H-2B visas endure numerous labor violations and offenses to their human dignity while planting trees in our national forests.

Many timber contractors utilize the H-2B temporary worker program to import workers from other countries when they can't find Americans willing to do the work. The occupation involves planting and thinning pine trees on our nation's public lands. The Southern Poverty Law Center has documented thousands of cases of abuse and exploitation of these workers, whom it calls "modern-day indentured servants." The following are direct quotations from these workers:

"[While working in the National Forest], we were forced to camp in the mountains as temperatures approached freezing. There were no sleeping pads, mattresses, or sleeping bags. The only drinking water came from the creek."
– Candelario, H-2B forestry worker

"We worked up to 12 or 13 hours and we could only plant 1,300 or 1,500 seedlings [because of difficult conditions]. Our pay would come out to approximately $25 for a 12-hour workday..."
– Escolastico, H-2B forestry worker

"What happens is the companies do not want to lose time. I cut my thumb while I was planting trees. I wrapped it up and worked two more days until I couldn't work anymore because of the pain. Seven days after the injury, they [the company] finally took me to the doctor because my thumb was infected. I was in the hospital for 14 days and they told me they wanted to cut off my thumb because the infection was so bad."
– Enrique, H-2B forestry worker

"They told me that I should be careful because some people could kill me because of the lawsuit that I have filed against the company..."
– Margarito, H-2B forestry worker

Source: Beneath the Pines: Stories of Migrant Tree Planters (Montgomery, AL: Southern Poverty Law Center, 2006), http://www.splcenter.org/images/dynamic/main/lip_beneaththepines_web.pdf (accessed August 17, 2009).

BARRIERS TO EMPLOYER-SPONSORED BENEFITS COVERAGE

The range of human capital and historical factors discussed above has channeled many Latinos into jobs with wages at or below the poverty level. Given their extremely limited resources, employer-sponsored benefits are vital to helping Latino workers and their families meet basic health care needs, prepare for unforeseen economic strains, and save for retirement. Yet of the nation's 21.8 million Latinos who worked in 2007, only 8.6 million (39.3%) were covered by health insurance sponsored by their employer, and 10.9 million (49.8%) had access to an employer-based retirement plan.[69] The following factors contribute to the pervasive benefits coverage gaps between Latinos and other workers.

Dwindling benefits coverage. The disparities Latinos face in health and retirement coverage through their employers is the most recent chapter in a long-term trend. Hispanic workers lost 23.1 percentage points of employer-sponsored health insurance coverage between 1979 and 2006, compared to a 10.7 point drop for White and Black workers. Similarly, Latinos lost 15.5 points of employer-provided pension coverage over the same time period, compared to a 3.7 point drop for White workers and an 8.3 point drop for Black workers.[70] Dwindling access to basic health and retirement plans also bars many Latinos from employer-based disability insurance, life insurance, and paid leave, which tend to be offered only in conjunction with health insurance and pensions.

Participation gap. As Chapter 3 shows, Latinos are less likely than Blacks and Whites to work for an employer who offers health and retirement benefits to their employees. In addition to the offer gap, the rate of participation in a benefits plan is another important consideration, especially when examining trends in retirement plans. Of Latinos who worked for an employer that offered a pension plan in 2007, only 28.5% participated in the plan, compared to 52.2% of White workers and 43.4% of Black workers.[71] Participation is particularly low among foreign-born Latinos; in 2006, 18.9% of foreign-born, working-age Latinos participated in an employer-sponsored

retirement plan, versus 38.5% of their native-born counterparts.[72] Contrary to conventional explanations for this gap, including income, firm size, and age, low participation persists even among Latinos with the "right" job demographic and job characteristics.[73] The Survey of Income and Program Participation reveals a complex set of reasons explaining why Latinos do not participate in employer-sponsored retirement plans.

Involuntary nonparticipation. In 2006, more than 1.5 million Latino wage and salary workers were ineligible for their employer's retirement plan. Of those excluded, 26.7% had not worked long enough for the employer; 26.5% did not work enough hours, weeks, or months per year; and 14.4% reported that employees in their type of job were simply not offered the plan. These reasons are consistent with those reported by ineligible White and Black workers.[74] One explanation for these barriers to eligibility is that ERISA, the law governing employer-based retirement plans, allows employers to exclude some workers from their plans to qualify for certain tax provisions. Exclusions are usually based on the amount of time an individual has worked for an employer.

Voluntary nonparticipation. Latinos are slightly more likely than other workers to choose not to participate in a pension plan through their employers. A larger share of Latino workers (26.5%) say that lack of affordability is the primary reason they do not participate, compared to 22.7% of Black and 20.6% of White workers. Like all workers, Latinos identify solvency as the second biggest deterrent to putting money in a retirement savings account, saying that they "do not want to tie up money." Third, Latinos are more likely than other workers to say that they "have not thought about" saving for retirement; 10.5% of Hispanics cited this as a reason for nonparticipation.[75] Similarly, a 2003 survey of minority workers found that 43% of Hispanics had "no knowledge" of investing or saving for retirement, compared to 13% of Blacks.[76] Clearly, limited financial knowledge is a factor preventing Latinos from contributing to employer-based retirement plans.

Disparate benefits coverage is made more troublesome by the fact that public safety net programs do not adequately cover Latinos. Although Latino families are nearly 2.5 times more likely than Whites to qualify for Medicaid and the Children's Health Insurance Program (CHIP), federal restrictions enacted in 1996 deny eligibility for these programs to a significant portion of foreign-born Latinos.[77] The unemployment insurance program compensates workers who lose their jobs through no fault of their own, ensuring that workers continue to meet basic family needs during spells of unemployment. However, due to program restrictions regarding work history and income, Latinos receive unemployment insurance benefits at a rate about 25% less than that of other workers.[78]

The Social Security system, to which most workers and employers contribute through payroll taxes, is another public program on which Latinos rely as a source of disability insurance and retirement income. Despite its importance, however, Social Security coverage is unusually low among Latinos; only 76% of Latinos age 65 and older receive Social Security retirement benefits, compared to 89% of the general population age 65 and older.[79]

The greatest obstacle to Social Security coverage is an inaccurate or absent record of lifetime earnings, usually resulting from unreported or underreported wages. Improper wage reporting can lead to reduced retirement benefits or the exclusion from Social Security coverage entirely. Whether accidental or deliberate, improper reporting is most common in low-wage occupations that employ large numbers of Latinos and other minorities, including domestic employees, restaurant workers, and farmworkers. Low-wage independent contractors often do not realize that they have been classified as independent contractors and thus fail to self-report wages, thereby jeopardizing their future eligibility for Social Security coverage.

Endnotes

[1] U.S. Department of Labor, "OSHA Enforcement: Striving for Safe and Healthy Workplaces," Occupational Health and Safety Administration, http://www.osha.gov/dep/enforcement/enforcement_results_07.html (accessed January 2009).

[2] One basic cost of hiring a traditional wage-and-salary employee is the employer's share of the tax burden. Both the employer and the employee are required to split the Federal Insurance Contribution Act (FICA) tax of 15.3%. In cases where personal protective equipment is required on the job, OSHA rules deem employers responsible for purchasing that equipment. U.S. Department of Labor, "Employer Payment for Personal Protective Equipment; Final Rule – 72:64341-64430," OSHA, http://www.osha.gov/pls/oshaweb/owadisp.show_document?p_id=20094&p_table=FEDERAL_REGISTER (accessed January 2008).

[3] *Rebuilding a Good Jobs Economy: A Blueprint for Recovery and Reform* (New York, NY: National Employment Law Project, 2008), http://nelp.3cdn.net/107e65168f65eacd6e_l1m6ibpdr.pdf (accessed November 2008).

[4] U.S. Senate Health, Education, Labor and Pensions Committee, *Discounting Death: OSHA's Failure to Punish Safety Violations That Will Workers*, 110th Cong., 2nd sess., 2008, http://kennedy.senate.gov/imo/media/doc/Worker%20Safety%20Report.pdf (accessed April 2008).

[5] U.S. Senate Health, Education, Labor and Pensions Committee, *Discounting Death*; Alexandra Berzon, "OSHA goes easy: after meeting with employer only, it often reverses findings, cuts fines," *Las Vegas Sun*, March 31, 2008.

[6] In the rare instance that OSHA refers these cases to the Department of Justice (DOJ) for prosecution, DOJ is unlikely to prioritize these low-level cases. David Barstow, "U.S. Rarely Seeks Charges for Deaths in Workplace," *New York Times*, December 22, 2003, http://query.nytimes.com/gst/fullpage.html?res=9C02E3DD103FF931A15751C1A9659C8B63&sec=&spon=&pagewanted=print (accessed April 2008).

[7] Ibid.

[8] Lenore S. Azaroff, Charles Levenstein, and David H. Wegman, "Occupational Injury and Illness Surveillance: Conceptual Filters Explain Underreporting," *American Journal of Public Health* 92 (2002): 1421–1429, http://www.ajph.org/cgi/reprint/92/9/1421.pdf (accessed June 2008).

[9] Ibid.

[10] Ames Alexander, Franco Ordoñez, and Kerry Hall, "Workers question medical care," *Charlotte Observer*, February 12, 2008, http://www.charlotte.com/716/story/490858.html (accessed May 2008).

[11] Restaurant Opportunities Center of New York, *Behind the Kitchen Door: Pervasive Inequality in New York City's Thriving Restaurant Industry* (New York, NY: Restaurant Opportunities Center of New York, 2005).

[12] Committee on Communicating Occupational Safety and Health Information to Spanish-speaking Workers et al., *Safety is Seguridad: A Workshop Summary* (Washington, DC: National Academies Press, 2003), http://books.nap.edu/openbook.php?record_id=10641&page=R1 (accessed January 2008).

[13] Committee on Communicating Occupational Safety and Health Information to Spanish-speaking Workers et al., *Safety is Seguridad*; Liany Elba Arroyo (Director, Institute for Hispanic Health, National Council of La Raza), conversation with the author, February 15, 2008.

[14] Committee on Communicating Occupational Safety and Health Information to Spanish-speaking Workers et al., *Safety is Seguridad*.

[15] Pascale Joassart, "Neighborhoods, mobility and wages: Latina immigrants in Southern California," in *Race and Economic Opportunity in the Twenty-First Century*, ed. Marlene Kim (New York, NY: Routledge, 2007).

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Chapter 6
Rebuilding Job Quality for Latinos and All Workers



As this report has shown, the Latino workforce as a whole faces immense disparities in job quality compared to their peers. Indeed, much consideration and policy debate must be devoted to raising the level of employer-based health and retirement plan coverage among Latinos.[1] Yet by focusing on protecting the wages and the workplace safety of low-wage and immigrant workers, it is possible to take steps to improve job quality for all workers. The following are essential to improving the quality of the jobs Latinos hold:

- **Improve compliance with existing laws. Holding employers accountable for adhering to existing labor laws requires credible deterrents: adequate penalties and empowered workers.**
- **Modernize legal protections to cover marginalized workers. Labor protections must adapt to new realities in order to protect workers in an increasingly complex labor market. Comprehensive immigration reform is central to improving job quality for all workers.**
- **Bolster federal outreach and enforcement. Strong protections for workers rely on adequate backing from the federal government, whose efforts can be strengthened by cooperating with entities at the local level.**

IMPROVE COMPLIANCE WITH EXISTING LAWS

The job quality impasse facing Latino workers could be narrowed significantly if employers simply follow the laws on the books and workers are better prepared to safely assert their rights.

Make the punishment fit the crime for employers who break the law. It is clear from the high frequency of labor law violations that many employers in a handful of American industries treat fines and citations as a cost of doing business rather than as deterrents against breaking the law. Compliance with the Fair Labor Standards Act (FLSA) and the Occupational Health and Safety Act (OSH Act) could be strengthened—especially in low-wage workplaces—by authorizing long-overdue increases in fines for violators. Legal remedies can also be stronger; for instance, the U.S. Department of Labor (DOL) should be allowed to seek additional damages—beyond payment of back wages—in wage and hour cases.[2] In addition to legal penalties, egregious and repeat violators of workplace regulations could also be subject to restrictions. Proven deterrents include stop-work orders or restricted eligibility for government contracts for employers who fail to comply with wage and hour laws or who refuse to carry a workers' compensation plan.[3]

As a tactic for reducing occupational injuries and fatalities, the case for raising the civil and monetary penalties in the occupational health and safety arena is incontrovertible. Quite simply, the penalties must reflect the true costs of breaking the law: workers' lives. An employer whose "willful" violation results in a worker's death should be charged with a felony rather than a misdemeanor. Not only would this stronger penalty be more consequential for employers charged with violating health and safety laws, it would function as a warning to other businesses by increasing the likelihood that prosecutors would take up worker fatality cases.[4] These changes would help to rein in the unacceptably high fatality rates among immigrant Latino workers.

Support community-based organizing structures for nonunionized and nontraditional workers. Throughout its history, the labor movement has enabled workers to organize for positive change in their workplaces by compelling employers to abide by the law and strive to improve job quality. Given the documented benefits to compensation that unionized Latinos experience, it is clear that improving opportunities for Latinos to join unions is an important way to elevate job quality for Latino workers. One essential step toward raising the Hispanic unionization rate is better outreach from unions to Latino and immigrant workers. Additionally, policies to strengthen protections for workers who choose to form unions, such as the "Employee Free Choice Act" (H.R. 1409/S. 560), can help more Latinos organize in the workplace.

These tactics alone will not suffice unless they address the growth of nontraditional employment

structures, which have challenged conventional union organizing. The shift from traditional single-site workplaces with long-term employees to multiple work sites, nontraditional arrangements, and contingent work—all of which are especially common among Hispanic workers—demands new ways of organizing workers. Various strategies have been proposed and tested; some campaigns target workers in specific occupations, such as dressmakers, while others attempt to organize entire production or subcontracting chains, such as the garment industry. Geographically based campaigns, which target low-income neighborhoods, are also gaining popularity.[5] In nearly all of these examples, community-based organizations (CBOs) play a central role. One community-based model that has seen tremendous expansion in recent years is the worker center, which typically serves low-wage, predominantly immigrant workers. In addition to offering a safe place for workers to gather, which is especially vital for day laborers,[6] most worker centers offer a wide range of resources, including worker rights information, worker advocacy activities, health and safety training, English-as-a-second-language classes, and other social services.[7]

It is important to note that while these new organizing models sometimes arise in the absence of unions, a community-based approach does not necessarily exclude union involvement. In fact, the success of such campaigns often depends on funding and support from unions. Unions have an important stake in the outcome of community-based organizing, since workers involved in nontraditional campaigns often go on to become union organizers themselves.[8]

Actively protect all whistleblowers, regardless of immigration status. Widespread violations of workers' rights will persist in Latino- and immigrant-dominated workplaces as long as substantial segments of the workforce are prevented from coming forward with formal complaints. The Department of Labor should allow anonymous complaints from workers as a way of opening up the grievance process to immigrant and other vulnerable workers. The Occupational Safety and Health Administration (OSHA) and the Department of Labor's Wage and Hour Division should be obligated to follow the same steps for pursuing anonymous complaints as they do under the current grievance process.[9]

In addition, federal agencies must send a strong signal to immigrant workers and their employers that the enforcement of immigration laws should never undermine the enforcement of labor laws. In 1998, the Department of Labor and U.S. Immigration and Customs Enforcement (ICE) signed a memorandum of understanding that discourages immigration enforcement activities in workplaces where labor law investigations may be underway.[10] However, recent immigration enforcement raids at workplaces with illegal labor practices have underscored the need to strengthen this agreement.[11] DOL and ICE should publicly reaffirm their commitment to keep their operations separate and bolster oversight of field offices to ensure that this guidance is followed in all communities.

MODERNIZE LEGAL PROTECTIONS TO COVER MARGINALIZED WORKERS

In order to guarantee basic standards of job quality for workers, policymakers must reform the federal worker protection framework. The dual objectives of these changes should be to eliminate outdated *de jure* exclusions and cover workers in emerging employment arrangements.

Correct historical inequities in wage and hour laws. The rampant exploitation of agricultural and domestic workers is no longer hidden from the public eye. Advocates have been active at the state level to achieve modest legal standards to protect domestic workers, and indeed some state laws have more comprehensive coverage than federal laws.[12] However, absent federal reform to the FLSA, court cases in defense of domestic workers have been met with strong resistance.[13] Congress must seriously consider extending reasonable legal protections to domestic workers, especially as the number of workers in this occupation grows.

Strengthening protections for farmworkers is another priority that is long overdue. While the Migrant and Seasonal Agricultural Worker Protection Act (AWPA) applies specifically to agricultural workers and employers, farmworkers continue to labor in some of the worst jobs in the labor market. Legislation that shores up protections for these workers, including the expansion of FLSA and National Labor Relations Act (NLRA) rights to farmworkers, is particularly crucial in the face of lobbying efforts by some agricultural employers to further weaken existing AWPA provisions.[14]

Strengthen policies to protect workers in nontraditional arrangements. As described in the previous section, contractor arrangements allow for various abuses of the current worker protection framework. Several policy interventions could help prevent abuses of contractor arrangements and protect workers in those categories. First, Congress should pass legislation to close the tax loophole that provides a safe harbor for employers who misclassify workers as independent contractors. One model bill from the 110th Congress is the "Employee Misclassification Prevention Act" (S. 3648/H.R. 6111). This bill would require stricter recordkeeping by businesses that employ contractors and higher penalties for those who deliberately misclassify workers. The "hot goods" provision of the FLSA is another important first step toward challenging employer exploitation of contractor arrangements to shield abuses against workers. This model should be thoroughly evaluated and its successful aspects expanded to the service sector. Other forms of multiple employer accountability, such as joint employer arrangements, should also be tested.

Uphold the rights of all workers through comprehensive immigration reform. By any measure, the largest and most vulnerable group of marginalized workers is the undocumented population. Yet immigrants are not the only workers who suffer at the hands of unscrupulous employers. As long as immigrants are prevented from fully exercising their rights in the workplace, and as long as some employers escape punishment for actively subverting workers' complaints, job quality declines for *all* workers.

The first step toward leveling the playing field in the labor market is to fix the nation's broken immigration system. A comprehensive approach to immigration reform, which addresses the source of the problem instead of attacking the symptoms, must deter employers from seeking to hire and exploit undocumented workers. Above all, any reform must legalize the nearly 12 million undocumented individuals in the U.S. Adjusting the legal status of foreign-born workers and increasing avenues for legal entry will help restore balance to the labor market.

The immigration system must also be updated to better respond to labor market pressures, thereby transforming an illegal flow of immigrants into a legal flow. Together with equal protections for incoming workers, these broad guidelines would restore and maintain order in the immigration system as well as uphold the rights of all workers. Although the current economic environment has decreased the need for workers, the demand will return as the economy recovers. Thus, the current environment provides a good opportunity to structure a system that better responds to economic needs while protecting workers. These actions would significantly reduce the size of the undocumented population, thereby freeing up resources to focus enforcement efforts on employers who hire undocumented workers to shield their unlawful labor law practices. Numerous national polls and multiple election cycles have demonstrated that the American public supports these measures as essential elements of reform.[15]

Clearing the path to citizenship for eligible immigrants is another important step toward safeguarding legal immigrants' rights in the workplace. Of course, the acquisition of citizenship is also critical to the full integration of individuals in their local communities. For these reasons, efforts to reform the immigration system must be accompanied by a more streamlined

naturalization process that is accessible to eligible applicants. This requires a stronger commitment from the federal government to integrate immigrants rather than erect more hurdles on the road to citizenship. Specifically, additional funding must be made available for U.S. Citizenship and Immigration Services to reduce the backlog of citizenship applications, lower the naturalization application fee, and establish structured immigrant integration initiatives. More resources must also be made available for community-based delivery of English classes. In addition, the change to the citizenship exam presents the agency and key stakeholders with an opportunity to enhance prospective applicants' knowledge of the naturalization process and prepare them to obtain citizenship through improved outreach in immigrant communities.

Finally, a comprehensive reform package should provide employers with a reliable employment verification system that addresses the problems with the E-Verify system and makes strong investments in the infrastructure on which such a system rests. For example, improving the current E-Verify system would require a tremendous increase in resources for the Social Security Administration (SSA). The Government Accountability Office (GAO) has warned that these measures are critical to ensuring that SSA has the capacity to address existing backlogs, fix data inaccuracies, and handle the estimated 63 million inquiries annually from employers verifying new hires.[16] SSA has estimated that expanding the current E-Verify program to all employers would require SSA to hire 700 new employees between 2009 and 2013.[17] In addition, adequate resources for compliance assistance for employers, as well as enforcement of the program's rules, must accompany any mass adoption of a verification system. Detailed rules to prevent discrimination must include strong protections against national origin discrimination to ensure that lawfully present immigrants and recently naturalized citizens are not disproportionately harmed.

BOLSTER FEDERAL OUTREACH AND ENFORCEMENT

The third strategy to improve job quality for Latinos is to restore government accountability for protecting workers. The Department of Labor must be given adequate funding to assist workers and businesses with compliance and to police rogue employers. However, since no amount of resources will ever enable DOL to monitor every workplace, DOL must be equipped to make smart decisions about where to focus its limited time and attention. Reaching the most vulnerable workers will require DOL to develop creative ways of gathering information from at-risk populations and community-based advocates.

Increase funding for OSHA and Wage and Hour, with special emphasis on hiring bilingual personnel. As noted above, the government agencies responsible for carrying out enforcement and compliance are woefully underfunded. Federal budget allocations for DOL must be restored to adequacy in order to more effectively tackle growing complexities of the labor market. The President's 2010 budget currently requests an additional $228 million devoted to hiring an additional 288 full-time employees dedicated to the enforcement of wage and hour standards.

Within a general funding increase, policymakers should target resources toward hiring and training inspectors who can communicate with workers whose primary language is not English. Bilingual investigators should be required to be present during an investigation in a workplace in which a majority of employees are limited-English-proficient. This will strengthen DOL's ability to uncover cases of exploitation of immigrant and undocumented workers.

Devote at least half of OSHA and Wage and Hour resources to targeting high-risk industries and work arrangements. While increased resources for DOL agencies is critical to improving its enforcement capacity, the sheer volume of OSHA and Wage and Hour caseloads calls for concentrated efforts. These agencies must be prepared to target the "types" of employers—whether by occupation or employment arrangement—who have shown egregious

violation of labor laws. At least 50% of OSHA and Wage and Hour resources should be devoted to planned initial and follow-up inspections in workplaces in high-risk industries.[18] The high-risk industries described earlier in this report, including agriculture, construction, leisure and hospitality, retail trade, and manufacturing, offer a preliminary sketch of the areas of workplaces where OSHA and Wage and Hour Division could target inspections in their annual plans.

Work with community-based observers to identify high-risk workplaces and repeat violators. Maximizing scarce resources to reach workers in the lowest-quality jobs requires DOL to construct an accurate and thorough picture of high-violation workplaces and at-risk workers. However, compliance data based on industry classifications may be too broad for effective targeting of specific tasks, employers, and occupations.[19] Furthermore, as discussed earlier, a host of barriers prevent some workers, especially Latino immigrants and low-wage workers, from filing formal reports of violations.

Community-based organizations could assist DOL in narrowing its focus. As trusted institutions providing education and resources to empower communities, CBOs have a unique "insider" perspective that qualifies them to serve as the voice for underrepresented workers. One possibility is for DOL officers to field complaints from workers off-site, using CBOs as a neutral meeting place for workers who are uninformed of their rights or are fearful of complaining on the job.

Invest in innovative worker outreach and education models. Latinos and other workers in high-risk occupations must be better prepared to identify hazards, avoid injuries, and participate in the reporting process at work. Since contingent work, language barriers, and low levels of literacy can compromise the effectiveness of traditional employer-based training schemes, it is necessary to develop and test new models on a national scale to deliver critical health and safety information to workers who face these barriers.

Many organizations also offer legal services and therefore actively track worker complaints. DOL should be required to formally consult with CBOs before designing their annual outreach and enforcement plans. DOL should also establish a process by which a CBO can issue a complaint on behalf of a worker.

- OSHA has demonstrated some success by hosting health and safety fairs in Hispanic communities to offer trainings on fall protection and electrical safety, among other topics.[20] These events, however, lack continuity and are not readily adaptable to different industries. Community-wide outreach events should be supplemented by specialized outreach campaigns that empower community members to educate their peers in a manner that is comfortable, convenient, and culturally and linguistically appropriate. Such lay health educators, or *promotores de salud*, have successfully raised awareness in Latino communities about other topics, such as diabetes and heart disease.[21] Some community-based groups have applied a similar model in an occupational health and safety context.[22] These pilot efforts warrant additional investment for evaluation and expansion.

Endnotes

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[9] *Rebuilding a Good Jobs Economy*.

[10] *Immigration Enforcement During Labor Disputes* (Los Angeles, CA: National Immigration Law Center, 2007), http://www.nilc.org/immsemplymnt/IWR_Material/Advocate/labordispute_infobrief_2007-04-23.pdf (accessed August 2007).

[11] For example, more than a year after a federal immigration raid detained 389 workers at a meatpacking plant in Postville, Iowa, the state of Iowa is still seeking payment of penalties from the employer, Agriprocessors, Inc., for failure to pay its employees, one of many violations of labor laws levied against the company after the raid occurred. Nigel Duara, "Iowa to cut fines by $9M against slaughterhouse," *Associated Press*, July 27, 2009.

[12] California law, for instance, requires employers to pay live-in domestic workers minimum wage and overtime compensation. Della Bahan and Puja Batra, *Seeking Justice for Trafficked Domestic Workers in American Courts* (Pasadena, CA: Bahan and Associates, 2005), http://www.iwpr.org/PDF/05_Proceedings/Bahan_Della.pdf (accessed October 2008). See also Testimony from Domestic Workers before the New York State Assembly Committee on Labor, *Public Hearing on Domestic Employment Conditions in New York State*, November 21, 2008, http://domesticworkersunited.org/static/testimony (accessed January 2009).

[13] National Women's Law Center, "Supreme Court Rules Minimum Wage, Overtime Protections Don't Apply to Home Care Workers," news release, June 11, 2007, http://www.nwlc.org/details.cfm?id=3059&section=newsroom (accessed September 2008).

[14] Farmworker Justice, "Labor Law and Legislation," http://www.fwjustice.org/Immigration_Labor/Labor%20Law.htm (accessed October 2008).

[15] In one national poll, 57% of respondents favored "a comprehensive approach that secures the border, cracks down on employers who hire illegal immigrants, and requires all illegal immigrants to register and meet certain requirements to become legal" over "we need to secure our border, stop giving taxpayer funded benefits to illegal immigrants, and make sure that those who broke our laws by entering this country illegally are forced to leave." Memorandum, "What the 2008 Elections Mean for the Future of Immigration Reform," January 2009, Frank Sharry, America's Voice, Washington, DC, http://amvoice.3cdn.net/e8ba7ee2f71fca6c6a_xam6i6bvh.pdf.

[16] U.S. House of Representatives Committee on the Judiciary, Subcommittee on Immigration, Citizenship, Refugees, Border Security, and International Law, *Employment Verification: Challenges Exist in Implementing a Mandatory Electronic Employment Verification System*, Statement of Richard Stana, 111th Cong., 2nd sess., 2008, http://www.gao.gov/new.items/d08895t.pdf (accessed June 2008).

[17] Senate Committee on Finance, *Social Security Administration Field Offices: Reduced Workforce Faces Challenges as Baby Boomers Retire*, 111th Cong., 2nd sess., 2008, http://www.gao.gov/new.items/d08737t.pdf (accessed May 2008).

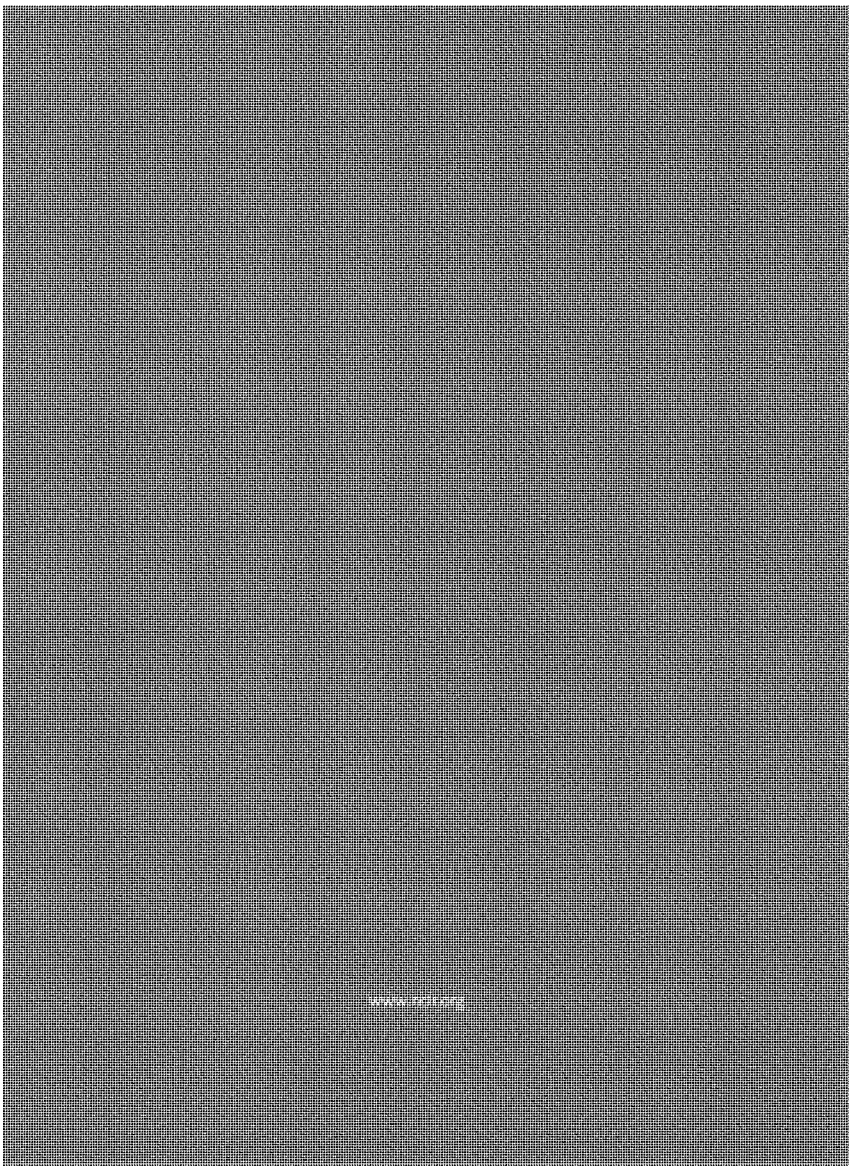
[18] Testimony of Kim Bobo before the U.S. House of Representatives Committee on Education and Labor, *Is the Department of Labor Effectively Enforcing Our Wage and Hour Laws?*, 110th Cong., 2nd sess., 2008, http://edlabor.house.gov/testimony/2008-07-15-KimBobo.pdf (accessed July 2008).

[19] *Safety is Seguridad: A Workshop Summary* (Washington, DC: National Academies Press, 2003), http://books.nap.edu/openbook.php?record_id=10641&page=R1 (accessed January 2008).

[20] U.S. Department of Labor, "OSHA Hispanic Safety in Health Fair in Wichita, Kansas Saves Lives," Occupational Safety and Health Administration, http://www.osha.gov/dcsp/success_stories/compliance_assistance/reg7_hispanic_safety.html (accessed June 2009).

[21] Llany Elba Arroyo, "Assessing a *Promotores de Salud* Approach to Increase Awareness, Knowledge, and Actions Relating to Depression in Hispanic Communities" (Washington, DC: National Council of La Raza, 2006), http://www.nclr.org/content/publications/detail/42651 (accessed September 2007).

[22] For example, see the Poultry Worker Project of the Center for Community Change: http://www.communitychange.org/our-projects/waje/poultry-worker-project/?searchterm=None (accessed September 2008).



NCLR
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July 28, 2009

The Honorable Timothy Geithner
Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Shaun Donovan
Secretary
United States Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

The Honorable Lawrence Summers
Director
National Economic Council
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Secretary Geithner, Secretary Donovan, and Director Summers:

We, the undersigned U.S. Department of Housing and Urban Development (HUD)-approved housing counseling agencies, write to express our concerns about the implementation of the administration's Home Affordable Modification Program (HAMP). Our organizations represent the people and communities hardest hit by the foreclosure crisis, and we have been working on the frontlines to provide assistance to distressed homeowners. We provide to the community at no cost foreclosure prevention counseling sessions, workshops, and home rescue fairs, which bring together attorneys, housing counselors, loan servicers, and other community groups for a day-long event where families can receive free foreclosure prevention advice, information, and resources. Our housing counselors work with families through the entire foreclosure prevention process and beyond to help them regain their financial security. Our agencies are part of the National Council of La Raza (NCLR) Homeownership Network (NHN). NCLR is the largest national Hispanic civil rights and advocacy organization in the United States.

We applaud the administration for its efforts in developing the most comprehensive response to the foreclosure crisis to date. The Making Home Affordable program focuses on long-term solutions for borrowers in distress. NHN counselors have successfully secured trial-period loan modifications for many families under HAMP. However, there are thousands of other families who are stuck in the loan servicing system and have not been able to modify their loans. Many lost their homes to foreclosure while they were in the loan modification process. We appreciate your willingness to work with us to make this program more accessible and efficient. To that

end, we have outlined the challenges that NHN counselors are facing with HAMP and offer recommendations to improve the program.

NHN counselors have identified four main challenges:

- **Homeowners eligible for HAMP are losing their homes to foreclosure.** Many families have lost their home to foreclosure sale and days later received notice that their loan modification has been approved. For those who manage to get a loan modification prior to the foreclosure, they are obligated to pay thousands of dollars in legal fees that have accumulated before they can accept the loan modification. There is no process set up to halt the foreclosure process once homeowners submit their loan modification workout packet.

- **The loss mitigation process is not streamlined or transparent.** NHN counselors must fax client authorization forms and workout packets to servicers multiple times because they are told that the documents have not been received, even though counselors have received confirmation that faxes have gone through. Moreover, NHN counselors must wait 24 to 48 hours after they have submitted the client authorization form to speak with loss mitigation staff on behalf of their client. This process takes much longer when they must repeatedly fax the same documents.

- **The loan servicing industry still lacks capacity.** Despite efforts to increase staff support, there are strong indicators that servicers are still struggling to meet the growing demand for loss mitigation services. It is not uncommon for NHN counselors to wait between three and six months to receive a response from servicers after submitting a loan modification request or a workout packet. We are concerned about the mounting reports of dropped calls and unreturned messages by servicers. These delays can have real consequences.

- **Servicers are not offering loan modifications with principal forgiveness.** Under HAMP, if the interest rate reduction is not enough to make the mortgage payment affordable, then, at minimum, a portion of the principal will be placed at the end of the loan as a balloon to be paid when the house is sold or the mortgage is paid off. HAMP regulations encourage servicers to forgive principal but most servicers are not. NHN counselors have not had any servicer offer a loan modification with principal forgiveness under the HAMP program.

Given these difficulties, we offer the following recommendations:

- **Prohibit foreclosure during loss mitigation.** Due to the bottleneck of cases in the loss mitigation system, too many borrowers are slipping through the cracks. Servicers and investors should be prohibited from moving forward on a foreclosure while the case makes its way through the company's own loss mitigation system. Practically speaking, this means that the servicer would be prohibited from moving a case to its internal legal

department once a borrower submits a loan workout package to the loss mitigation department. This will improve the borrower's chances of understanding all workout options before excessive legal fees pile up or foreclosure proceedings begin.

- **Require servicers to implement a streamlined and transparent loss mitigation process.** Servicers should be required to accept an electronic version of client authorization forms and workout packets. Once the client authorization form and workout packet have been submitted, a loss mitigation staff person should be assigned to work on the loan modification and a hard copy or electronic letter should be sent to the borrower and housing counselor indicating that the workout packet is being reviewed. Leaving borrowers in the dark about their loan modification request increases stress on the family, the likelihood that they will abandon their home, and the chances that they will be lured in by a foreclosure rescue scam artist.

- **Encourage services to offer loan modifications with principal forgiveness.** Given the slow increase in property values and inflated home appraisals, many homeowners will have a difficult time building home equity, which could have provided for a secure retirement, higher education for their children, or savings for a financial emergency.

- **Offer short-term forbearance and rent-to-own options for borrowers who are temporarily unemployed or underemployed.** Borrowers who are temporarily unemployed or underemployed are not eligible for HAMP. A six- to nine-month forbearance or a rent-to-own option will give many families an opportunity to secure a job and resume paying their monthly mortgage payments. Having an owner-occupied home will also help stabilize home values in communities.

- **Urge servicers to create partnerships with HUD-approved housing counseling agencies and provide funding to support their foreclosure prevention services.** Families turn to our trusted community-based organizations for assistance. Housing counseling agencies work closely with borrowers through the entire loss mitigation process. Our organizations are struggling to provide services to all families in need. Unfortunately, many do not know about the free services available and are lured in by foreclosure rescue scams.

Again, we appreciate your willingness to work with us and we are available if you would like to discuss these issues in more detail. Should you have any questions, please contact Graciela Aponte, Legislative Analyst, Wealth-Building Policy Project, National Council of La Raza, at (202) 776-1578 or gaponte@nclr.org.

Sincerely,

Avenida Guadalupe Association, Inc., San Antonio, Texas
Community Housing Resources of Arizona, Phoenix, Arizona
Community Services of Nevada, Las Vegas, Nevada

Cuban American National Council, Inc, Miami, Florida
Dalton-Whitfield Community Development Corporation, Dalton, Georgia
Del Norte Neighborhood Development Corporation, Denver, Colorado
East LA Community Corporation, Los Angeles, CA
Economic Opportunity Agency of Washington County, Springdale, Arizona
El Centro, Inc., Kansas City, Kansas
El Concilio Community Center, Modesto California
Hacienda CDC, Portland, Oregon
HBC Services, Inc., West Allis, Wisconsin
Hispanic Committee of Virginia, Falls Church, Virginia
Housing For Nevada, Inc., Las Vegas, Nevada
Housing Our Communities, Inc., Mesa, Arizona
Housing & Education Alliance, Tampa, Florida
La Fuerza Unida, Inc., Glen Cove, New York
Lawrence Community Works, Inc., Lawrence, Massachusetts
Montebello Housing Development Corporation, Montebello, California
Neighborhood Christian Legal Clinic, Indianapolis, Indiana
New Economics for Women, Los Angeles, California
Self-Help Enterprises, Visalia, California
Southwest Housing Solutions, Detroit, Michigan
Southwest Key Programs, Austin, Texas
Spanish American Committee, Cleveland, Ohio
Spanish Coalition for Housing, Chicago, Illinois
Tejano Center for Community Concerns, Houston, Texas
The Resurrection Project, Chicago, Illinois
United Community Center, Milwaukee, Wisconsin
Visionary Home Builders, Stockton, CA
YWCA El Paso del Norte Region, El Paso, Texas

The 2009 MetLife Study of the American Dream

MetLife®



Rebooting the American Dream.
Shifted. Altered. Not Deleted.

THE 2009 METLIFE STUDY OF THE AMERICAN DREAM

STUDY OBJECTIVES

More than two years ago MetLife commissioned the first groundbreaking *Study of the American Dream* to determine how the U.S. public's perception of the American dream had been impacted by the erosion of corporate and social safety nets. The study uncovered that Americans were struggling with increased financial obligations and that the "financial burden shift" had profound implications for the American dream. Where previous generations had generally defined the American dream as a combination of homeownership, a good family life and a degree of financial security, the initial *MetLife Study of the American Dream* found that the dream had shifted — to an almost singular focus on financial security.

With the inaugural study, MetLife was one of the first to uncover and assess the impact of the financial burden shift — the debate about the future viability of government programs such as Social Security and Medicare, declining pensions, the growing affordability crisis, and, at the time, the recent corporate and government scandals — a shift that continues to have a profound impact on nearly all Americans. MetLife's first study also explained the changing definition of the dream. As it became harder and harder to achieve — due to the financial burden shift, the need for Americans to work harder than ever just to get by and increased pressures to consume more and better products and services — the definition of the dream was no longer a hard and fast destination, it was now seen as a never-ending chase.

The study was conducted again in early 2008 amid a historic presidential campaign, just as the first cracks were beginning to show in the U.S. economy. By that time, the public's view of the economy had already darkened considerably driven by high energy prices and falling home values. However, Americans remained optimistic with the majority expecting their own personal financial situation to be about the same — or even better — than it was one year earlier. So while we found the American dream to he alive last year — propped up by Americans' characteristic optimism — we did not necessarily find it alive and well.

Now in its third year, the *2009 MetLife Study of the American Dream* finds that the dream has once again been revised — possibly to a greater extent than could have been imagined just one year ago. The tectonic shifts that will be described on the following pages would typically be expected to span decades. Yet, as this year's study reveals, the country has experienced major changes that will likely have a lasting impact on how Americans achieve and sustain the dream.

EXECUTIVE SUMMARY

The *2009 MetLife Study of the American Dream* finds the dream very much alive. Over the past twelve months, the American dream has been shifted and altered...but it hasn't been deleted. Roughly one-third of Americans believe they have already achieved the dream, down only slightly from one year ago. For those still in pursuit, however, the quest to reach their destination has become more difficult. And for those Americans who believe they have reached the dream, many are worried about backsliding. No longer the permanent destination it once was, being able to sustain the dream is becoming as important as achieving it in the first place.

The Bar Stops Rising

The inaugural MetLife study revealed that there was an insatiable hunger for—and a persistent pressure to buy—more and better material possessions. The bar for "basic necessities" was continually rising. But this year, for the first time, there is evidence that the bar is holding steady. Nearly half (47%) of all consumers—and 66% of those born before 1946—say they already have all the possessions they need, up from 34% in November 2006. Four in ten Americans are even feeling "buyers' remorse" about past purchases—wishing they had spent less and saved more over the years. Freed from pressures today to "keep up with the Joneses," some Americans may have seen the economic crisis as "permission" to change their behavior. Today, for many Americans, keeping up with the Joneses has been replaced broadly by an acutely felt need to keep up with the mortgage payment, the car loan and credit card statements.

American Dream Revised Not Reversed

Against the backdrop of more contained consumerism, the very nature of the American dream has shifted. While the inaugural MetLife study first characterized the dream as a never-ending chase, today's dream is much more closely aligned with the traditional view of the dream of previous generations.

Revised—and potentially even on pause—but not reversed, the American dream is now buoyed by American pragmatism rather than consumerism as Americans begin to re-evaluate their priorities. Still defined first and foremost by financial security, the dream now includes a much greater emphasis on personal relationships—family, children and marriage. Echoing this movement toward hearth and home, 44% of Americans report that they are placing greater importance on personal life and family rather than finances.

For most Americans, the dream remains a viable destination, but not one that has to be reached immediately. In fact, for some the "pause button" has been hit until 2010—or beyond.

A Wake-Up Call

Across generations, the economic crisis has been a loud wake-up call for consumers. Economic concerns that arose in 2007—e.g., savings, job security, retirement shortfalls—have expanded dramatically over the past 12 months; cracks in the foundation of the American dream have worsened considerably. Concerns about the health of the American economy, inadequate personal safety nets and the erosion of corporate and social safety nets have left major portions of the American public—across all socio- and economic-demographics—exposed to financial hardship (possibly even ruin) on a scale not seen in most Americans' lifetimes.

[redacted]

In response to economic conditions — and in light of the dream's shifting definition and greatly reduced consumerism — Americans report that they are eating at home more often, shopping more at big box discount stores, spending less on movies and moving away from brand-name products to generics. While some of these adjustments may be short-lived, others may have lasting effects, signaling a long-term change in both consumption and the dream.

On a personal level, roughly two-thirds of Americans surveyed for the study feel more stress about their own financial situation than they did one year ago. Now, 55% believe their finances are heading in the right direction, down from 61% in November 2006. Unlike previous downturns, no one — no social, political, generational, economic or racial group — is immune. While some differences in concern exist among generational cohorts, ethnic groups and income levels, what is most notable about the current financial crisis is its scale and scope. Even the mass affluent (defined in this study as those making $100,000+ in income per year) are feeling the squeeze. More than half of mass affluent Americans are worried about losing their job over the next 12 months — and 53% say they are concerned about having to file for bankruptcy in the event of a job loss.

Work is the Linchpin Holding the Dream Together

Despite consumer behavioral and attitudinal shifts, Americans remain precariously close to the financial edge. With the erosion of public safety nets, tightening credit and declining home values, more than half (56%) are concerned about losing their job in the next year as a result of the current economic situation. For many Americans, a job loss could have dire consequences since they have little financial cushioning to survive a job loss. A startling 50% of Americans surveyed say they could only meet their financial obligations for one month if they were to lose their job, and the majority believe they are already working as hard or harder than ever just to get by.

The looming threat of job loss is giving way to an overall sense that most Americans are simply trying to get by in the current economy. While *job mobility* had been seen as a means to achieving greater financial compensation and career growth, *job stability* is now a primary concern for many Americans. The dream is shifting to accommodate the desire to end 2009 financially solvent, with jobs and homes intact.

In this environment, work (and the paycheck and benefits associated with it) are propping up the dream. A startling 59% of Americans say they would be somewhat or very concerned about having to file for bankruptcy if they were to lose their job. This concern cuts across all generations and income levels, with 53% of mass affluent Americans identifying themselves as at risk if they were to lose their job.

Survey results show such concerns are well founded. Nearly three-quarters of Americans have been touched in some way by unemployment over the last year. Nearly two in ten report having lost their own job, and an additional 55% have a friend, relative or neighbor who has lost theirs as a result of the financial crisis.

Flying Without a Safety Net

With concern about job loss affecting the masses, Americans are putting a high premium on protection and stability—signaling a major change in the way that Americans think about creating and protecting their financial future. Across generations, 81% say having a personal safety net will be more important this year than last. They believe that a safety net should include a mix of protection and savings products. Those who report that they have a safety net say that it includes not only cash on hand, but also products such as health and life insurance, auto and homeowners' insurance and retirement savings. But for the majority without a safety net, nearly two-thirds say they first need to build up a cash reserve. They are also craving stable investments and savings products with predictable returns. Eight in ten Americans say they are now more concerned with guarantees and stability than they are with returns.

A New Generational Cluster: GenFleX

Particularly vulnerable—and largely flying without a safety net—are Generations X and Y, born between 1965–1978 and 1979–1991, respectively. While nearly three-quarters of the public worries that their safety net is inadequate, the percentage rises to 81% for GenXers and 80% for Generation Y. These two demographic groups have been particularly hard hit by job loss, yet they remain optimistic about their long-term ability to achieve the dream.

Central to their optimism is a sense of self-reliance and flexibility. These two generations—which we refer to collectively as Generation FleX—believe they will achieve the dream without help from the government. They have redefined the dream to focus more squarely on home and hearth, and they are the groups most likely to believe that they "control whether [they] achieve the dream more than external factors."

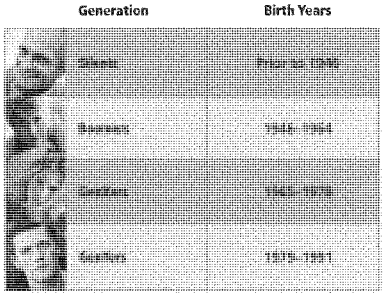
A Healthier Dream?

Many of the behavioral changes exhibited by respondents in the *2009 MetLife Study of the American Dream* may be rooted in economic necessity. For example, insatiable consumerism is clearly on the wane... at least in the short-run. It is not yet clear whether the shifts detailed in the pages that follow represent a permanent return to the values that were traditionally thought to comprise the American dream or a short-term speed bump en route to the vision of the dream articulated by the first *MetLife Study of the American Dream*. What is clear is that the definition of the dream has shifted significantly over the past 12 months—and that the public is in the midst of redefining what success and meaning look like in America.

MAJOR FINDINGS

I. AMERICAN DREAM REVISED, NEW CONCEPT OF BACKSLIDING EMERGES

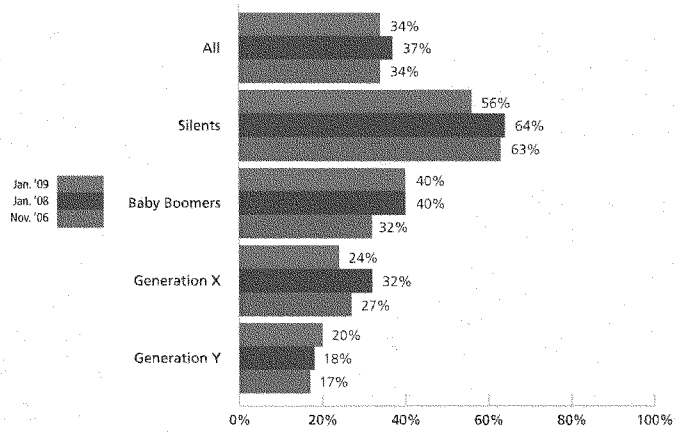
In the midst of the economic crisis, Americans remain optimistic about their long-term ability to achieve the American dream. Roughly one-third of Americans (34%) believe that they have already achieved the dream—down only slightly from 37% one year ago—and 72% believe they can achieve the American dream in their lifetime. However, nearly half (49%) are worried about their ability to sustain the dream, highlighting fears of "backsliding."



For certain generations—most notably the Silents (born prior to 1946) and Generation X (1965–1978)—the downturn has had a particularly strong impact, with the percentage of individuals saying that they have achieved the American dream falling by 8 points among Silents and 8 points among GenXers over the past 12 months.

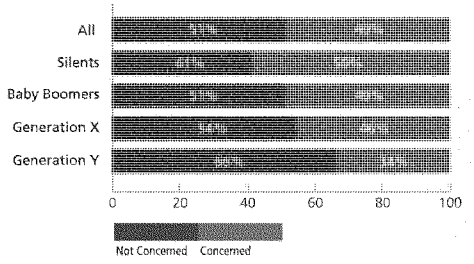
Achievement of the American Dream Holding Steady

Do you think that you have achieved the "American dream?"
% Say Yes



Sustaining the American Dream: Half Worried About Backsliding

IF HAVE ACHIEVED: Are you worried about not being able to sustain the "American dream?"



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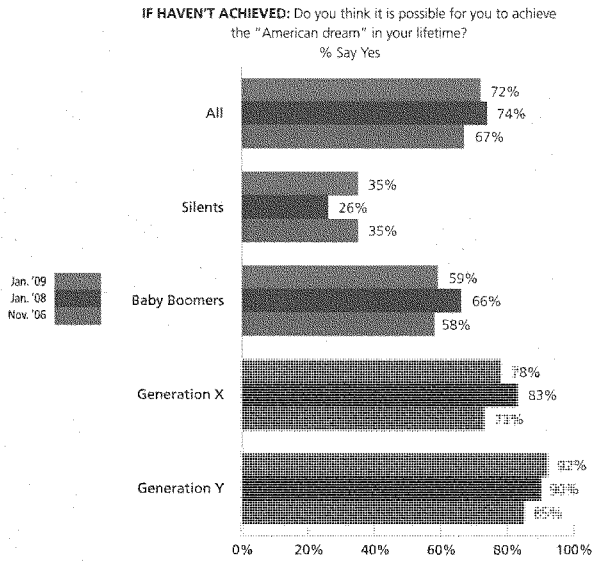
Across all generations, more than eight in ten (83%) of the individuals surveyed by MetLife agree that the "U.S. still offers the greatest opportunities in the world for people of all backgrounds to achieve success and happiness." And nearly three in four (72%) still believe that they will achieve the American dream in their lifetime, up from 67% in November 2006. Hope remains particularly strong among Generation Y, 92% of who believe the dream is well within their reach.

The Dream is Still Alive, Even if Deferred



The American Dream Redux?

This hope appears to be fueled in part by Americans' ability to adjust—and perhaps reinvent—their definition of the dream. As credit remains in short supply and investments deteriorate, Americans have replaced (at least temporarily) their desire for a better financial future with the pragmatic goal of staying fiscally afloat and focusing on relationships with family and friends. They have also revised their definition of the dream to focus less on external factors (e.g., stock market, home equity) and more on personal relationships such as family, children and marriage. While 66% of Americans still define the dream first and foremost as "financial security," more than half (56%) now say their definition includes "family and children," up from 47% just one year ago. The greatest percentage increase has been among Boomers, 53% of whom now include family and children in their definition of the dream, up from 37% just 12 months earlier. Marriage also figures more centrally in the dream; 27% of Americans now identify marriage as synonymous with the dream, up from 17% just one year ago. Generation Y, in particular, sees marriage as a prerequisite, with 32% of young Americans now defining the dream in terms of wedlock—a definition more closely aligned with what one might think of as their grandparents' worldview than with the explosive consumerism of the recent past.

A New Dream Emerging?
Significant Shifts in the Definition of the Dream

	All			Silents			Boomers			GenX			GenY		
What does the "American dream" mean to you today? Please select your top 3 choices.	Jan. '09 %	Jan. '08 %	Nov. '06 %	Jan. '09 %	Jan. '08 %	Nov. '06 %	Jan. '09 %	Jan. '08 %	Nov. '06 %	Jan. '09 %	Jan. '08 %	Nov. '06 %	Jan. '09 %	Jan. '08 %	Nov. '06 %
Financial security	66	62	59	64	60	55	67	64	60	68	64	64	61	55	54
▲ Family/children	56 ◀	47	42	50	54	35	53 ◀	37	41	62 ◀	54	43	59 ◀	48	51
Free from want, my basic needs are met	45	42	43	53	50	38	51	47	47	40	38	43	35	31	38
Comfortable retirement	38	35	31	62 ◀	49	55	45	45	34	29	27	24	21	18	13
Home ownership	35	35	31	26	33	28	35	34	38	38	37	38	39	37	34
Successful career	29	27	28	15	7	10	21	22	23	32	25	28	50	55	52
▲ Marriage	27 ◀	17	21	26	17	22	23 ◀	15	17	27 ◀	18	22	32 ◀	19	26
Others	3	5	4	3	2	5	5	6	4	4	4	3	2	5	3

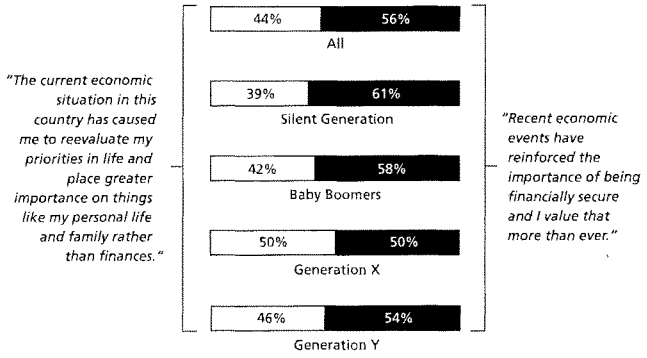
◀ Notable increase

[redacted]

Echoing this shift toward hearth and home, 44% of Americans — and 50% of GenXers — report that "the current economic situation in this country has caused [them] to reevaluate [their] priorities in life and place greater importance on things like personal life and family rather than finances."

Crisis Causing a Reevaluation of Priorities

Which is closer to your view?



II. AMERICANS REEVALUATE PRIORITIES: THE BAR STOPS RISING, CONSUMERS SLOW SPENDING

In response to economic conditions — and in light of the dream's shifting definition — Americans are making significant lifestyle changes. Most are eating at home more often, with 66% of all consumers — and 71% of GenXers — reporting fewer restaurant meals. Many Americans also report shopping more economically, with 39% transitioning to big-box stores and 50% shifting from brand-name products to generics. However, it remains to be seen whether this movement away from consumerism is a stopgap in response to the current economic climate, or if it is a true shift in the value-set of Americans today.

Charity Begins at Home

Beyond changes in consumption patterns, Americans are devoting significant energy to self-improvement. More than half of the individuals surveyed (59%), for example, say they are spending more time thinking about personal life goals. And, an additional 38% report a greater focus on healthy living — i.e., they are sleeping well, exercising and monitoring their diet more carefully. Nearly half (44%) are also spending more hours with friends and family.

The Public Is Making Adjustments — What They Are Doing More Often

	All		Silents		Boomers		GenX		GenY	
(Percentages)	More often	Less often	More often	Less often	More often	Less often	More often	Less often	More often	Less often
Eating at home	66	5	61	2	65	5	71	4	64	9
Thinking about my personal life goals	59	7	37	10	58	5	66	6	68	9
Spending time online	54	7	45	3	55	4	58	8	55	14
Watching movies at home	52	10	37	10	51	7	58	8	58	14
Buying generic rather than brand name products	50	8	45	7	52	5	54	8	47	14
Spending time with friends and family	44	14	42	7	42	13	47	16	48	19
Shopping at big box stores like Wal-Mart or K-Mart	39	14	32	10	37	15	44	11	43	19
Living healthy (getting enough sleep, exercising, eating well, etc.)	38	20	41	8	34	19	39	22	40	28
Buying environmentally-friendly or green products	35	15	38	9	37	14	34	17	32	21

Net More

[redacted]

Counter to conventional wisdom, there is scant evidence that the current economic climate has resulted in more Americans turning to religion to fill the void. In fact, while religious attendance has increased for older Americans — 17% say they are attending religious services more often — this is offset by 22% of Generation X and 33% of Generation Y attending religious services less often than they did in the past.

Also on the decline is a broad notion of community; nearly one-quarter of Americans (23%) are spending less time in their communities. Cash flow concerns have also meant a significant rollback in charitable giving, with 40% saying they are donating to charity less often.

Unlike years past, when religion, community and charity factored into the achievement of the dream, the current dream is focused squarely on self/family. What remains to be seen is whether this shift in attitude will prevail over the long term, or if it is a matter of individuals righting their own ship before they feel able to help their neighbor.

The Public Is Making Adjustments — What They Are Doing Less Often

	All		Silents		Boomers		GenX		GenY	
(Percentages)	More often	Less often	More often	Less often	More often	Less often	More often	Less often	More often	Less often
Spending time in my community	19	23	19	13	20	20	18	24	20	35
Attending religious services	17	19	21	8	16	15	17	22	17	31
Giving to charity	11	40	11	35	9	41	11	40	16	43
Eating at fast food restaurants	7	58	5	44	4	61	6	60	12	60
Going to the movies	5	57	3	48	3	57	5	61	10	59
Going on vacations	5	59	3	50	4	61	6	61	7	59
Dining out at nice restaurants	3	67	1	59	1	70	4	71	8	66

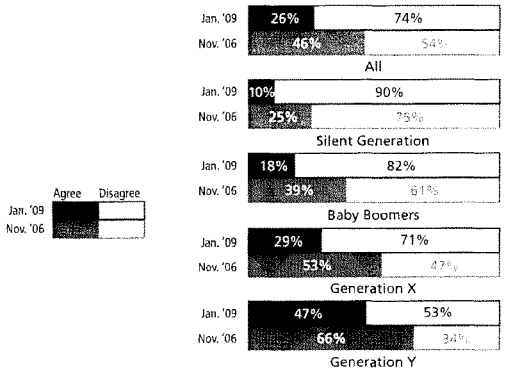
Net Less

Consumerism on the Wane

While some of these adjustments may be short lived, others may have lasting effects, signaling a long-term change in the American dream. In 2007, MetLife first identified that the quest for the dream was marked by an insatiable hunger for material goods. In this year's study, however, there is evidence that this hunger is dissipating. For the first time, only 26% of Americans believe that "the pressure to buy more and better material possessions is greater than ever," down from 46% in November 2006. Similarly fewer Americans feel the bar for necessities is rising, with 47% of all consumers—and 66% of Silents—saying they already have all of the possessions they need, up from 35% among all consumers in 2008 and 34% among all consumers in November 2006. Keeping up with the Joneses may have finally given way to the reality of keeping up with monthly bills.

Less Pressure to Keep Up With the Joneses

How much do you agree or disagree with the following statement:
"The pressure I feel to buy more and better material possessions is greater than ever"?



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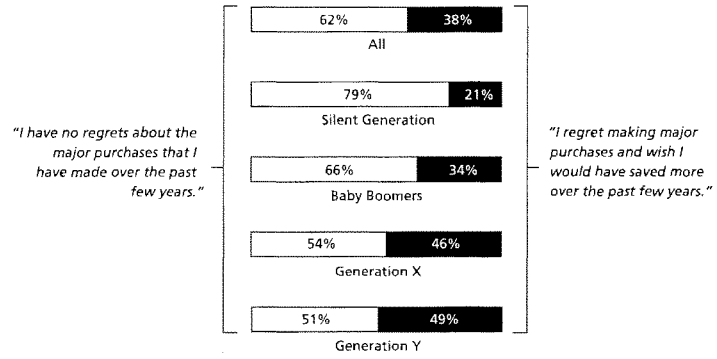
Across generations, the current economic crisis has been a loud wake-up call for consumers—and for none louder than GenXers. While 68% of consumers admit that the economic situation has "changed how I think and act when it comes to personal finances," the percentage increases to 72% for GenXers. Nearly six in ten (59%) Americans—and 61% of GenXers—say they have already started saving more and spending less, and an additional 34% plan to take this step.

Increased savings, together with newfound spending restraint, may be fueling Americans' sense of personal financial optimism. Consumer spending fell by 1% in December 2008 and personal spending only rose 3.6% in 2008, its smallest gain since 1961 (*America's New Frugality*, by David Serchuk, Forbes.com, February 17, 2009). With the ability to curtail spending and redefine success, many Americans feel hopeful about the future and optimistic about their long-term ability to achieve the dream.

High Level of Buyer's Remorse Among Younger Generations

Which of the following is closer to your view?



While some of these attitudinal changes are rooted in economic necessity, American consumerism is clearly on the wane—at least in the short run. Americans still view material goods such as a car, washer/dryer and residential Internet access as necessities. Yet some discretional purchases have been recalibrated in consumers' minds. More than eight in ten (81%) Americans now view vacations as a luxury, up from 73% in 2006. Similarly 91% see eating out as a luxury, up from 87% in 2006.

Recalibrating Perceptions of Necessities and Luxuries

	Please categorize each of the following things as either a necessity or a luxury for you personally. Showing % Saying Necessity	All		Silents		Boomers		GenX		GenY	
		2009	2006	2009	2006	2009	2006	2009	2006	2009	2006
Necessities	One car	93	92	93	97	95	92	92	92	90	90
	One house	88	88	87	95	89	86	89	89	87	85
	A washer and dryer	86	82	90	87	85	81	85	83	84	77
	Internet access at home	75	69	75	71	74	69	74	67	75	74
	A television	73	73	82	82	77	73	68	70	65	70
	A cell phone	62	54	54	50	55	46	66	58	75	68
Luxuries	Cable TV	42	42	54	51	41	40	39	41	36	39
	A dishwasher	32	33	42	40	28	29	31	32	33	35
	More than one car	26	28	17	23	29	31	28	34	24	22
	Vacations	19	27	22	34	18	26	19	28	17	20
	Eating out regularly	9	13	11	14	7	10	7	16	13	11
	An mp3 player (such as an iPod)	8	6	2	1	5	4	7	11	17	8
	A high definition or plasma screen television	8	6	8	4	8	5	9	10	8	4
	A PDA such as a PalmPilot, Blackberry or iPhone	7	6	4	3	5	6	9	10	11	5
	More than one house	1	3	2	1	1	2	1	5	1	5

[redacted]

It's not yet clear whether these shifts represent a permanent return to the more traditional view of the American dream or a short-lived speed-hump en route to the more consumerist view of the dream seen in the last couple of years. Longer term, will consumerism reemerge from the dust of the recent financial implosion? What is clear is that the definition of the dream has shifted significantly over the past 12 months — and that the public is in the midst of redefining what success and meaning look like in America.

Fundamental to this redefinition is renewed appreciation of financial sacrifice. Nearly nine in ten (89%) Americans — and 94% of Silents — believe that earlier generations made much greater sacrifices than young Americans today. This appreciation of sacrifice — combined with slowing pressure to keep up with the Joneses — has potentially profound implications for how the public defines and approaches the American dream.

Americans Place a Renewed Premium on Trust

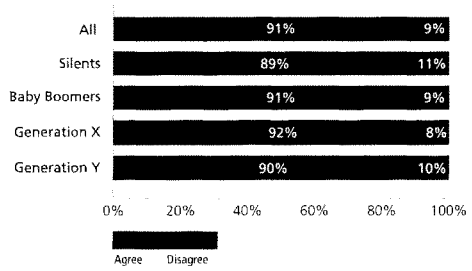
In keeping with consumers' new appetite for security comes greater demand for predictable returns and guarantees. Eight in ten (80%) of those surveyed report that they are now more concerned with guarantees and stability than they are with returns; among Silents and Boomers, the percentages opting for stability over returns climbs to 91% and 84% respectively. While only 17% of Americans have already rehalanced their investment portfolios to reflect heightened appetite for stability, an additional 33% plan to take this step as a result of the financial crisis.

The reputation of financial services organizations — like guarantees — is increasingly important to Americans as they build and/or reinforce their safety nets. More than nine in ten (91%) Americans agree with the statement "It is more important than ever to understand the financial health of the companies I do business with or am considering doing business with," including 51% who strongly agree.

Despite budgetary pressures, 68% of Americans say they are generally willing to pay more for financial and protection products if they come from a company they trust. Two in ten (20%) Americans strongly support the idea of a "trust premium"; an additional 48% support it somewhat.

The New Trust Premium

Please indicate how strongly you agree or disagree with the following statement: "It's more important than ever to understand the financial health of the companies I do business with or am considering doing business with."



III. WORK IS THE LINCHPIN HOLDING THE DREAM TOGETHER

Many Employees Are Just Two Paychecks Away from Serious Financial Hardship

With the number of Americans collecting unemployment benefits in early February 2009 at its highest rate since 1982 (Source: U.S. Department of Labor), few have cash reserves on hand to cover monthly expenses in the event of a job loss. Equally few have an adequate safety net to cover lost income or household emergencies. In this environment, work — and the paycheck and benefits associated with it — is propping up the American dream.

The fear of job loss by 56% of Americans, combined with the fact that many believe that they are working harder than ever simply to get by, is having a significant impact on how Americans view the dream. In the past, job mobility was key to maintaining (or strengthening) income to meet consistently rising basic needs. Most Americans believed they would change jobs more times in their life than their parents did. Today, job stability is the key.

With the erosion of social and corporate safety nets, tightening credit and declining home equity, most Americans have little financial cushioning to survive a job loss. Without a steady paycheck, 50% of Americans say they could not meet their financial obligations for more than a month — and, of that, a disturbing 28% couldn't support themselves for more than two weeks of unemployment.

Half Could Not Meet Financial Obligations

IF EMPLOYED: *If you were to lose your job, for how long could you afford to be out of work and still meet your financial obligations including monthly expenses?*	All	Silents	Boomers	GenX	GenY
Less than 2 weeks	28	11	25	31	32
2 weeks to a month	22	17	21	21	27
2 to 3 months	22	23	24	19	22
4 to 6 months	14	15	11	17	12
7 months to a year	5	7	5	6	2
More than a year	10	27	14	5	6

While all generations are worried about job loss, Generations X and Y — the youngest workers and the least likely to have accumulated cash reserves — are the most anxious. Roughly six in ten GenXers (58%) and GenYers (60%) are concerned about losing their jobs over the next 12 months as result of the downturn, compared with 52% of Boomers and 45% of Silents. Minority employees are also feeling higher-than-average levels of concern, with 63% of African Americans and 68% of both Hispanic and Asian Americans expressing anxiety.

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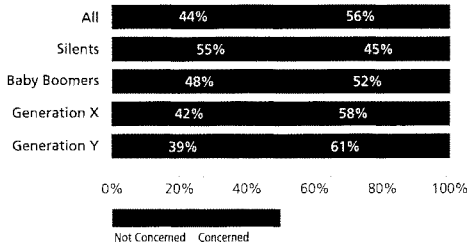
Concerns About Job Loss Are Pervasive

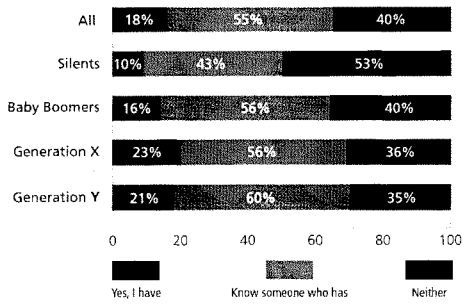
IF EMPLOYED: Are you or are you not concerned about losing your job in the next year as a result of the current economic situation?



Survey results show that such concerns are well founded. Nearly three-fourths (73%) of Americans across all demographic groups have been touched in some way by unemployment over the past year. Nearly two in ten (18%) of those surveyed report that they have lost their own job as a result of the current economic situation. An additional 55% know someone (a friend or family member) who has become unemployed. Generations X and Y have been hardest hit, with 23% of GenXers and 21% of GenYers having lost a job themselves as a result of the current economic crisis.

Unemployment Already Touching Half of Americans

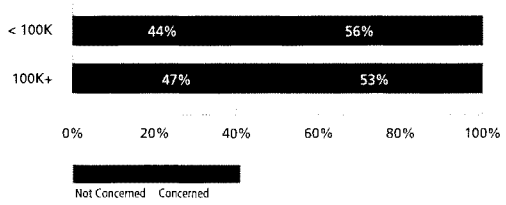
Have you or have any friend(s) or family members lost their job as a result of the current economic situation in this country?
MULTIPLE RESPONSES PERMITTED



Still, nobody is immune. Americans of all generations — and all income levels — are worried and vulnerable. Among the mass affluent (i.e., those making $100,000+ in income per year), more than half (53%) are worried about losing their job over the next year. And, although a disproportionately high percentage of mass affluent Americans believe they have already achieved the dream (50% vs. 32%), more than four in ten (42%) are concerned that they will not be able to sustain it.

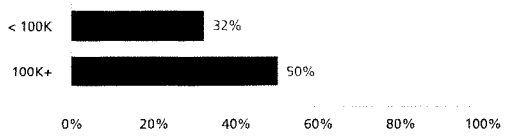
Affluents Not Immune to the Economic Crisis

IF EMPLOYED: Are you or are you not concerned about losing your job in the next year as a result of the current economic situation?

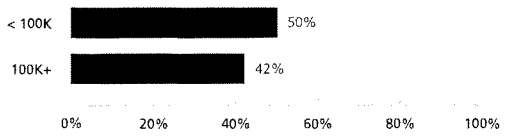


Affluents More Likely to Have Achieved the Dream

Do you think that you have achieved the "American dream?"
% Say Yes



IF ACHIEVED THE DREAM: Are you worried about not being able to sustain the "American dream?"
% Say Yes



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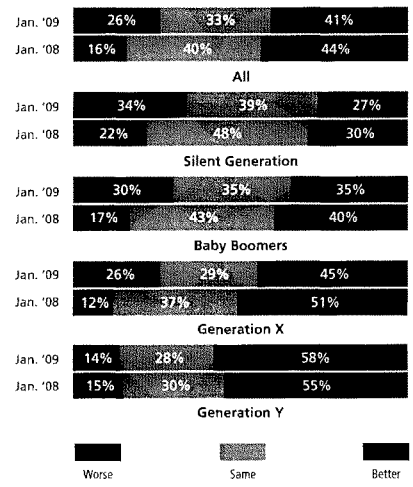
As with last year's study, despite collective pessimism about the country's economic situation, individual optimism prevails. On a personal level, even though 62% of Americans report feeling more stress about their own financial situation than they did 12 months earlier and fewer (55%) Americans believe their finances are heading in the right direction—down from nearly two-thirds (62%) in November 2006—roughly four in ten (41%) expect their own financial situation to be better in 2009 than it was in 2008. An additional 33% expect it to be about the same. Levels of personal optimism run highest among Generation Y, more than half of whom (57%) predict some improvement to their personal finances over the next 12 months.

Personal Financial Outlook

Do you expect your personal financial situation to be better, worse or about the same in 2009 than it was in 2008?



Fears of Bankruptcy and Foreclosure

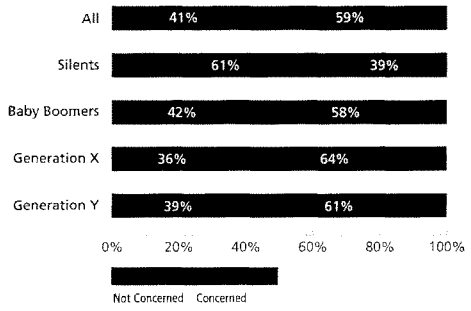
A startling 59% of Americans say they would be somewhat or very concerned about having to file for bankruptcy if they were to lose their job. This cuts across all generations and income levels, with 64% of GenXers expressing concern, 61% of GenYers, 58% of Boomers and 39% of Silents. Even mass affluent Americans are deeply concerned about bankruptcy, with 53% identifying themselves as being at risk without a job.

An equally high percentage of Americans is worried about home foreclosure; two in three homeowners (64%) are concerned they would lose their home if they were to lose their job. Generation X feels the most vulnerable, with 73% of Americans in this demographic group expressing concern. Baby Boomers are the next most vulnerable group, with 63% reporting worry. The Silent Generation is least likely to be anxious about home loss (31%)—in all probability, because one-third of them own their home outright.

Fears of bankruptcy and foreclosure are also unusually high among Middle Market consumers—i.e., those between the ages of 35 and 44 with income of $35,000–$100,000 per year. Two-thirds (66%) of these Americans risk bankruptcy if faced with a job loss. An even higher percentage of Middle Market consumers are worried about home foreclosure, with 75% expressing concern that unemployment would lead to the loss of their home.

Bankruptcy a Significant Concern

IF EMPLOYED: If you were to lose your job, would you or would you not be concerned about having to file for bankruptcy?



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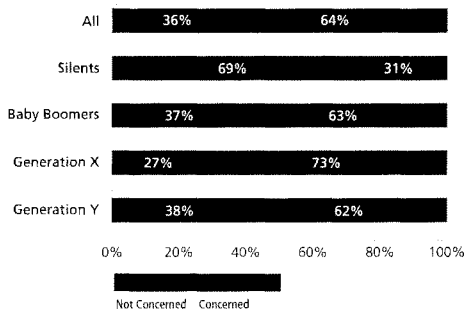
Home Loss a Significant Concern

IF EMPLOYED AND OWN HOME: If you were to lose your job would you or would you not be concerned about losing your house?



A More Proactive Approach to Personal Finances

One silver lining of the current crisis may be a more proactive approach to personal finances. Unable to count on traditional safety nets and uncertain of the long-term demand for employment, among younger workers, the percentage of Americans paying more attention to benefits—or planning to do so—is particularly high, with 65% of GenXers and 73% of GenYers focusing more time and energy on making smart financial decisions at work.

While the majority of Americans continue to be frustrated (61%) that they can't count on employer-sponsored benefits, such as health care and pension plans, Boomers, Generation X and Generation Y are showing slightly more confidence than they have in years past that they can achieve financial security on their own. With uncertainty about traditional corporate and social safety nets, roughly three in four Americans now plan to create their own safety net.

The 2009 MetLife Study of the American Dream

Americans are starting to save more, spend less and take control of their own finances. Nearly one-third (32%) report that they are becoming more educated on financial topics, 25% are reviewing their retirement savings plans and 24% are paying more attention to their employers' benefits offerings.

Major Shift Underway in Financial Behavior

What steps have you taken or will you take towards securing your financial future as a result of the current economic situation in this country? (Percentages)	All		Silents		Boomers		GenX		GenY	
	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step
Saving more and spending less	59	34	61	30	59	33	61	34	58	38
Becoming more educated on financial topics	32	43	29	34	33	41	31	46	34	50
Reviewing my retirement savings plan	25	40	31	25	32	37	20	47	19	46
Paying more attention to my employers' benefits offerings	24	29	12	9	24	23	28	37	30	43
Re-evaluating my life insurance needs	17	37	15	23	18	35	16	42	19	45
Rebalancing my investment portfolio	17	33	18	24	20	30	14	36	15	40
Meeting with my financial advisor	12	26	17	16	14	22	11	27	9	38

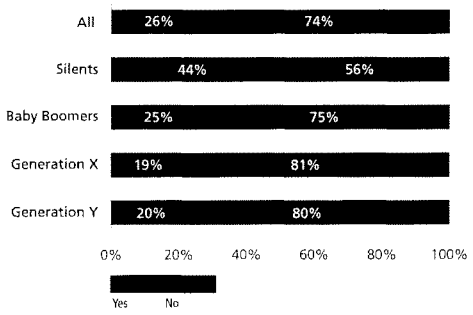
[redacted]

IV. FLYING WITHOUT A NET—PERSONAL SAFETY NETS DESIRED BY MANY, POSSESSED BY FEW AND MORE IMPORTANT THAN EVER

With concerns about job loss at an all-time high, Americans are putting a premium on protection and stability. Across generations, eight in ten say having a personal safety net will be more important this year than last. Despite this, nearly three-quarters (74%) of the public—and 81% of GenXers—admit to not having an adequate safety net.

Most Lack Adequate Safety Net

Do you feel that you currently have an adequate safety net?

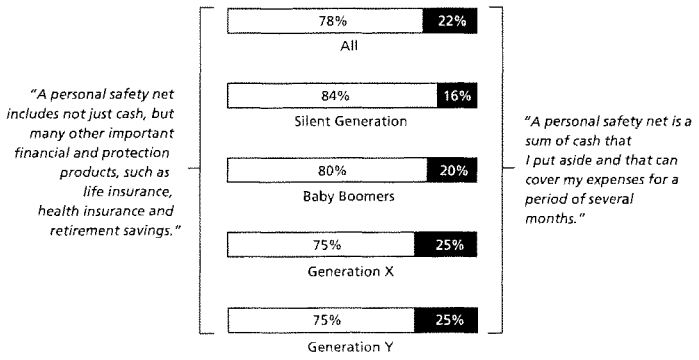


The Safety Net Defined

At least in theory, Americans understand that a personal safety net should not just include a cash cushion to cover expenses for a period of several months. They also acknowledge that it should contain a broad range of protection and savings products such as health and life insurance, and retirement savings.

Personal Safety Net Defined

Which of the following is closer to your view?



For Americans who feel they currently have a safety net, it is composed first and foremost of auto insurance (60%), health insurance (57%), life insurance (46%), homeowner's insurance (45%), a retirement savings plan such as a 401(k) (40%), and cash on hand for three to six months (35%). Among Americans who do not feel they have adequate protection, nearly two-thirds (62%) desire cash on hand for three to six mooths.

[redacted]

What's Included in Americans' Safety Nets

Today, which of the following currently make(s) up your personal safety net? Please select all that apply (percentage selecting)	All	Silents	Boomers	GenX	GenY
Auto insurance	60	76	67	56	40
Health insurance	57	77	63	52	40
Life insurance	46	62	52	43	30
Homeowner's insurance	45	66	54	39	23
Retirement savings plan such as a 401(k)	40	38	45	40	34
Cash on hand for 3–6 months	35	48	32	32	34
Real estate	28	51	35	19	11
Stocks	19	26	20	17	12
Disability insurance	18	13	26	19	12
Mutual funds	18	26	19	15	12
Financial support from family members	17	8	13	20	25
Financial support from the government	16	35	17	8	12
Long term care insurance	13	14	15	10	15
Annuities	10	15	12	7	4
Bonds	9	10	10	9	7
Financial support from my community/ church	4	1	4	5	6
Financial support from friends	4	1	2	6	7
Others	3	5	5	2	1
None of the above	14	6	9	20	21

As Americans improve their savings positions, will they look beyond cash to fill out their safety nets and, if so, how long will that take? With uncertainty surrounding traditional social and corporate safety nets — Social Security, Medicare, and defined benefit pension plans — three-quarters of Americans say they are taking steps to put their own protection products in place. But only 35% of Americans are now confident that they will be able to go it alone — down from 37% in November 2006 and 36% in 2008.

Equities Decline in Importance While Protection Takes Precedence

Signaling a shift in priorities from "investments" to "protection," demand for financial products is shifting in tandem with the dream. Unlike 12+ months ago when Americans craved a moderate dose of risk in their portfolios, today's consumers are eyeing more conservative investment and/or protection products for their personal safety nets.

Among the top ten items that consumers would most like to have in their safety net, most are insurance products—long-term care insurance, health insurance, life insurance, annuities—or conservative investments such as cash or bonds. Only the fourth-ranked (real estate) and tenth-ranked (mutual funds) carry a moderate level of risk. Last year, by contrast, the number one priority was health insurance that continues through retirement (60%), followed by retirement savings (52%). Stability and security are the new growth frontiers.

Personal Safety Net Products of Greatest Interest

IF YOU DO NOT HAVE AN ADEQUATE PERSONAL SAFETY NET: *Which of the following would you most want to have in your personal safety net that you don't currently have? Please select your top 3 choices.*	All	Silents	Boomers	GenX	GenY
Cash on hand for 3–6 months	62	56	67	65	54
Retirement savings plan such as a 401(k)	27	27	23	30	30
Long term care insurance	26	51	32	19	16
Real estate	24	14	21	29	27
Health insurance	23	18	22	23	28
Life insurance	20	15	19	20	23
Financial support from the government	16	18	15	17	15
Annuities	13	20	15	12	8
Bonds	13	14	11	13	14
Mutual funds	12	9	12	15	12

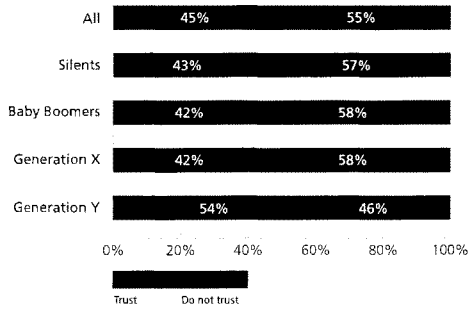
[redacted]

V. LONG ROAD TO ECONOMIC RECOVERY: MORE GOVERNMENT INVOLVEMENT NEEDED, WITH A FOCUS ON CONSUMERS, NOT BUSINESSES

Fully 84% of Americans believe the U.S. economy is heading in the wrong direction, up from 64% in November 2006. On a national level, nearly half (44%) of Americans expect the overall economy to be worse in 2009 than it was in 2008. Rooted in this assessment is a deep mistrust in the U.S. financial system. More than half (55%) of Americans say they no longer trust the U.S. financial system—e.g., banks, institutions, financial markets and the regulatory system.

Distrust of the U.S. Financial System

How much do you trust the U.S. financial system? By U.S. financial system we mean the financial institutions banks, financial markets, and the regulatory system in the United States.



(Percentages)	All	Silents	Boomers	GenX	GenY
A great deal	6	4	4	7	8
Somewhat	39	39	38	35	45
Not very much	42	45	41	44	39
Not at all	13	12	16	15	7

Perhaps because of this mistrust, the majority of Americans expect the road to recovery to be long and bumpy. Most predict that it will take one to five years for the country's economy to improve, with 35% forecasting one to two years and an additional 34% saying three to four years. The Silent generation is most optimistic (or perhaps hopeful) about a short-term recovery. While only 11% of Silents expect the economy to improve within a year, more than half (51%) believe that they will see a recovery within the next two years.

Americans Expect a Long Haul

When, if ever, do you expect the country's economic situation to improve? *(Percentages)*	All	Silents	Boomers	GenX	GenY
Within a year	8	11	8	6	9
1 to 2 years from now	35	40	36	33	32
3 to 4 years from now	34	29	31	34	40
5 to 10 years from now	15	15	17	17	11
More than 10 years from now	3	3	4	4	2
Never	5	2	5	6	5

[redacted]

Nearly half of Americans believe that the creation of new jobs is the action that will do most to jump-start the economy, followed by the economic stimulus package (19%) (which had yet to be introduced, voted on and passed at the time this survey was fielded), and improvement in the housing market (10%). Increased consumer spending is seen as less important, at 7%.

More than half of Americans would like to see more government involvement in the U.S. financial system and believe that is the best way to restore confidence in the financial system. Americans are weary however of another Troubled Asset Relief Program (TARP)-like bailout. Going forward, they want the government's involvement to focus more on consumers (69%) and less on businesses (31%). But how long will America's patience hold?

In the short-term, financial worry and mistrust are widely felt by GenYers, GenXers, Boomers and Silents alike. Roughly two-thirds (68%) of Americans are very concerned about the current economic situation in the U.S.—and an additional 27% are somewhat concerned.

VI. GENERATIONAL DIVIDE: GENERATIONS X AND Y CHANNEL EXTREME FLEXIBILITY; SILENTS AND BOOMERS REACT "IN CHARACTER"

Generations FleX—Confident in Ability to Weather Storm

While Generations X and Y have been hard-hit by job loss—more than two in ten in Generation X and Generation Y have reported losing their job as a result of the current economy—they remain optimistic, and highly flexible, about their personal financial futures. These generations—which we term "Generations FleX" based on their willingness to redefine the dream—appear to be more confident in their ability to weather the current economic storm than other generations.

Marriage and family have become increasingly important to Generations FleX. More than one-quarter (27%) of Generation X now counts "marriage" as part of their definition of the American dream, up from 18% in 2008. And both Generation X and Y believe their own actions will have the greatest impact on their ability to achieve the dream; Silents and Boomers are more likely to believe that policymakers have a greater impact.

This self-reliance reflects the social, economic and political eras during which the FleX generations came of age. Generation X—growing up amid widespread divorce, an increase in dual-family incomes, the AIDS epidemic and a generally "hurried" childhood—may find their adaptability well suited to the current crisis. The challenges they have faced and overcome may have given a number of them a hardened edge. While it's difficult to make generalizations about any particular generational cohort, commonly available research about Generation X suggests that, as a group, they favor pragmatism over idealism; volunteerism over membership; and free agency over corporatism.

Over the past year, GenXers have needed to draw on their inner strength and self-reliance. Of all the generations, they have been hardest hit by the economic downturn in terms of job loss. Perhaps, as a result, nearly seven in ten (69%) are feeling more personal financial stress compared to one year ago. They are the generation most likely to have re-evaluated their priorities, placing "greater importance on things like personal life and family rather than finances." Half (50%) of GenXers report that the current crisis has caused them to focus more on personal life and family, compared with 39% of Silents and 44% of Americans overall. As a generation, GenXers have historically rejected free-spending consumerism and may be relieved that the bar is no longer rising.

Generation Y also seems to be equipped to adapt to the current economic crisis. New to the workforce, many GenYers are experiencing widespread financial hardship (and limited opportunity) for the first time. They indicate that they are already taking or plan to take action to secure their financial futures but they don't demonstrate the hardened attitude of Generation X. Nine in ten (92%) believe they will be able to achieve the American dream in their lifetime, compared to their slightly less optimistic GenX counterparts (78%).

For those who have already achieved the American dream, the dream is sustainable in the eyes of Generations FleX because they're taking an active role in what it means to achieve it. Only 46% are concerned about not being able to sustain the dream versus 59% of the Silent Generation.

The FleX generations are already taking steps to secure their personal financial futures and are thinking about their personal life goals more than other generations.

[redacted]

GenFleX: Financial Behavioral Changes

What steps have you taken or will you take toward securing your financial future as a result of the current economic situation in this country? (Percentages)	All		Silents		Boomers		GenX		GenY	
	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step	Taken step	Plan to take step
Saving more and spending less	59	34	61	30	59	33	61	34	58	38
Becoming more educated on financial topics	32	43	29	34	33	41	31	46	34	50
Reviewing my retirement savings plan	25	40	31	25	32	37	20	47	19	46
Paying more attention to my employers' benefits offerings	24	29	12	9	24	23	28	37	30	43
Re-evaluating my life insurance needs	17	37	15	23	18	35	16	42	19	45
Rebalancing my investment portfolio	17	33	18	24	20	30	14	36	15	40
Meeting with my financial advisor	12	26	17	16	14	22	11	27	9	38

Boomers—Financial Security Is Key

Boomers, on the other hand, have felt the squeeze somewhat less than GenXers—but have also responded with less flexibility and reinvention. Roughly the same percentage (40%) of Boomers believes they have now achieved the American dream as in years past. But among the six in ten who are still in pursuit, optimism is on the wane. Only 59% are now confident that they will achieve the dream in their lifetime, down from 66% one year ago.

Unlike Generations FleX, only 42% of Boomers (versus 44% of all Americans) report that the current economic situation has caused them to reevaluate their priorities in life and place greater importance on things like personal life and family rather than finances. Despite this, family and children now factor prominently in Boomers' definition of the dream. In fact, of all the generations surveyed, Boomers show the greatest increase (in percentage terms) of individuals broadening their definition of the dream to include family and children (53% in 2009 vs. 37% in 2008).

Overall, however, financial security remains the Boomer mantra. They and Generation X are the generations most likely to define the dream in terms of financial security; they and the Silents are the demographics most likely to define financial security as "freedom from want."

Having come of age during an era when defined benefit pension plans were on the decline and defined contribution plans on the rise, Boomers are more likely than other generations to have a 401(k) in their safety net; nearly half (45%) of the Boomers surveyed have such a plan. In response to the current economic downturn, more Boomers have also taken steps to review their retirement savings plan — or plan to do so. Among Boomers who feel they do not yet have an adequate safety net, cash on hand is the most pressing need, with 67% saying they want to build up a cash reserve of three to six months and 32% eyeing long-term care insurance.

Silents — Impacted by Economic Crisis, Seeking Help from Outside, Guarantees

While the Silent Generation is more likely than any other generation to say that they have achieved the dream, they are also more likely than their cohorts (59% vs. 49% overall) to be concerned about their ability to sustain it. With 51% of Silents holding real estate in their safety nets and more than one in four (26%) holding stock and mutual funds, many have been hard hit by the financial crisis. Still, Silents are the generation most likely to already have cash reserves on hand to carry them three to six months. Nearly half (48%) of all Silents say they have cash reserves in their current safety net compared with 32% of Boomers and 35% of Americans overall.

Members of the Silent Generation — more accustomed to traditional corporate and social safety nets than any other generation — may be the last generation to rely in large numbers on defined benefit pension plans and retiree health benefits. Two-thirds of the Silent Generation believe that policymakers' actions will have a greater impact on their short-term financial future than their own actions than other generations (54%). They are also more likely than any other generation (54%) to believe that external factors that are out of their control will have a greater impact on whether or not they achieve the American dream.

Because of their familiarity with government and corporate safety nets, guarantees matter more to the Silent Generation than any other. An overwhelming majority (91%) say that when selecting financial and protection products, they are mostly concerned with having guarantees that offer stable but somewhat lower returns, compared to 80% of the general population.

[redacted]

VII. MINORITY POPULATIONS—PATH TO DREAM FUELED BY OPTIMISM AND PAVED BY JOB SECURITY

Compared to the general population, African Americans, Hispanics and Asians are less likely to say they have achieved the American dream than their Caucasian counterparts. While 34% of Americans overall—and 38% of Caucasians—believe that they have achieved the dream, the percentage falls to 30% for Asians, 29% of Hispanics and just 19% for African Americans.

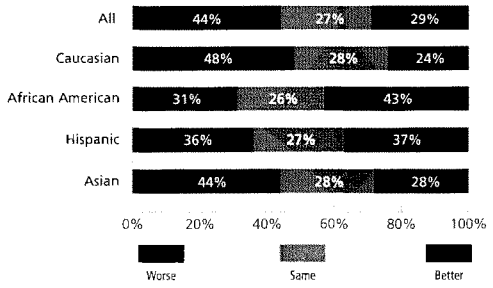
Ethnic Groups Surveyed

Ethnicity	Number of Respondents
Caucasian Americans	547
Hispanic Americans	332
African Americans	323
Asian Americans	241

However, despite conventional wisdom, minority populations are more optimistic than Caucasian Americans that the dream is still possible. Nearly nine in ten (89%) Hispanic Americans believe that they will achieve the American dream in their lifetime, as do 82% of African Americans and 83% of Asian Americans. Only two-thirds (66%) of Caucasians concur. Minority groups are also more optimistic about the overall direction of the U.S. economy. Minorities, particularly African Americans (43%), believe the economy will be better in 2009 than it was in 2008.

Minorities More Optimistic About the Economy

Do you expect the U.S. economy to be better, worse or about the same in 2009 than it was in 2008?



Career Success and Its Role in the Dream

More so than the general population, minorities view career success as a key component of the American dream. Roughly half of Asians (53%), Hispanics (44%) and African Americans (43%) include career success in their top three definitions of the dream, compared with 24% of Caucasians and 29% of the public overall. Minority groups—especially Hispanics and Asians—are also more likely than the general public to define "financial security" in terms of job security, with 40% of Hispanics and 37% of Asians including a steady paycheck as an integral component of financial stability, compared with 27% of Americans overall.

Perhaps because of this, minorities are more worried than their peers about losing their job over the next 12 months. While 56% of the general public is concerned about losing their job as a result of the current economic situation, the percentage climbs to 68% for Asians and Hispanics and 63% for African Americans. Minority groups all feel more pressure to keep up with the basic necessities of life. While roughly half (53%) of Americans—and 50% of Caucasians—believe "the bar is constantly rising in terms of the basic necessities of life," more than two-thirds (68%) of African Americans feel that they are pursuing a moving target as do 60% of Hispanics and Asians. Minorities also feel more pressure to keep up with the Joneses. Half (50%) of Asian Americans believe that the pressure to buy more and better material possessions is greater than ever, compared with 44% of Hispanics, 30% of African Americans and 22% of Caucasians.

Happily, Asian Americans are more likely than their peers to feel they have an adequate safety net in place, with more than one-third (38%) of Asians reporting a solid cushion, compared with 26% of Americans overall. Asians and Hispanics are also more likely than their peers to have cash reserves on hand as part of their safety nets. Roughly half of Asians (58%) and Hispanics (42%) report having cash on hand for three to six months, compared with 34% of African Americans and 35% of Caucasians. African Americans are the group most likely to see their personal safety net as inadequate overall, with only 18% feeling they have the right protection and savings products in place.

CONCLUSION

In the midst of one of the worst economic crises ever experienced, the *2009 MetLife Study of the American Dream* finds that the dream is still alive, but the very notion of what it means to achieve the American dream is shifting.

As Americans start to align their behavior with new attitudes around achievement of the dream, many have refocused their energies on surviving the present. Consumers have hit the "pause button" and are turning their attention to near-term survival rather than material accumulation or long-term accomplishments. They are also focusing more on family, marriage and stability. While 66% of Americans still define the dream as "financial security," more than half (56%) now say their definition includes "family and children," up from 47% just one year ago.

This fundamental shift is leading many Americans to focus more on "home and hearth" and less on external factors (such as the government and financial markets) to help them achieve the dream. Anxiety around job loss, bankruptcy and home foreclosures has increased, and many have stopped trying to "keep up with the Joneses"—a significant change from two years ago, when the American dream was largely driven by the perpetual quest for financial prosperity.

The silver lining in the cloud hovering over the U.S. financial system is that many Americans have moved from "intent" to "action" when it comes to securing their financial futures. More Americans are paring back and putting vacations and restaurant dinners on hold in favor of time at home with friends and family, possibly signaling the end of the "era of ever-increasing consumerism."

As a new, redefined dream emerges, trust and guarantees increase in importance as Americans decide what companies to do business with and what products to buy. Employee benefits—once seen as an important, but not critical, component of the dream—take on greater significance as the workforce becomes a cornerstone of the American dream.

Economic recovery in the United States will likely take some time—anywhere from one to five years, according to consumer estimates. In the meantime, Americans have heard their financial "wake-up call"—and are taking new steps to achieve the American dream. Many questions, of course, remain. Among them: Will changes to the dream be permanent or temporary? Is unbridled consumerism diminished or (like the dream) simply on hold? Will American optimism continue to thrive? Will those who have achieved the dream be able to sustain it—or will they backslide? Will Americans emerge from the current crisis better prepared and protected?

One thing that is clear is that the United States, despite its current challenges, is still perceived by most Americans as offering the greatest opportunities in the world for people of all backgrounds to achieve success and happiness. That American spirit of optimism is unwavering and is perhaps one of the country's greatest assets as we emerge from the crisis.

METHODOLOGY

From January 7–16, 2009, Strategy First Partners in conjunction with Penn, Schoen & Berland Associates conducted 2,243 online surveys in the United States among the general population as part of the *2009 MetLife Study of the American Dream*. The following groups were surveyed:

	N-Size	Margin of Error %
 **U.S. General Population**	1443	+/- 2.6%
 **Silent Generation** Born between 1933 and 1945	201	+/- 6.9%
 **Baby Boomers** Born between 1946 and 1964	501	+/- 4.4%
 **Generation X** Born between 1965 and 1977	404	+/- 4.9%
 **Generation Y** Born between 1978 and 1994	302	+/- 5.6%
 **African Americans**	323	+/- 5.5%
 **Hispanic Americans**	332	+/- 5.4%
 **Asian Americans**	241	+/- 6.3%
 **Middle Market** Age 25–44, Household Income of $35,000–$100,000	665	+/- 3.8%

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National Urban League
Policy Institute

Weathering the Storm: The Current State of Low-Income Renters

by Mark McArdle

The headlines are filled with stories of subprime mortgages and foreclosed homes during this economic crisis, but often overlooked is the effect this crisis is having on the 35 million households—almost 33 percent of all households—who rent.[1] The most direct impact has been on renters that are evicted as the homes they rented are foreclosed on, and if commercial loans to apartment buildings begin to fail, the number of displaced renters could continue to grow. In any case, as foreclosures rise and mortgage lending criteria tighten, the population of renters is likely to increase as former homeowners and others forced to forgo homeownership for financial reasons enter the rental market—a market that has become increasingly unaffordable in recent years.

Minorities, as a population more likely to rent, more likely to pay higher percentages of their income for housing and more likely to have a subprime loan (and therefore at higher risk of foreclosure), have been and will continue to be greatly impacted by the lack of affordable rental housing. In fact, low-income people, minorities and people living in central cities are all more likely to rent than the national average. In 2007, while 32.7 percent of all households rented, 53.5 percent of African-American households and 50.1 percent of Latino households rented their place of residence[2] (Figure 1).

Housing affordability, usually measured by the percent of one's income spent on housing, has declined for much of the decade. Rents have increased while the median renter income fell. As a result, nearly half of all renters paid more than 30 percent of their income for housing in 2006, and nearly 25 percent spent more than half of their income on housing.[3] Housing affordability also disproportionately affects minority communities. Thirty percent of black renters and 27 percent of Latino renters have a severe housing cost burden, which according to HUD is defined as spending more than 50 percent of their income on housing. This compares to 21 percent of white renters.[4]

This paper focuses on those 35 million households that rent, examining currents trends in affordability as well as examining some of the current programs operated by the Department of Housing and Urban Development (HUD) that are available to help people afford their rent and increase the supply of rental housing for low-income renters.

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[1] U.S. Census Bureau, 2007 American Community Survey data
[2] U.S. Census Bureau, 2007 American Community Survey data
[3] Joint Center for Housing Studies (JCHS). *America's Rental Housing: The Key to a Balanced National Policy.* Harvard University, 2009.
[4] Joint Center for Housing Studies, ibid.

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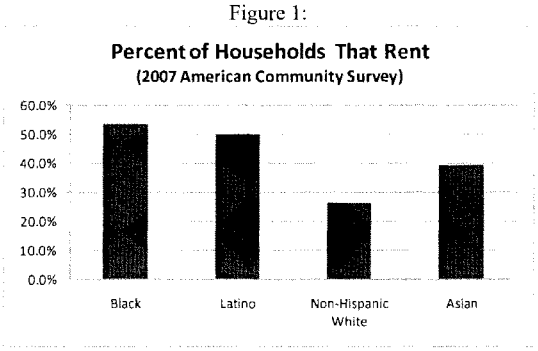
Figure 1:



Renters in the Housing Crisis

In 2004, the homeownership rate peaked at 69 percent. Since then, due in part to the housing crisis, the homeownership rate has fallen back to 67.3 percent (as of the first quarter of 2009), about where it was in 2000.[5] The recent wave of foreclosures and the decline in the homeownership rate has affected renters and the rental market in at least two major ways. First, some renters were directly impacted when the home or condo they were renting was foreclosed on. According to the National Low Income Housing Coalition (NLIHC), a fifth of the properties in foreclosure are rentals and as many as 40 percent of the families that face eviction due to foreclosure are renters.[6] Renters have limited rights in a foreclosure. So, the short-term impact from this crisis may be severe.[7] So far, large rental buildings have avoided large scale foreclosures, but there is worry that this could change as problems in the commercial lending market come into focus. The second major effect of widespread foreclosures on the rental market is the likely increase in the number of renters over the next couple of years. After averaging just 0.7 percent annual growth from 2003 to 2006, the number of renter households jumped by 2.8 percent in 2007, which was still before the bulk of foreclosures began to occur.[8]

There is some evidence that the housing crisis coupled with the lack of affordable rental housing has already led to an increase in homelessness, especially in high-cost areas. NLIHC reports a 33 percent increase in the number of families living in shelters in the past year in Massachusetts; New York City has reported a 31 percent increase in applications for housing assistance from families; and Fairfax County, VA has reported 1,200 homeless students in their schools—a 24 percent increase from last year.[9] Although this crisis will eventually pass and foreclosures will decline, unless deliberate actions are taken, the long-term affordability crisis will remain.

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[6] Crowley, Sheilia, Danielo Pelletiere, Maria Foscarinis, *Renters in Crisis*. National Low Income Housing Coalition. February 20, 2009.
[7] P.L. 111-22, *The Helping Families Save Our Homes Act of 2009*, signed May 20th of 2009 will provide legal tenants 90 days notice prior to eviction or to the end of their lease if there is no purchaser for the property.
[8] Joint Center for Housing Studies. *ibid.*
[9] Crowley et al, ibid.

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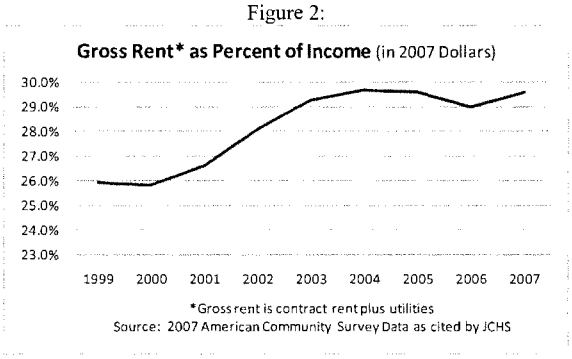
The Long-Term Affordability Crisis

The best data on affordability is from the U.S. Census, which asks American households how much of their income they spend on housing. In 2007, the latest data available, 16.4 million renter households faced unaffordable housing costs (spending more than 30 percent of their income on rent and basic utilities) (Figure 2); over 8 million households spent more than half of their income on rent and utilities. The number of households paying over 50 percent of their income for housing increased by 2 million households (or almost 32 percent) between 2000 and 2007.[10] It is uncertain how the recession will ultimately affect housing affordability. On the one hand, many households have lower (or no) income due to lost jobs. On the other hand, there is evidence that rental vacancies remain high—perhaps due to vacant or converted condominiums—which may lead to lower or at least stable rents.[11] The National Low Income Housing Coalition's annual *Out of Reach* report found a "national housing wage" (the annualized hourly wage required to afford a two-bedroom apartment at the average fair market rent) of $17.84 in 2009, slightly up from $17.32.[12] One explanation for the rise in rents is a contraction in the supply of rental units. From a peak of 500,000 units in 1986, completions for new multifamily units for rent were down to 169,000 units in 2007 (and this was before the current recession).[13] Also, many affordable units have been lost to conversions. Between 2005 and 2007, the overall net rental housing stock grew by over 3 percent, but in the most affordable categories (affordable to those making less than 50 percent of the area median income) there was a decline of almost 7 percent.[14]

Figure 2:



The root of the problem is that there is a fundamental disconnect between what many low-income people make and what rental housing costs. The national minimum wage is now $7.25 an hour, more than $10 short of the "national housing wage" as calculated by NLIHC.

[10] Douglas Rice and Barbara Sard, *Decade of Neglect has Weakened Federal Low-Income Housing Programs.* Center for Budget and Policy Priorities (February 24, 2009), page 10.
[11] U.S. Department of Housing and Urban Development. *U.S. Housing Market Conditions, 1st Quarter 2009* (May, 2009). Notes that "conditions in the rental housing market have softened . . . and the vacancy rate remains high".
[12] National Low Income Housing Coalition. *Out of Reach 2009.*
[13] Joint Center for Housing Studies, ibid.
[14] Department of Housing and Urban Development, *Rental Market Dynamics: 2005-2007.* June 2009; calculations based on combination of CINCH and AHS weights.

Traditionally, government has attempted to fill this gap, but the amount that it offers has traditionally been and continues to be far short of the amount needed. Since 1994, federal spending on low-income housing assistance has fallen by over 20 percent, both as a share of all non-defense discretionary spending and as a share of the Gross Domestic Product (GDP).[15] This trend accelerated at the end of the Bush Administration's second term. In 2008, total funding for all low-income housing programs was $2 billion (or 5 percent) below the 2004 level, adjusted for inflation (Figure 3). Nevertheless, these programs provide a crucial support for those families that receive assistance. The Center for Budget and Policy Priorities estimates that rental assistance helped 4 million people, including 1.6 million children, out of poverty.[16] In the Fiscal Year 2009 budget, passed in March, there was a small uptick in funding for several major housing programs (Figure 4).

Figure 3:

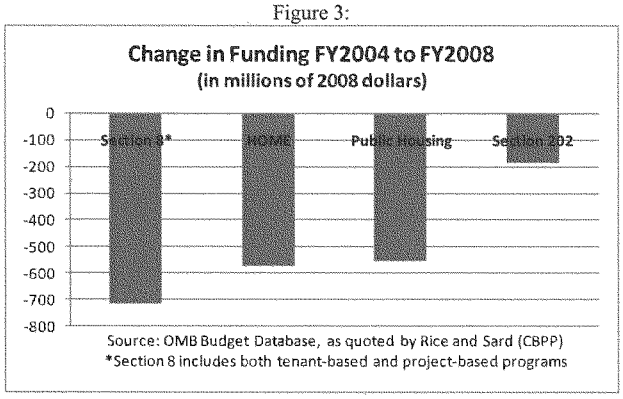
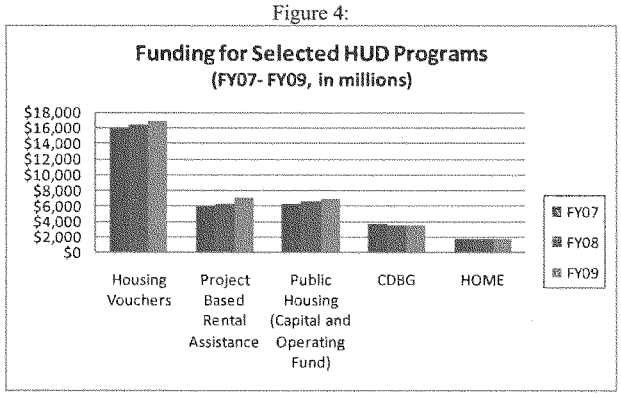


Figure 4:



[15] Rice and Sard, ibid.
[16] Rice and Sard, *ibid*, page 10.



FEDERAL PROGRAMS THAT HELP ADDRESS RENTAL AFFORDABILITY

Federal assistance for low-income housing programs can basically be divided into two broad approaches: (1) programs that directly aid the tenant (such as housing vouchers), and (2) programs that assist the builder or landlord in order to create and maintain affordable housing. In many programs that help create housing, such as with project-based rental assistance or the Low-Income Tax Credit, the builder receives assistance under the stipulation that the units remain affordable to a certain segment of the population for a period of time (e.g. 25 years). Sometimes projects combine different programs (i.e. both project and tenant-based funding). Other large federal programs, such as the Community Development Block Grant (CDBG), the HOME program or the newly enacted Housing Trust Fund provide flexible funding to local jurisdictions that can use the funding for a variety of affordable housing projects.

Housing Vouchers

This is the largest federal housing assistance program. The program was started in 1974 as a way to help low-income people afford rent while maximizing flexibility. Unlike public housing or other building-based programs, this subsidy travels with the tenant. If he or she gets a new job, or the neighborhood and/or apartment becomes less desirable, they can theoretically move and take their voucher with them to another neighborhood or even another city. The program has proven to be one of the most efficient ways to aid low-income tenants. GAO found that even in tight (low-vacancy) markets, vouchers are more cost effective than most other housing programs, including new construction or rehabilitation programs.[17]

The housing voucher program is currently targeted to very low-income families -- 75 percent of vouchers go to those with less than 30 percent of the area median income (AMI) and the remaining 25 percent can have incomes up to 80 percent of the AMI. While recipients must be below an income limit to obtain a voucher (generally 80 percent of AMI), a household can continue to receive a voucher even if its income later rises above the limit. In the latest data available (2008-2009), 44 percent of all those receiving a voucher were black, 18 percent were Latino, 47 percent of households had children under age 18 and 55 percent had income below 30 percent of the area median. Only 17 percent had been in the program more than 10 years.[18]

The program is administrated by approximately 2,500 state and local housing agencies, which award vouchers to qualified families who then conduct their own housing search. The recipient can rent any apartment that can pass a basic housing inspection, give that the landlord is willing to enter into a contract with the local agency and the rent is less than the HUD designated "Fair Market Rent" for that size apartment in a region (traditionally the median rent although there are often exceptions for certain low-poverty areas and for larger families where higher rents are allowed). According to the most recent data, 2 million units were rented through Housing Choice Vouchers; 54 percent of them to families with children.[19] The program receives almost $17 billion in annual funding, but almost 150,000 families were eliminated from the program between 2004 and 2006. The recently enacted 2009 budget includes some funding for new vouchers. Estimates are that only one in four households that are eligible for vouchers receive

[17] GAO, *Comparing the Characteristics and Costs of Housing Programs*, GAO-02-76, available at http://www.gao.gov/new.items/d0276.pdf
[18] All data from HUD, Resident Characteristics Report, available at https://pic.hud.gov/pic/RCRPublic/rcrmain.asp
[19] Ibid.



any form of housing assistance and many housing authorities have closed their waiting lists to new applicants because the lists had become too long.[20]

Over the years there have been several ideas to improve the voucher program and several of these have been tried as pilot projects. Family Self-Sufficiency (FSS) was created in 1990 as a HUD program that helps households in public housing or receiving rental assistance to build assets and make progress towards self-sufficiency. FSS offers case management to assist families in getting access to training and services with the ultimate goal of increasing earnings. If the family's earnings rise, it also offers them the chance to forgo any rent increases they normally would pay and instead deposit the additional money into an escrow account which is given over to the family once they complete the program. The ultimate goal is for families to become self-sufficient and no longer need a housing subsidy. Another program called "Moving to Work" allows agencies flexibility to design and test approaches to vouchers that reduce costs and encourage work. These types of approaches show great promise at encouraging work and greater independence among participants. In cases where these approaches result in greater earnings, they may actually reduce the need for housing assistance in the long-term for families who achieve self-sufficiency and free up their vouchers for other families in need.[21]

Project-Based Rental Assistance

Project-based rental assistance, also sometimes referred to as Section 8, is a program based upon agreements between the federal government and landlords to provide affordable homes for a certain period of time. The contracts provide financial assistance to the landlords in exchange for them continuing to provide affordable units. Variations of this program produced units from 1965 to the mid-1980s, hut no additional units have been produced by these programs since Congress repealed authorization for building new units in 1983. The key issue now for this program is preservation of units already created. Initially, the contracts were for 20 to 40 years and after the contract expires the owner can leave the program or the agreement can be renewed on an annual basis. Many owners in recent years have left the program due to payment delays and other problems. Like the other programs discussed, most residents can have incomes of no more than 80 percent of AMI, and a percentage of new residents must have incomes below 30 percent of AMI. Seventy-five percent of the households living in these units are headed by a disabled or elderly person.[22] Currently, the program provides housing to around 1.3 million households and was authorized for just over $7 billion in fiscal year 2009.[23]

Public Housing

Public housing is the third largest subsidized housing program. Currently an estimated 14,000 public housing developments run by 3,100 housing authorities provide housing to 1.2 million families.[24] Like housing vouchers, public housing is targeted to the neediest families—at least 40 percent of newly admitted households must have income at or below 30 percent of the area median. Unlike vouchers, all public housing residents must have income below 80 percent

[20] Center for Budget and Policy Priorities, *Introduction to the Housing Voucher Program*. Revised May 15, 2009.
[21] For additional data on FSS and Moving to Opportunity, go to http://www.hud.gov/offices/pih/programs/hcv/fss.cfm and http://www.hud.gov/offices/pih/programs/ph/mtw/
[22] NLIHC, Advocates Guide
[23] Rice and Sard, ibid.
[24] Rice and Sard, ibid.

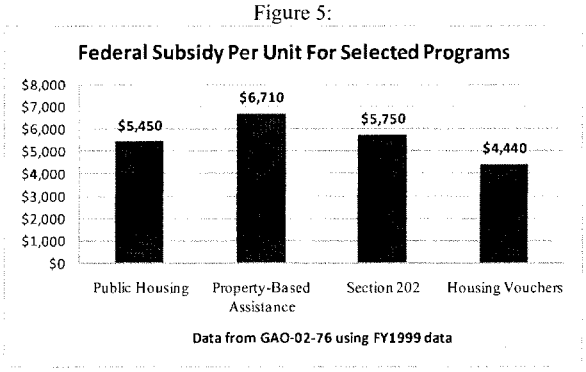
of the area median; so if a participant household's income rises above that limit, they must leave the unit. Most families who live in public housing are required to pay 30 percent of their income for rent and utilities, but deductions are provided for children, child care and those households with elderly or disabled occupants. About 41 percent of the units are occupied by families with children, 31 percent are elderly and 32 percent are households headed by people with disabilities. In 2000, 45 percent of residents were black and 23 percent Latino; 15 percent were over age 62; 56 percent were extremely low income (below 30 percent of the area median) and another 16 percent were very low income (below 50 percent of median). In contrast to housing vouchers, almost 30 percent had been in public housing at least 10 years.[25]

Public housing has both a capital fund (funded at just below 2.5 billion in FY2009), used to repair and rehabilitate projects, and an operating fund (funded at 4.45 billion), totaling almost 7 billion for public housing. Public housing began in 1937, but since the early 1980's few public housing units have been built and as many as 150,000 net units have been lost through HOPE VI, which provides funds to revitalize troubled public housing developments through demolition, construction and rehabilitation. Since far fewer units have been built than destroyed through this program, many of the residents displaced as a result of HOPE VI were given housing vouchers and now rent in the private market.[26]

Section 202 Supportive Housing for the Elderly

Nearly one-fifth of the households that pay more than 50 percent of their income for housing are elderly.[27] Supportive Housing for the Elderly (known as Section 202) is a program designed to meet the needs of this growing population. This program provides funds to build and operate housing for seniors with very low incomes. In FY2009, the program received over $600 million in regular funding, and another $250 million of stimulus funding. The program began in 1959 and currently there are more than 300,000 Section 202 units serving people who are at least 62 years old and have incomes less than 50 percent of the area median. They also target some units to elderly households who have disabilities.

Figure 5:



[25] HUD Residents Characteristics Report, ibid.
[26] NLIHC, ibid.
[27] 2007 ACS data, as quoted by Sard and Rice.



CDBB and HOME

Another major federal funding source for low-income housing projects are flexible, formula-based grant programs that are controlled at the local level. The Community Development Block Grant (CDBG) is a program that aims to improve communities by providing housing, improving the living environment and providing economic opportunity for low-income people. Seventy percent of the funds received by a jurisdiction must be spent to benefit people with low and moderate incomes. Housing is one of the primary things jurisdictions use these funds for, including housing rehabilitation, new housing construction by nonprofits and purchasing land or buildings for low-income housing. Each jurisdiction must incorporate citizen participation into its plan to spend the funds. President Obama has proposed a 25 percent increase in this program for FY2010.[28]

Unlike CDBG, all of the activities funded under the HOME Investment Partnerships Program must be housing related. Funds may be used to help buy, rehab or build affordable housing. It also may be used, like housing vouchers, for direct assistance to renters who then pay no more than 30 percent of their income for housing. Fifteen percent of funds must be for housing that is developed by community-based housing development organizations. When used to assist renters, at least 90 percent of the units must be occupied by households with incomes below 60 percent of the area median income. The funds are distributed, similar to CDBG, by a formula that measures population, poverty and the condition of the housing stock. Also similar to CDBG, the jurisdiction must incorporate public input into its "Consolidated Plan", which guides the distribution of funds.[29]

Low Income Housing Tax Credit

One of the more important programs for adding to the supply of low-income rental housing is not a spending program but a tax credit. The Low Income Housing Tax Credit has been around since 1986 and offers tax credit to investors to encourage the construction of affordable rental units that are occupied by income-eligible households (generally at or below 60 percent of area median income at the time of initial occupancy). The law requires the units to be rent-restricted and occupied by low-income households for at least 15 years, with an extended-use period of another 15 years—though some states may extract commitments for longer terms. The credits are administered by the IRS and allocated to states based on their population, who in turn (through state and local housing finance agencies) award credits to various projects that meet the agency priorities as outlined in their Qualified Allocation Plan. As of 2005, the program had created almost 1.4 million units. In 2007, almost $800 million in credits produced 75,000 units.[30] The cost to the Treasury varies by year, but since the credit offsets other incomes, it is greatly affected by current economic conditions. Evidence that credit activity has dropped off during the current recession indicates the need for additional measures to bolster the supply of low-income housing.

[28] NLIHC Advocates Guide
[29] NLIHC Advocates Guide, ibid.
[30] NLIHC, Advocates Guide



The National Housing Trust Fund

The National Housing Trust Fund's purpose is to increase and preserve the supply of rental housing for low income families. It was signed into law by President George W. Bush in 2008, but the original funding mechanism (contributions from Fannie Mae and Freddie Mac) fell apart with the recent economic collapse of these entities. President Obama has proposed an initial seeding of $1 billion to be obligated for the Trust Fund in FY2010, getting the trust fund started until regular funding mechanisms can be restored. At least 90 percent of the funds must be used for the production, preservation or operation of rental housing and all the funds must benefit low-income households—including at least 75 percent of the rental housing funds for extremely low income (less than 30 percent of area median income). The funds would be distributed by formula to the states, which will use the funds to finance the development, rehabilitation and preservation of affordable housing.[31] The National Housing Trust Fund shows great promise, along with tax incentives like the Low Income Housing Tax Credit, to help ensure that there will be an adequate supply to meet the growing demand for low-income rental housing in the future.

RECOMMENDATIONS & CONCLUSION

The current economic crisis may fundamentally alter our housing market. Millions of foreclosures and tightening credit standards may permanently swell the population of renters for years to come. What remains to be seen is how the market will respond. Evidence from the past indicates that without government help—both on the supply side by stimulating the stock of affordable housing and on the demand side by assisting low-income households—low-income households may fall even farther behind, paying a greater share of their income for rent and leaving less for food, clothing, day care, transportation, health care and educational expenses.

The good news is we have programs that have been proven to work and are reasonably cost-effective, like the housing voucher program. There has been a modest increase in the funding for this program recently, but the demand is still great. In Chicago, the 40,000-person long waiting list was reopened for the first time in 11 years.[32] In Baltimore County, the average wait for a voucher is seven years.[33] With mounting job losses, even more people will need help. Increased funding for the voucher program is an important step to help low-income renters. Another problem is that voucher holders often have trouble finding landlords who will accept the vouchers. More can be done to improve the ease of use by landlords, reducing the wait for checks and inspections and reducing any administrative burden. The Section 8 Voucher Reform Act (SEVRA), currently being considered by Congress, would make many of these changes, including streamlining housing inspection rules. One other action that could greatly help is to add source of income, including vouchers, as something that is protected under fair housing laws. Twelve states have already done this.[34]

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[31] President Obama's Fiscal 2010 Budget and NLIHC Advocates Guide.
[32] Riley, Elizabeth. "CHA Reopens Voucher Waiting List after 11 Years", *Medill Reports*. April 11, 2008.
[33] Baltimore County Social Services, www.baltimorecountymd.gov
[34] CA, CT, DC, ME, MA, MN, NJ, ND, OK, OR, UT, VT, WI; some other local jurisdictions, such as Montgomery County MD and Seattle WA have done this as well. Source: Cynthia Watts Elder, CT Fair Housing Center for testimony given September 22, 2008 for the National Commission on Fair Housing.



Another way to get people the help they need is to free up vouchers already in use. There should be additional support for programs like Family Self-Sufficiency and Moving to Opportunity that try innovative approaches that not only house a family, but to increase the earnings of that family and maybe even eventually move that family off assistance. A voucher is a limited resource, but if used effectively, it can also be a tool to provide recipients with an opportunity to obtain the skills and resources that could eliminate their need for housing assistance. SEVRA, already mentioned, helps simplify existing work incentives by deducting 10 percent from the first $9,000 in earnings for all working families while including deductions for child care expenses. SEVRA will also help encourage tenant mobility toward greater economic opportunities by simplifying how different jurisdictions handle families who relocate and creating more accurate "Fair Market Rents" so families can access housing in lower-poverty neighborhoods.[35]

Finally, for demand-side programs (like vouchers) to work efficiently there must be an adequate supply of low-income units. Programs that help the market meet the demand for low-income housing are an essential part of an effective housing policy. Therefore, strong support for programs such as the Low Income Housing Tax Credit and the flexible federal-local partnership National Housing Trust Fund, both of which will help increase the supply of low-income rental units, are vital. Both tax credit programs and direct funding programs are needed so that supply is maintained even during economic downturns. Only by addressing both supply- and demand-side barriers will we make a dent in reducing the number of households with severe housing burdens; thus freeing up income for those families to spend on other necessities like food, clothing, child care and education.

Homeownership will always be an important part of the American dream, but if there is one lesson to be learned from the current crisis it's that the goal is not just homeownership but sustainable homeownership. If we want to encourage households to pursue economic mobility, to find good-paying jobs and make educational investments in themselves and their family, ensuring the availability of affordable rental housing must be a key part of any comprehensive economic mobility strategy for our society.

* * *

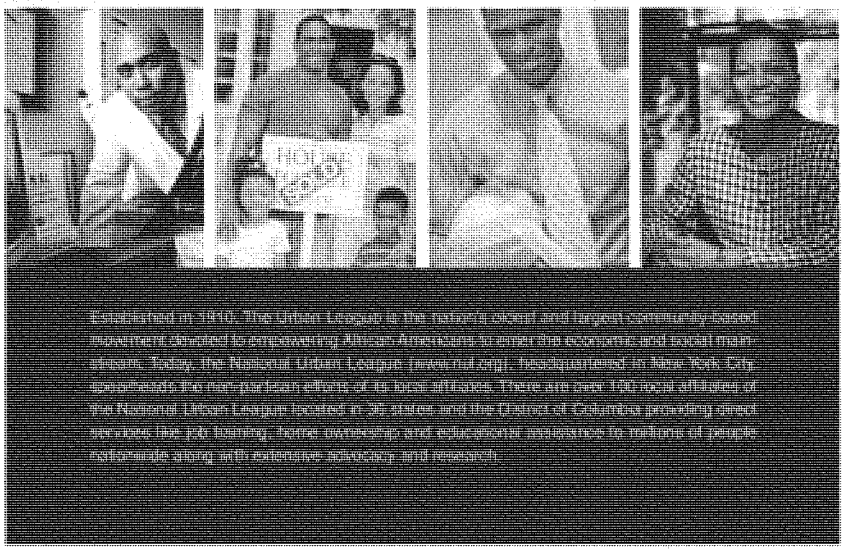
[35] Will Fischer, Center for Budget and Policy Priorities, *Testimony on the Section 8 Voucher Reform Act* (June 4, 2009).

THE OPPORTUNITY COMPACT

BLUEPRINT FOR ECONOMIC EQUALITY

NATIONAL URBAN LEAGUE

July 2007



Established in 1910, The Urban League is the nation's oldest and largest community-based movement devoted to empowering African Americans to enter the economic and social mainstream. Today, the National Urban League (pictured left), headquartered in New York City, spearheads the non-partisan efforts of its local affiliates. There are over 100 local affiliates of the National Urban League located in 36 states and the District of Columbia providing direct services like job training, home ownership, and educational assistance to millions of people nationwide along with extensive advocacy and research.

INTRODUCTION

To The Opportunity Compact

Opportunity • *noun*:
a good chance for advancement or progress

Compact • *noun*:
a signed written agreement between two or more parties to perform some action

WHAT IS THE OPPORTUNITY COMPACT?

The Opportunity Compact is a comprehensive set of principles and policy recommendations set forth by the National Urban League (NUL) designed to empower all Americans to be full participants in the economic and social mainstream of this nation. In pursuit of this end, NUL 1) identifies principles that reflect the values inherent in the American dream; 2) examines the conditions that have separated a significant portion of the American population - particularly the poor and disadvantaged residents of urban communities — from accessing that dream; 3) proposes, for honest evaluation and discussion, several policy recommendations intended to bridge the gap between conceptualization and realization of the American dream.

The Opportunity Compact is the culmination of extensive research and policy analysis by the National Urban League Policy Institute (NULPI) and is based upon the input of dozens of policy experts from academia, public policy think tanks, non-profit service and advocacy organizations, the business sector, and the Urban League movement. Among other things, the NULPI hosted a series of roundtable discussions and obtained feedback and recommendations from numerous experts concerning the development of a coherent and comprehensive plan for empowering the nation's urban communities. As the foundation for such a plan, NUL has clearly identified four cornerstones that reflect the values represented by the American dream: (1) The Opportunity to Thrive (Children), (2) The Opportunity to Earn (Jobs), (3) The Opportunity to Own (Housing) and (4) The Opportunity to Prosper (Entrepreneurship). These cornerstones are supported by a list of ten policy priorities.

WHO ARE THE ENTITIES INVOLVED?

The words *opportunity* and *compact*, as defined above, offer a concise and self-explanatory description of what *The Opportunity Compact* represents – an agreement between interested parties to take actions that will improve the chances for advancement and progress of those living in America's cities. The diversity of talents, experiences, ideas and interests represented in the population of the United States is the greatest asset this country possesses. As such, NUL believes that the collaborative efforts of private citizens, national, state and local governments, community-based service providers and the business community will expand opportunities for advancement and progress among the poor, disadvantaged and underserved. The policy recommendations offered in this report are not a laundry list of things for the federal government to perform on behalf of a select group of citizens. Rather, there is a role for all parties – public and private - to play as we together seek to strengthen our nation by maximizing the potential of all our citizens.

WHAT IS THE DESIRED OUTCOME?

The National Urban League embarked upon the task of developing *The Opportunity Compact* with the goal of drawing upon the strength of NUL's ninety-seven year history as the nation's oldest and largest community-based movement for social and economic empowerment to reassert the organization as a proactive and effective agent in the development of public policy. This document serves as a vehicle through which to assert specific principles and policy recommendations as the foundation for a plan of action to address the challenges faced by those in urban communities throughout the country. As such, this document is also intended to elicit serious responses from the 2008 presidential candidates, legislators, the private sector, the public and other community-based organizations with the ultimate objective of putting in place a comprehensive plan for advancing the promise of America's cities. By generating new ideas, initiating productive partnerships and fostering collaboration, *The Opportunity Compact* seeks to expand access to the incentives and rewards that act as the driving force behind what makes this country great – personal responsibility, initiative and hard work.

CORNERSTONES & GUIDING PRINCIPLES OF THE OPPORTUNITY COMPACT

There are four cornerstones to *The Opportunity Compact*:

1. Opportunity to Thrive (Children)

- Every child in America deserves to live a life free of poverty that includes a safe home environment, adequate nutrition, and affordable quality health care.

- Every child in America deserves a quality education that will prepare them to compete in an increasingly global marketplace.

2. Opportunity to Earn (Jobs)

- Every willing adult in America should have a job that allows them to earn a decent wage and provide a reasonable standard of living for themselves and their families.

- Every adult in America should have equal access to the resources that enhance employability and job mobility, including postsecondary education and other investments in human capital.

3. Opportunity to Own (Housing)

- Every adult in America should have access to the financial security that comes from owning a home.

4. Opportunity to Prosper (Entrepreneurship)

- Every individual in America who possesses entrepreneurial vision, ingenuity, drive and desire should have access to the resources needed to establish and grow a viable business enterprise.

TOP TEN POLICY PRIORITIES OF THE OPPORTUNITY COMPACT

Opportunity to Thrive (Children)

1. Commit to mandatory early childhood education beginning at age three as well as guarantee access to college for all.

2. Close the gaps in the health insurance system to ensure universal healthcare for all children.

3. Establish policies that provide tools for working families to become economically self-sufficient.

Opportunity to Earn (Jobs)

4. Create an urban infrastructure bank to fund reinvestment in urban communities (e.g. parks, schools, roads).

5. Increase economic self-sufficiency by indexing the minimum wage to the rate of inflation and expanding the Earned Income Tax Credit to benefit more working families.

6. Expand "second chance" programs for high school drop outs, ex-offenders and at-risk youth to secure GEDs, job training and employment.

Opportunity to Own (Housing)

7. Adopt the "Homebuyer's Bill of Rights" as recommended by the National Urban League.

8. Reform public housing to assure continuing national commitment to low-income families.

Opportunity to Prosper (Entrepreneurship)

9. Strongly enforce federal minority business opportunity goals to ensure greater minority participation in government contracting.

10. Build capacity of minority business through expansion of micro-financing, equity financing and the development of strategic alliances with major corporations.

IMPLEMENTATION
of the
TOP TEN POLICY PRIORITIES

Opportunity to Thrive (Children)

1. Commit to mandatory early childhood education beginning at age three as well as guarantee access to college for all.

All children must enter school ready to take advantage of teaching and learning. According to "Years of Promise", the report of the Carnegie Task Force on the Primary Grades, these early years are crucial in a young person's life when a firm foundation is laid for healthy development and lifelong learning. The National Urban League recommends that all three- and four-year olds have access to full day, developmentally appropriate, high quality early childhood education. Incentives should be put in place to encourage all service providers to become NAEYC (National Association for the Education of Young Children) accredited.

In addition to a commitment to education in early childhood, The National Urban League also recognizes that, although the current system of K-12 education as a free public right may have been sufficient at a time when a high school education qualified people for most jobs in this nation, it is no longer enough. In a competitive global economy, more training, education and skills are needed for the jobs of the future. A program which provides sufficient per student funds to pay for basic tuition at most public universities (at least for two years) is a necessary component of a system that meets the needs of the future.

2. Close the gaps in the health insurance system to ensure universal healthcare for all children.

While Medicaid and the State Children's Health Insurance Program (SCHIP) have made tremendous progress in improving children's health insurance coverage, nine million children in America, almost 90 percent living in working households and a majority in two-parent families, are still uninsured. If enacted, the *All Healthy Children Act* (H.R. 1688) would close the coverage gap by simplifying and consolidating Medicaid and SCHIP while expanding eligibility for more children as well as pregnant women below 300% of poverty. In addition to the provision

of health insurance, The National Urban League also recommends that the policies advancing universal healthcare encompass improvements in access and quality of care in poor communities.

3. Establish policies that provide tools for working families to become economically self-sufficient.

Family support policies are a crucial part of moving low-income families into economic self-sufficiency. Since many of the country's low-income families are headed by single mothers, the National Urban League urges the creation and implementation of policies that include, but are not limited to, quality child and infant care, transportation assistance, education and training programs that encourage, rather than penalize, additional skills attainment, and paid leave time for all working parents as proposed by the *Healthy Families Act.* The National Urban League also urges reconsideration of the 5-year lifetime limit for Temporary Assistance for Needy Families (TANF).

Opportunity to Earn (Jobs)

4. Create an Urban Infrastructure Bank to fund reinvestment in urban communities (i.e. parks, schools, roads).

The Urban Infrastructure Bank would be financed by a stream of federal bond revenue used to create a large pool of funds to rebuild schools, water, wastewater, parks, playgrounds, community centers, recreation centers, as well as streets in economically underserved urban areas. Such a bank would allow a significant infusion of capital expenditures into employment generating activities in urban communities.

5. Increase economic self-sufficiency by indexing the minimum wage to the rate of inflation and expanding the Earned Income Tax Credit (EITC) to benefit more working families.

The National Urban League has consistently supported increases in the federal minimum wage and has called for future increases to be indexed to inflation so that workers never again have to beg politicians to protect their income during the economy's inevitable ups and downs. At least four states currently index their minimum wage to prices; maintaining purchasing power for minimum wage workers without creating adverse effects for the broader state economy.

As accomplished through the EITC, alleviating the tax burden and supplementing the wages of low-income working families have been effective means of encouraging economic self-sufficiency through employment. The National Urban League recommends building upon the success of the EITC through: 1) simplification of the process for claiming the credit; 2) more outreach to eligible families who have not claimed the credit; and 3) increasing the size of benefits for all eligible families, including those without minor children and those with three or more minor children, in such a way that further reduces poverty and hardship among working families.

6. Expand "second chance" programs for high school drop outs, ex-offenders and at-risk youth to secure GEDs, job training and employment.

"Second chance" programs may include anything from blended high schools that provide flexibility for non-traditional students by integrating academic and career education to the development of a comprehensive reentry mechanism for ex-offenders that includes housing, job training, adult basic education, psychological counseling and drug treatment. The evidence suggests that local agencies could play an important intermediary role with employers in low-wage labor markets by providing job placement, transportation, basic skill enhancements, and assistance in developing career advancement strategies for low-wage adults. In addition to these "second chance" efforts, it is also important to have in place a well-defined pipeline that facilitates the transition of socially and economically disadvantaged youth into the labor force through college, apprenticeships or internships.

Opportunity to Own (Housing)

7. Adopt the "Homebuyer's Bill of Rights" as recommended by the National Urban League.

The *National Urban League Homebuyer's Bill Of Rights* asserts that every homebuyer in America should have: 1) The right to save for homeownership tax free; 2) The right to high quality homeownership education; 3) The right to truth and transparency in credit reporting; 4) The right to production of affordable housing for working families; 5) The right to be free from predatory lending; and 6) The right to aggressive enforcement of fair housing laws. The full list of recommendations for

accomplishing these goals can be found on the National Urban League's website: *(www.nul.org/PressReleases/2007/2007PR389.html).*

8. Reform public housing to assure continuing national commitment to low-income families.

In the judgment of the National Urban League, the HOPE VI program, while well-intentioned, is broken and in need of overhaul. Therefore, the National Urban League proposes a return to the core stated tenets of the program: *to transform public housing communities from islands of despair and poverty into a vital and integral part of larger neighborhoods; and, to create an environment that encourages and supports individual and family movement toward self-sufficiency.* The following actions are important in accomplishing this end: 1) HUD should be required to publish an updated list of public housing developments eligible for HOPE VI funds according to a new definition of 'severe distress' created in collaboration with public housing residents, housing advocates, housing experts, and others; 2) All public housing units subject to demolition or redevelopment under HOPE VI should be replaced with new public housing units on a one-for-one basis; 3) HUD should be required to issue regulations governing the administration of HOPE VI redevelopment activities, which should provide enforceable, on-going rights of resident participation; 4) Public housing residents should be guaranteed the right to occupy units redeveloped under HOPE VI, and the relocation rights of displaced residents should be strengthened and clarified.

Opportunity to Prosper (Entrepreneurship)

9. Strongly enforce federal minority business opportunity goals to ensure greater minority participation in government contracting.

In addition to the enforcement of established minority contracting goals, it is also imperative that these goals are updated and revised as the marketplace changes and grows. Compliance with established goals should be supplemented by appropriate matching between government agencies and potential minority contractors as well as maintenance of an appropriate mix of contracts attainable to businesses of various sizes. The National Urban League also calls for greater transparency in the government contracting process by making RFPs easier to access, conducting ongoing disparity studies, and providing truth in procurement spending through disclosure of the competitive and non-competitive bidding processes.

10. Build capacity of minority business through expansion of micro-financing, equity financing and the development of strategic alliances with major corporations.

Capacity building is an important part of sustaining a profitable business enterprise of any scale. The National Urban League proposes three distinct methods for providing access to the capital necessary to sustain and grow a business at any stage of development. These methods include: 1) micro-financing, which provides small business loans (typically under $100,000) to microentrepreneurs (those with five or fewer employees); 2) equity financing (money acquired from investors or the small-business owner) for businesses seeking to expand beyond the scale of a small-business; and 3) strategic alliances between major corporations and larger-scaled minority-owned businesses in search of the kind of synergistic relationships necessary for major industry presence and scale.

MAKING THE CASE

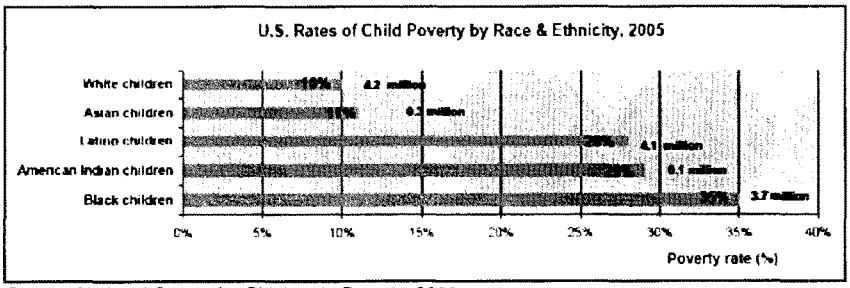
The Opportunity to Thrive (Children)

America's performance, relative to other global leaders, in the provision of services to children offers a sobering picture of our national priorities. According to UNICEF, among developed countries, the United States ranks 20 out of 24 in children's material well-being, 14 out of 24 in children's educational well-being, and last in children's health and safety[1]. These international comparisons only tell part of the story about the unforgiving injustices that minority children face daily due to disproportionate rates of poverty, inadequate education and a lack of accessibility to healthcare.

U.S. Childhood Poverty

Despite moderate economic growth, about 1.3 million more children were living in poverty in 2005 than in 2000. The fact that nearly 13 million American children live in families with incomes below the federal poverty level doesn't tell the entire story of disparities based on locale and race. Children in urban areas are more likely to live in low-income families than are rural or suburban children and the rate of poverty for African American children (35%) is higher than that of any other group in this country (Figure 1). The poverty disproportionately experienced by African American and Latino children and families has led to experiences in poor education and school facilities, a lack of quality health care, isolation in poor, segregated urban neighborhoods, and high unemployment and underemployment of family members.

FIGURE 1



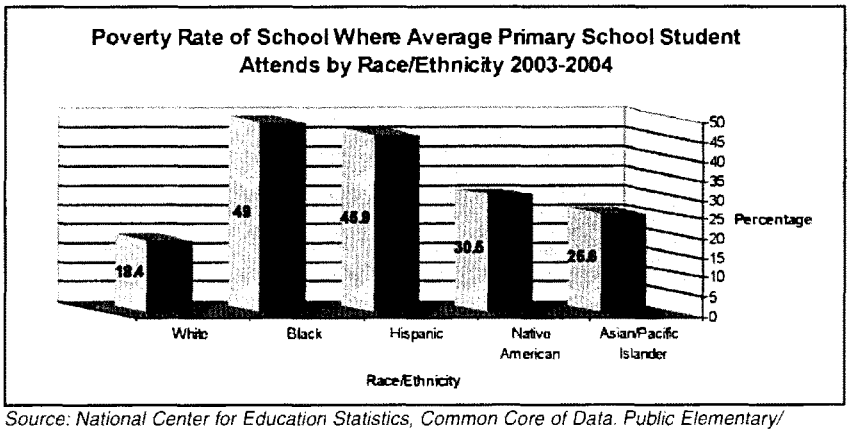
Source: National Center for Children in Poverty, 2006

[1] See UNICEF. "Child Poverty in Perspective: An Overview of child well-being in rich countries," Innocenti Report Card 7, 2007.

Education and the Achievement Gap

Despite the goals of the No Child Left Behind Act (NCLB), African American and Latino students continue to lag behind their white and Asian American peers on national standardized achievement tests. The disadvantages many minority students face on a daily basis can have a serious impact on their educational experiences. For example, minority students often attend high-poverty, poorly resourced schools with less rigorous curricula[2] (Figure 2). They also experience the injustices of overrepresentation in special education classes and under-representation in gifted and advanced placement classes[3]. In addition to inadequate resources, minority students are more likely to be taught by poorly qualified or inexperienced teachers[4]. Research also suggests students of color may experience bias, such as lower teacher expectations and less challenging academic standards than their white counterparts[5].

FIGURE 2



Source: National Center for Education Statistics, Common Core of Data. Public Elementary/ Secondary School Universe Survey

The gaps that exist in grade school often have their roots in the early stages of child development. Before entering kindergarten, the average cognitive scores of pre-school age children in the highest socioeconomic group are 60 percent above the average scores of children in the lowest socioeconomic

[2] See Christopher B. Knaus. "Still Segregated, Still Unequal: Analyzing the Impact of No Child Left Behind on African-American Students." In *The State of Black America 2007.* National Urban League. 2007.

[3] See Caroline Rothert. "Achievement Gaps and No Child Left Behind." *Youth Law News.* April – June 2005.

[4] Ibid.

[5] Ibid.

group[6]. At age 4, children who live below the poverty line are 18 months below what is normal for their group; by age 10 that gap is still present[7]. These statistics eventually translate into achievement gaps in high school as well. Statistics show that 12th grade African American and Latino students have reading and math skills that are almost equivalent to eighth-grade white students[8].

Health Disparities and Healthcare for Poor Families

Poor and minority children, especially African American and Latino children, continue to lag behind Whites and affluent children in almost every health indicator. Poor children and children of color are at a disproportionate risk for exposure to environmental hazards like lead paints, dampness and mold, and inadequate ventilation. As a result, African Americans and Latinos are two to six times more likely than whites to die from asthma[9] and African American children are 5 times more likely than white children to suffer from lead poisoning[10]. The pandemic of childhood obesity is also more common among African American children. In 2003-2004, a quarter of non-Latino black females ages 12 to 19 were overweight, compared to 15 percent of non-Latino whites and 14 percent of Mexican American youth[11]. Children who are overweight run the risk of developing type-2 diabetes, cardiovascular problems and arthritis.

Children from communities of color are less likely to have employer-based coverage and are more dependent upon government programs such as Medicaid and SCHIP which provide a safety net for the growing number of families without private health insurance. Slightly more than half of insured African American (51.3%) and Latino children (50.3%) are covered by these programs[12]. However, even since the inception of the State Children's Health Insurance Program (SCHIP), African Americans remain twice as likely as whites to go uninsured, while Latinos remain three times as likely to go uninsured than whites (Figure 3). Uninsured African American

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[6] See Lisa G. Klein and Jane Knitzer. "Promoting Effective Early Learning: What Every Policymaker and Educator Should Know." National Center for Children in Poverty. January 2007.

[7] Ibid.

[8] See Caroline Rothert. "Achievement Gaps and No Child Left Behind." *Youth Law News*. April – June 2005.

[9] National Institute of Allergy and Infectious Diseases. 2002.

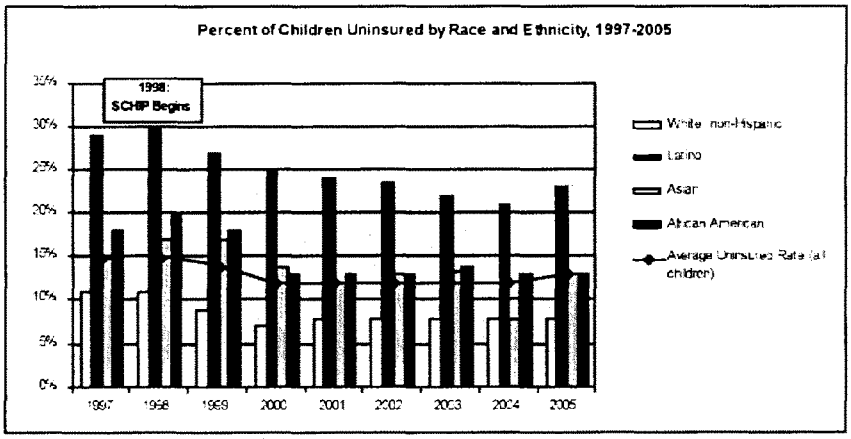
[10] See "Update: Blood Lead Levels in the United States, 1991-1994." *Morbidity and Mortality Weekly Report*, 46(7). Centers for Disease Control. 1997.

[11] See Cynthia Ogden et al. "Prevalence of Overweight and Obesity in the United States, 1999-2004." *Journal of the American Medical Association*. April 2006.

[12] See Kaiser Family Foundation. "SCHIP and Children's Health Coverage: Leveling the Playing Field for Minority Children." December 2006. (www.kff.org)

children are at higher risk for reduced access to health care. For example, they are 26 percent more likely to have delayed medical care due to cost and have an 81 percent higher likelihood of having no usual place of health care[13].

FIGURE 3



Source: U.S. Census Bureau Current Population Survey

The Opportunity to Earn (Jobs)

THE ECONOMIC PLIGHT OF WORKING FAMILIES

The existence of a relatively large middle class makes the United States unique among nations and represents a real opportunity for social and economic mobility as a bridge between the extremes of poverty and wealth. For many Americans, attainment of middle class status has become synonymous with achieving the "American dream;" a dream rooted in a shared work ethic and sense of independence which says that there is value in work that empowers people to provide certain necessities and comforts for themselves and their families including economic security, a safe home, a quality education for their children, reliable health care and a comfortable retirement. This strong sense of independence, however, is balanced by a sense of fairness and social connectedness, as demonstrated by the public provision of certain types of safety nets.

Unfortunately, for a growing segment of the population, particularly working and middle-class families, economic security has grown increasingly

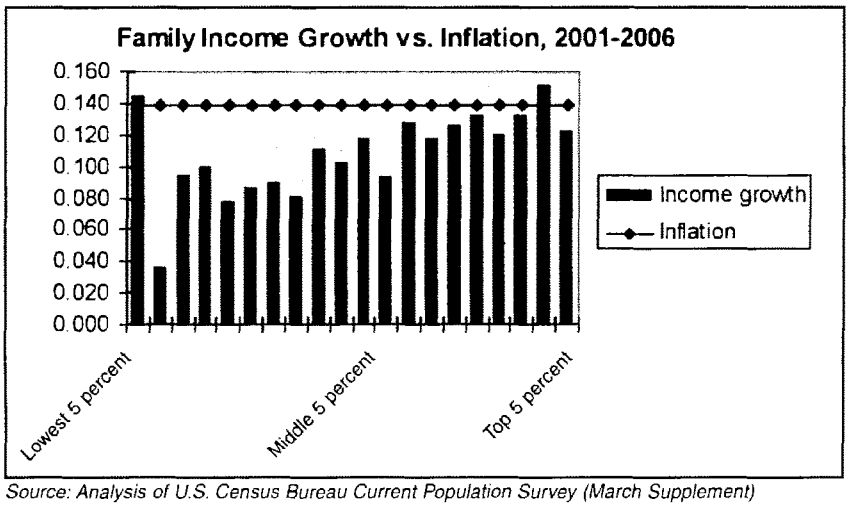
[13] See Children's Defense Fund. *The State of America's Children: Yearbook 2004.* July 2004.

difficult to maintain. In fact, according to a 2006 report from the Center for American Progress, the increase in downward short-term mobility from 1997-98 to 2003-04 was driven by the experiences of middle-class households (those earning between $34,510 and $89,300 in 2004 dollars)[14]. Some of the factors affecting the economic well-being of working families include low wage growth, rising costs of food, housing, medical care, child care, higher education and gasoline, and the disappearance of employer-provided pensions and health care benefits.

Income Growth and Changes in the Cost of Living

Working families[15] have experienced a dramatic increase in the cost of living, while wage growth has failed to keep pace with these increases. For example, between 2001 and 2006, overall inflation increased by 14 percent[16]. This was accompanied by a less than 14 percent increase in the median family income of working families (Figure 4). Over the same period of time, there were especially dramatic increases in the price of goods such as gasoline (79%), college tuition and fees (45%), child care (26%), and medical care (23%).

FIGURE 4



Source: Analysis of U.S. Census Bureau Current Population Survey (March Supplement)

[14] See Tom Hertz. "Understanding Mobility in America." Center for American Progress publication. April 2006.

[15] For the purpose of this analysis, a family is defined as a married couple or single parent primary family with at least one child under the age of 18. A family is considered working if in the last 12 months, family members age 15 and older have a combined work effort of at least 39 weeks or a combined work effort of at least 26 weeks plus one unemployed parent actively looking for work in the past four weeks.

[16] All inflation estimates in this paragraph are based upon the Consumer Price Index for All Urban Consumers (CPI-U).

Poverty

In 2006 7.5 percent of working families were living below the poverty threshold, while one-fourth of working families lived below 200 percent of poverty (Figure 5). Working families with a minority parent were three to four times as likely to be in poverty as families with a white parent (Figure 6). This statistic has intergenerational implications in that research suggests that African American children born in the bottom quartile are almost twice as likely to remain there as adults than white children born to parents with identical incomes[17]. These differences persist even after controlling for parental background factors, such as whether the household was female-headed or receiving public assistance.

FIGURE 5

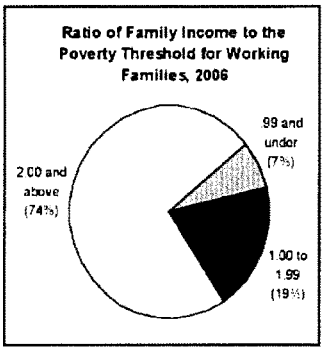
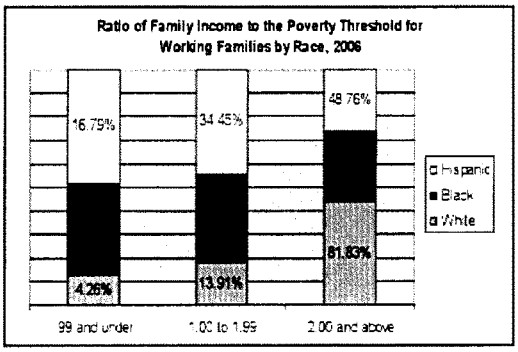


FIGURE 6



Source: Analysis of U.S. Census Bureau Current Population Survey (March Supplement)

Two of the underlying factors in the existence of economic disparities along racial lines are differences in family composition and educational attainment. Family composition has a major effect on the number of wage earners in a home and thus the family's total income. Less than one-third of families in the lowest 20 percent of the income distribution have multiple earners, compared to 81 percent of families in the top 20 percent. In terms of family composition, slightly more than half (51%) of African American working families are headed by a married couple compared to over 82 percent of white and 79 percent of Latino families. Over three-fourths (77%) of all single parent working families are headed by a female[18].

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[17] See Tom Hertz. "Understanding Mobility in America." Center for American Progress publication. April 2006.

[18] Based on analysis of Current Population Survey, March Supplement, 2006.

Educational attainment is also closely related to earnings. According to 2005 estimates from the Bureau of Labor Statistics, individuals with a bachelor's degree earn more than one and a half times as much as high school graduates and more than twice as much as those without a high school diploma. Also, the black-white earnings gap narrows considerably when you compare median earnings of blacks and whites with a bachelor's degree or higher[19]. Most adults in working families with a white parent have a bachelor's degree or higher (37%), while for African American working families, most adults have only a high school diploma (36%) and most adults in Latino working families have less than a high school diploma (33%).

Occupations of Adults in Working Families

Finally, the majority of non-white adults in working families are employed in service occupations (23% of African American and 22% of Latino workers) while the majority of whites (23%) are employed in professional occupations[20]. This in part reflects differences in average educational attainment and much of the resulting differences in family income by race. However, based upon research in *The State of Black America 2006* report, there is a general pattern of exclusion in the most desired management and professional occupations even for black males with the requisite educational qualifications. This pattern, known as "crowding out", also holds for the sales and office occupations[21]. As a matter of fact, only 14 percent (67 out of 475) of occupations in the U.S. exhibit no "crowding out" and the average wage across "crowded" occupations is 74 percent lower than the average wage across "crowded out" occupations[22].

THE URGENT PROBLEMS OF LOW-INCOME AFRICAN AMERICAN MALES

The State of Black America 2007 report was dedicated to various aspects of the plight of African American males. In many ways, two different worlds exist for African American males. In one world, the number of black men graduating from college has quadrupled since the passage of the 1964 Civil Rights Act; in the other, more black men are earning high school equivalency diplomas in prison each year than are graduating from college. In one world, black families consisting of a father and a mother have a median family income nearly equal to white families; in the other, more than half of the

---

[19] See *http://nces.ed.gov/programs/coe/2006/section2/table.asp?tableID=475*

[20] Based on analysis of Current Population Survey, March Supplement, 2006.

[21] See Darrick Hamilton. "The Racial Composition of American Jobs." In *The State of Black America 2006* report. National Urban League. 2006.

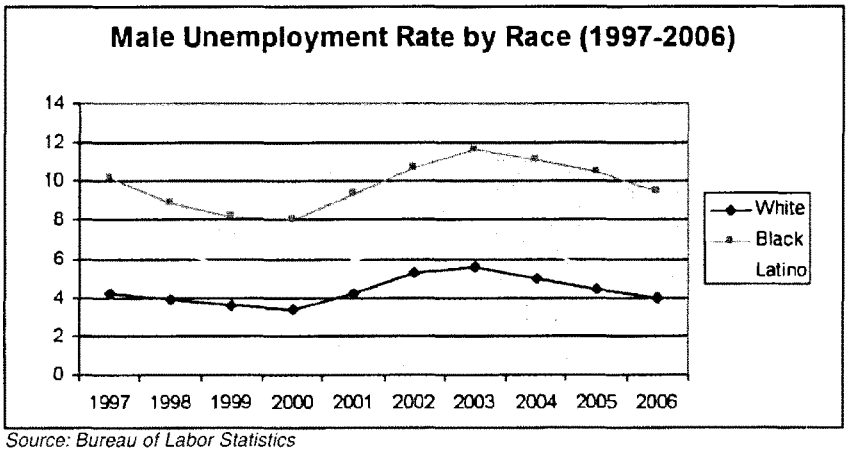
[22] Ibid.

nation's 5.6 million black boys live in fatherless households, 40 percent of which are impoverished[23]. The existence of these two worlds is both an example of what is possible, and a warning about the consequences of marginalization, racism and inequality.

Unemployment

Although the unemployment rate for all racial and ethnic groups follows the economic cycle (higher during recessions, lower during recoveries), black male unemployment is consistently higher than any other group and usually twice that of whites (Figure 7). These high rates of unemployment among black males have been attributed to a lack of skills necessary for participation in today's mainstream labor force, a shortage of relatively well-paying jobs for those with less than a college education, and disproportionately high rates of incarceration, accompanied by discrimination by employers against former prisoners.

FIGURE 7



Source: Bureau of Labor Statistics

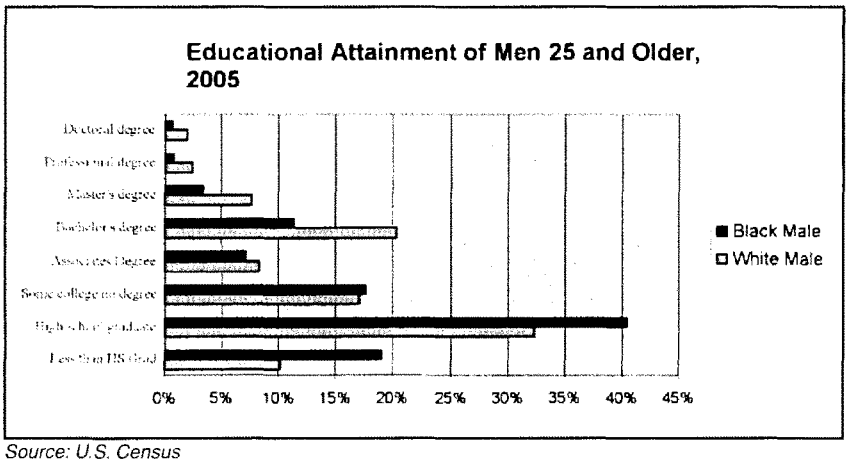
Education

One explanation for why black men experience higher rates of unemployment is the fact that the average level of educational attainment is lower for this group. In many inner cities, more than half of all black men do not finish high school[24], and in 2004, 72 percent of black male high school

[23] See Michael A. Fletcher. "At the Corner of Progress and Peril." The Washington Post. June 2, 2006.
[24] See Gary Orfield, ed. *Dropouts in America: Confronting the Graduation Rate Crisis*. Harvard Education Press. 2004.

dropouts in their twenties were jobless[25]. Nearly 20 percent of all black men over age 25 have no high school diploma compared with only 10 percent of white men (Figure 8). At the upper end of the educational spectrum, black men are getting master's degrees, PhD's and professional degrees at half the rate of white men. It has been well-documented that education is a major determinant of earning power and employability. According to the Bureau of Labor Statistics, in 2005 the unemployment rate of those without a high school diploma was nearly three times the unemployment rate of college graduates.

FIGURE 8



Source: U.S. Census

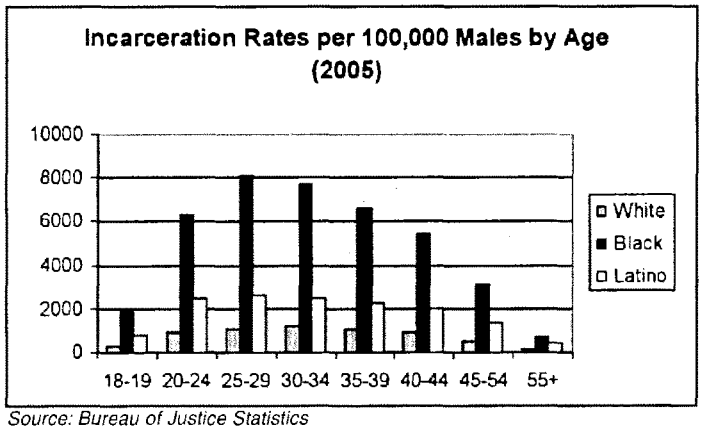
Incarceration

Another contributing factor to higher unemployment for Black men is their much higher incarceration rates. Although comprising only 12 percent of the U.S. population, nearly 40 percent of all prison inmates were black in 2005, and the black incarceration rate was *over 6 times* the incarceration rate for whites[26]. The rate of incarceration is highest for men between the ages of 25 and 29, when over 8 percent of black men are in prison, compared with only 1 percent of white men (Figure 9). The rate of incarceration among black males has been increasing since the 1990s due in large part to harsher punishments for repeat offenders (e.g. "three strikes law") and drug laws that impose harsher sentences on those found in possession of crack cocaine. In 2005, drug offenders comprised 20 percent of state prisoners

[25] See Bruce Western. *Punishment and Inequality in America*. Russell Sage Foundation. 2006
[26] Bureau of Justice Statistics

and almost 55 percent of federal prisoners[27]. A history of incarceration not only interferes with educational attainment, but also becomes a significant employment barrier; therefore, the effect of even a short imprisonment can last a lifetime.

FIGURE 9



Source: Bureau of Justice Statistics

The Opportunity to Own (Housing)

For most Americans, the largest single asset they will ever own will be their home. Homeownership means greater personal wealth. Empowering more Americans to become responsible homeowners takes us a step closer to closing the wealth gap that exists between blacks and whites in the United States. In addition to the economic benefits, homeownership has also been linked to educational gains for children, increased civic participation and even health benefits[28].

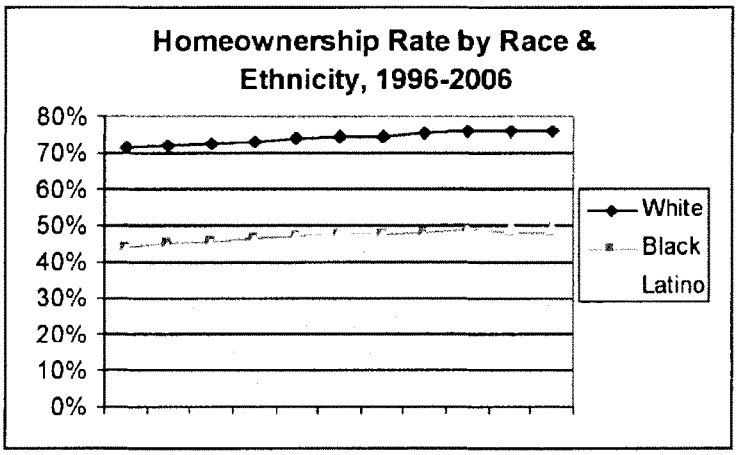
Homeownership Rates

According to the U.S. Census, nearly 70 percent of Americans owned their homes in 2006 – down slightly from the all time high in 2004. Yet there are troubling disparities in homeownership rates when segmented by race (Figure 10). After increasing for the previous ten years, homeownership has

[27] Ibid.
[28] National Association of Realtors. 2006.

declined for blacks in each of the last two years (from 49.1% in 2004 to 47.9% in 2006; nearly 28 points below whites).

FIGURE 10



Source: U.S. Census

The *National Urban League Homebuyer's Bill Of Rights*, released in March 2007, identifies four major obstacles standing in the way of more Americans owning their homes: 1) lack of net savings for down payments and closing costs; 2) lack of information on how to shop for homes and apply for loans; 3) lack of quality affordable units in livable locations; and 4) lack of consumer protection. Other studies have found that lower homeownership rates for African Americans are due to lower application rates, which are affected by differences in the role that families play in helping to generate mortgage down payments, as well as differences in wealth, income and marital status[29].

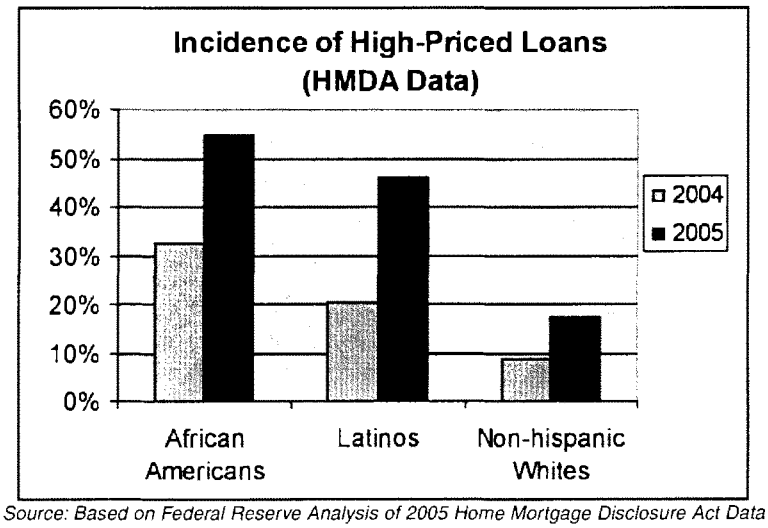
Lending Practices

Recently, the lending industry has been characterized by three main trends: (1) an increase in lending products, (2) more places to get a loan, and (3) a distinct need for housing counseling. Compared with only a handful of products available ten years ago, there are now a myriad of lending

[29] See Kerwin Kofi Charles and Erik Hurst. *"The Transition to Home Ownership and the Black-White Wealth Gap"*. *The Review of Economics and Statistics*. March, 2000; Donald Haurin, et al. *"Homeownership Gaps Among Low-Income and Minority Households"*. Ohio State University Working Papers, 07-02. January, 2007.

products including interest-only loans, reverse mortgages, and 15-year loans with balloon payments. Whereas commercial banks were once the primary providers of home loans, mortgage brokers now account for half of all originations and 70% of originations in the subprime market[30]. With the loosening of lending standards, minimal oversight of brokers and far more options, there is a greater chance that a borrower can be placed in an inappropriate loan. For example, between 35 percent and 50 percent of those with subprime loans could have qualified for a prime loan[31].

FIGURE 11



Source: Based on Federal Reserve Analysis of 2005 Home Mortgage Disclosure Act Data

According to Home Mortgage Disclosure Act (HMDA) data, in 2005 there was a 37.5 percentage point gap between African Americans and whites in the incidence of high-priced loans, compared to the previous year's gap of 23.7 percentage points. A Federal Reserve study found that almost 20 points of the difference is due to choice of bank resulting from aggressive marketing, lack of consumer education or fewer local lending choices. Just less than 8 points of the difference was due to borrower characteristics in the data such as loan size and income, while the remaining 10 points of the difference could not be explained by available lender or borrower characteristics.

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[30] See "Residential Mortgage Origination Channels." *MBA Research Data Notes*. September 2006.
[31] Fannie Mae, 2001.

Housing Segregation and Discrimination

While racial segregation has decreased over the last three decades, in part due to fair housing enforcement, segregation still persists in many areas and neighborhoods that are predominately minority are much more likely to be poor. On average, homes in predominantly minority neighborhoods are often worth less (according to one study, 18% less value), even accounting for differences in income[32]. The Census Bureau's *Racial and Ethnic Segregation in the United States* identifies only 8 of 220 metropolitan areas which had an increase in black-white segregation, while 203 experienced a decrease.

Finally, fair housing enforcement continues to be important. The National Fair Housing Alliance (NFHA) believes that there are at least 3.7 million violations of the Fair Housing Act against minorities in rental and sales alone, but less than one percent is reported or even detected. Support for fair housing enforcement has remained essentially level over the last few years, despite continued evidence of discrimination in rental, sales and lending markets.

The Opportunity to Prosper (Entrepreneurship)

Minority business enterprises (MBE) are defined as business entities in which minorities own 51 percent or more of the stock or equity. In 2002, MBEs represented 18 percent (4.1 million) of classifiable firms, grossed 8 percent of all annual gross receipts ($668 billion), and employed 9 percent of all paid employees (4.7 million)[33]. In that same year, there were 1.2 million African American-owned firms in the U.S. employing 754,000 persons and generating $89 billion in revenue[34]. The importance of minority-owned businesses to urban economic development is well documented. Minority-owned firms are more likely to locate in urban communities, making them more likely to hire minority workers, lowering local unemployment rates. They are also more likely to purchase from minority-owned suppliers, contributing to the growth of other minority-owned businesses. Despite these benefits, MBEs continue to face a number of barriers to firm formation and

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[32] See David Rusk. "*The Segregation Tax: The Cost of Racial Segregation to Black Homeowners*". Brookings Institution. 2001.

[33] See *The State of Minority Business Enterprises*. Minority Business Development Agency. August 2006.

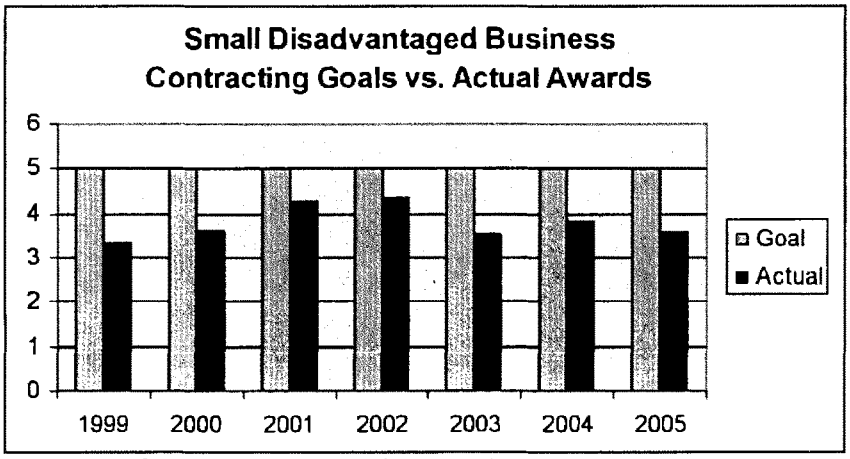
[34] Ibid.

growth including lack of financial capital, lack of social capital, lower human capital endowments, and limited access of minorities to broader consumer markets[35].

Government Contracting of Minority Business Enterprises

Procurement provides governments with a powerful way of promoting opportunities for MBEs and counteracting the effects of discrimination. Although set-aside programs exist at all levels of government including federal, state, city, county and special district[36], the established contracting goals often go unmet. A widely cited 1996 disparity study[37] by the Urban Institute reported that at the state and local government levels, minority-owned firms received only $0.57 for every dollar they would be expected to receive based on their availability[38]. The House Small Business Committee reports that since the beginning of the *Scorecard* report in 1999, failure of the federal government to meet its 5 percent small disadvantaged business goal has cost minority entrepreneurs $21.2 billion in contracting opportunities (Figure 12).

FIGURE 12



Source: House Small Business Committee, Scorecard VII

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[35] See Maria *Enchautegui*, et. al. "Do Minority-Owned Businesses Get a Fair Share of Government Contracts?" Urban Institute. 1996.

[36] Special district includes airports, water, sanitation, parks and schools.

[37] Disparity is measured by comparing the percentage of all government contract dollars received by minority-owned (women-owned) businesses to the percentage of all businesses "ready, willing and able" to carry out government contracts that are minority-owned (women-owned).

[38] See Maria *Enchautegui*, et. al. "Do Minority-Owned Businesses Get a Fair Share of Government Contracts?" Urban Institute. 1996.

The three main barriers to minority participation in government contracting are contract bundling, subcontracting and coding errors. Bundling contracts is the act of combining 2 or more contracts into a large single agreement. This has most often pushed smaller minority-owned firms out of the competition while subcontracting has most often benefited prime contractors over (typically minority) subcontractors. Procurement data can also be distorted by coding errors in that companies coded as "small" are sometimes misidentified as such or in fact no longer qualify as small as a result of having been acquired by larger businesses during the course of the contract.

Small Business Financing

Loan markets have become more competitive over the past decade due to an expanding nationwide market for credit lines & credit cards along with the entry of large regional banks in local markets. Although banks are the most often used credit source for small firms in general, minority firm owners are less likely to have bank loans of any kind[39]. Research has also found that African American and Latino firm owners face significantly greater loan denial probabilities than white male firm owners and are often charged higher interest rates[40].

In recent years, microfinancing has grown in popularity as source of capital for microenterprises (a business with five or fewer employees), which account for 94 percent of all firms and are overwhelmingly owned by minorities and women. Patterned after the successful Grameen Bank in Bangladesh, microfinancing promises great benefits. The Aspen Institute has estimated that it can be implemented at one-tenth of the cost of creating opportunities through tax breaks and other public subsidies. However, there are some challenges to microfinancing, including the fact that competition limits interest rates U.S. microlenders can charge, making it less profitable than in developing nations, and U.S. businesses typically have greater capital requirements and need larger-sized loans faster.

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[39] See Karlyn mitchell and Douglas Pearce. "Availability of Financing to Small Firms Using the Survey of Small Business Finances." For SBA Office of Advocacy. May 2005.

[40] Ibid.

CONCLUSION

The Opportunity to Thrive. The Opportunity to Earn. The Opportunity to Own. The Opportunity to Prosper. Each of these opportunities for upward economic and social mobility are available in few other countries outside the United States. Therefore, maintaining equal access to these opportunities is a vital part of preserving the very principles that make this country unique and will prove to be an effective way to eliminate gaps in income, wealth and educational attainment within this country that are too often defined along the lines of race or socioeconomic status.

Although this document serves as a vehicle through which to develop a serious plan of action to address the persistent inequalities faced by those in urban communities; all Americans, regardless of place of residence or racial identity, can benefit from the policy recommendations presented in *The Opportunity Compact.* Furthermore, there is a role for all parties to play — private citizens, national, state and local governments, community-based service providers and the business community — as we together seek to strengthen our nation by maximizing the potential of all our citizens. By generating new ideas, initiating productive partnerships and fostering collaboration, *The Opportunity Compact* seeks to expand access to the incentives and rewards that act as the driving force behind what makes this country great – personal responsibility, initiative and hard work.

ACKNOWLEDGEMENTS

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Jobs II: African American Males

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Children

Dr. Avis Jones-DeWeever (Institute for Women's Policy Research); Ms. Julia Isaacs (Brookings Institution); Dr. Valerie Polakow (Eastern Michigan University)

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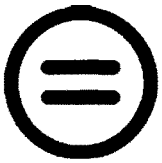

National Urban League

Empowering Communities. Changing Lives.

The National Urban League's Homebuyer's Bill of Rights

1. The Right to Save for Homeownership Tax-Free

Recommendation – Create Individual Development Accounts for Homeownership administered by employers as matched savings plans for the future purchase of a home.

- Similar to 529 plans, the IDA for Homeownership would be a tax-advantaged investment vehicle designed to encourage saving for the future home purchase expenses of a designated beneficiary.

2. The Right to High-Quality Homeownership Education

Recommendation – Redesign of an industry-wide system that integrates pre- and post-purchase homeownership education and counseling; and expansion of HUD's budget for housing counseling from $42 million to at least $80 million in FY 08.

- HUD funding does not cover all costs of homeownership education and counseling and limits non-profits' ability to collect fees for their services. The private sector contributes only a small share of funding to homeownership education and counseling efforts, and even if the industry's (banks) support matched HUD's, non-profit education and counseling programs would be grossly under-funded if services were expanded to include a larger share of first-time buyers.

3. The Right to Truth and Transparency in Credit Reporting

Recommendation – Demystify the credit reporting system through creation of a public education and awareness campaign about credit scoring and its impact on wealth creation, and establishment of a penalty structure for credit reporting bureaus that maintain inaccurate client files.

- In the United States, once every 12 months, each person is entitled to one free credit report from each of the three nationwide consumer credit reporting companies: Equifax, Experian and TransUnion. Under fear of penalty, credit reporting agencies should be required to collect, maintain, and report data that is accurate, relevant, and up-to-date.

- The Government could offer a free publication called Understanding Your Credit Report and Credit Score. This publication would provide sample credit report and credit score documents with explanations of the notations and codes that are used. It would also contain general information on how to build or improve credit history, and how to check for signs that identity theft has occurred. The publication could be made available online.



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4. The Right to Affordable Housing for Working Families

Recommendation – Cities and other municipalities should require that at least 30% of all new and rehabilitated market-rate construction be made available for purchase and rental by households earning up to 80% of the locality's area median income (AMI).

- A blend of housing types would include single-family homes, townhouses, condominiums, starter homes, and apartments that are affordable to an area's workers such as: teachers, firefighters, municipal employees and the other workers who provide essential services in communities – policing, healthcare, manufacturing, and retail workers.

- A program that once held great promise in this regard – HOPE VI – is broken and should be re-thought and re-built. With a vague and changing mandate, HOPE VI strayed from its initial intent of rehabilitating 6% of the nation's public housing stock; instead, it has funded the demolition of housing and displaced many thousands of poor families to meet the demands of private developers. A "one-for-one" unit replacement strategy must be employed.

- New York City provides an innovative example of one such local approach to the issue. Under their current program, known as "421-a", developers of new and rehabilitated buildings in most neighborhoods are eligible for a 10- to 15-year exemption from the increase in real estate taxes resulting from the work. Developers do not receive a tax break unless 30 percent of all the units are affordable to families earning no more that 50 percent of the median income for the area, or about $35,000 for a family of four.

5. The Right to Fairness in Lending

Recommendation – Lenders must gauge ability to repay and offer borrowers the most affordable and well-suited products for which they qualify. Lenders should demonstrate commitment to the building of personal assets. All participants in the making, collecting, holding and buying of debt have a duty to deal fairly with the borrower. Our society should pay particular attention to communities that have traditionally been underserved or at a disadvantage when obtaining credit, including communities of color and the elderly, to ensure they have full access to the most appropriate loan products that can help them build and maintain wealth. Those who are shown to have taken advantage of vulnerable populations by offering inappropriate products or charging unjustified rates fees should be held fully accountable for their actions.

- NUL believes there must be strict limits to prepayment penalties. Prepayment penalties must not apply after the expiration of teaser rates in ARM prime and subprime loans. NUL believes at least a 90 day time period is needed so that borrowers have sufficient time to shop for and receive another loan if necessary. For fixed-rate subprime loans, prepayment penalties must not extend beyond two years. Responsible lenders have voluntarily applied limits



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to prepayment penalties similar to NUL's recommendations. Limiting prepayment penalties prevents borrowers from being trapped in abusive and predatory loans.

- NUL asserts that steering borrowers qualified for prime loans into subprime loans is an unfair and deceptive practice. Numerous studies have documented that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans. Consequently, borrowers lose substantial amounts of wealth when they are steered into high-cost loans. NUL further urges prohibition of incentive compensation, such as yield spread premiums, that is based on the terms of a loan.

- NUL believes that escrows must be required for all loans, prime and subprime, fixed and adjustable rate. Currently, since escrows are not required, deceitful lending flourishes when unscrupulous brokers and lenders blind borrowers to the true cost of their loans by not discussing payments for insurance and taxes.

- NUL agrees with the Comptroller of the Currency that stated income or low doc loans are prone to abuse when predatory lenders and brokers inflate borrowers' incomes to qualify them for unsustainable loans. Stated income or low doc loans must be prohibited on subprime and/or ARM loans. Clear protections and procedures must be established for reduced documentation loans including the requirement that pay stubs, tax forms, and other acceptable verification of income must be received by the lender.

- NUL maintains that lenders must be held liable for deceptive and fraudulent practices committed by brokers with whom they do business. Since up to 70% of the loans originated start with brokers, lenders must be motivated to strictly monitor broker behavior. Likewise, lenders and brokers must face serious financial penalties if they intimidate or pressure appraisers to meet certain home values, as fraudulent appraisals have contributed significantly to the rise of delinquencies and defaults. NUL further believes that individual mortgage brokers and loan officers must be licensed and registered, and required to act "in the best interest" of the consumer under guidelines comparable to those that financial advisors are subject to.

- The National Urban League supports the passage of legislation that works to better protect the consumer such as the Mortgage Reform and Anti-Predatory Lending Act of 2007 (H.R. 3915), recently passed by the U.S. House of Representatives.



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6. The Right to Fair Treatment in Case of Default

Recommendation – Across the country, people have lost jobs, become temporarily disabled, incurred unexpected medical expenses or have had to make a choice between paying the mortgage or repairing the car that gets them to the job that pays that mortgage. Laws regarding mortgage default and foreclosure differ from state to state and mortgage lenders and servicing companies vary in the way they approach delinquent borrowers. NUL is generally pleased that many lenders, as well as the big mortgage gatekeepers such as Freddie Mac, FHA and the VA, have amended their approach to managing delinquencies, having finally realized that it is more cost effective to help a borrower to stay in his/her home than to pursue foreclosure and then confront the need to deal with owning, managing, and selling the resulting real estate. Consequently, there are myriad scenarios that can play out as a mortgage delinquency progresses; however, in the case of default NUL believes that three key provisions must be afforded to homebuyers:

- Opportunity for restructuring of a loan if the loan is determined to be onerous including the possibility of conversion to a fixed rate loan.
- Fair and unbiased counseling.
- Access to the holder of the loan for development of reasonable workout plans where the objective is preservation to the greatest extent possible and foreclosure is a least resort after all other measures have been exhausted.

7. The Right to Aggressive Enforcement of Fair Housing Laws

Recommendation – Create a HUD Task Force to vigorously investigate and prosecute violations of fair housing laws, and authorize congressional oversight hearings to ensure accountability.

- In a multiyear study using homebuyer "tests" funded by HUD and completed in 2005, the National Fair Housing Alliance found that potential homebuyers were steered to white or minority neighborhoods 87% of the time.
- In collaboration with non-profit organizations, the Task Force would investigate and process mortgage lending complaints, including such actions as inappropriate steering to sub-prime loans, stricter qualification standards for minority borrowers and higher rates and/or conditions for minority homebuyers.

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A Brief Note on Joblessness in Indian Country

According to the most recent data published by the US Bureau of Indian Affairs, the rate of joblessness on American Indian reservations and in Alaska Native villages was a staggering 49%.[1] Over the last decade, this rate has not been significantly below 50% with the exception of one year.[2] The rate is calculated on the basis of the total available work force, including those who do not actively seek work because they know that none is available in their community.

Reservations in some parts of the country show joblessness rates that are much higher. Indian joblessness on reservations in the Northern Plains was calculated by BIA as averaging 77%. Reservations in the Northern Rockies showed an average rate of 67%, while those in most of Arizona, Utah and Nevada averaged a rate of 63%.

These rates are many times higher than is the unemployment rate for the country as a whole. With a recession now officially one year old, the US Bureau of Labor Statistics reported that the national unemployment rate in November was 6.7%.[3] Economists are concerned that it may rise to nearly 10% in the coming months. The rate has been high enough to trigger the federal government to consider or enact economic stimulus programs running to as much as several trillion dollars.

Yet the national unemployment rate pales in comparison to the severity of joblessness in Indian Country.

Even the broadest measure of joblessness for the US population as a whole does not come close to the rate for Indian Country. The so-called U-6 alternative measure of labor underutilization, which includes discouraged workers, others only marginally attached to the labor force and those employed only part time for economic reasons, was 12.5% in November.[4] In concept, this rate resembles the way joblessness is calculated in the BIA labor force report series.

Other factors compound the seriousness of joblessness across Indian Country. These include low educational attainment levels, a product of decades of

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[1] US Department of the Interior, Bureau of Indian Affairs, Office of Indian Services. (2005). *2005 American Indian Population and Labor Force Report.*

[2] See the BIA American Indian Population and Labor Force Reports for 1997, 1999, 2001, 2003 and 2005.

[3] US Department of Labor, Bureau of Labor Statistics. (December 5, 2008). "The Employment Situation: November 2008."

[4] See Table A-12. Alternative measures of labor underutilization in the December 5, 2008 BLS release on the employment situation.

underinvestment in Indian education, a lack of work experience among Indian youth and adults and endemic poverty.

Detailed data from the 2000 Census illustrates the extent of these problems.

Indicators of the Ability of American Indian/Alaska Native Workers to Compete in the 21st Century Workforce[5]

Indicator	AI/AN Population on Reservation	AI/AN Population Nationally	Total US Population All Races
Adults 25 and Older with Less than HS Diploma or GED	35.9%	29.1%	19.6%
Unemployment Rate as Officially Measured	21.9%	12.4%	5.8%
Labor Force Participation Rate	51.5%	61.1%	63.9%
Persons 16 and Older with No Work Experience at Any Time in 1999	44.0%	32.5%	30.5%
Poverty Rate	39.4%	25.7%	12.4%

By any measure, the lack of work on Indian reservations across the country and in Alaska Native villages warrants increased federal resources even more than the alarming increase in joblessness within the general US population.

Compiled December 9, 2008 by Norm DeWeaver, Staff for the Census Information Center provided by the Indian and Native American Employment and Training Coalition, Early 1990's-2005

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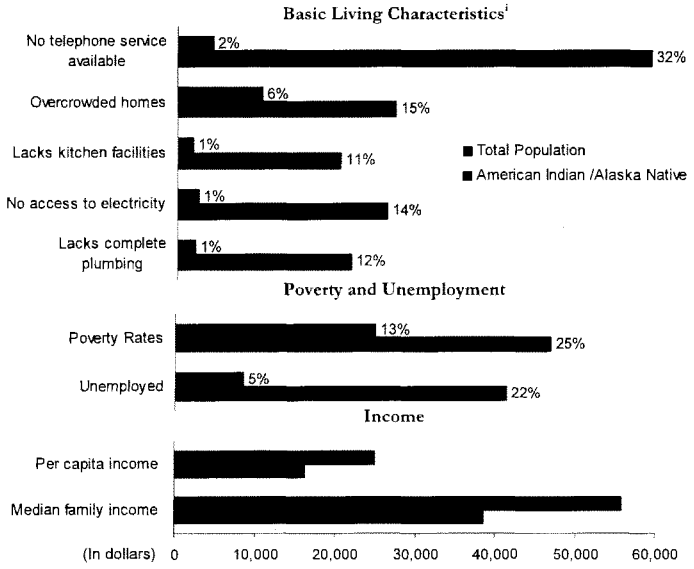
[5] US Department of Commerce, Bureau of the Census. (2002). *2000 Census of Population and Housing, Summary File 3.*

DEMOGRAPHIC PROFILE OF INDIAN COUNTRY

Prepared February 17, 2009

POPULATION STATISTICS

- Total American Indian/Alaska Native alone population: 2.48 million or 0.9% of the US population.
- Total AI/AN in combination with other races: 4.12 million or 1.5% of the US population.
- States with the highest proportion of AI/AN: Alaska (19%), Oklahoma (11%), New Mexico (10%).
- States with the largest populations of AI/AN: California, Oklahoma, Arizona, Texas, New Mexico.



HEALTH DISPARITIES

- Native people die at higher rates than other Americans from
  - tuberculosis: 600% higher
  - alcoholism: 510% higher
  - diabetes: 189% higher
  - vehicle crashes: 229% higher
  - injuries: 152% higher
  - suicide: 62% higher
- Indian youth have the highest rate of suicide among all ethnic groups in the US and is the second-leading cause of death for Native youth aged 15-24.[ii]

TRIBAL ECONOMIES[iii]

- Between 1992 and 1997, the number of Native-owned businesses grew by 84% to a total of 197,300 businesses, and their receipts increased by 179%.
- Between 1990 and 2000, income levels rose by 33% and the poverty rate dropped by 7%, with little difference between those tribes with gaming operations and those tribes without gaming.

- Real per capita income of Indians living on reservations is still less than half of the national average and unemployment is still double the rest of the country.

PUBLIC SAFETY AND SECURITY

- In 2001 half the tribes in the lower 48 states employed at least 1 full-time sworn officer with general arrest powers.[iv]
- Indian Country has a 42% unmet staffing need in law enforcement officers. There are 2,555 officers, yet a needed total of 4,409, resulting in a gap of 1,854 officers.[v]
- About 59% of tribes have a tribal judicial system.[vi]
- The rate of aggravated assault among American Indians and Alaska Natives is roughly twice that of the country as a whole (600.2 per 100,000 versus 323.6 per 100,000).[vii]
- 1 out of 10 American Indians (12 and older) become victims of violent crime annually.[viii]
- More than 25 Indian tribes govern lands that are either adjacent to borders or directly accessible by boat from the border. These tribal lands encompass over 260 miles of international borders – a distance 100 miles longer than California's border with Mexico.

ENERGY ON TRIBAL LANDS

- Indian land contains an estimated 10% of all energy resources in the United States.

HOUSING AND INFRASTRUCTURE

- Native Americans are becoming homeowners at an increasing rate, 39% more from 1997 to 2001.
- Indian Reservation Roads (IRR) comprise over 104,000 miles of public roads and are owned by the Bureau of Indian Affairs (BIA), Indian tribes, states and counties.
- More than 65 percent of the system is unimproved earth and gravel, and approximately 24 percent of IRR bridges are classified as deficient.
- While the number of fatal crashes in the nation declined 2.2 percent over the past 25 years, the number of fatal motor vehicle crashes per year on Indian reservations increased 52.5 percent.

FORESTRY

- There are 302 forested Indian reservations which encompass 17.9 million acres of Indian forest lands – 7.7 million acres of timberlands and 10.2 million acres of woodlands.
- 199 reservations contain timberlands and 185 reservations contain woodlands.

EDUCATION[ix]

- The number of American Indian and Alaska Native students enrolled in colleges and universities and the number of postsecondary degrees awarded has more than doubled in the past 30 years.
- Only five percent of American Indians and Alaska Natives have received graduate or professional degrees, compared to 10 percent for the total population, and only nine percent of American Indians have earned bachelor's degrees compared to 19 percent for the US population.

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[i] U.S. Census, 2000; Energy Information Administration, *Energy Use and Renewable Energy Development Potential on Indian Lands*, 2000; 2006 GAO 06-189 Report , *Challenges to Assessing and Improving Telecommunications For Native Americans on Tribal Lands*

[ii] SAMHSA, *National Survey on Drug Use and Health. 2003*

[iii] Kalt, J. & Taylor, J. (2005). *American Indians on Reservations: A Databook of Socioeconomic Change Between the 1990 and 2000 Censuses.* Cambridge, MA: Harvard Project on American Indian Economic Development.

[iv] US Department of Justice, Bureau of Justice Statistics, *2002 Census of Tribal Justice Agencies*

[v] BIA *2006 Gap Analysis* of police to service population based on the FBI's 2004 Uniform Crime Report and BIA data

[vi] US Department of Justice, Bureau of Justice Statistics, *2002 Census of Tribal Justice Agencies*

[vii] Rennison, C. (2001). Violent Victimization and Race, 1993-98. U.S. Department of Justice, Bureau of Justice Statistics, March, (NCJ 176354).

[viii] 2004 report, *American Indians and Crime, A BJS Statistical Profile, 1992-2002*

[ix] DeVoe, J.F. and Darling-Churchill, K.E. (2008). *Status and Trends in the Education of American Indians and Alaska Natives.* Washington, DC: U.S. Department of Education. National Center for Education Statistics. (NCES 2008-084).

Labor Market Indicators from 2000 Census

The lack of labor force attachment and its consequences are tragically illustrated by the most complete profile of the Native population available, that from the last Census. The 2000 Census of Population reveals that American Indian and Alaska Native people not only have the highest unemployment rate of any racial or ethnic segment of the population, but that they are the least prepared to compete in the 21st century workforce. Further, these indicators also show that conditions are even worse in the reservation areas that a majority of Section 166 grantees serve.

Indicators of the Ability of American Indian/Alaska Native Workers to Compete in the 21st Century Workforce

Indicator	AI/AN Population on Reservation	AI/AN Population Nationally	Total US Population All Races
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Persons 16 and Older with No Work Experience at Any Time in 1999	44.0%	32.5%	30.5%
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Source: Data on the American Indian/ Alaska Native "Alone" Population, Summary File 3, 2000 Census of Population, US Census Bureau

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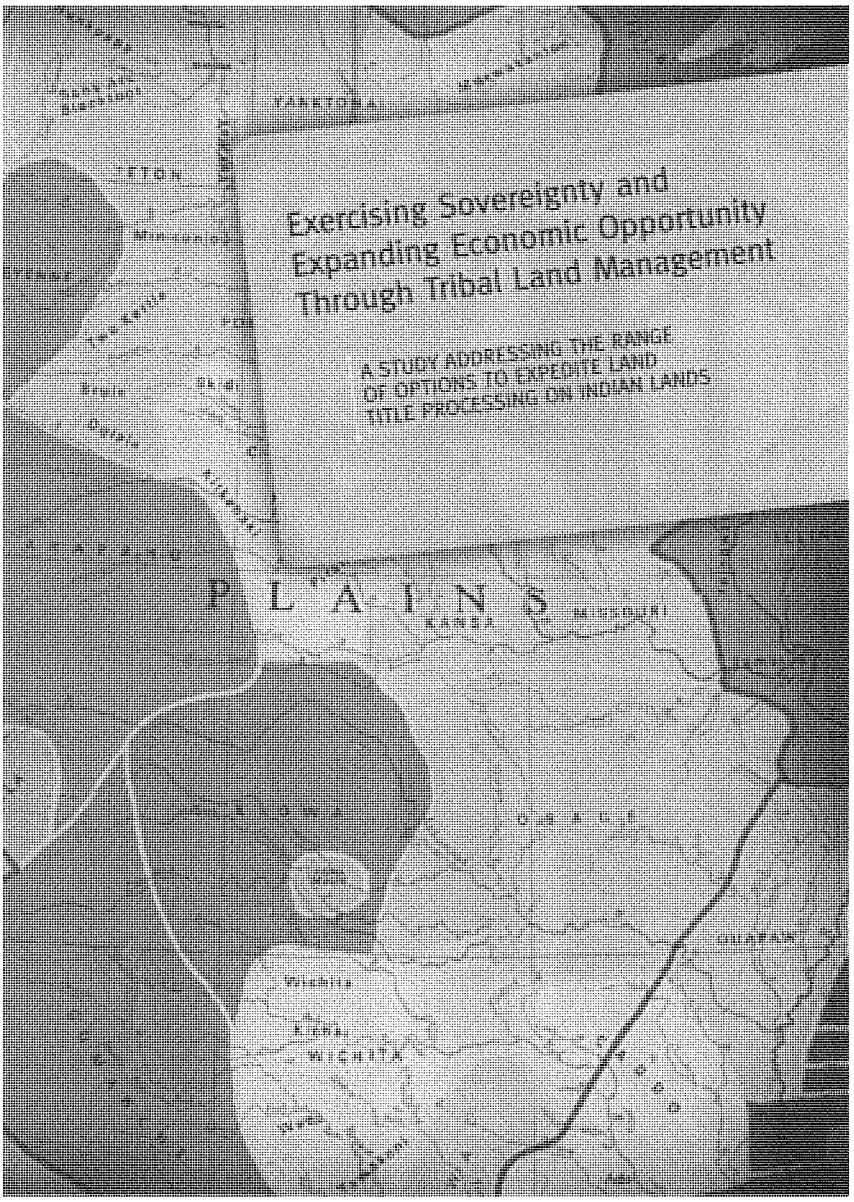
Exercising Sovereignty and
Expanding Economic Opportunity
Through Tribal Land Management
A STUDY ADDRESSING THE RANGE
OF OPTIONS TO EXPEDITE LAND
TITLE PROCESSING ON INDIAN LANDS
PLAINS
KANSA
MISSOURI
OSAGE
WICHITA

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The information contained in this report is not intended to be comprehensive but to provide an introduction to relevant issues and policies and some preliminary thoughts about options available to tribal (and other) policymakers. The positions and opinions found within this paper are the views of the authors only and are not representative of the views of the NCAI, the NCAI Policy Research Center or First Nations Development Institute.

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EXECUTIVE SUMMARY

While the United States faces one of the most significant housing crises in the nation's history, many forget that Indian housing has been in crisis for generations. This report seeks to take some important steps toward a future where safe, affordable, and decent housing is available to Native people in numbers sufficient to meet the housing needs that exist in Indian country today.

This study provides first-of-its-kind analysis of a critical barrier to homeownership on Indian lands. It analyzes the success of tribes that have taken responsibility (in whole or in part) for administering the land title process on tribal lands. It also addresses the challenges those tribes have faced.

While recent policy interventions (like the 184 loan product of the Department of Housing and Urban Development (HUD)) have encouraged expanded mortgage lending on Indian lands, the lengthy time often required to generate Title Status Reports (TSRs) for many Native peoples poses a critical threat to homeownership on Indian lands. Some major banking institutions have abandoned the 184 program (or not utilized it in the first place) because of frustrations with the process for generating title reports on reservation lands.

Whether managed by state governments, local governments, or private contractors (on the behalf of state or local governments), title processing is almost universally faster and more efficient on non-Indian lands. The exceedingly slow title processing on Indian land presents at least three major challenges for Native nations: sovereignty, economic development, and equity. With regard to sovereignty, land title processing impacts the capacity of tribal governments to make and enforce their own decisions. With respect to economic development, the frustratingly long process for generating a title report leads some —both tribal leaders and citizens—to give up completely on dreams of home ownership for tribal members and on successful economic development for the tribe. Finally, this barrier presents a fundamental inequity. Native people who wish to build, improve, or purchase a home on Indian lands face a barrier to their dream that is not faced by any other person or community in America.

The case studies and profiles presented in section 2 detail remarkably different tribes that share very similar experiences as they attempt to transform the title process for their communities. Each tribe we interviewed identified a positive motivation (i.e., the tribe wants to exercise sovereignty and manage this process) and a negative

motivation (i.e. the tribe knows there is a significant backlog and the Bureau of Indian Affairs (BIA) is not going to clear it unless we step in) for playing a role in land title processing. The case studies also identify the commonalities among tribes related to the process for transferring Land Title and Records Office (LTRO) functions from the BIA to the tribe, as well as the outcomes of that process. Interviews with BIA regional offices revealed promising practices that would significantly improve land title processing if enacted in all regions.

The data in the report supports a number of conclusions:

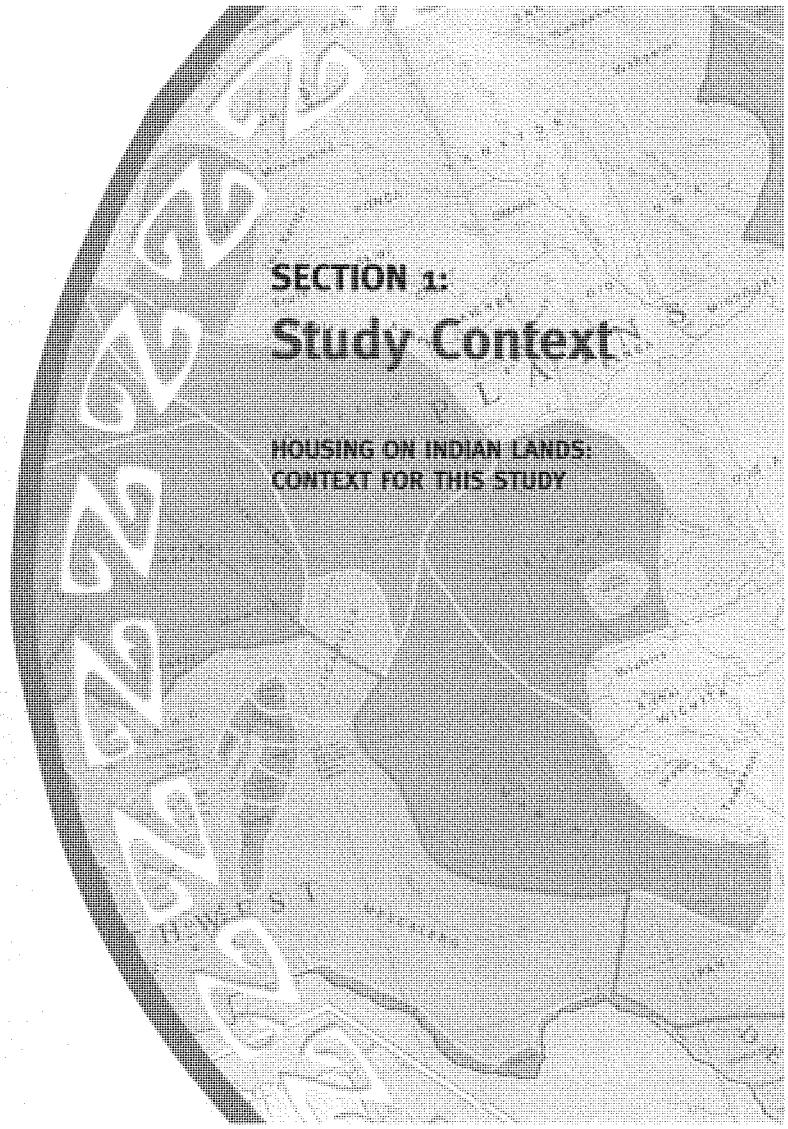
- Tribal LTROs have had positive impacts on their communities.
- The BIA does not provide tribal LTROs with sufficient funds for setup and operation.
- Tribes that lack the resources to pay for the LTRO transition need alternative ways to manage LTRO functions.
- Creative alternatives for establishing tribal LTROs may exist and should be developed.
- Related policies can expedite the ultimate goal of expanded tribal homeownership.
- The BIA needs to clarify and standardize their land management processes.
- Additional tribal LTRO pilot sites will likely enhance existing and future policy.

This report includes many important recommendations that are supported by data:

- Clear the backlog of encoded and updated title documents (Recommendation 1).
- Standardize the LTRO process and develop consistent messages across both local and regional BIA offices (Recommendations 2-3).
- Identify and support tribes interested in managing the land title process through pilot studies, training, and technical assistance (Recommendations 4-6).
- Conduct detailed studies of the costs associated with start-up and ongoing management of tribal LTROs (Recommendation 7).
- Provide access to model citizen education strategies, alternative title processing systems, and other policies that can expedite tribal homeownership (Recommendations 8-10).

INTRODUCTION

This report provides first-of-its-kind analysis of the experience of tribes seeking to expedite the processing of land title on Indian lands. To frame the report's findings, Section 1 outlines the significant obstacles to homeownership strategies for Native communities, then addresses the motivations for conducting the study, details the research methods, and outlines the insights of the Study Committee that guided the Research Team's activities. In Section 2, the report delves into the experiences of five tribes that are managing aspects of the land title process in their communities. At least three Native nations currently compact or contract with the BIA to manage all aspects of the land title process: Confederated Salish and Kootenai Tribes (CSKT), Confederated Tribes of the Colville Reservation (Colville), and Morongo Band of Mission Indians. Several LTRO staff members and tribal members at Morongo Band of Mission Indians were interviewed for this report, on site; CSKT and Colville were not available for a site visit at the time of our research, due to the Trust Asset and Accounting Management System (TAAMS) conversion process occurring at that time (an explanation of this software is provided later in the report; it is a necessary item for a full-fledged tribally run LTRO office). However, we provide two profiles of the LTRO establishment process for CSKT and Colville, based on public knowledge, with some additional feedback from members of the advisory committee. At least two other tribes—the Saginaw Chippewa Tribe of Michigan and Oneida Nation of Wisconsin—manage some aspects of the land title process (but do not compact or contract for all aspects of the process), and on-site interviews with key LTRO staff and other stakeholders from these two tribes are included in this section. In Section 3, the report details findings from a site visit and in-depth interview at BIA regional offices—the Northwest Office in Portland, Oregon, and the Great Plains Office in Aberdeen, South Dakota. Finally, Section 4 of the report draws conclusions and makes specific recommendations about the future of land title processing on Indian lands.



SECTION 1:
Study Context

HOUSING ON INDIAN LANDS: CONTEXT FOR THIS STUDY

SECTION 1: STUDY CONTEXT

Housing on Indian Lands: Context for This Study

As an increasing number of Americans face the reality of foreclosure, financial institutions struggle to stay afloat, and Congress enacts bold recovery measures, many forget that Indian housing has been in a state of crisis for generations. Forty percent of on-reservation housing is considered substandard (compared to six percent outside of Indian country), and nearly one-third of homes on reservations are overcrowded. Less than half of the homes on reservations are connected to public sewer systems, and 16 percent lack indoor plumbing.[1] This report seeks to take some important steps toward a future where safe, affordable, and decent housing is available to Native people in numbers sufficient to meet the housing needs that exist in Indian country today. It will not be a short journey.

The contemporary challenges for Indian housing find their source in successive federal policies that have undermined the availability of adequate housing on Indian lands for hundreds of years. The removal and allotment eras substantially altered both the volume and type of land available for the development of Indian housing. Proponents of homeownership look to the Homestead Act as a keystone moment in the history of "the American Dream" of homeownership. However, this view fails to acknowledge that the Homestead Act depended upon the allotment policy's confiscation of nearly two-thirds of Indian lands to provide a large amount of land for non-Indian settlement (framed as "surplus" land at the time).[2]

Despite the devastating effects of these federal policies, dedicated federal funding for Indian housing strategies is a relatively recent phenomenon. It was not until the Self-Determination era began in the 1960s that the federal government actively focused on the housing needs of non-urban Native people. Policy to encourage the development of Indian Housing Authorities (IHAs) was only implemented in the early 1960s as a result of a 1961 departmental report that revealed the severe crisis in Indian housing. Although Congress established the U.S. Department of Housing and Urban Development (HUD) in 1965 to consolidate several housing programs and address nationwide housing concerns, a unified approach to tackling the unique and pronounced challenges in Native communities did not emerge until almost 30 years later. The creation of HUD's Office of Native American Programs (ONAP) provided the government with a structure through which to coordinate housing strategies, in partnership with tribes, to ensure safe, affordable, and decent housing for Native people.

The 1990s offered a number of important innovations in Indian housing. The 1996 enactment of the Native American Housing Assistance and Self-Determination Act (NAHASDA) was rightly seen as a significant event in the history of Indian housing.[3] NAHASDA consolidated a number of existing programs into the Indian Housing Block Grant (IHBG). This system empowered tribes to more effectively develop, implement, and manage strategies to meet the specific housing needs of their community. NAHASDA also created the Title VI program that provides guaranteed loans for the development of affordable housing projects. This funding source has provided gap financing in the early stages of development and has successfully supported innovative housing strategies such as the "Apache Dawn" project of the White Mountain Apache Tribe, a 250-unit housing project built using the first-ever mortgage revenue bond in Indian country.[4]

Section 184 of the Housing and Community Development Act of 1992 began to address one of the fundamental challenges faced by Indian housing—the lack of private mortgage financing. The program provided an assured federal payment of 100% of an outstanding mortgage balance if a borrower defaulted on his/her loan. The program authorizes the BIA and HUD to approve borrowers and land leases in order to guarantee loans from private lenders to Native American families, tribes, and housing authorities. The home and the leasehold interest in the home site are mortgaged and are subject to liquidation in case of foreclosure,

although eligible tribal members, the tribe, or the relevant Indian Housing Authority are first offered a chance to assume the leasehold interest and continue payments. In order to participate in HUD mortgage guarantee programs, HUD must review the tribe's legal ordinances which include: leasing, mortgage lending, eviction and foreclosure as well as the code enforcement process through the tribal courts system or another court of competent jurisdiction (designated by the tribe). In 2004, HUD expanded the Section 184 program to allow tribes to petition the agency for the right to extend their service area or "Indian Area" to include Native-owned homes off-reservation. These off-reservation units exist in areas where a particular tribe traditionally resided or where significant members now live. As a result, certain tribes can now apply the Section 184 program to all of their members residing within a particular state instead of just within their reservation's borders.[5]

Additional mortgage programs are offered by USDA Rural Development and the U.S. Department of Veterans Affairs. These programs are not uniquely tailored to Indian country, but they do provide qualified borrowers with access to affordable credit to purchase homes. These agencies have also partnered with ONAP and the BIA in efforts to improve the mortgage-lending process on Indian Lands and to provide resources that will better explain the process for accessing a mortgage on tribal lands.

Amidst these positive developments stands a persistent barrier—the unacceptably long process of generating a Title Status Report (TSR). A TSR takes the place of a title commitment for land that is held in trust. (The distinction relies on the unique federal obligation over trust lands.[6]) The TSR is a necessary precursor to issuing a mortgage for a property on trust land. Tribal members have reported waiting months and even more than a year for their TSRs to be processed. The National American Indian Housing Council (NAIHC) has reported that some major banking institutions have abandoned the HUD Section 184 program (or not utilized it in the first place) because of frustrations with the process for generating title reports on reservation lands.[7]

While federal law mandates that the BIA maintain land title records offices (LTROs) and record tribal land documents, federal law does not mandate that the federal recording system serve as the basis for determining priority among mortgagees. That this is, in fact, the practice of mortgagees results from the lack of an alternative reliable recording system. The data in this report will underscore this point by demonstrating that the establishment of tribal land records offices is not only an exercise in sovereignty but may also provide a system of recording mortgages and other title documents that is more efficient than the current system. This will likely result in increased mortgage lending.

In recent years, the Bureau of Indian Affairs has implemented a range of information management systems in an attempt to expedite title processing. The most recent iteration—the Trust Assets Accounting Management System (TAAMS)—is covered extensively in this report in the sections on site visits with specific tribes and particular BIA offices.

The lengthy process to attain a title report is rooted, in part, in historical policy failures. The allotment policy of the late-nineteenth and early-twentieth century allowed land allotted to Indians to be divided among their heirs (and so on, for generations). This policy led to a proliferation of fractionated interests in each tract of land, presenting an enormous impediment to housing development and undermining the efficient use of Indian land for other economic development purposes.[8] The intransigence of the problem has often served as the basis of the argument for continued BIA control over the land title process and often functions to magnify the inefficiencies of the process.

The problem of fractionation is also closely linked to difficulties managing probate. This is a particularly severe problem that costs time and resources in the management of ever-smaller parcels of land.[9] The federal government has attempted to address this problem through a variety of federal policy instruments, including the Indian Land Consolidation Act of 1983 and its subsequent amendments.[10] These efforts culminated in 2004 with the passage of the American Indian Probate Reform Act (AIPRA)[11],

which replaced state law with a universal federal probate code for Indian lands. The federal code was enacted "to limit fractionation, keep land in the hands of the Indian children of the owner, and encourage the drafting of wills."[12] At a fundamental level, the strategies outlined in this report are focused on clearing the significant hurdle posed by long wait times to receive TSRs.

Why conduct a study like this?

In light of the challenges detailed above, a study like this is essential. The intolerably slow title process on Indian land presents at least three challenges—to sovereignty, to economic development, and to equity. Whether managed by state governments, local governments, or private contractors (on behalf of state or local governments), title processing is almost universally faster and more efficient on non-Indian lands. In fact, international experts on title systems rightly claim that "only those societies with a settled system of land tenure and exchange will have achieved stability and economic progress."[13] In other words, the future economic success and political stability of Indian country is dependent—to no small degree—on effective and efficient land management systems.

On a macro level, land title processing impacts the capacity of tribal governments to make and enforce their own decisions. If the tribe wants to develop a housing project to meet the needs of its citizens, it faces a significant barrier. If the tribe wants to develop an enterprise, create a wildlife reserve, or change the designation of any tract of land at all, it needs to wait a considerable amount of time—sometimes years—before it can enact the plan. The above examples of the impediment to sovereignty also underscore the challenges to economic development. Tribal leaders and tribal members are frustrated by the lengthy and often unnecessarily complex process required to obtain a TSR. This frustration leads some, both leaders and citizens, to give up completely on dreams of home ownership for tribal members and successful economic development for the tribe.

Finally, this barrier presents a fundamental inequity. Native people who wish to build, improve, or purchase a home on Indian lands face a barrier to their dream that is not faced by any other person or community in America. There are, undoubtedly, barriers to homeownership for other Americans, but none that present such a persistent and pervasive challenge as the barriers created by the broken system for managing title on Indian lands. Therefore, addressing this subject presents innovations that can strengthen sovereignty, expand opportunities for economic development, and increase equity of access to homeownership for all Americans.

This study is a natural fit with the mission and vision of the two organizations leading the Research Team and those represented on the Study Committee. The NCAI Policy Research Center works to achieve the vision of "supporting Indian country in shaping its own future," and First Nations Development Institute believes that, "when armed with appropriate resources, Native peoples hold the capacity and ingenuity to ensure the sustainable, economic, spiritual, and cultural well-being of their communities."[14] The content of this report will support the innovation of Native people in shaping their own future. The case studies emphasize innovation at the individual tribal level and highlight areas that require systemic reform. The study was shaped by a diverse committee of experts and stakeholders from the tribal, federal, nonprofit, and private sectors, united by a shared goal: to fix a broken system in the interests of a brighter economic future across Indian country.

It is also important to note that this study is intended to be a foundational document on and introduction to this topic. It is one of the first reports to study the system for processing title on Indian lands in this level of detail, from both the tribal and BIA points of view. As we explored the expertise of the Study Committee, Research Team, and outside experts, it became clear there was much about land title processing options that still needed to be explored. While we initially gained a sense that a considerable number of tribes are seeking to address challenges with the title processing system, no one we interviewed proved to be entirely clear about which tribes were managing their own title process and what their experience had been.

Compiling the answers to these and other questions will better equip tribal and federal policymakers to most effectively address this significant challenge to the economic success of Native communities.

Research Methods

In order to understand the extent of the issues related to land title processing in Native communities, the Research Team went directly to people in the communities and organizations whose work touches these issues on a regular basis. These key informants guided the Research Team to form a strategy that would identify and address specific issues and problems with a particular focus on viable solutions. Project leaders established a research agenda, research parameters, and research protocols to collect the data needed to better understand the issues and make useful recommendations for addressing them. Researchers then identified and interviewed a number of experts and leaders in the areas of Native American land tenure, land title processing, and mortgage lending.

The data collection strategy included the following steps:

- reviewing a large body of literature to create a framing piece that examines the policies, issues, and challenges related to land management and land tenure issues for American Indian tribes (with a focus on barriers to homeownership)
- establishing a Study Committee of experts in the areas of land title processing, housing, and mortgage lending (particularly related to Native communities) to assist us in gaining important information about how policies are implemented in the field and to establish project focus and parameters
- interviewing representatives of tribes compacting and/or contracting with the Bureau of Indian Affairs (BIA) to control and implement LTRO functions
- completing on-site interviews with LTRO staff in at least one Native community with a fully functioning, tribally run LTRO, and closely examining others
- interviewing representatives of tribes that have instituted a number of the functions of an LTRO, but have not compacted or contracted with the BIA for all functions
- interviewing LTRO and supervisory staff at regional BIA LTRO offices

Project researchers and partners used these methods to identify common challenges and innovative strategies for operating LTRO functions, to compile useful information, and to make recommendations to tribes who wish to gain more control over and better manage their lands.

Reasons for Forming a Study Committee and Key Insights

The complex nature of the issues addressed in this study, coupled with the shared interest of many stakeholders, led NeighborWorks, NCAI, and First Nations to form a Study Committee of experts to guide and advise the Research Team as the research progressed.[15]

In addition to participating in a number of conference calls and two meetings—one to launch the study, another to shape the final research design—a representative group of Study Committee members were asked to participate in in-depth interviews to give their perspective on the issues to be addressed by the study. A number of themes emerged from these interviews that supported the findings of the fieldwork conducted as the study proceeded.

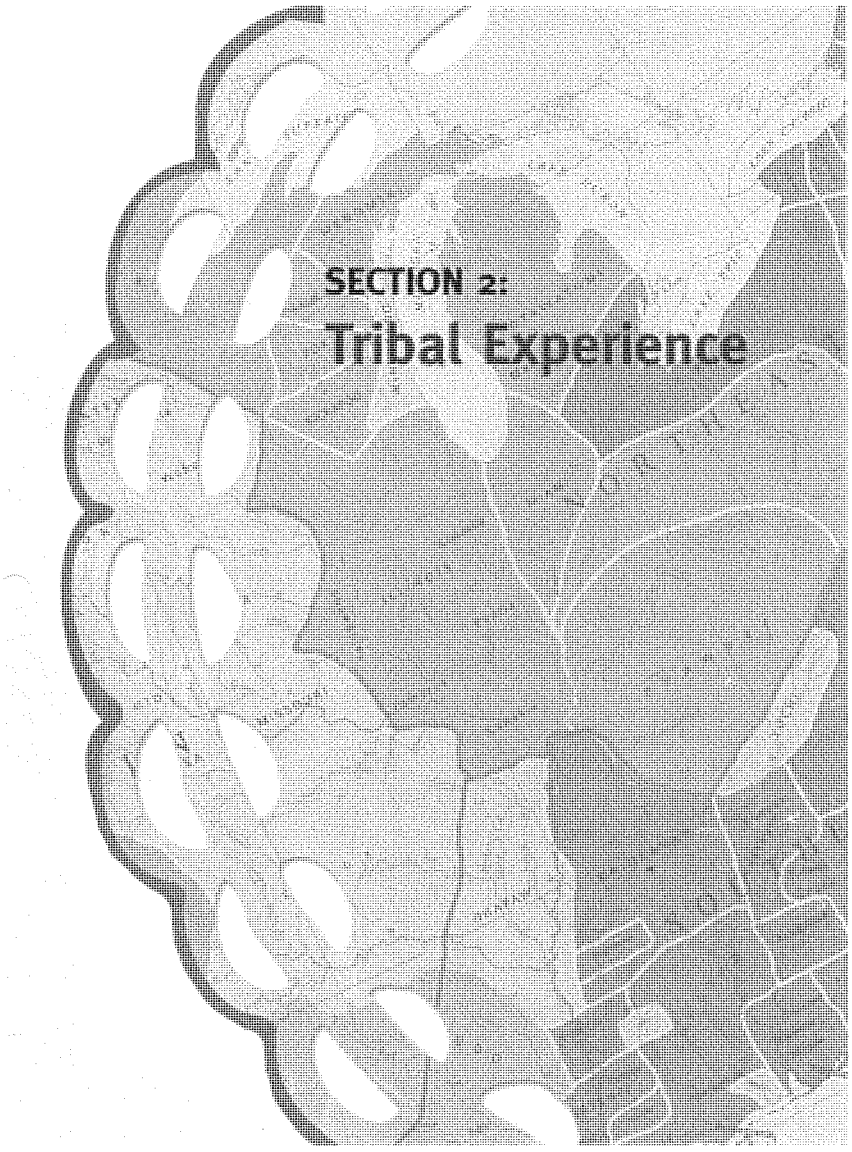
Key Findings from Study Committee Interviews

Study committee members and interviewees from tribes agreed on some key issues related to land ownership and management functions for Native Nations. First, it was agreed that tribes should not only be allowed but encouraged to gain more control over land, home, and business ownership sales and transactions, and to more directly participate in

realty, land title, and records processes. This could mean that a more streamlined BIA/tribal system for land title processing would include provisions where tribes were granted more control over sales and transactions and at least some of the resources necessary to implement them (or to implement them through tribally sanctioned entities). A critical component of any such proposal would be the flexibility to allow for local innovation. Interviews revealed a significant level of tribal interest and desire for land control that is likely to improve efficiencies of such functions as title tracking, certifying, and encoding.

The main issue facing both tribes and BIA offices in this regard seems to be that a system has been established over time, in the name of the "trust relationship" between tribes and the U.S. Government, granting effectual control over Native lands to the BIA. It should be possible for the United States to exercise trust responsibility to Native nations while encouraging true self-governance (sovereignty). The federal government should seriously examine laws and regulations that do not actually facilitate land title processes for tribes, and strengthen those that do effectively facilitate those processes. In many cases, these laws actually impede tribes from making progress in developing a land title process that meets their needs. Furthermore, the BIA is the BIA—a government agency, not a realtor or mortgage broker. Land title is a process that has significant private sector involvement for almost every other person in America. The knowledge of many BIA staff in this area appears to be somewhat limited, particularly in the workings of land title processing in the private sector. This means BIA staff who do have training and experience may lack a natural career path that would allow Indian country to continue to benefit from their expertise. Many knowledgeable staff leave, transfer, get promoted, or retire, forcing slowdowns that are due either to prolonged periods of training or cutbacks (i.e., no one is hired to take their place). This can result in inefficiencies, slowdowns in processing, and general confusion.

The study committee highlighted some promising practices (and related laws) that allow tribes to take the lead on effective land ownership, management, and control. One practice the committee underscored is mentioned several times in this report. The Indian Self Determination and Education Assistance Act of 1975, Pub. L. 93-638 25 U.S.C. Sec. 450, often referred to as the "Self Determination Act" or, simply, "Public Law 638," gives tribes the ability to compact and/or contract with the federal government to discharge government, utility, and other services and functions that were previously performed by the BIA. Four of the tribes whose LTRO offices are described in this report have taken advantage of this opportunity. Another is assignment law, which allows tribal members the equivalent right to will land to family members, so that they gain more control over anything that takes place on the land than they would have otherwise.


SECTION 2:
Tribal Experience

SECTION 2: TRIBAL EXPERIENCE

The three case studies and two profiles outlined in this section detail remarkably different tribes that share very similar experiences as they attempt to transform the title process for their communities. The case studies and analysis, along with information in the profiles, underscore the twofold challenge of improving LTRO processes. On the one hand, there is significant underinvestment in the resources necessary to get tribal land records updated. That is, when tribes take over the process and make significant investments of tribal resources, the records are brought up to date, and the process functions much more efficiently. On the other hand, the process itself is cumbersome. No matter how many resources are dedicated to improving title functions, federal regulations, the impact of the Cobell litigation, and several other external factors continue to keep land title processes from operating at maximum efficiency.

Each tribe we interviewed identified a positive motivation (i.e. the tribe wants to exercise sovereignty and manage this process) and a negative motivation (i.e. the tribe knows there is a significant backlog, and the BIA is not going to clear it unless we step in) for playing a role in land title processing. As each tribe undertook land title functions, they identified a significant backlog in land title processing at the BIA office. They each express varied levels of frustration at unclear messages from the BIA. These conflicting messages range from different information given by the local and regional BIA offices to a frustration that the process for becoming a TAAMS pilot site seemed less than transparent. The access to TAAMS was a particular issue for tribes that did not have a BIA office on the reservation.

Most of the tribes were primarily motivated by the challenges the land title process posed to their homeownership strategy, which was typically a key part of their self-determination plan. Access to the 184 loan product (and other conventional mortgages) was limited by the slow delivery of TSRs and a number of tribes identified this as a key motivation for taking on the land title process (at least in part) at the tribal level.

The experiences of the tribal sites revealed that insufficient BIA resources were dedicated to the LTRO function. In each case the BIA lacked the necessary staff to clear the existing backlog and maintain updated land title records. When tribes chose to contract or compact for the land title function (or take on a part of that function), the BIA could not provide sufficient funds to cover start-up and ongoing costs for tribal LTRO offices. This left each tribe in a position where they needed significant tribal resources to make the process both effective and sustainable.

Below is a bulleted list detailing findings that emerged as key themes in each of the site visits.

Typical reasons for tribes wanting to take over LTRO functions:

- to establish and increase tribal sovereignty over existing tribal lands (or lands that have been recently acquired and placed into trust)
- to facilitate access to homeownership for tribal members by reducing the time it takes to purchase or build homes on tribal lands, including the elimination of backlogs at the BIA
- to increase the number of community members obtaining traditional financing for home and business property loans
- to establish tribal control over and improve the general processing of chains of title and ownership, including instituting better records management

Typical process for transferring LTRO functions from the BIA to tribes:

- Conduct a careful study of all aspects of the potential transfer.
  - What is the extent of the backlog? (How long has it been since the records have been updated and encoded, and what is the volume of outstanding records?)
  - How much will it cost to implement the transition? Consider the following factors:
    - How many staff members will be needed to manage the office? What skills/training do they need?
    - What equipment will be needed? How much will it cost?
  - How much funding is available from the BIA to pay for the transition and ongoing execution of the LTRO function?
  - What is the tribe's relationship with the local and regional BIA offices? Where are those offices located? Will the tribe have access to the TAAMS system on-site?
  - Talk to other tribes who have experienced the transition. Focus particularly on those tribes that are similar in size, economic profile, etc. and/or who have had to work with the same BIA regional office.
- Tribes must consider the following factors, if the transfer moves forward:
  - The transition agreement with the BIA must detail the amount of start-up and ongoing funding allocated to the tribe.
  - The transition process is costly, and BIA funds are currently not adequate. To move forward effectively, tribes must be willing and able to subsidize LTRO establishment and ongoing operations (sometimes heavily), including paying for mapping and plotting lands, surveying, creating zoning rules, recording services, etc.
  - Tribes must identify staffing needs (both training of current staff and recruitment of new staff) and ensure they are hired, trained, and/or cross-trained in all LTRO functions and processes.
  - Equipment, computers, software, supplies, and related services must be purchased and additional space acquired (for new employees and equipment).
  - A good working relationship with a local and/or regional BIA office is essential, as this will facilitate a positive training and information-sharing environment for LTRO staff.
  - Agreements about access to software must be in place. A number of tribes had difficulty negotiating the installation of the TAAMS system at tribal land management facilities (particularly when there was no BIA office on the reservation).
  - Additional relationships and/or memorandums of understanding (or similar agreements) established with local financial institutions, mortgage lenders, title companies, and other community partners are helpful.
  - Citizen education proves very important, as certain challenges remain and tribal members must know exactly what kind of improvements they can (and can't) expect.

Typical outcomes of taking over the LTRO functions:

- increased mortgage volume through increased opportunities for tribal members to get 30-year and other standard conventional loans at fair market value
- expedited (and more accurate) access to title information
- increased economic development opportunities for the tribe
- increased confidence in tribal government from tribal members, when members experience the improvements in service resulting from the work of the tribal government and their partners

A Note About TAAMS

This study was complicated by the fact that the BIA title management system is a moving target. Since at least the mid-1990s there has been recognition of the need to improve the BIA land title management system, resulting in the leasing of a technological solution—the Trust Asset Accounting Management System (TAAMS). TAAMS is a centralized data management system outsourced to CGI Inc. that includes modules for title, leasing, accounting, and reports. This IT system is intended to improve all aspects of the trust system, but particularly the management of title data and integration with other systems. For the last 10 years, the BIA has been implementing the TAAMS system in a phased process and converting data from previous systems. According to the BIA, TAAMS implementation was completed as of mid-2008, with the only remaining task of "post cleanup" where records that have been converted to TAAMS by contractors must be reviewed and corrected. However, it appears that much data encoding is still a work in progress. (State Report Number 33 in Cobell v. Kempthorne, August 1, 2008).

The Bureau of Indian Affairs reports that the TAAMS system is successful in improving the responsiveness in requests for title information, and there is some evidence that this is true. Quarterly accounting reports provided to Indian landowners now include title ownership data, and some regions of the BIA report better response times to requests for TSRs. In addition, the centralized TAAMS system appears to enhance the possibilities for federal-tribal partnerships and cooperation in managing title data. However, most of the reports regarding the TAAMS system come in the context of the Cobell v. Kempthorne trust accounting litigation and may be difficult to accept at face value. Also, it appears that in some regions the BIA is still experiencing significant delays in TSRs because of shortages in personnel, training, and a lack of management priorities. As a recommendation for future study, an independent study of the TAAMS system and related management issues should be conducted in order to evaluate whether TAAMS will be effective in delivering mortgage TSRs and other necessary title information to tribal and Indian landowners.

Tribally Run LTRO Office

The following case study of the Morongo Band of Mission Indians (Morongo) in California highlights some of the land management efforts of Native nations currently operating LTROs in their communities. Morongo is located just outside of a major metropolitan area in California, near Palm Springs. They are one of the three tribes that have compacted and/or contracted with the BIA to run all LTRO functions, and they receive funding from the BIA to do so. Morongo is a key example of the tribes that have taken over all aspects of LTRO functions since the tribe, like the others, has invested (and continues to invest) significant tribal resources for development and ongoing support of land management operations, including establishing their LTRO office.

We conducted telephone, online, and in-person interviews with staff from the LTRO and land management office of Morongo to collect data for use in this report. Interviewees were candid with project researchers, generously sharing information pertaining to the challenges and successes they experienced while establishing their LTRO, their current challenges and successes, and their thoughts on the value to tribes of establishing tribally run LTROs. The main interviewees also expressed interest in doing what they can to assist other tribes who are considering exploring the opportunity to initiate this process in their community.

Morongo Band of Mission Indians LTRO Office

KEY FEATURES, OUTCOMES, AND RECOMMENDATIONS

The Morongo Band of Mission Indians (Cahuillas) reside on the Morongo Indian Reservation, located in northern Riverside County, California, amidst the cities of Banning and Cabazon, both of which extend partially onto reservation land. The reservation has a land area of about 49 square miles, with a resident population of close to 1,000 people (the majority of whom are Native Americans). Information about Morongo Indian Reservation land management provided by our interviewees include the following:

- The Morongo Indian Reservation is comprised of approximately 34,500 acres.
- The reservation consists of tribal and individual trust tracts.
- The number of individual tracts managed is approximately 625, ranging from a maximum of 5 acres to a minimum of .5 acres, with total acreage of individual parcels at approximately 1250 acres.
- There is no BIA office located on the Morongo Indian Reservation.

Lessons learned from the Morongo LTRO experience:

- Conduct an extensive assessment of the existing backlog.
- Explore the funding options extensively to ensure your tribe accesses all available resources for start-up and ongoing costs.
- Encourage the BIA to consider approving a tribal consortium to manage tribal LTRO processes (if appropriate).
- Ensure access to effective software is a consideration as you prepare for a possible transition. This may include extensive negotiation with the BIA over off-site access to the TAAMS system.
- Identify and train existing and/or new staff to ensure they have the necessary skills to effectively manage the tribal LTRO office.
- Develop a plan—in cooperation with the tribal council and other key stakeholders—to ensure tribal members are educated about the benefits (and limitations) of tribal administration of the LTRO functions.

Morongo runs most of their own tribal services under P.L. 638, compacted or contracted agreements made prior to 2003, which is also the case with the other tribes we interviewed. The tribe has a self-determination strategy, which includes gaining control over resources, services, and tribal lands; they run their own public works department, fire department, and other services. The Realty and LTRO functions were contracted with the BIA in 2003 (although the conversation began over a year before), and the tribe has taken over all aspects of these two functions. The decision to take on these functions originated from motivations that include the desire to regain, control, and better utilize tribal lands, as well as to eliminate the considerable backlog of TSR requests that create long waits to get certified TSRs for obtaining mortgages and completing other land transactions for the tribe and tribal members.

In the late 1970s, Morongo was a member of the All Mission Indian Housing Authority (AMIHA) in the state; but the tribe left AMIHA and instituted their own tribal housing authority in 2000. Since 2000 the tribe has managed approximately 60 HUD leases, the majority of which have been paid off over the last 7 years. They currently maintain 20 leases. The tribe has been utilizing HUD 184 loans since 2000 but wanted to better utilize the product for their members, since the potential for doing that was compromised by both the Cobell case "stoppage" and the backlog of un-encoded records and TSRs. From the time Morongo contracted for LTRO functions, the Morongo Realty Department has been performing the services of Realty and LTRO in a more timely fashion than was accomplished previously by the local BIA agency. The tribe has since processed a significant number of mortgages and residential leases (before the transition, hardly any were completed). Morongo still has a backlog of requests for TSRs for the purpose of 184 loans, but that is being reduced at an expeditious rate. Morongo Realty Department is also catching up on the BIA's backlog of probate, gift deeds, land sales, and other land transactions.

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The closest BIA Agency office to Morongo is in Riverside, California, which is approximately 37 miles from the Reservation. Travel times, due to traffic, etc., can be as much as one hour each way. The tribe has an excellent working relationship with their BIA Agency office, and our interviewee stated that the Riverside office is generally supportive of the tribe's efforts to perform the function of Realty and Title. The distance between tribe and agency, however, did create some issues in getting permission to utilize TAAMS as part of the transition to a tribal LTRO. The other two tribes that have transitioned to a tribal LTRO (Confederated Salish and Kootenai Tribes [CSKT] in Montana, and Colville Indian Reservation in Washington) also have a BIA Agency office on reservations.

In spite of the challenges posed by the travel between the tribal realty offices and the BIA LTRO, Morongo was chosen as a pilot project (along with CSKT and Colville) for conversion to TAAMS at the Tribal level (the tribe previously used LRIS and IRMS). It was the sense of our interviewee (and additional research conducted by the research team) that, had Morongo not been selected as a pilot site, they may not have gotten access to TAAMS—at least not without a longer wait and additional negotiations —and would not have made as much progress in updating their records. The tribe utilizes the BIA TAAMS systems for all titles, encumbrances, recordings, and distributions of income from land, greatly expediting the tribe's land management processes. Morongo Realty staff attended all trainings necessary to utilize the TAAMS system and receive ongoing technical assistance provided by the contractor who developed the TAAMS system.

The tribe had to involve legal counsel in order to win approval for the installation of the TAAMS system on the reservation. Approval was received in September 2007. The process of operating TAAMS is currently the same with the tribe as it is for the BIA, and the Morongo Realty Department conforms to all BIA policies and regulations. The BIA handed over all related land records to the tribe after the contract went into effect, and the tribe now organizes, maintains (updates), and stores these records.

The main impact of tribal management of the LTRO process is that many more land and home purchase transactions are currently being made than ever before. The tribe has significantly increased com-

munication and cooperation between the Realty and LTRO functions because it controls the entire process. In other words, the two offices work closely together to resolve title issues and to "clean up" title to expedite land and mortgage transactions. Everyone in the department is cross-trained to ensure better understanding of the purpose of each function and how various function duties and tasks affect each other. LTRO functions are completed in a more immediate fashion, with the tribe approving all TSRs. The only process retained by the BIA is signing authority (the tribe still needs the Superintendent's signature for all conveyance documents).

As was the case at CSKT and Colville, Morongo received contract allocation funds from the BIA for LTRO. The BIA Agency office had never contracted with a tribe for Realty and LTRO, and had to research how they might go about the process. Morongo was proactive about the situation and met with the BIA staff director of the Pacific Region office, the deputy regional director in Sacramento, the superintendent at the Southern California Agency, and the superintendent's key staff, to expedite the process and help determine the best way to proceed. It took about 18 months to actually negotiate the whole contract, the main sticking point being what is a fair calculation of the total funds Morongo would get for start-up costs and for contracting these functions. In the end, Morongo received $25,000 from the BIA for the title function and $15,000 for the realty function, for a total of $40,000 for both functions.

As it turned out, that amount was not nearly enough to run the Realty and LTRO offices. The tribe had to expend significant resources to hire staff, purchase equipment, and fund office expenses and related functions. While preparing for the transition, the tribe was made aware of the opportunity to apply for one-time start-up funds from the BIA. They estimated all start-up costs for items like computers, furniture, and office supplies. Their experience led them to advise that other interested tribes carefully consider all possible expenses in advance. For instance, if a tribe does not have office space on the reservation for the LTRO and must lease space off-site, they could include security deposits and related costs in their start-up funding request. The tribal interviewee recommended a comprehensive strategy to estimate all possible expenses and ensure a margin for oversights and disallowed costs. For example, one important thing Morongo did not consider was the cost to copy BIA records, which ended up costing the tribe about $35,000 (to make over 56,000 copies). That particular "hidden" cost only covered Realty records—they have yet to copy the LTRO records. Many such "unplanned" costs will come up, and the tribe has to cover them if the BIA does not.

In the end, Morongo opted to take the amount of dollars they were to receive from the BIA compacts and contracts for running their government functions and put part of those funds into the Realty and LTRO functions. They reconfigured the functions of all tribal programs and placed them into four trust services (realty, title, social services, and natural resources). This strategy made dedicated funds available to pay for LTRO salaries, hire more staff, and assist in providing additional funds for equipment and services deemed necessary for catching up on realty records.

Our interviewee suggests that executing an LTRO transition process should be feasible for any size tribe if the scale is adjusted. It could also be done at the BIA level, through a consortium of tribes paying for staff at the Bureau to work solely on their Realty and LTRO functions. Morongo is part of a fee-to-trust consortium of about seven tribes in California that are allocated one person in the BIA Realty office to work solely on their fee-to-trust transactions. The BIA has not yet offered tribes the option of such a consortium for the title function, but it may be a possibility.

Our interviewee found the actual process of transitioning from BIA Realty and LTRO to tribal-run functions very time consuming and somewhat tedious. The 638 contract negotiations took approximately 18 months to complete, and even though the tribe actually took over the LTRO functions in 2004, they had to work with the Department of Interior until late in 2007 to get access to TAAMS at the tribal level. Morongo experienced issues related to creating a secure space for the computer and obtaining security clearances for staff. When they finally received approval they had to work with

a team of technology experts to install the system and then undergo training on the system. Additionally (as it also was with the other tribes), not all documents received from the BIA had been converted to TAAMS. Some land records were converted but still had to be encoded by hand (due to errors), posing significant challenges to catching up on and maintaining records.

Despite all the challenges of negotiating LTRO functions, getting TAAMS installed, and maintaining effective functions, the Morongo Realty Department established its own Realty and LTRO functions, and is providing high-quality services to the tribe. For example, Morongo Realty can now complete a gift deed in approximately 4 to 6 months, rather than the 2 to 3 year wait experienced prior to the transition. The response from tribal members has been mostly positive. There have been only a few negative reactions from some tribal members that seem to believe that, since Morongo is now running the Realty and LTRO functions, the tribe does not need to comply with onerous federal regulations that can significantly slow the process. Morongo Realty Department is trying to resolve this perception through education—offering workshops and meetings with tribal members to explain the processes for completing various land transactions and describing how tribal land transactions relate to federal regulations. This need to develop effective community education strategies was a common experience of tribal LTRO offices who were interviewed as part of this study.

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Our interviewee wholeheartedly recommends that other tribes take over these functions if they determine that such a transition is both feasible and cost-effective. The interviewee also suggests that once the decision to operate an LTRO at the tribal level has been made, tribes research the processes and status of land records at local BIA agencies and pay attention to the need for careful staff training. Morongo has learned that nothing is cookie cutter in this regard. Every tribe's situation at the BIA office is unique and cannot be handled or addressed without detailed review by the individual tribe. One thing Morongo might have done differently is implement their own computer system at the beginning of the transition (instead of opting to wait and use TAAMS). The assumption was that it would be done well before the actual 3-year wait Morongo experienced in the transition process, due to the negotiations needed to approve the installation of TAAMS at the tribal level, but that didn't happen. If other tribes are told that they must access TAAMS at the BIA-Agency office, they should contest that decision on the basis that it can be very time consuming, pose significant travel and other expenses, and create general difficulties when seeking to research tribal ownership and encumbrances from a distance. These factors all make the transition from BIA to tribal LTRO more costly and less productive if the tribe is required to access TAAMS only at the BIA-Agency office.

The main benefit that tribes will gain if they establish their own LTRO is control over their tribal lands and all of the self-governance benefits that come from that control. Morongo tribal members now have land-related documents easily accessible and available to them. Our interviewee also suggests that other tribes wanting to take over the LTRO process will need to hire staff who have backgrounds in real estate, title, or escrow—some will have to have an understanding of legal descriptions, surveys, and mapping. Morongo's local BIA Office was very helpful with training and technical assistance regarding the realty function, but the LTRO function was a more difficult transition. The BIA staff was not as cooperative and forthcoming with the tribe on the LTRO side, and obtaining needed information for the LTRO transition was a considerable challenge.

Two Land Management Profiles of the Other Known Native Nations Currently Running an LTRO Office

Two additional tribes are operating their own LTRO, having compacted and contracted with the BIA to do so. When we approached the tribes to schedule on-site interviews about their experience with this process, they were in the midst of the time-consuming and staff-intensive project of making the records conversion to TAAMS (getting on-site secure computers and security-approved staff, transferring

records, etc.). Staff members at both tribes conveyed a willingness to participate in this study, but after several attempts to schedule on-site interviews (and, in some cases, phone interviews) it was evident that it would have been too burdensome to the tribes to carve out the staff time to assist us in that way.

In lieu of on-site and telephone interviews, we compiled the following "profiles" of these tribal LTROs, using both publicly available information and additional information provided by Study Committee members.

Land Management Profile: Confederated Salish and Kootenai Tribes LTRO

The Confederated Salish and Kootenai Tribes (CSKT) are comprised of the Bitterroot Salish, the Pend d'Oreille, and the Kootenai tribes, and share the Flathead Reservation in northwest Montana, in the vicinity of the cities of Polson and Kalispell. Tribal membership numbers about 7,000. CSKT were the first tribes in the nation to compact or contract with the BIA for all LTRO functions (in 1996). As part of the tribes' self-determination and self-governance strategy—initiated in the early 1990s—they contracted or compacted almost every aspect of the functions and programs that the BIA previously managed for them.

The Flathead Reservation is comprised of approximately 1.4 million acres of land, with over 6,000 tracts of land managed by the CSKT Tribal Land Department (TLD). Land classifications managed include tribal trust, tribal fee, individual trust, state, federal, fee simple, water, and fee land off-reservation. Land ownership on the Flathead Reservation is approximately half in tribal trust status, with the remainder owned in the various other classifications. A BIA office is located on the Flathead Reservation, with which CSKT has had a good relationship for many years.

When CSKT compacted with the BIA to run an LTRO, several BIA LTRO staff members were transferred to the TLD office as part of the original agreement. CSKT leaders have been open about the fact that restoring as many tracts of lost tribal land to the tribe as possible is important to them, and that they seek to establish greater control and stewardship over their own lands—which is likely their greatest motivation for establishing a tribally managed LTRO. But, as with Morongo, a secondary motivation was likely that the BIA serving CSKT did have a backlog of requests for certified titles, making tribal land transactions take much longer than necessary.

CSKT now facilitates the completion of a much higher number of mortgage transactions and title certifications than they did before taking on full responsibility for their LTRO. CSKT continues to maintain a good relationship with the BIA office on the reservation, having made a relatively smooth transition to tribal management of the LTRO. CSKT Tribal Land Department staff spent considerable time at the BIA office, studying functions and processes related to running and managing an LTRO, eventually convincing the BIA that the CSKT staff was fully qualified to move un-encoded records to the TLD office to be brought up to date.

During and after the transition, CSKT acquired additional staff and equipment, including computers for their office, mostly supplied by the tribe, and took responsibility for training LTRO employees. As part of the contract agreement with the BIA, some funds were allocated to the tribe by the BIA, on a formula basis but, as with the other tribes, it is likely that these funds did not cover all the costs necessary for establishing an LTRO.

In all aspects of processing title, CSKT follows the same procedures as the BIA, however, the BIA must still approve leases, leasehold mortgages, and fee-to-trust transactions for CSKT. Title Status Reports (TSRs) require two approvals—one from the LTRO (managed by CSKT), and the other from the BIA superintendent. CSKT also purchased and uses the Trust Asset and Accounting Management System (TAAMS) for LTRO functions, which is the land management computer system supported by the BIA. TAAMS is designed to serve unique tribal needs, creating a "real time" situation between tribal LTROs and BIA records. The title process is not the

same for non-Indian communities; there are other computerized accounting systems that are more useful for their purposes. Morongo noted that the conversion to TAAMS from the previous BIA-supported Land Records Information System (LRIS) was time-consuming and somewhat complex, and CSKT had to make the same conversion.

The CSKT LTRO system could be replicated by other tribes, but at least several similar circumstances would likely have to be in place:

- a good relationship with a local BIA office (located on or close to reservations and tribal land management offices)
- ready access to both updated and not-updated tribal land records, and staff able to work extensively with the BIA office to learn LTRO methods and practices
- tribal funding and support for these efforts, and the costs and staff associated with infrastructure, equipment, staff, and training not supported by the BIA
- an LTRO training program for all land management staff

Land Management Profile: The Confederated Tribes of the Colville Reservation (Colville) LTRO Office

The Colville Reservation is located in the vicinity of Spokane, Washington. Twelve Bands of American Indians comprise the Confederated Tribes of the Colville Reservation: the Chelan, Colville, Entiat Lake; Methow, Moses-Columbia, Nespelem, Nez Perce, Okanogan, Palus, San Poil, and Wenatchee Bands. Tribal membership numbers about 8,500. Colville followed CSKT in compacting and contracting with the BIA to establish a tribal LTRO (in 1997).

Approximately 1.3 million acres of land comprise the Colville Reservation, with over 9000 reservation and public domain tracts of land managed by the tribe. Land classifications managed include tribal trust tracts, tribal fee tracts, surface allotments with mixed ownership, mineral trust ownership with some fee interests, fee-to-trust acquisitions, non-Indian and Indian-owned fee land (taxable), and parcels owned by the Federal government. Land ownership on the Colville Reservation is approximately 75% in trust status, with the remainder owned in various other types of classifications. A BIA office is located on the Colville Reservation, with which the tribe has traditionally maintained a good relationship.

As with CSKT, the Colville self-determination plan includes land reclamation, control, and management. Colville leaders have dedicated considerable efforts toward establishing tribal control over land management systems, with the goal of reclaiming as much of their reservation land as possible. Through self-determination efforts they have made it more feasible for tribal members to purchase, will, or gift land; build or purchase homes; and establish businesses on reservation land. Also, as with other tribes we interviewed, Colville Agency had to deal with a fairly extensive backlog of documents to be encoded by their local BIA. As previously mentioned, this backlog can severely slow down processes related to land ownership and management.

In the early 1990s, the Colville Indian Agency implemented LRIS and the Integrated Records Management System (IRMS) for funds distribution, demonstrating their ability to update tribal land ownership records in a timely manner. The tribes' ability to significantly improve efficiencies in these areas, whereby reducing the backlog of land records to be updated and encoded, seemed to have been a key incentive for Colville to begin negotiating with the BIA to take over all LTRO functions.

Colville Agency LTRO hired and trained staff to chain title, write and read legal descriptions, and interpret probates, wills, and deeds to restricted Indian lands, leases, liens, and encumbrances.

However, as with CSKT, the transition was made somewhat easier by the fact that the BIA office was located on the Colville Reservation—just a short distance from the Colville Agency—and some BIA staff members trained in LTRO functions were transferred to the Colville Agency. Colville realty staff had already maintained up-to-date manual records for allotment or inherited (trust) tracts within jurisdiction of the Colville Indian Agency, likely also helping to ease the transition.

When the BIA/Colville LTRO compact was struck, Colville was also using LRIS (as with CSKT) but has since converted to the newer TAAMS system. Both CSKT and Colville were chosen as pilot sites for TAAMS conversion by BIA superintendents (Morongo was later selected as the third site). The TAAMS system had to be routed to a secure location at a tribal facility and only security-approved staff was permitted to encode and update land ownership records and documents.

As with all the other tribes we interviewed, the process of taking over LTRO functions was likely costly for Colville. Besides new hires and training costs, Colville also purchased new equipment and supplies and had to expand physical space to store increased documents and house additional staff. BIA funding for Colville, determined through the compact, was also established and allocated by a consideration formula, which could not have been adequate to cover Colville's costs in establishing and running an LTRO.

The Colville LTRO system could be replicated by other tribes but, again, at least several similar circumstances would likely have to be in place:

- Extensive research on the BIA LTRO processes would have to be conducted to ensure the tribe fully understands the expertise to be acquired and the time and costs involved in contracting or compacting for LTRO functions.
- The local BIA agency should be on reservation, or as close as possible to tribal lands.
- A plan would have to be developed to update records as fully as possible before taking responsibility for the LTRO function.
- BIA is likely to be inadequate to cover all costs of the transition and ongoing LTRO function; a plan would have to be developed to cover those additional costs.

Two Case Studies of Tribes That Perform Some Functions of an LTRO, But Do Not Contract or Compact With the BIA for All LTRO Functions

Several tribes currently perform some, but not all, of the functions of a BIA LTRO office. These tribes have not yet compacted or contracted for all the LTRO functions with the BIA, including access to TAAMS. However, some of these tribes have created remarkably innovative solutions to lengthy title approvals, stalled mortgage transactions, lack of control of land records, and backlogs of pertinent records not updated or encoded—all related to BIA hold-ups. The following case studies showcase the efforts of these tribes to accomplish self-determination and sovereignty through land purchase and control by developing "work-arounds" to BIA LTRO and Realty backlogs and sluggish LTRO functions. Many of these tribes hope to be able to compact/contract with the BIA soon to take over all LTRO functions (including on-site access to the TAAMS system).

The Saginaw Chippewa Tribe of Michigan

KEY FEATURES, OUTCOMES, AND RECOMMENDATIONS

The Saginaw Chippewa Tribe of Michigan, which is comprised of the Saginaw, Swan Creek, and Black River Bands of Ojibwe Indians, is located on the Isabella Reservation, adjacent to the city of Mt. Pleasant, Michigan. There are 2,767 members of the tribe, many of whom live on or near the reservation. The tribe owns 3,200 acres, or an estimated 2 square miles of recently regained trust land, which is a small percentage of the original historical tribal territory (216 square miles or 138,248 acres). The LTRO of the Saginaw Chippewa Tribe, which runs in a parallel fashion to the local BIA LTRO, manages 80 tracts of land. The Isabella reservation boundary consists mainly of tribal trust land, with allotted lands located within the six townships of the reservation, consisting of 18 allotted individual land tracts held in trust by the federal government.

Lessons learned from the Saginaw Chippewa LTRO experience:

- Ensure the legal infrastructure is in place to support the effective functioning of the tribal LTRO.
- Secure program and financial support from the tribal government.
- Centralize necessary records.
- Identify the skills and experience required of new staff and hire them.

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Saginaw Chippewa, like the other tribes interviewed, is pursuing a role in the LTRO process to enhance tribal sovereignty. The tribe first decided to intervene in BIA land title processing after trying and failing to utilize the HUD 184 Loan Guarantee Loan product for members. The tribe was ready to process their first 184 loan when they received a letter from the BIA stating that the Cobell litigation meant TSRs would not be available. This eventuality brought the 184 loan program to a halt because one of the HUD 184 loan underwriting requirements is to present lenders with certified TSRs from the BIA. The tribe then began to look for solutions to this dilemma, and in 2000 a tribal LTRO office was established on the reservation and tasked with assuming the responsibility of the BIA LTRO functions for tribal trust lands. Specifically, the office was established to expedite the mortgage process for members seeking to buy existing or newly built structures on tribal trust land. The tribal LTRO is completely funded by the tribe and supports one full-time and one part-time employee. The staff is self-trained—everything the staff learned about running an LTRO was learned by observation and trial and error. The LTRO manager observed

processes at the local BIA office, studied systems at a local Abstract Company (how to chain title and verify legal descriptions), and went to the County Register of Deeds to learn how documents were filed, recorded, and retrieved. Other staff also had to learn how to chain title, read and verify legal documents, and certify TSRs from the BIA, among other things.

After establishing an LTRO, the tribe began working with a lender who was able to assist them in developing a plan for completing 184 mortgages. All the legal issues were worked out among the tribe, the lender, Fannie Mae, Mt. Pleasant Abstract Company (a title insurance agent that is underwritten by Stewart Title), and a private mortgage company, utilizing an MOU established between the tribe and the BIA. The tribe then entered into partnership agreements with all these organizations and businesses, and implemented a mortgage facilitation plan.

Prior to the establishment of a tribal LTRO office, the tribe was accustomed to waiting 1 to 2 years before receiving certified TSRs from the BIA LTRO. Today, the tribal LTRO office can provide a certified TSR for tribal trust land mortgage transactions (which lending partners accept) in 24 hours or less. Tribal members had limited opportunities for home ownership before the tribal LTRO became operational. Typical on-reservation options were limited to single and double wide mobile homes, HUD mutual help homes, and HUD rentals. At that time, typical lending opportunities included a local lender offering 5-year balloon interest rate loans, and many predatory lenders offering high interest rate loans. Today, four reputable lenders offer tribal members standard 30-year fixed-rate mortgages. These loans are salable to Fannie Mae at current market interest rates.

Since the implementation of the tribal LTRO, 200 tribal members have been able to obtain mortgages on trust land property (a significant number, constituting almost 10% of the tribal population), for a total amount leveraged in mortgages of over $19 million. Under the BIA LTRO, hardly any mortgages were completed at all. These changes have enabled tribal members not only to qualify and get mortgages, but also to select the home of their choice—with purchase processes not dictated by federal governmental guidelines. The tribe considers these gains to be significant contributors to individual economic improvement and tribal self-governance.

The Saginaw Chippewa Tribe had always maintained impeccable records, so the biggest challenge in establishing a tribal LTRO was in centralizing documents from various sources, including the BIA, tribal legal staff, the tribal clerk, and the tribal administration. This initial process was very time consuming. However, this effort was accomplished, and the records the Tribal LTRO maintains contain real-time data at the tribal level. A complete audit of the BIA records at the time the tribe took over these processes found that the BIA backlog consisted of 5 years of documents that were yet to be updated.

Saginaw Chippewa's local BIA agency is the Michigan Office in Sault Ste. Marie (about a few hour's drive from the reservation), and their Regional BIA Office is in Aberdeen, South Dakota. There is no BIA office on the reservation. The tribal LTRO staff has developed a strong and collegial relationship with the LTRO staff at the local BIA agency. The tribal LTRO office receives calls on a daily basis from the local BIA requesting assistance with legal description verification, and the office consistently retrieves documents for the local agency. Recently, the local BIA agency was given the responsibility of entering all of the older land records and documents into the TAAMS system. They determined they would rather rely on backup documents provided by the tribal LTRO than the Regional office, since the tribe's process has proved faster and more accurate.

Currently, the tribe has not assumed the LTRO functions of allotted lands, probate, and the distribution of trust income. They use the LandMarc Land Titles and Records Management System (produced by Affiliated Computer Services [ACS]) to update and store records that are utilized by many County Registers of Deeds. However, the tribe wants eventually to assume all the LTRO functions, including probate and allotted lands; and when LTRO functions are negotiated with the BIA, they will also request that the TAAMS System be

installed on site, merging ACS records with TAAMS records. ACS, an independent system used solely for land title and records, is leased by the tribe, so there are ongoing costs, but there were no upfront costs. The ACS lease contract provides the tribe with the system, related equipment, and extensive on-site training and technical support (in cooperation with the tribe's IT Department). ACS and the tribe's IT Department provide all technical support for the tribal LTRO, with daily backups done in-house by the tribal department.

The success of this parallel or "limited" tribal LTRO has exceeded the tribe's expectations. This success continues to prove to Saginaw Chippewa's title and mortgage partners that the tribal LTRO meets the highest standards as they protect the integrity of the original documents and move toward securing the future of the tribe's land base and natural resources. The tribal LTRO staff members are seen as leaders in land management efforts and tribal self-determination and are highly sought after for presentations at various national conferences and forums.

The Saginaw Chippewa LTRO manager was inexperienced when the transition took place and was hesitant to make initial contact with the local BIA to start the process (given the contentious relationship between the federal government and Native peoples over time). However, the initial conversations went better than expected; and the manager would certainly advise other tribes to do the same. The manager established processes through learning from partners, then bringing those processes back to the tribe and customizing what was learned to work for the Saginaw Chippewa community. The manager believes this method of learning the LTRO function from the ground up has given the tribe a more complete knowledge of both the processes and related consequences. This knowledge extends both to the impact on the transfer and control of Native lands and creating a homeownership strategy that works best for the tribe.

However, our interviewee suggests that other tribes wanting to institute an LTRO combine this type of hands-on learning with knowledge obtained from one or more of the tribes that have already established an LTRO. Tribes could then customize all the existing insights to create a strategy that fit the unique needs of their community without having to reinvent the wheel.

The Oneida Nation of Wisconsin

KEY FEATURES, OUTCOMES AND RECOMMENDATIONS

The Oneida Nation of Wisconsin has 14,533 members, one-third of whom live on or near the 65,000-acre Oneida Reservation, located just southwest of the city of Green Bay, Wisconsin. The Oneida Nation and tribal members own about 25% of the total land within the borders of the Oneida Reservation in both Brown and Outagamie counties in Wisconsin. This percentage will increase as the Oneida Nation continues to implement a plan to reacquire title to all the land within the boundaries of the reservation defined by the 1838 Treaty. Long-term goals of the Oneida Tribe include purchasing and recovering all lands within the original 1838 treaty boundaries; converting tribal-owned fee lands into trust; and distributing these lands according to the needs of the community. In recent years, they have returned about 21,000 acres to tribal control.

Lessons learned from the Oneida LTRO experience:

- Stay current in title paperwork and processing. Do not get behind.
- Good communication within the tribal organization and between the tribe and the BIA is key.
- Teamwork and cross-understanding of job functions is essential.
- Challenges will present themselves but don't get discouraged when things slow down. Remember the progress that has already been made.
- Realize that what you are doing will make a positive impact on creating a solid land base for the tribe and will get many more tribal members into homes.

As with the other tribes we interviewed, self-governance is a driving force behind Oneida's land management strategies. The Oneida Nation's self-governance process (through P.L. 638) began in 1997. Around that time, researchers were hired by the tribe to research all original Oneida allotments, to gain chain of title on those tracts. In 2004, a fee to trust consortium was developed with the Shakopee Mdewakanton Sioux Community of Minnesota. (Fee to trust relates to the process for taking land already owned by a tribe in fee (currently in the local or state land titles system) and getting the approval of the Secretary of the Interior to take it into trust. While the process is distinct from land title processing, the two coincide once the land has been placed into trust and the tribe requests TSRs and related documentation to develop the land). The consortium expanded in 2006 and 2007 to include the Mille Lacs Band of Ojibwe of Minnesota and the Ho-Chunk Nation of Wisconsin. The expanded consortium then formed a fee to trust working group, which was formalized through an MOU, and was intentionally more interactive. Funding from the consortium tribes and the BIA went to the BIA Midwest Regional Office exclusively for the purpose of hiring extra staff to process backlogged applications for the tribes. Before the consortium was developed, only about one property per year was converted from fee land into trust land. Since the consortium, that number has increased considerably, and the four tribes plan to renew the current 3-year contract with the BIA. The consortium primarily takes the Ashland BIA office out of the process, but the process (especially getting certified TSRs from the BIA LTRO) is still quite lengthy. The tribe believes that their investment in this effort is worthwhile, but thinks the BIA could contribute more funds and/or staff to the process.

In 2004, the tribe requested that land records from the BIA be transferred to tribal control so that the tribe could begin to update records and expedite the process. Many boxes of files were transferred, but the tribe was not sure how to store and organize them most efficiently. Over the years, considerable organization and updating of these files and records has taken place, and the files contain all the backup documentation needed to get TSRs certified.

However, there are still some major roadblocks to the tribe's completion of this process. The main obstacle is that the tribe must maintain their records without on-site access to the BIA's TAAMS system.

The Oneida Nation plans to subdivide much of the land converted from fee to trust to build homes and sell them to tribal members (leasing the land). Agricultural and business properties will also be established. The Oneida Nation has created land lists for types of transactions and phases for completion. With these goals in mind, the Oneida Division of Land Management has instituted several policies to expedite the fee to trust process, particularly by developing an infrastructure, such as registered deeds being kept in a locked fireproof vault. However, as land records are brought up to date (a lengthy process), responses from the BIA to tribal requests for processing and certifying TSRs are confusing, sometimes contradictory, and not readily forthcoming.

The tribe has divided their fee-to-trust strategy into several phases, with the final goal of having a process in place at the completion of the phases that will allow the tribe to offer increased home ownership (and other tribal land transactions) opportunities for the tribe. Phase one has been mostly completed and was largely related to documenting Oneida's government buildings. Phase two is still ongoing. Establishing trust between the tribe and BIA has become an issue, since the tribe has received conflicting information on the requirements of the fee-to-trust process from various BIA agency staff. The Great Lakes agency, in Ashland, Wisconsin, is Oneida's local BIA office, and Aberdeen (South Dakota) is the Tribe's regional LTRO. There is no BIA office on the reservation.

Phases one and two will soon be completed, and the tribe plans to take over the complete LTRO process in the coming years. The transition process is working effectively at this point, with more land placed into trust in the last few years than was done in the 15 years prior to the start of the transition. However, this transition could be more efficient if the records were completely up-to-date. The speed of the second phase is still primarily in the hands of BIA, causing persistent delays. Even though a

regional BIA conference was held at Oneida in July, the tribe and BIA are still making slower-than-hoped-for progress in this regard. Many properties are "in the pipeline." They are "in trust" as far as the county is concerned, but the BIA process still needs to be completed. Like Saginaw Chippewa, Oneida is learning the process strictly through trial and error. Currently the tribe is only working on properties obtained by the tribe before October 2004.

The Oneida Land Management Office file room is completely filled with all the backup documentation needed for LTRO functions. These documents have been fastidiously organized and carefully managed over the last several years. However, even with all the positive strides that have been made, Oneida still waits too long for the BIA LTRO to certify TSRs. The lack of a computer system link with the BIA means even access to general information is difficult. The tribe previously used LRIS for records management, but their capacity to use this system was affected by the Cobell lawsuit. The tribe has been told that until that issue is resolved, they are not allowed to have a computer system connection with the BIA.

The tribe wants an on-site TAAMS-dedicated and secured computer and security-cleared staff, which would allow them to complete all LTRO functions in-house and in a timely manner. They would like to be accepted as a pilot program for conversion to TAAMS (like CSKT, Colville, and Morongo) and are willing to work with the BIA to make this happen.
26 The tribe has submitted an application to be a pilot site but is receiving mixed messages about their options. The local BIA Office has informed Oneida that no process for the complete transition to a tribal LTRO is currently established (with their office), so they do not know what the needed paperwork and documents would be.

Since the Oneida tribe has not compacted or contracted with the BIA for LTRO functions (other than through the fee to trust consortium), the tribe has completely covered the considerable cost of all land acquisition and management functions to date. The tribe would like to take over all LTRO functions but has been given contradictory estimates of how much this would cost, and how much of that money would be supplied by the BIA. The tribe is willing to shoulder a reasonable amount of the burden but is not sure if the transition is worth the additional cost, which could possibly amount to hundreds of thousands of dollars.

However, the Tribe is proud of the accomplishments made in the area of LTRO to date, which include updated land-ownership records, more complete and organized files, acquisition of considerable amounts of new land, many completed applications for TSRs, two popular tribally instituted and run internal mortgage loan programs, a shortened TSR processing timeframe (a few months compared to a previous time frame of 1 to 2 years), streamlined land acquisition processes, and many more tribal members getting into their dream homes.



SECTION 3:
Insights from BIA Regional Offices

SECTION 3: INSIGHTS FROM BIA REGIONAL OFFICES

In order to better understand the land title process and related issues from the BIA point of view, we interviewed representatives from two of the four BIA offices mentioned by our interviewees as being progressive, knowledgeable, cooperative with tribes, and dedicated to a smooth transition: the Northwest Office in Portland, Oregon; and the Great Plains Office in Aberdeen, South Dakota.

Each office addresses LTRO processes and functions with both uniformity and flexibility, and in ways that are more similar to each other than dissimilar. The two offices provided a range of insights to the Research Team. The following are a compilation of information, comments, and recommendations from both offices, organized by key insights.

Prioritizing Mortgage Transactions

- Both offices have 1- to 2-day turnarounds for mortgage TSRs.
- Both have a 1- to 2-month completion period on leasehold mortgages.
- A backlog still exists in post-TAAMS conversion clean up of general TSR requests for both offices, but not in mortgage TSRs.

Ongoing Issues With Backlogs

- Time taken to certify TSRs can vary from a few hours to a few years, depending on the documentation available.
- Both have a backlog of cleanup work related to conversion to TAAMS from LRIS and IRMS; both offices think that it will take some time to completely clear the backlogs.

Staffing and Training Insights

- Both offices stated that they could use more staff and more funding to accomplish adequate trust services, particularly in light of post-conversion cleanup; their current staff is excellent but not adequate in numbers.
- TAAMS works well for them in general, but sufficient training is an issue for both.
- The Portland Office compacts and/or contracts with two tribes for LTRO (CSKT and Colville) and thinks that tribal LTRO staff should be required to get the same training as BIA LTRO staff (the Aberdeen Office does not compact or contract with any tribes for LTRO).

Communication Challenges

- Key staff (at both offices) were not aware that tribes in their region were interested in contracting/compacting for LTRO (other than those already doing so). The Research Team interviewed two tribes from one office's area and one from another that are interested, indicating a communication gap between the regional office and the tribes.

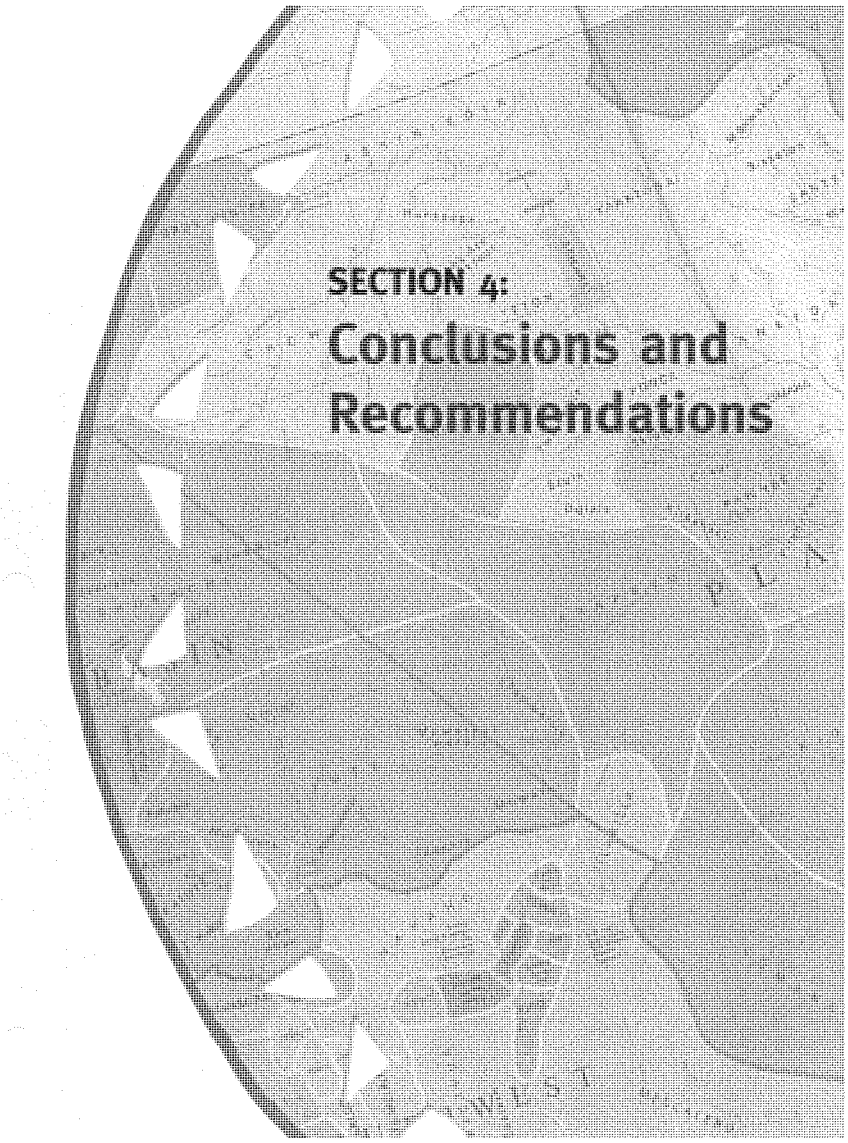
General Strengths of the Regional Offices

- Staffs in both offices attribute their success to a combination of good organization, prioritization skills of Superintendant, and good leadership.
- Both staffs express good will towards the tribes they work with who want to improve land title processes and want to continue to be part of the solution rather than become part of the problem.
- Both offices have exceptionally organized services, including excellent filing systems.

- Both offices employ land-mapping specialists.
- The Aberdeen LTRO staff has been granted several awards for accurate speed of service and quantities of product.

All BIA Office staff members that were interviewed think they work equally well with both the tribes they compact/contract with and the tribes not operating their own LTRO. This opinion is at least backed up by the tribes we interviewed. However, issues may still arise because many tribes deal more with the local BIA LTRO offices than the regional offices, and some of the local (and other regional) offices do not work as well with tribes. We interviewed two tribes who expressed interest in instituting tribal LTROs but found the process a daunting task due to the roadblocks and poor attitudes encountered at their local BIA office LTROs. According to these two tribes, staff in their local BIA offices responded negatively to requests for information. One interviewee reported the poor responses speak to a concern that the tribes' attempts to create tribal LTRO functions make BIA staff "worried about their jobs [going away]." It may be that the local BIA offices are not as progressive, easy to work with, or knowledgeable as the regional offices, but that has yet to be evaluated. Tribes report that the regional offices seem hesitant to intervene in negotiations between tribes and local BIA offices.

Some alterations of the system are already planned, but changes in the BIA system take many years—a time period that is unacceptably long for most tribes we interviewed. It is unlikely that complete separation of BIA and tribal LTROs will happen in the near future, so the development of parallel land title systems may be necessary (for both tribes and the BIA or other agency or department). These parallel systems may serve to convince the U.S. Government that tribal control can work as well or better than the present system. It may even perform at a level comparable to industry standards outside Indian country.



SECTION 4:
Conclusions and Recommendations

SECTION 4: CONCLUSIONS AND RECOMMENDATIONS

This section addresses key conclusions and recommendations supported by the work of the Research Team in developing this report. The conclusions are organized into the following themes:

- Tribal LTROs have had positive impacts on their communities.
- The BIA does not provide tribal LTROs with sufficient funds for setup and operation.
- Tribes that lack the resources to pay for the LTRO transition need alternative ways to manage LTRO functions.
- Creative alternatives for establishing tribal LTROs may exist and should be developed.
- Related policies can expedite the ultimate goal of expanded tribal homeownership.
- The BIA needs to clarify and standardize their land management processes.
- Additional tribal LTRO pilot sites will likely enhance existing and future policy.

The 10 recommendations are further explained below. In brief, the report recommendations are as follows:

1. Clear the backlog.
2. Standardize the LTRO process across local and regional offices.
3. Clarify the messages from the BIA, making them consistent across regions.
4. Identify the tribes that are interested in managing land title processes.
5. Provide funding for pilot studies.
6. Provide access to training and technical assistance for all tribes interested in managing the LTRO function/s.
7. Conduct detailed studies of the transition and ongoing costs associated with tribal LTRO offices.
8. Provide tribes with access to model citizen education strategies.
9. Identify additional policies that could facilitate tribal homeownership strategies.
10. Conduct further research to explore alternatives to the current title system.

Conclusions

Tribal LTROs have had positive impacts on their communities.

Tribal LTRO representatives were overwhelmingly positive about their tribes' decisions to initiate the process of establishing tribally run LTRO offices. Interviewees unanimously agreed that establishing an LTRO was a good thing for their tribal governments and communities on several levels. They also acknowledged that their particular tribal governments have, so far, been both willing and able to invest the considerable resources and commit themselves to establish all the functions of an LTRO within the tribe.

These tribal LTROs have firmly exercised self-determination by establishing a more effective mechanism for asserting control over their land base and by creating a sense of hope that their tribe can regain control over their land. The tribal LTROs almost buzzed with a sense of pride and hope for the work they were accomplishing. There was also

general consensus among tribal interviewees that tribes, as governmental institutions, are the natural place to house and manage land title records and backup documents, and provide updated, chained, and approved titles for tribal land transactions and sales.

The BIA does not provide sufficient funds.

While the impact of tribally run LTROs was universally positive, there was general agreement that the federal government, through the BIA, does not provide adequate funding for LTRO start-up and operational costs. In particular, they noted that additional funds should be provided for both BIA and tribal efforts to update the thousands of records that must be "cleaned up," mostly due to ongoing staffing issues at the BIA and particular challenges posed by the conversion to TAAMS. This insight that emerged from each site visit experience underscores the reality that sufficient investment in the LTRO function by the BIA could significantly improve the land title process—regardless of whether the BIA continues to manage the title process or tribes compact or contract to manage it themselves.

Tribes that lack the resources to pay for the transition need alternatives.

Tribal LTRO staff, tribal leaders, Study Committee members, and many others agree that the process of establishing a tribally run LTRO is one that should be available to all tribes. However, this option may not be feasible for many tribes because of the required resources to cover staffing, equipment, and related expenses. The transition and operational costs for a tribal LTRO are considerable—perhaps too expensive for smaller tribes or those with no high-earning businesses, no high-yield natural resources, no casinos, or adequate physical government infrastructures to fund and administer a tribal LTRO.

Creative alternatives may exist and can be developed.

Where the size of the tribe is the major impediment to tribal management of the LTRO function, there are a range of alternatives. These tribes could explore partnerships with other tribes currently managing LTRO services; forming a consortium of tribes interested in managing their own LTRO function; or directly funding a position at the BIA to expedite the LTRO functions for their tribe particularly. In some instances, for tribes large and small, size is irrelevant to success in this area. Expenses could be completely prohibitive for less affluent tribes with a large number of members and a large land base.

Tribes could work with tribal intermediary organizations and the BIA to develop viable solutions to these problems. The issue of all tribes being able to afford running a system like TAAMS is also one that will have to be dealt with creatively. It may be that more low cost and less complex alternative land management software systems would be appropriate for some tribes.

Another alternative might be to study other successful models of land tenure outside Indian country in areas that share similar features with Indian lands, such as rural areas or other countries. For example, the notion of a county register of deeds model could be explored. There may be several such simple models that could be adapted by tribes. These models typically do not have onerous regulations and have been accepted as entirely reliable by courts, private businesses, and other government agencies over many years.

Related policies can expedite the ultimate goal of expanded tribal homeownership.

Mortgage lending on tribal trust lands requires not only the issuance of title status reports by BIA but also the approval of leases by BIA. Therefore, leasing is another important piece of the puzzle.

Most effectively expediting leasing transactions may include tribes enacting their own leasing ordinances, perhaps as part of a realty ordinance that also addresses land records. Study Committee members and tribal LTRO employees identified Congressional action to grant tribes the same authority enjoyed by the Navajo Nation (under 25 U.S.C. § 415(e). Under Section 415(e)) to enact a leasing ordinance that, once approved by BIA, empowers the tribe to issue leases with no further BIA approval. The benefits, both from a sovereignty enhancement and member service perspective, of tribal control over lease issuance and recording is obvious.

The BIA needs to clarify and standardize their processes.

Outside of Indian country, uniformity in laws and processing techniques is a key element of the success of the land title system. Uniformity is one of the main elements that is sorely lacking in many land tenure transactions related to Native lands. The standardization of BIA processes would be a significant benefit for tribes operating LTRO offices. Since BIA offices follow a range of different procedures and processes (intended or not), streamlining BIA processes could be a monumental task but would certainly improve efficiencies.

Streamlining and clarifying the process would also help to reduce confusion and frustration at each stage for tribes seeking to expedite title processing on tribal lands. The tribes presented in this study have good working relationships with their BIA offices, most often with both the local and regional offices. However, there was general consensus that there is a need for more consistent policies and messages coming from various BIA offices, related to Realty and LTRO functions, processes, and requirements. A particular example of this challenge was the need for transparency in the selection of "pilot" tribally run LTROs for TAAMS conversion. The selection process for tribes to become these pilot sites seemed somewhat arbitrary to many tribes, particularly those that struggled to access the TAAMS system. There appeared to be wide divergence in the extent that BIA offices were willing to explore innovative solutions to land title processing issues and challenges experienced by tribes.

It is important to note that section 3 offers insights that can be applied immediately at the BIA regional office level. The priority given to mortgage TSRs and the efficiencies gained through those policies, could significantly improve outcomes at other regional offices. Best practices at BIA regional offices should be standardized across regional offices as soon as possible.

Improvements in the process have emerged from tribal innovation.

Each case study revealed key insights into the land title process. Uniformly, the case studies demonstrated that, even without tribal management of the LTRO process, sufficient investment in the land title process at the BIA level could significantly improve the process. It is important to remember, however, that absent these tribal innovations—both through 638 compacts/contracts and more targeted strategies—that insight would not be verifiable. Without the significant improvements in land title processing at CSKT, Colville, Morongo, Saginaw Chippewa and Oneida, the need to invest additional funds at the BIA level and to support ongoing innovation would lack empirical support. While system-wide reform is desirable, tribal innovation offers significant insight into that process.

Additional pilot sites will likely enhance existing and future policy.

The level of interest in the TAAMS pilot site opportunity indicates that additional pilot funding may support further tribal innovation in expediting the land title process. Federal funding to support pilot projects would provide more equal access for tribes (particularly those facing the barriers described above related to resources or scale) and likely enhance the range of insights available for improving the land title process at the local and national level.

Recommendations

The data presented in this report support the following recommendations:

1. Clear the backlog.

The federal government must provide sufficient resources and focus on the issue of land title processing to clear the backlog of encoded and updated title documents. It is a significant impediment to economic development on Indian lands.

2. Standardize the LTRO process across local and regional offices.

Section 3 of this report outlines procedures implemented at the regional office that have brought title processing much closer to industry standards outside of Indian country (though significant challenges still remain). These procedures (some as simple as prioritizing mortgage TSRs) should be mandated for all regional offices. Similar efforts should be enacted at the local level to ensure that the process is clear and equitable for all tribes.

3. Clarify the messages from the BIA.

Related to the previous recommendation, each regional and local BIA office seems to have divergent messages regarding the process and options for tribes seeking to play a role in title processing. Given the promising practices outlined in this report, it is essential that regional and local BIA offices develop standard processes for tribes that want to be involved in the land title process.

4. Identify the tribes that are interested in managing land title processes.

Interviews with BIA regional offices underscored the limited knowledge regarding tribes who are (or may be) interested in playing an active role in land title processing. Particularly if/when the BIA clarifies their process, a detailed study should be conducted to explain to tribes the options available for managing their land title process and to identify the full extent of those who are interested.

5. Provide funding for pilot studies.

Tribal management of the LTRO functions has identified innovations, strengthened the exercise of tribal sovereignty, empowered tribal communities, and underscored existing systemic problems. The high level of interest in managing land title processes, coupled with the low level of access to that opportunity, recommends an extensive pilot study, or studies, that would allow tribes to demonstrate further innovation and identify ongoing challenges.

6. Provide access to training and technical assistance for tribes interested in managing the LTRO function(s).

The content of this report serves as a helpful foundation to guide tribes in preparing to manage all or part of the LTRO process. Tribes need a guide to support their efforts to prepare for and effectively manage the LTRO functions. Whether pilot studies are funded or not, access to introductory training and ongoing technical assistance is critical. Collecting that information and offering it as a training session at relevant conferences and providing information as an ongoing resource provided by relevant tribal intermediary organizations, would substantially expand the number of tribes able to manage the LTRO function(s).

7. Conduct detailed studies of the transition and ongoing costs associated with tribal LTRO offices.

While somewhat dependent on BIA process, the costs associated with tribal management of LTRO functions should be studied in more depth. Both tribes and the federal government need a better understanding of the true costs associated with the transition and ongoing tribal management.

8. Provide tribes with access to model citizen education strategies.

As the case studies demonstrated, many tribal members do not know what to expect once the tribe takes over the LTRO process. It is critical that tribes communicate effectively with their citizens to ensure there are realistic expectations and that successes can be celebrated.

9. Identify additional policies that could facilitate tribal homeownership strategies.

Per the conclusions above, a range of policies (including tribal and federal laws related to leasing) can significantly improve tribal homeownership efforts. These policies, along with other relevant strategies, must be considered by tribes and the federal government to help meet the goal of expanded homeownership opportunities for Native people.

10. Conduct further research to explore alternatives to the current title system.

Case study and Study Committee interviews identified relevant models—both internationally and in other areas of tribal self-governance—that could be applied to the land title process. Further study to assess the relevance and applicability of those models would be helpful to effective LTRO management.

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Final Note

This report has illuminated some of the key strategies necessary to change the economic future for Native communities around the country. The Research Team and Study Committee look forward to working with tribes, the federal government, and other stakeholders to make this vision a reality.

[1]US Commission on Civil Rights, *A Quiet Crisis, Federal Funding and Unmet Needs in Indian Country*, Executive Summary, July 2003, p. X and 50 available at http://www.usccr.gov/pubs/na0703/na0204.pdf (Last accessed February 1, 2007).

[2]Getches, Davis, Charles Wilkinson and Robert A. Williams, *Cases and Materials on Federal Indian Law*, 4th Edition, St. Paul, MN: West Group, 1998, pp93-99, 141-143.

[3]Native American Housing Assistance and Self-Determination Act of 1996, Pub. L. No. 104-330, 110 Stat. 4016 (codified as amended at 25 U.S.C. §§ 4101 4195 (Supp. IV 1998)).

[4]Statement of Assistant Secretary Orlando J. Cabrera, Field Hearing before the United States House Committee on Financial Services, Subcommittee on Housing and Community Opportunity. For more information on Apache Dawn, see also Harvard Project on American Indian Economic Development, *State of the Native Nations*, New York: OUP, 2007: 258.

[5]Mark Fogarty, *Liu adds to legacy though HUD 184 expansions*, Indian Country Today, May 9, 2005, available at http://www.indiancountrytoday.com/archive/28165849.html (Last accessed Feb. 28, 2007).

[6]For more information on the federal recording function, see 25 CFR Part 150, which defines that function. Further details are available at www.ncaiprc.org/landtitle.

[7]Press Release, NAIHC, Barriers to the Pathway for Homeownership High for Native Americans, NAIHC Chair Testifies- Bureau of Indian Affairs Hindering Home Ownership with Slow Title Process (July 31, 2006) available at http://naihc.net/NAIHC/files/ccLibraryFiles/Filename/000000000894/073106-camp-verde.pdf (Last accessed Feb. 10, 2007).

[8]Jessica A. Shoemaker, *Like Snow in the Spring Time: Allotment, Fractionation, and the Indian Land Tenure Problem*, 2003 Wis. L. Rev. 729, 729 (2003).

[9]*Id.* at 758-761.

[10]Indian Land Consolidation Act of 1983, Pub. L. No. 97-459, 96 Stat. 2515, 2517-19 (1982) (codified at 25 U.S.C. § 2201-2210 (1982)). And Jessica A. Shoemaker, *Like Snow in the Spring Time: Allotment, Fractionation, and the Indian Land Tenure Problem*, 2003 Wis. L. Rev. 729, 771 (2003).

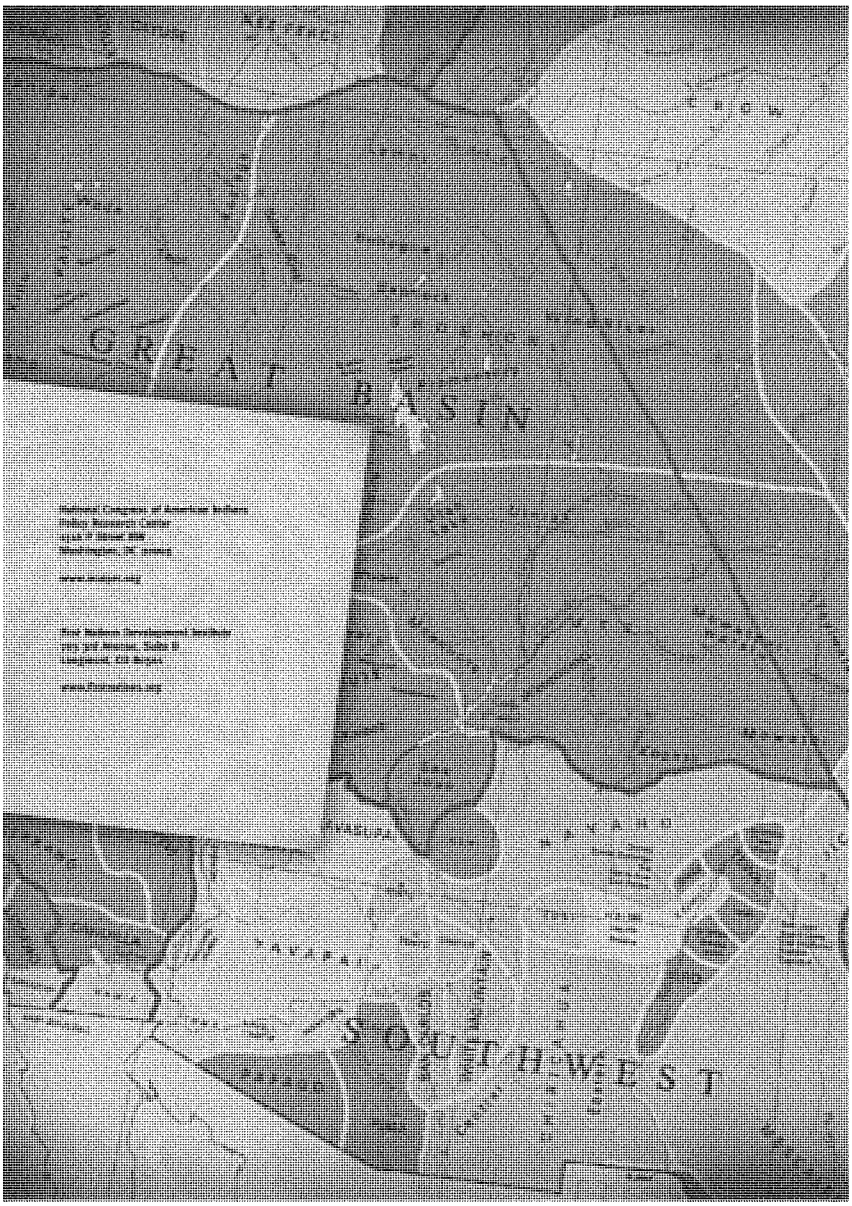
[11]American Indian Probate Reform Act of 2004, Pub. Law No. 108-374, 118 Stat. 1773 (2004).

[12]*A Quick Guide to the American Indian Probate Reform Act*, National Congress of American Indians, April 13, 2006 available at http://www.itmatrust-funds.org/documents/IndianLandWorking%20group%20comments/06Apr13,%20Summary%20-%20American%20Indian%20Probate%20Reform%20Act,%20101306.pdf (Last accessed March 2, 2007).

[13]John Manthorpe, "Land Registration – A health check," Keynote address to the "Registering the World" conference, "On the Occasion of the Tercentenary of Land Registration in Ireland," July 2007

[14]For more information on these organizations see www.ncaiprc.org and www.firstnations.org.

[15]A list of Study Committee members is available in the Acknowledgement section of this report.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Policy Report

Asset-Building in Tribal Communities: Generating Native Discussion and Practical Approaches

Sarah Hicks, Karen Edwards, Mary Kate Dennis
and Christy Finsel

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Center for Social Development

Washington
WASHINGTON UNIVERSITY IN ST. LOUIS
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POLICY REPORT

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Finally, the authors wish to thank the U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services (OCS) for their support of this work. However, the authors wish to state that the contents of this report do not necessarily reflect the views of OCS, ANA, or DHHS.

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"Assets...are not simply resources that people use in building livelihoods: they...give them the capability to be and to act." -Anthony Bebbington[1]

"People think and behave differently when they are accumulating assets, and the world responds to them differently." -Michael Sherraden[2]

"To empower people to strengthen their political voice, we need to help them gain access to the sources of power in any society. Typically these include assets such as skills that are marketable, economic resources, and social supports. This is essential if we are to make a difference." -Geeta Rao Gupta[3]

"Development consists of the removal of various types of 'unfreedoms' that leave people with little choice and little opportunity of exercising their reasoned agency. The removal of substantial 'unfreedoms'... is constitutive of development" -Amartya Sen[4]

Introduction to Asset-Building Policies

Asset-building policies, on the whole, seek to encourage and assist individuals, families, and communities to build economic security by fostering the accumulation of wealth. Building assets has traditionally been a mainstay of national strategies for economic growth in the United States. However, most existing asset-building policies do little to foster accumulation of wealth for individuals and families who do not already have financial wealth or pay significant taxes.

American Indians, and other low-income groups, have not benefited from key historic asset-building programs in the United States.[5] As Dr. Michael Sherraden[6] (1991) points out, historically, the major U.S. asset-building programs are: (a) the Homestead Act of 1862;[7] (b) the

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[1] Bebbington, Anthony. *Capital and Capabilities: A Framework for Analyzing Peasant Viability, Rural Livelihoods and Poverty in the Andes*. London, UK: International Institute for Environment and Development, 1999, p. 5.
[2] Sherraden, Michael. *Assets and the Poor* Armonk, NY: Sharpe, Inc., 1991, p. 155-156.
[3] Geeta Rao Gupta, President, International Center for Research on Women. Interview with the Ford Foundation, 12/13/01.
[4] Sen, Amartya. *Development as Freedom*. New York, NY: Random House, 1999, p. xii.
[5] Moreover, American Indian communities have suffered as a result of asset-depleting policies. Federal treaties with Indian tribes as well as policies such as the Indian Reorganization Act, the Dawes Act, the institution of boarding schools for Native children, the termination of numerous Indian tribes and relocation of Native families to urban centers, and many others have all served to strip tribal communities of assets such as land, timber, fish and wildlife, oil, minerals, tribal languages and cultures, Native forms of government, Native religions, and community bonds. See DeWees, Sarah and Lou Florio. Sovereign Individuals, Sovereign Nations: Promising Practices for IDA Programs in Indian Country. Fredericksburg, VA: Native Assets Research Center, First Nations Development Center, 2002; and King, Juliet, Sarah Hicks, Karen Edwards, and Alisa Larson. American Indian Tribal Communities and Individual Development Account (IDA) Policy. St. Louis, MO: Center for Social Development, George Warren Brown School of Social Work, 2003.
[6] Dr. Michael Sherraden is the Director of Washington University's Center for Social Development.
[7] The Homestead Act of 1862 allowed 1.5 million households to claim 160 acres for their homesteads. 246 million acres of land were transferred into private ownership. Williams (2000) estimates "a quarter of the [current] population (age 25 and up) has a legacy of property ownership and assets in their background that can be directly linked to national policy." For more information, see Williams, T. *The Homestead Act – Our earliest national asset*

G. I. Bill, or the Servicemen's Readjustment Act of 1944;[8] and (c) the creation of a 30-year mortgage product, to subsidize new home construction. Sherraden (1991) and Ray Boshara (2001) note that these programs target people in middle- and upper-income brackets, allowing individuals and families with resources to increase their assets, sometimes dramatically so.[9]

A more recent example of asset-building policy is Individual Development Accounts. As a concept, asset-building policy as matched savings accounts, such as Individual Development Accounts (IDAs), is only about 10 years old.[10] In Sherraden's original conception, asset-building policies would be universal—each child receiving an asset account at birth. But, during the 1990s, some distortion occurred in the design and implementation of these policies; IDA programs, including those resulting from policy initiatives, were designed as "demonstrations" both because of the newness of the idea and the related lack of substantial funding commitment on the part of state and federal governments.[11] Also, there were some initial concerns that the poor could not save, might not contribute to their children's accounts, or might divert resources that were intended for their children, toward other purposes.

More than 500 matched savings account programs are now operating at the community level in all 50 states, serving over 20,000 low-income individuals, and perhaps as many families, throughout the country. Additionally, there are 24 state-supported IDA programs being implemented, out of IDA legislation in 35 states, and additional programs initiated by administrative rule-making.[12] Included in these numbers are a small (but growing) group of IDA programs that serve American Indians and Alaska Natives, some of which are run by tribal governments, and some by tribal non-profit entities.

State-supported IDA programs, generally administered through partnering non-profit organizations, serve a modest number of families and individuals who are determined eligible because their income falls at or below 150 to 200 percent of the federal poverty line (income eligibility guidelines vary by program – the other most common income cap is 50 to 80 percent of the area median income of the targeted population). Most IDA program participants are required to identify a savings goal, participate in financial literacy training, and save a minimum amount in their IDA on a regular basis, most often monthly (again, this requirement and attendant amounts vary by program). Participant savings are generally matched at a rate of 1 to 4 dollars for every dollar the participant saves, up to a specified savings cap. After savings goals

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policy. Paper presented at the inclusion in Asset Building: Research and Policy Symposium, Center for Social Development, Washington University in St. Louis, MO, 2000.

[8] The G. I. Bill, or the Servicemen's Readjustment Act of 1944 is one of the most well known postsecondary education asset based program. The G.I. bill offered veterans attending college $500 annually for tuition and other educational expenses and a $50 monthly stipend compensation for each month spent uniformed in service. Additionally, veterans were able to purchase homes through mortgage subsidies. The loan guarantee program financed one fifth of the homes built in the 20 years following World War II.

[9] Boshara, Ray. *The Rationale for Assets, Asset-Building Policies, and IDAs for the Poor* in Building Assets: A Report on the asset-development and IDA field. Corporation for Enterprise Development, Washington, D.C., 2001.

[10] Sherraden, Michael. *Assets and the Poor* Armonk, NY: Sharpe, Inc., 1991.

[11] Edwards. K, and L.M. Mason. State Policy Trends for Individual Development Accounts in the United States: 1993-2003 (Policy Report). St. Louis, MO: Washington University, Center for Social Development, 2003.

[12] Ibid.

are met, participants may only withdraw savings for specified uses, the three most common of which are homeownership, starting or investing in a business, or higher education.[13]

Besides the fact that IDAs are being instituted differently from their original theoretical conception, there has also been little discussion about the social inclusiveness (or lack thereof) of these policies and the related program implementation. Research has shown that a variety of barriers exist to the development of typically designed IDA programs in American Indian communities.[14] Also, most federal and state asset-building policies do not give tribal governments the authority to directly administer, or receive funds for, IDA programs. Even in the minority of cases where tribes can directly access funding, program rules and requirements are often seen as problematic.[15]

The lack of tribal participation in developing asset-building policies and programs may be a bigger problem than that of American Indians being disproportionately unable to benefit from the major historic asset-building policies[16]. The lack of input in policy development has rendered tribal communities largely unable to directly access the $125 million Assets for Independence Act five-year demonstration project.[17] Increasingly, federal policy and funding streams are being directed toward asset-building programs, mostly in the form of "individual asset accounts." The accumulation of individual assets and wealth is an ever-increasingly popular policy goal. Consider President George Bush's recent proposals to address the viability of the Social Security program through the development of individual asset accounts.[18] Individual Retirement Accounts (IRAs), 401(k)s, 403(b)s, Roth IRAs, Earned Income Tax

[13] For information on state-specific IDA policies and programs, see http://gwbweb.wustl.edu/csd/statepolicy/.

[14] Barriers that have been highlighted in recent research include: the need for tribal governments to partner with a non-profit in order to administer an Assets for Independence Act (AFIA)-funded IDA program, the inability for AFIA-funded programs to incorporate home repair as an IDA savings goal, the 200% or below poverty line restriction for program eligibility, and the 15% administrative cap on AFIA funds. For more information, see DeWees, Sarah and Lou Florio. Sovereign Individuals, Sovereign Nations: Promising Practices for IDA Programs in Indian Country. Fredericksburg, VA: Native Assets Research Center, First Nations Development Center, 2002; and King, Juliet, Sarah Hicks, Karen Edwards, and Alisa Larson. American Indian Tribal Communities and Individual Development Account (IDA) Policy. St. Louis, MO: Center for Social Development, George Warren Brown School of Social Work, 2003.

[15] DeWees, Sarah and Lou Florio. Sovereign Individuals, Sovereign Nations: Promising Practices for IDA Programs in Indian Country. Fredericksburg, VA: Native Assets Research Center, First Nations Development Center, 2002; King, Juliet, Sarah Hicks, Karen Edwards, and Alisa Larson. American Indian Tribal Communities and Individual Development Account (IDA) Policy. St. Louis, MO: Center for Social Development, George Warren Brown School of Social Work, 2003. For proposed changes during AFIA reauthorization, see http://www.idanetwork.org/initiatives/reauthorization_recommendations_memo.pdf.

[16] King, Juliet, Sarah Hicks, Karen Edwards, and Alisa Larson. American Indian Tribal Communities and Individual Development Account (IDA) Policy. St. Louis, MO: Center for Social Development, George Warren Brown School of Social Work, 2003.

[17] The Assets for Independence Act, enacted by Congress in 1997, provided the first dedicated funding stream for IDA programs. Whereas previous legislation, such as the 1996 welfare reform law, allowed some existing program funds to be used for IDA programs, AFIA provided a dedicated stream of $125 million/year for IDA demonstration projects. Tribal governments were not eligible for direct funding under AFIA and had to partner with a non-profit organization (a significant barrier) in order to receive any funding. To date, no tribal governments have received AFIA funds. Two Native non-profits, the Lakota Fund and Cook Inlet Tribal Council (a non-profit service provider of tribes), have received AFIA funds. For a timeline of relevant asset-building policies, see Appendix A.

[18] See White House website at http://www.whitehouse.gov/infocus/social-security/ for more information.

Credits (EITC), College Savings Plan accounts, Medical Savings Accounts, and Lifetime Savings Accounts (proposed) are also illustrative of this policy trend toward tax incentivized savings schemes. The growing focus on individual assets and wealth will likely be problematic for many population groups, who are poor or have low-incomes, including American Indians, people with disabilities, urban blacks, refugees, and immigrant groups, who, besides paying disproportionately smaller amounts of taxes, may view at least some types of assets as community holdings, and therefore need asset-building strategies that also foster building the asset bases of whole communities.

There is an urgent need to further explore the nascent concept of asset-building in American Indian communities and to determine the appropriateness of mainstream asset-building policies for tribal communities.[19] Tribes must weigh in on the asset-building policy debate and determine an approach (or a concert of approaches), and framework, that would work effectively in tribal communities. Little research has been done to examine this question.[20] To date, few tribes and tribal organizations have thoroughly discussed the mainstream asset-building approaches mentioned above, whether or not they are appropriate for tribal communities, and how, because of unique tribal environments, conditions, and circumstances, asset-building strategies might best work in an American Indian cultural context.

This paper attempts to create a forum for discovering the appropriate questions related to these issues, including questions that might spark a related and much needed research agenda on this topic, and provide new information for a tribal discussion about (a) the appropriateness of mainstream asset-building approaches in Indian communities; (b) a framework for a unique approach to asset-building in Indian communities; and (c) the application of such an asset-building approach in Indian communities.

We begin by presenting a brief summary of some important economic and social concepts related to asset building. Then we will pose some questions around the appropriateness of the application of mainstream asset-building approaches to tribal communities. Finally, we explore current tribal models of asset building and present a framework that summarizes the key aspects of these models. From these models, we draw recommendations for policy, practice and research. The conclusion discusses the importance of tribal sovereignty as the foundation for Native asset-building approaches.

Conceptualizing the Road Map: Where Do We Start, and Where Are We Going?

Building assets moves beyond the daily struggle for survival, or attempts to reduce poverty.[21] Although income maintenance, creation of jobs and income, and poverty reduction are important ends in themselves, and ones that are desperately needed in tribal communities, building assets is

[19] While there is certainly a need to examine the utility of asset-building strategies for urban Native communities, this paper does not specifically address the urban Indian population. Some of the discussion here is applicable to urban communities, but the focus of this paper is on federally-recognized tribal communities residing on Indian lands.

[20] DeWees, Sarah and Lou Florio. Sovereign Individuals, Sovereign Nations: Promising Practices for IDA Programs in Indian Country. Fredericksburg, VA: Native Assets Research Center, First Nations Development Center, 2002.

[21] Ford Foundation. *Building Assets To Reduce Poverty and Injustice.* New York, NY: Ford Foundation, no date, p. 6.

compatible with these ends, and has been shown to increase the power of "agency," or "self-determination," in individuals, collectives, and ultimately communities.[22] Key to the concept of self-determination is the ability to act out one's will, creating choices and options.[23]

Regressive federal asset-building policies and practices,[24] those designed to serve current asset-holders, have produced significant, long-standing, and growing disparities in wealth accumulation between the groups with various income levels that make up the United States population. This trend makes the prospect of building assets problematic and slow-going for those in lower income tiers. Since building assets typically demands an incremental approach, time is a critical factor. As policies are analyzed and shaped to reduce historical disparities that favor building the assets of upper and middle class individuals and families,[25] inequities continue to erode within the present generation. Building assets over time has been proven to better ensure an exponentially higher quality of life for next and future generations.[26] Over generations, as transfers from one family or community member to the next accrue, cumulative positive effects of building assets are increased.

It is unlikely that a single asset-building strategy or mechanism is universally appropriate or effective. Rather, creating a fabric of efforts, a weaving together of multi-faceted interventions, within a flexible universal policy framework, is called for. To accomplish this task we must thoughtfully examine and attempt to understand the power that assets hold for tribes and tribal citizens and create policies that facilitate creative approaches to building assets, creating "wealth" for tribal citizens in a culturally appropriate way. We must support the construction of an overarching asset-building policy that includes a policy framework flexible enough to accommodate diverse culturally-based asset-building approaches and layered strategies.

A broad tribal outreach effort may be one way to begin this exploratory task. Comprehensive Federal outreach to tribes will make policy and programming efforts in asset-building more accessible, and afford tribes the tools necessary to use their unique cultural contexts to develop appropriate asset-building programs. Tribes, in turn, will need to develop the necessary tools for inviting community dialogue, decision-making and planning around building assets. Tribal,

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[22] Amartya Sen's *Development as Freedom* (1999) addresses the issue of "agency" and greater self-determination as a goal of development.

[23] Tribal governments are familiar with the concept of self-determination, albeit, in practice, perhaps a stunted form. Almost since European contact and certainly especially within the last two hundred years, actual tribal self-determination has not been realized because of the imposition of outside political and economic constraints on tribal sovereignty. In short, tribes are quasi-sovereigns, and the majority of tribal governments do not yet have resources to act out their will.

[24] Regressive policies are designed to benefit those who pay the most taxes; therefore best serving those who already have significant savings and investments. As mentioned earlier, the most significant social welfare policy direction in the country today is moving toward a system of individual asset accounts – such as IRAs, 401(k)s, 403(b)s, Roth IRAs, College Savings Plan accounts, Medical Savings Accounts, and those proposed for Social Security investments and retirement, by the current administration. The current designs of these policies continue this tradition of serving those with high to moderate to high incomes, and significant existing assets, leaving those less fortunate behind.

[25] See Sherraden's *Assets and the Poor* (1991) for a detailed discussion of federal policies that build assets of middle- and upper-income Americans.

[26] Schreiner, Mark, Margaret Clancy, and Michael Sherraden. Saving Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts, research report. St. Louis: Center for Social Development, Washington University, 2002.

community-driven, approaches will produce culturally-appropriate efforts at initiating individual, collective, and community asset-building strategies; creating a more stable foundation for success.

Key Concepts: How We Get There

Previous work, supported by the Ford Foundation, is useful in explaining some of the key concepts related to asset-building. Like the Ford Foundation, we choose to define assets as "a broad array of resources that enable people and communities to exert control over their lives and to participate in their societies in meaningful and effective ways."[27] The desired outcome of asset-building strategies is to develop "resources—assets—that individuals, organizations, or communities can acquire, develop, improve, or transfer across generations."[28] The Ford Foundation distinguishes four categories of assets:

(a) **Financial holdings**, such as savings, equity in a business, homeownership, revenues from trust land and natural resources, and Individual Indian Monies;
(b) **Natural resources**, such as timber, wildlife, land, and livestock, that provide aspects of a sustainable livelihood and are often of substantial cultural value;
(c) **Interpersonal resources**, such as social bonds and community relations that form the social capital and civic culture of a community, giving individuals security and support; specialized knowledge of food, medicine, hunting, fishing, craft-making, and other traditions, stories, and Native languages may also be included here; and
(d) **Human assets**, such as marketable skills and job experience that allow people to find employment that pays a sufficient wage, as well as comprehensive health care, education, and basic adult living skills.[29]

First Nations Development Institute, a national Native non-profit organization committed to helping tribes, Native communities, and individuals identify and control their assets, and building the capacity to direct their economic futures, distinguishes four categories beyond Ford's initial four assets:[30]

(a) **Physical assets**, or the physical infrastructure within tribal communities, including transportation, utilities, and technological systems;
(b) **Institutional assets**, or the institutions and organizations within a community, like financial intermediaries, nonprofit organizations, tribal community colleges, and philanthropic institutions;

[27] Ford Foundation. *Building Assets To Reduce Poverty and Injustice.* NY, NY: Ford Foundation, no date, p. 1.
[28] Ibid.
[29] Building an educated, professional workforce of tribal members to govern the tribe, administer tribal programs, and provide governmental services is a critical part of tribal human asset-building strategies. The $10 million Hopi educational endowment established under Chairman Wayne Taylor is a good example of this strategy. (See page 15 of this publication for more information about the Hopi Endowment Fund.)
[30] First Nations Development Institute. Asset Framework and Elements of Development. Fredericksburg, VA: First Nations Development Institute, 2000.

(c) **Cultural assets**, such as the customs, traditions, language and indigenous knowledge of Native communities;[31] and
(d) **Legal and political assets**, or the legal rights and claims that a Native community may possess, including their sovereign status, tax immunity, and authority to make decisions.

Communities may use a variety of strategies, mechanisms, and institutions to build assets. From a strengths-based perspective, we suggest initially approaching the building of assets with an assessment of existing assets and capacities. The determined endowment will be the cornerstone of the development process, the foundation upon which to develop existing assets, and build additional assets.

Assets built for the longer term are not meant to be quickly consumed, but are "stock that endures and can be used in many ways to generate economic, psychological, and social benefits that foster resilience and social mobility."[32] With a shift in focus away from immediate consumption and toward building an enduring asset base, three types of tangible outcomes of asset building become clear.[33] The Ford Foundation differentiates these three "asset-effects:"

(a) **Economic benefits**. Assets can provide a cushion, increasing household stability and giving individuals and families the capacity to address changes, like the loss of a job or household income, caused by business cycles, restructuring, or family crisis. Accumulating assets also has an additive effect – it helps to build other assets and provides the opportunity to transfer assets to later generations, giving the next generation a better initial endowment to start from.
(b) **Psychological benefits**. Ford cites Sherraden's (1991) explanation, "Assets are hope in concrete form."[34] Assets "provide a sense of security, control, confidence, and a belief that one can take advantage of opportunities. They can provide an incentive to reduce risky behavior. Assets engender a desire and ability to look toward the future, make plans, and take an interest in additional steps toward independence. Assets support action on behalf of oneself and the next generation."[35]
(c) **Social benefits**. Assets can increase the commitment of individuals, families, and groups to one another and their community as a whole. Assets have the potential to increase shared vision and community action. Sharing individual assets and building community assets leads to a broader, increased sense of well-being and quality of life. Ultimately, assets create stronger families and communities for future generations.[36]

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[31] Culture is not an asset that tribes desire to sell for financial gain but an asset that can guide tribal efforts to gain and manage other assets. Culture is an asset in the sense that it is valued and can be preserved and passed on to future generations.
[32] Ford Foundation. *Building Assets To Reduce Poverty and Injustice.* New York, NY: Ford Foundation, no date, p. 7.
[33] In identifying the benefits of asset-building strategies it is critical to recognize not only the financial, but the non-financial value of assets as well.
[34] Sherraden, Michael. *Assets and the Poor* Armonk, NY: Sharpe, Inc., 1991, p. 155-156.
[35] Ford Foundation. *Building Assets To Reduce Poverty and Injustice.* New York, NY: Ford Foundation, no date, p. 7.
[36] Ibid.

The second and third asset-effects, the psychological and social benefits, are at least as important as economic benefits. Tribal communities have learned from experience that, as important as financial resources are, money alone cannot combat the socioeconomic problems that plague their communities. Social, psychological, and institutional environments are also important components to improving the quality of life in Indian Country.

The benefits of asset-building are directly related to the multiple layers of asset-building strategies, from building individual assets to familial or clan assets to community wide assets. The asset effects follow a similar path, with each strategy and its effects influencing and mutually reinforcing complementary strategies. For example, a southern Arizona tribe's community action program has recently begun practicing some traditional agricultural customs. In addition to contributing to the local economy, these practices have bonded community members together and helped them, as individuals and a community, to gain more knowledge about their ancestors' way of life. Further, reinstituting some of the practices has served to newly energize ceremonial life; a ceremony related to agricultural traditions, which had not been practiced for over 30 years, was recently brought back into practice, provoking both individual and communal feelings of cultural pride.

Although policymakers have recognized the value of building assets for some time, increasing attention is being devoted to an understanding of the effects of asset building. More concentrated policymaking efforts are surfacing toward developing policies with dedicated funding streams that better facilitate community-driven asset-building efforts. This promising movement has been charted by communities, supported by scholarly work, and largely funded by private philanthropic entities. However, as illustrated by the support afforded the undertaking of this project, government agencies are also taking an interest in asset building on a larger scale, and seeking to determine the appropriate role of government in supporting asset-building efforts.

Moreover, recent social, economic and political trends have increased the potential yield of asset building,[37] making it a more promising policy course than ever before. In short, new balances of power are being struck in the world today. The devolution of federal authority to more local levels of government, increased economic globalization, increased access to sophisticated technologies, and a growing appreciation of the benefits of sustainable environmental practices are altering institutionalized power structures and making way for new power sharing arrangements and distribution of power. The opportunities for tribal, federal and state governments, businesses, non-profit organizations, and community-based organizations to partner in new and more effective ways is unprecedented. Developing innovative, progressive, inclusive, and universal asset-building strategies and policies should be integral to these new partnering opportunities.

Developing an Asset-Building Mentality

The success of any asset-building strategy depends greatly on the belief that there is value in deferring consumption in favor of savings and making investments. A significant precursor to the implementation of asset-building strategies is asset education, or fostering a family and

[37] Edwards. K, and L.M. Mason. State Policy Trends for Individual Development Accounts in the United States: 1993-2003 (Policy Report). St. Louis, MO: Washington University, Center for Social Development, 2003.

community understanding of the benefits of deferring the use of assets. For individuals, families and communities who have never, or rarely, saved to build assets or invest assets, it is difficult to think of resources as savings that one allows to accumulate over time, rather than resources that are placed in a checking account (or coffee can) to be available for spending.[38] Incentives to save, such as the matched savings feature of IDAs, must be accompanied by an educational process. Disincentives to save, such as asset limits tied to eligibility for means-tested programs, must be minimized or eliminated to increase the potential "take-up" and effectiveness of savings initiatives for people with little monetary income.

Although developing an asset-building mentality may sound as simple as acquiring some financial education and financial literacy training; having established incentives to save also plays a key role in an asset-building effort, and the combination of the two strategies has been shown to be more likely to result in gained assets and developing a future orientation. An example of this principle, from a Minnesota tribe, highlights the general unwillingness of tribal citizens to apply an asset-building mentality toward natural resources management. In this instance an incentive was there, but adequate asset-management training was missing, and tribal citizens were concerned about their governments' initiatives to reforest some depleted land and restock an over-fished lake. Rather than considering the preservation of these resources for future generations and the preservation of culturally significant resources, tribal citizens were more concerned about their current situation and the diversion of existing tribal funds that would be required to fund these initiatives. As one tribal citizen commented, "people are more inclined to worry about tomorrow when it gets here."

The difficulty of establishing an asset-building mentality is by no means unique to tribal communities. In environments in which immediate needs may be largely unmet and/or the future seems highly uncertain, there are strong disincentives to saving. Asset-building programs should not be seen as substitutes for human services and funding that provides for immediate needs. An asset-building strategy should not reduce budgets or decrease service provision immediately. Rather, during the phase of building community readiness (including education about assets and the inter-related benefits of building various assets),[39] strong support services should be provided, in a way that allows capacity and motivation for building savings to be incrementally increased.

[38] Common in many societies, this "cash 'n carry" mentality is also exemplified in the immediate expenditure of significant trust accounts for Indian youth when the youth turn 18 years old. In these cases, trust funds that have been developed with per capita payments from natural resource development, gaming revenues, or court settlements to build assets for tribal youth may be rapidly spent on consumables, such as cars and "partying."

[39] Although building community readiness is described here as a phase, it should be noted that it is not something that is done and accomplished once and for all. Rather it is a continual process, requiring on-going support and energy to bring increasing community members along, preparing them for participation in asset-building strategies.

An Asset-Building Approach: A Cultural Match?[40]

When Dr. Eddie Brown, former Assistant Secretary of Indian Affairs, first heard about Individual Development Accounts, he was skeptical. "In traditional American Indian cultures, assets are given away," he commented, "Think about ceremonies, like potlatches or give-aways at Pow Wows. Sharing and reciprocity are important. The whole point of possessing assets is that one can use and share them. Status and power are derived from the ability to share and to provide others in the community with the resources that they need. The pride of acquiring something is directly related to being able to give it away."[41]

Dr. Brown's comments illustrate some of the tensions around the application of mainstream asset-building models to tribal communities. In our view, four core issues arise when relating traditional asset-building principles to tribal communities:

(a) **Asset building as a private sector strategy vs. underdeveloped reservation private sector economies.** At first glance, asset-building strategies may appear to be imposing a western economic model of capital development and building of the broader private sector on tribal communities. However, even though some mainstream asset goals, such as housing, higher education and small business development, may prove much more challenging on Indian lands than in urban, suburban or even less remote rural areas, they are not necessarily less desirable. Building assets for Native families may require both those strategies that look far ahead in time and those that are aimed outside of the immediate geographical area. For example, opportunities for higher education for tribal youth most often require substantial (long-term) savings and actually leaving the reservation.[42] In addition, research finds that tribes would like to use asset-building policies for home repair, transportation, and other resources that are "short-term," and more survival-oriented, than "long-term" assets. This finding may indicate that tribal communities still lack a considerable amount of necessary available assets, and interim steps to fulfill immediate needs are required.[43] Moreover, the creation of an infrastructure that facilitates the building of assets will also be necessary.[44]

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[40] A pool of research by the Harvard Project on American Indian Economic Development found that modern forms of tribal government that replicate or parallel traditional forms of tribal government are more legitimate in the eyes of tribal citizens. They call this concept "cultural match"-- the fit between present rules and indigenous concepts of how authority should be organized and exercised. Research shows that societies with culturally appropriate governing institutions are more likely to thrive. See Cornell, Stephen J. and Joseph P. Kalt. "Reloading the Dice: Improving the Chances for Economic Development on Indian Reservations," in *What Can Tribes Do? Strategies and Institutions in American Indian Economic Development*, ed. Stephen Cornell and Joseph P. Kalt. Los Angeles, CA: University of California, 1992. Here we use the term "cultural match" in a similar vein. We are posing a question about whether asset-building strategies are compatible with tribal culture.

[41] Dr. Eddie F. Brown, Dean, American Indian Affairs, George Warren Brown School of Social Work, Washington University in St. Louis. Interview with Sarah Hicks, 09/19/03.

[42] Although 31 tribally controlled community colleges have been established on Indian reservations and serve as a strong asset to their home communities as well as surrounding communities, only a small minority of tribes benefit from these resources.

[43] Consider Maslow's hierarchy of needs. Immediate survival needs must be met before people can consider meeting other, more long-range or less immediate needs.

[44] General financial education as well as education specific to the asset goal are required. Many good examples of curriculum exist. For example, see "Building Native Communities: Financial Skills for Families" developed in

(b) **Sharing and reciprocity vs. savings and accumulation**. Traditionally, American Indian and Alaska Native communities have focused on sharing and reciprocity rather than longer-term savings and accumulation of wealth and assets. The difficulty of a history of subsistence lifestyles and requisite division of labor made sharing and reciprocity necessities for community survival. Although the majority of tribal communities are now mixed economies and not solely reliant on subsistence activities, sharing and reciprocity are still valued. They play integral roles in the interrelationships between family and community members. In contrast, mainstream asset-building programs focus on individual asset accumulation and use of wealth for personal homes, educations, and businesses, although research anticipates positive community effects related to increased individual and family assets among low-income populations, even in densely populated urban areas.

(c) **Communal accumulation and use of resources vs. individual accumulation**. Very much related to the previous two points, which address the typical objectives of asset building, is a point about the unit of focus and process of asset-building. Traditionally, American Indian communities accumulated assets in a communal fashion; economic assets were mostly owned by families or clans, and everyone in the family or clan had a distinct role and function in using the assets wisely. The process of acquiring and maintaining resources was multi-faceted, with each persons' role needed, and, in the end, the assets were shared property. In contrast, most natural resources were not considered "owned" by any one, but to be jointly used by all. This approach differs from mainstream asset-building programs, which focus on the individual as the locus for asset building. The individual contributes toward building the asset, and reaps the greatest benefits (although of course, families and communities must also derive some benefit from the building of individual assets).[45]

(d) **Mainstream vs. tribal definition of assets**. Even the types of assets valued and desired may be different in mainstream vs. tribal communities. Mainstream asset-building approaches, with a focus on individual capital, homeownership, businesses, and higher education, may differ from tribal community assets, not because these assets are not needed in Native communities, but because American Indian communities may prioritize assets in other ways. For example, rather than promote individual savings for the establishment of a new convenience store owned by an individual tribal citizen, clans or community sub-groups may wish to build assets through which many citizens may benefit, i.e. a revolving loan fund to which many citizens contribute assets and can, in their turn, draw from the fund to develop an individual or communal business, that will be used to serve the community. Another example could be an Alaska Native village that pools resources to buy a new boat motor. The boat will benefit all through its use by skilled hunters or fisherman to provide resources for the whole community. Considering these examples, the use of communally related assets (i.e. natural resources) to build more individually related assets (i.e. income or wealth) might be objectionable to tribes. The point here is that the types and use of assets desirable in Native communities are likely to differ from those built in mainstream communities.

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partnerships by the Fannie Mae Foundation and the First Nations Development Institute, available on-line at: http://www.firstnations.org/fnoc/resourceguide.pdf

[45] For example, in a community where a new arts and crafts shop opens, nearby businesses, such a gas station and diner, may also benefit.

The assumption of the authors is not that asset-building strategies are not appropriate for Indian communities; in fact, discussion with tribal communities indicate that the opposite is the case, and the tensions highlighted in this section may be more easily resolved than supposed. Certainly some of these tensions are naturally resolved by adopting an expanded time horizon for building assets. In an expanded temporal view, the conflict between accumulation and sharing may be nonexistent. A resource must be accumulated before it can be shared. Before one can giveaway food, clothing, and blankets at a potlatch or Pow Wow, a family has to save, sometimes for more than a year, to accumulate the resources. Another example of this concept is the necessity to save significant resources so that one might leave the community, get a higher education, and return to the community with more to contribute.

However, giving tribes the opportunity to explore appropriate asset-building strategies will take more than merely making tribes eligible for current, prescriptive programs and the attached funding streams. It is critical to more fully explore how asset-building might best occur (i.e. be most effective, useful, and desired) in a Native context, rather than encouraging tribes to access available programs that are likely to prove unsuccessful in a tribal context and create setbacks to further exploring the overall concept. We see it as a given that tribal communities will greatly benefit from "asset effects"—all of the good byproducts of asset building expected to occur in mainstream economies. The challenge is to design policies that allow tribes the flexibility to develop their own uniquely appropriate, and therefore most effective, asset building approaches.

Demonstrating Workable Approaches

The most difficult part of developing asset-building policy is determining what opportunities the policy should facilitate, what constraints it should include and avoid, and then convincing policymakers of the benefits of the most flexible policy approach. In order to get a sense of some potentially effective policy structures, consider the following case scenarios, based on input from tribal representatives, which suggest workable approaches to asset-building strategies:

Red Lake Tribe, Minnesota

The Red Lake Ojibwe Tribe in Minnesota invested in and exercised tribal sovereignty through the development of a compact for reforestation of tribal lands.[46] The tribe invested funds received from a recently settled lawsuit. Through implementation of this strategy, the tribe hopes to increase the stability of tribal government, and develop a common vision of investing in tribal assets for the future vitality of the tribe.

Hopi Tribe, Arizona

The Hopi Tribe of Arizona committed to investing in the human capital of the tribe by establishing the Hopi Endowment Fund, generated by "638" funds.[47] The Fund supports graduate

[46] See forthcoming Kathryn M. Buder Center for American Indian Studies and Center for Social Development publication by Bobby Whitefeather, a detailed case study of the Red Lake reforestation strategy.
[47] "638" funds are federal funds received under Indian Self-Determination Act (Pub. Law 93-638) contracts from the BIA and/or IHS.

education and professional development for tribal citizens in areas that the Tribe considers of critical administrative importance. An additional goal is to encourage Hopis, who leave the reservation to achieve higher levels of education, to commit to returning to the reservation to establish their careers in all levels of tribal administration and services. The tribe was able to implement this asset-building strategy through a commitment of tribal funds and a partnership with the Endowment Fund Board, creating solid internal policy for the development and implementation of the Hopi Endowment Fund. The tribe successfully created the program by capitalizing on tribal staff, creating the position of Fund Manager (whose sole job responsibility is to manage the endowment fund), and networking with other appropriate partners such as attorneys, the Internal Revenue Service, and First Nations Development Institute. The program initially performed outreach to their post-secondary tribal citizens living on the reservation. They plan to expand and broaden the program to increase beneficiaries and employment options.

Confederated Salish and Kootenai Tribes, Montana

The Confederated Salish and Kootenai Tribes (CSKT), through the work of a stable, forward thinking tribal council, embarked on a tribal land acquisition and recovery plan. The tribe surveyed lands that were determined, with the use of land records and the "land use plan," to have cultural and tribal significance. These lands include ceremonial and burial sites and travel routes. The tribe dedicated resources toward this project with the goal of purchasing these lands, which had been previously lost by tribal citizens. Additionally, the CSKT were able to more effectively strategize and plan for this project due to their role as a critical member of the national Indian Lands Working Group. After purchasing the land, the tribe successfully categorized it into trust and fee simple tribal lands. Having increased their tribal land ownership from 22% to 46% with this land recovery effort, the tribe has invested in cultural preservation of the land and decreased the "checkerboard effect" on the reservation, simplifying the exercise of tribal jurisdiction and offering new employment opportunities (in forestry) for tribal citizens. The CSKT were also able to create a buffer zone from development, and save a historically and culturally significant mountain from outside development, thereby protecting the petroglyphs, fish, sheep and other associated natural resources from outside exploitation.

Southern Ute Tribe, Colorado

The Southern Ute Tribe of Colorado is rich in natural resources, such as coal and natural gas, and has been able to capitalize on these natural resources and invest in assets for tribal citizens. Through the vision of tribal leadership and resultant establishment of rights to much of the natural gas on the reservation lands, the tribe invested millions of dollars of royalties and profits into two funds, a Permanent Fund and a Growth Fund. In addition to making conservative investments for the tribe, the Growth Fund supports and develops new and existing tribal businesses. Tribal citizens benefit in perpetuity from the profits generated by these funds, which provide better access to higher education, homeownership, and other assets. Additionally, the tribal council manages and directs the priorities of a portion of the funds used for tribal development.

Tanana Chiefs Conference, Alaska

The Tanana Chiefs Conference (TCC), based in Fairbanks, Alaska, is a non-profit Native consortium of the 42 villages in Interior Alaska. The TCC philosophy is based on a belief in tribal self-determination and the need for regional Native unity. Tanana Chiefs has been using University of Alaska business students to assist tribal citizens in filing federal tax returns in order to receive the refundable Earned Income Tax Credit (EITC), bringing many refunded income tax dollars back into the Villages that were previously going unclaimed. Several other tribal governments and organizations in Indian Country are supporting efforts to make tribal citizens more aware of EITC, more trustful of the free tax preparation process, and gain better access to tax-filing assistance.[48]

Navajo Nation, Arizona

Indigenous Community Enterprises, Inc., based in Flagstaff, Arizona, employs high school students to work in a program to build traditional Navajo hogans for elders. Attached to the Elder Hogan Project (ICE HOME), is an Individual Development Account program for the tribal youths who build the hogans. As of Fall 2003, the Youth IDA Savings Program had eleven active participants. Each participant was required to attend a series of financial literacy trainings in addition to saving $500 over a twelve (12) month period. ICE matches this amount at a 2:1 ratio. If a youth participant meets his/her savings goal and other requirements by a certain date, they are eligible to withdraw $1,500 toward an approved asset. ICE defines an approved asset as secondary educational expenses, down payment on a home, or small business development. ICE partnered with Wells Fargo Community Development, Fannie Mae and First Nations Development Institute to obtain the matching funds. ICE is a member of the developing statewide IDA movement in Arizona, *Assets for Arizona Alliance*, and is expanding this savings program to include adults. More than twelve American Indian and Alaska Native IDA programs currently exist in the U.S. (Salish and Kootenai also successfully implemented an IDA program.)

These diverse case scenarios all highlight the ability of tribal governments and Native non-profits to develop uniquely appropriate asset-building strategies. In any given community, tribal asset-building strategies will certainly vary (based on the asset, mechanism, tribal infrastructure, etc.) and, because of this diversity, may need to be almost tribe-specific. These strategies have policies lessons for other tribes embedded within them.

Recurrent Themes: What Do these Strategies Have in Common?

The asset-building and resource generation strategies cited above include five key elements:

(a) Exercising of tribal self-determination. In every example we considered, asset-building strategies were developed and employed within tribal communities.[49] The concept and impetus

[48] For more information on EITC outreach on Indian lands, see Annie E. Casey's Native outreach website at: www.eitc.info/native.

[49] Tribal IDA evaluations conducted by First Nations Development Institute suggest that IDA programs (and asset-building strategies generally) must be Native directed and managed and must use tribes to deliver services.

came from within the community, and the community determined the proper approach to build desired assets.

(b) Deliberate and balanced building of assets. In each case, tribal leaders and community members identified needs for particular assets and appropriate ways to facilitate the building of those assets. The strategies were weighed against potential benefits and costs. The impacts of employing these strategies were evaluated at the community level in the context of their affect on increasing other, sometimes individual, assets. The positive impacts that the generation of some assets would have on other assets were clear considerations. For example, in the case of the Confederated Salish and Kootenai Tribes' Land Recovery Project, acquiring more tribal land increased the tribes' natural resources and financial holdings. This strategy also exercised the tribes' legal and political assets. It may prove to develop human assets, as tribal citizens are trained to take on new jobs in forestry and land management. This strategy may also develop cultural assets as citizens learn more about the history of the newly acquired land and how their people traditionally used it. Moreover, from the increased pride in their community as well as the sense that their community is a permanent and desirable place to live, citizens may invest more of themselves in their community, building interpersonal resources and institutional assets. The end result may be higher levels of participation in tribal community and political events. The mentioned tribes considered all of these layers of effects when they determined that they would move forward with their Land Recovery Project.

(c) Community leadership with vision. In each case, champions for asset-building had to start a dialogue with community members. Someone, such as an elected tribal leader or an informal community leader, had to have the vision for what could be possible. They then had to engage other people in a community conversation.

(d) Community support. Community members were recruited to participate in the process. Community members had to discuss and weigh strategies and agree on a particular asset-building strategy (or concert of strategies). They had to make a commitment to expend resources (time, money, staff, etc.) in order to develop particular assets.

(e) Resources. A commitment of resources was necessary in all cases. Depending on the strategy adopted and the asset being built, varying amounts of resources were required. The community had to agree to commit resources to the effort while forgoing many other possible uses of the time, money, staff, etc. This required making a commitment to increasing future assets and improving future quality of life at the expense of current consumption that could be used for other necessities.

Recommendations for Policy, Practice and Research

Based on research and discussions with tribal leaders, program administrators and community members, a number of recommendations for policy, practice and research that can facilitate tribal asset-building strategies have come to the forefront. These recommendations are organized below according to the groups we consider most appropriate to undertake them: tribal government, federal government, philanthropic organizations, and researchers.

Tribal governments have the single most important role in tribal asset-building. It is up to tribal governments and community members to develop a forum for, and participate in, dialogue about building assets. Infrastructure and community readiness are critical. In practice, tribal governments and institutions can take stock of current assets and how they are being used;

explore other appropriate assets to build and strategies for building them; and identify appropriate resources to support asset-building strategies. Finally, successes will be increased if tribes share information with one another (providing peer-to-peer technical assistance) and contribute to national tribal discussions about federal policy and research that can better support and facilitate identified strategies for tribal asset-building.

The federal government can conduct tribal outreach with regard to asset-building. It can seek input from tribes regarding mainstream asset-building policy development and amendment, and better provide information to tribes about current policy and available resources (i.e. funding, technical expertise, administrative resources, etc.). The federal government also has a role to play in providing support for tribal asset-building strategies (including clarifying that federal funds can be invested by the tribes, and that derived interest can be used to support tribal asset-building strategies) and in directly funding a scaled-up tribal IDA demonstration project. Finally, the federal government can support tribally-driven research efforts to assess and evaluate the effectiveness of tribal asset-building strategies.

State governments can also conduct tribal outreach regarding the development of state asset-building initiatives, inviting tribal governments and tribal representatives to the policymaking table early in the process. States can encourage tribal participation in existing state asset-building programs ensuring, through tribal consultation, that state programs are appropriate and flexible enough to meet tribes' needs. States should offer tribal governments the opportunity to directly administer asset-building strategies in their community whenever possible.

National and regional inter-tribal Indian organizations can facilitate and support tribal dialogue and debate about mainstream asset-building approaches, whether or not they are appropriate for tribal communities, and how, because of unique tribal environments, conditions, and circumstances, asset-building strategies might best work in an American Indian cultural context. Inter-tribal organizations can also be a resource to tribes who wish to pursue asset-building strategies, providing tools like asset inventories and effective tribal models being used in other places around the country. Finally, inter-tribal organizations can help raise awareness of the need for research and evaluation and can encourage tribes to address the effectiveness of the asset-building strategies they are employing.

The philanthropic community can support tribal community dialogue, asset inventories, and planning processes with regard to determining asset-building strategies. Foundations can fund asset-building projects and research as well as help to document models and community learning. They can also support national tribal dialogue regarding determining appropriate asset-building policy and research.

Researchers, both academic and community-based, can help evaluate tribal asset-building strategies, documenting the most effective practices and identifying key determinants of successful strategies. Researchers also have a role to play in helping tribes think through process and outcome evaluation criteria and methodology for individual project evaluation for the purpose of determining the effectiveness and appropriateness of various asset-building strategies. Finally, any national asset-building demonstration must necessarily include a comprehensive evaluation, if it is to carry lessons and helpful information to others.

Tribal Sovereignty as the Foundation

Ultimately, building individual, family, and community assets may increase the capacity and capability of tribal governance. Research has shown that communities with greater financial, natural, interpersonal, and human assets are better able to exercise their sovereign authority.[50] Through asset-building strategies, tribal governments, like the citizens they serve, may acquire more options and an increased ability to act in self-determined ways, achieving tribally-desired outcomes.

Former chairman of the Red Lake Nation, Bobby Whitefeather, noted that, relatively speaking, "Tribal self-governance is in its infancy."[51] Yet, as much as tribes need to build assets to strengthen their ability to act in self-determined ways, tribal sovereignty is, in itself, an asset-building tool. As our case scenarios point out, sovereignty, as a legal and political asset, makes possible unique tribal asset-building strategies, like controlling tribal trust lands and accounts and using lease money for education accounts. Tribal sovereign authority and land can be used as leverage to create a different infrastructure for tribal asset-building strategies. Tribes can choose to re-invest a variety of tribally controlled funds in other effective asset-building strategies. Tribes can invest federal funds, such as NAHASDA and 638 funds and use the interest gained to support asset-building strategies. Tribes can help their employees to build assets through offering matched savings accounts as an employment benefit.[52] Resource-rich tribes have unique opportunities to support individual asset-building strategies through the structure, requirements, and incentives around per capita payments.[53] Tribes can also endow foundations to secure resources to meet future tribal needs, and develop tribally run non-profits.

Support for asset-building strategies begins with a tribal community adopting an asset-building philosophy. Such a philosophy reflects a balance between building assets for the future, meeting immediate needs, and sustaining tribal identity. This philosophy is characterized by acknowledging time as a critical factor and focusing on building an enduring stock of assets for future generations rather than current consumption. An asset-building philosophy must be accompanied by an asset-building environment. Creating an environment conducive to asset building necessitates developing tribal policy that supports and models effective asset-building strategies, while maintaining traditional community supports and resources.

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[50] Cornell, Stephen J. and Joseph P. Kalt. "Reloading the Dice: Improving the Chances for Economic Development on Indian Reservations," in *What Can Tribes Do? Strategies and Institutions in American Indian Economic Development*, ed. Stephen Cornell and Joseph P. Kalt. Los Angeles, CA: University of California, 1992.

[51] Personal communication with Bobby Whitefeather, October 17, 2003.

[52] This strategy will also provide a greater incentive for employees to stay with the tribal government, building greater human and institutional capacity.

[53] Increasingly tribes are requiring a high school diploma (or GED) and/or financial education before tribal members are qualified to receive per capita payments. Tribes can also think through ways to structure incentives for saving and/or investing per capita payments for individual asset-building (including buying a home, starting a small business, or pursuing higher education). The Mashantucket Pequot and St. Regis Mohawk tribes require financial education and offer investment assistance for tribal members.

Conclusion

In conclusion, tribes do recognize the importance of building assets, but must find new strategies to identify, develop, and maintain a variety of assets, at both the individual and community levels, to increase chances of escaping persistent poverty which is, in large part, due to asset stripping over many years. In many ways, tribes have been struggling to recover stripped assets and build individual, family, community, and tribal assets, albeit not always using the term "assets," for hundreds of years. Tribal sovereignty gives tribal communities some unique tools and leverage to use in building assets. By exercising sovereign authority, modeling tribally-driven and regulated governmental asset-building strategies, involving the community in all aspects of an approved asset-building strategy, and committing dedicated resources to asset-building strategies, for the long term, can lead to new assets that will both help the current community and be left behind for future generations. These long-term asset-building strategies, which will be more comprehensive than any single "silo-ed" asset-building program (i.e. just an IDA program or EITC outreach), are much more likely to leave behind an abundance of resources for individuals, families, communities, and ultimately tribal governments, than relying on a support services strategy, alone. These combined strategies may change the initial endowment that new generations start with; but will likely make possible even larger asset accumulations, dramatically changing the social and cultural possibilities for future American Indian/Alaska Native peoples.

Please feel free to submit comments and questions to Sarah Hicks at shicks@wustl.edu.

Appendix A: Timeline of Major Asset Policy and Program Events

Date	Event
1862	Homestead Act passed by Congress
1944	G.I. Bill enacted by Congress
1980s	Michael Sherraden (social work professor at Washington University) offers theory of asset-based social welfare
1991	"Assets and the Poor" written by Michael Sherraden and published by M.E. Sharp, Armonk, NY (proposes policy structure for Individual Development Accounts)
1991	State of Oregon legislates first state-level IDA policy for children
1992-93	First three community-based IDA programs launched (Indianapolis, IN; Tupelo, MS; and Bozeman, MT)
1993	State of Iowa legislates first state-level IDA program for adults (program is implemented in 1996)
1997	National American Dream IDA Demonstration (ADD) launched in 13 sites throughout the U.S. (funded by private foundations)
1998	First Nations Development Institute (FNDI) funds 5 American Indian IDA programs
1998	First federal IDA policy, the Assets for Independence Act (AFIA), passed ($125 million appropriated over 5 years), implemented in 1999
1999	Office of Refugee Resettlement (ORR) funds 16 IDA programs specifically for refugee populations
1999	AFIA funds first 20 IDA programs through competitive request for proposals process ($10 million appropriated for first year)
1999	Federal legislation, Savings for Working Families Act, proposed to fund IDA programs through tax credits
1999-2000	United Kingdom proposes IDA-like initiatives
2000	FNDI funds 4 more American Indian IDA programs

2000	ORR funds 13 more IDA programs
2000	AFIA funds second round of IDA programs (45 programs, $10 million appropriated)
2001	National "Learn $ave" IDA policy demonstration launched in Canada
2001	Children's Saving Program demonstration launched in Singapore
2001	Children's Matched Savings Program launched in Ireland
2001	AFIA funds third round of IDA programs (60 programs, $25 million appropriated), other rounds funded in 2002 and 2003 through $25 million appropriations each year
2002	"Savings Gateway" IDA policy demonstration launched in United Kingdom (funded by Parliament)
2003	"Children's Trust Accounts" matched savings accounts approved and funded by Parliament (accounts from birth), for roll out in 2005
2003	AFIA up for reauthorization – success likely
2003	35 states in the U.S. have legislated IDAs, 25 state-supported programs have been initiated
2003	An estimated 20,000 accounts established in 500 IDA programs in the United States, spread over all 50 states

Appendix B
Asset-Building in Tribal Communities:
Generating Native Discussion and Practical Approaches
Mystic Lake, Minnesota: October 17, 2003
Small Discussion Groups Summary

How would you define assets?

- Something of value; increases in value over time
- Comprehensively, according to a holistic view, in relation to other systems
- Contributes to balance within the community and to building a healthy community

What purpose do assets serve for individuals, communities, and tribes?

- Strengthen tribal government capacity and self-determination
- Increase current and future resources
- Improves quality of life over time (a long-term investment)

What categories or classifications would you use to group various types of assets?

- Groups concurred with 8 categories (identified by Ford and First Nations Development Institute) identified and outlined in attached asset-building discussion paper

What types of assets is your community interested in building?

- Preservation of cultural and spiritual assets
- People (human capital) – assets we currently have, and we're nothing without our people
- Generational assets: the assets of elders will be used to develop the assets of children
- A professional tribal workforce (to use instead of importing "experts")
- Land: buy back, and better develop, according to tribal needs
- Housing: people need it, and it can be used to build equity in the reservation economy
- Institutional infrastructure
- Technological infrastructure

What kinds of asset-building programs and/or strategies does your community use?

- Developing long-range plans
- Developing local community plans
- Building capacity and infrastructure to manage resources
- Use available tax credits, if able
- Invest 638 funds (flexible base to accomplish things for which there is no federal funding)

What is the potential use and outcomes of asset-building strategies in your community?

- Meet needs locally (people won't have to leave the reservation)
- Reinforce the importance of spiritual and cultural assets
- Security ("Rainy Day Fund")
- Transfer assets to next generation (improve quality of life for future tribe)
- Strengthen and leverage tribal sovereignty
- Recover stripped resources

Appendix C: Generating Resources for Tribal Asset-Building Programs

A key issue in the development and implementation of asset-building strategies, such as those described in this paper, is finding dedicated resources to support the effort. While there is no current ideal pool of dedicated resources to support tribal asset-building strategies, there are, as previously mentioned, various non-dedicated federal funding sources such as Temporary Assistance for Needy Families (TANF), Native American Housing and Self-Determination Act (NAHADSA), Community Services Block Grant (CSBG), and Community Development Block Grant (CDBG), that may be used, depending on the asset goal and the strategy applied to it.[54]

While it's true that these sources are not dedicated specifically to a general asset-building agenda, and are already being used for the programs for which they were intended in many communities, the implementation of any asset-building strategy does require a trade-off of resources that can be currently used in favor of saving and accumulating greater resources in the future. Tribes have found other creative ways to support their strategies including leveraging existing, but perhaps underutilized, assets into additional assets by creating a pool of incentives. Such a model allows for sustainable development through the building of both economic and social capital.

For example, in order to build the capacity of individual persons and the tribe, incentives are needed to increase funding sources that will better allow for asset building. Tribal citizens could have incremental incentives to build assets through participation in an Individual Development Account (IDA), a matched savings account for dedicated asset-building purposes, which could allow them to start a small business, purchase a home, or gain further education. While an individual was participating in an IDA program, they could be building financial expertise and marketable skills, leading to the development of a community asset as well. Also possible during IDA program participation is information gained about the Earned Income Tax Credit (EITC), which gives the tribal member more personal assets to invest in a tribal business. With the acquiring of marketable skills, individuals, and the wider community, would have more opportunities for job training, employment, and contributions of earnings to a tribal investment fund, for example. This would allow the tribe to build their own matching funds to leverage additional asset building for the tribe, thus, increasing the ability of the tribe to exercise its self-determination.

Selected development and funding strategies:

(a) Identify assets and renegotiate leases. Tribes could perform an inventory of their assets, including BIA negotiated leases that are held at below-market rates. When the identified leases come up for renegotiation, the tribes could demand that they be negotiated at the current market rate. Tribes could also get upfront payments for oil or grazing leases, whereby the companies would make a payment on the lease immediately in addition to negotiated monthly payments.
(b) Buy land and postpone putting it into trust. Tribes could acquire land and postpone putting the land into trust, which would allow them to use the land for their own asset-building

[54] For a thorough discussion of potential funding resources for tribal asset-building strategies, see forthcoming Kathryn M. Buder Center for American Indian Studies and Center for Social Development publication by Alisa Larson.

purposes for a period of time. To lessen concerns by states about lands leaving the state tax base, tribes could negotiate with states, delaying putting the land into trust for a year or so. For productive leverage for other negotiations on cigarette tax compacts, for example, a tribe could offer to pay ½ of the cigarette tax or so to the state.

(c) Promote the establishment of an American Indian tax credit. With changes in federal legislation, such as with IRS laws on corporation taxation, an American Indian tax credit could be created that allows tribes to sell the credits to corporations to leverage funds. Thus, for example, targeted entities could buy tribal credits, reduce their federal tax burden, and direct their tax dollars for the specific purpose of asset building and economic development on tribal lands.

(d) Assist city-based home ownership for tribal citizens. The Mille Lacs Band of Ojibwe in Minnesota helps tribal citizens buy houses in the city of Minneapolis. If citizens retain the property until the value has increased, they can sell the property later and move back to the reservation, holding greater individual assets (acquired through equity in their homes) that benefit the tribe. In this sense, community assets are a collection of individual assets. Helping citizens to move back with greater individual resources, increases the community's asset base as well.

(e) Set up mortgage programs using Native American Housing and Self Determination Act (NAHASDA) funds. Tribes could consider setting up mortgage programs using NAHASDA funds, whereby tribes would hold the mortgage and families would pay the tribe back.

(f) Consolidate economic development funding streams. In order to streamline administrative costs and to more effectively combine federal and tribal resources, legislation, along the same lines as the existing "Indian Tribal Development Consolidated Funding Act of 2003," could establish new policies to facilitate asset building and acquiring matching funds.

(g) Create a tax-deductible tribal investment fund. A tax-deductible tribal investment fund could be created; tribal citizens that live off the reservation could also be invited to participate in the investment fund. The tribe could receive fifty percent of the interest earned, and the non-resident tribal citizen investor could take the other fifty percent.

(h) Levy tribal personal income tax or taxes on such activities as fishing. Tribal citizens could pay personal income tax to the tribe, to be used for a pool of asset building and matching funds for the benefit of all tribal citizens. Also, tribes could levy a tax on tribal fishing, for example, whereby they could tax 5% of a catch and generate income for the benefit of tribal asset building.

United States Government Accountability Office

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Testimony before the Chairman, Committee on Ways and Means, House of Representatives

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POVERTY IN AMERICA

Consequences for Individuals and the Economy

Statement of Sigurd R. Nilsen, Director
Education, Workforce, and Income Security Issues



GAO-07-343T

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GAO
Accountability · Integrity · Reliability
Highlights

Highlights of GAO-07-343T, a testimony before the Chairman, Committee on Ways and Means, House of Representatives

POVERTY IN AMERICA

Consequences for Individuals and the Economy

Why GAO Did This Study

In 2005, 37 million people, approximately 13 percent of the total population, lived below the poverty line, as defined by the Census Bureau. Poverty imposes costs on the nation in terms of both programmatic outlays and productivity losses that can affect the economy as a whole. To better understand the potential range of effects of poverty, GAO was asked to examine (1) what the economic research tells us about the relationship between poverty and adverse social conditions, such as poor health outcomes, crime, and labor force attachment, and (2) what links economic research has found between poverty and economic growth. To answer these questions, GAO reviewed the economic literature by academic experts, think tanks, and government agencies, and reviewed additional literature by searching various databases for peer-reviewed economic journals, specialty journals, and books. We also provided our draft report for review by experts on this topic.

www.gao.gov/cgi-bin/getrpt?GAO-07-343T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Sigurd R. Nilsen at (202) 512-7215 or at nilsens@gao.gov.

What GAO Found

Economic research suggests that individuals living in poverty face an increased risk of adverse outcomes, such as poor health and criminal activity, both of which may lead to reduced participation in the labor market. While the mechanisms by which poverty affects health are complex, some research suggests that adverse health outcomes can be due, in part, to limited access to health care as well as greater exposure to environmental hazards and engaging in risky behaviors. For example, some research has shown that increased availability of health insurance such as Medicaid for low-income mothers led to a decrease in infant mortality. Additionally, exposure to higher levels of air pollution from living in urban areas close to highways can lead to acute health conditions. Data suggest that engaging in risky behaviors, such as tobacco and alcohol use, a sedentary life-style, and a low consumption of nutritional foods, can account for some health disparities between lower and upper income groups. The economic research we reviewed also points to links between poverty and crime. For example, one study indicated that higher levels of unemployment are associated with higher levels of property crime. The relationship between poverty and adverse outcomes for individuals is complex, in part because most variables, like health status, can be both a cause and a result of poverty. These adverse outcomes affect individuals in many ways, including limiting their development of the skills, abilities, knowledge, and habits necessary to fully participate in the labor force.

Research shows that poverty can negatively affect economic growth by affecting the accumulation of human capital and rates of crime and social unrest. Economic theory has long suggested that human capital—that is, the education, work experience, training, and health of the workforce—is considered one of the fundamental drivers of economic growth. The conditions associated with poverty can work against this human capital development by limiting individuals' ability to remain healthy and develop skills, in turn decreasing the potential to contribute talents, ideas, and even labor to the economy. An educated labor force, for example, is better at learning, creating and implementing new technologies. Economic theory suggests that when poverty affects a significant portion of the population, these effects can extend to the society at large and produce slower rates of growth. Although historically research has focused mainly on the extent to which economic growth alleviates poverty, some recent empirical studies have begun to demonstrate that higher rates of poverty are associated with lower rates of growth in the economy as a whole. For example, areas with higher poverty rates experience, on average, slower per capita income growth rates than low-poverty areas.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the important topic of poverty and its effects on individuals and our economy. My testimony is drawn from our report *Poverty in America: Economic Research Shows Adverse Impacts on Health Status and Other Social Conditions as well as the Economic Growth Rate* (GAO-07-344), being released this morning. Our work looks at what the economic research tells us about the relationship between poverty and adverse social conditions, such as poor health outcomes, crime, and labor force attachment; and what links economic research has found between poverty and economic growth.

According to the Census Bureau, approximately 37 million people in the United States—nearly 13 percent of the total population—lived below the poverty line in 2005.[1] This percentage was significantly larger for particular population groups, specifically children, minorities, and those living in certain geographic areas such as inner cities. The federal government spends billions of dollars on programs to assist low-income individuals and families.[2] These programs included Medicaid, food stamps, Temporary Assistance for Needy Families (TANF), and the Earned Income Tax Credit (EITC), to name some of the largest. While some have taken issue with Census' official poverty measure and proposed alternative measures, it is generally recognized that poverty imposes costs on the nation as a whole, not merely in terms of programmatic outlays but also through lost productivity that can affect the overall economy.

In conducting our work, we reviewed the economic literature by academic experts, think tanks, and government agencies, which we collected from searches of various databases, peer-reviewed economic journals, specialty journals, and books. We also provided our draft report to four external reviewers. They are recognized experts who have conducted research and published on the topic of poverty and economic growth and whose work has recommended a variety of approaches and strategies to policymakers. We limited the scope of our work by looking at recent studies published since 1996, excluding anything older, with exceptions made for work that was considered seminal. Thus, our results are not an exhaustive or

[1]In 2005 the poverty threshold for a family of four was $19,971.

[2]Congressional Research Service, *Cash and Noncash Benefits for Persons with Limited Income: Eligibility Rules, Recipient and Expenditure Data, FY2002-FY2004* (Washington, D.C.: Mar. 27, 2006).

historical treatment of the topic. Our review was primarily driven by the economic literature focused on the United States either exclusively or including other developed nations; studies from other disciplines were excluded unless they were captured in either the economic study under review or its bibliography. When we refer to poverty in the report, we are using an absolute measure, not a relative one. This means that, for the most part, the studies we reviewed typically used the official poverty line published by the Census Bureau as its benchmark. A few of the studies we reviewed used relative measures such as the poorest 10 percent of the population.

Our work was conducted between October 2006 and January 2007 according to generally accepted government auditing standards. Because we did not evaluate the policies, operations, or programs of any federal agency to develop the information presented in this report, and because we are not making any recommendations, we did not seek agency comments. However, we met with agency officials from the Departments of Commerce, Health and Human Services, Justice, and Labor to obtain information on research they or others had conducted related to our work objectives.

Summary

Economic research shows that poverty is associated with a number of adverse outcomes for individuals, such as poor health, crime, and reduced labor market participation, and has a negative impact on the economic growth rate. Some research suggests that adverse health outcomes are due, in part, to limited access to health care as well as exposure to environmental hazards and engaging in risky behaviors. The economic research we reviewed also suggests that poverty is associated with higher levels of certain types of crime. The relationship between poverty and adverse outcomes for individuals is complex, in part because most variables, like health status, can be both a cause and a result of poverty. Regardless of whether poverty is a cause or an effect, however, the conditions associated with poverty can work against the development of human capital—that is the ability of individuals to remain healthy and develop the skills, abilities, knowledge, and habits necessary to fully participate in the labor force. Human capital development is considered one of the fundamental drivers of economic growth. An educated labor force, for example, is better at learning, creating, and implementing new technologies. Economic theory suggests that when poverty affects a significant portion of the population, these effects can extend to the society at large and produce slower rates of growth. Though limited,

empirical research has demonstrated that higher rates of poverty are associated with lower rates of growth in the economy as a whole.

Background

Economic growth is one of the indicators by which the well-being of the nation is typically measured, although recent discussions have focused on a broader set of indicators, such as poverty. Poverty in the United States is officially measured by the Census Bureau, which calculates the number of persons or households living below an established level of income deemed minimally adequate to support them. The federal government has a long-standing history of assisting individuals and families living in poverty by providing services and income transfers through numerous and various types of programs.

Measuring the Nation's Well Being: Economic Growth and Other Indicators

Economic growth is typically defined as the increase in the value of goods and services produced by an economy; traditionally this growth has been measured by the percentage rate of increase in a country's gross domestic product, or GDP. The growth in GDP is a key measure by which policy-makers estimate how well the economy is doing. However, it provides little information about how well individuals and households are faring.

Receutly there has been a substantial amount of activity in the United States and elsewhere to develop a comprehensive set of key indicators for communities, states, and the nation that go beyond traditional economic measures. Many believe that such a system would better inform individuals, groups, and institutions on the nation as a whole. Poverty is one of these key indicators. Poverty, both narrowly and more broadly defined, is a characteristic of society that is frequently monitored and defined and measured in a number of ways.[3]

[3]GAO, *Informing Our Nation: Improving How to Understand and Assess the USA's Position and Progress*, GAO-05-1 (Washington, D.C., November 2004).

How Is Poverty Defined in the United States?

The Census Bureau is responsible for establishing a poverty threshold amount each year; persons or families having income below this amount are, for statistical purposes, considered to be living in poverty.[4] The threshold reflects estimates of the amount of money individuals and families of various sizes need to purchase goods and services deemed minimally adequate based on 1960s living standards, and is adjusted each year using the consumer price index. The poverty rate is the percentage of individuals in total or as part of various subgroups in the United States who are living on income below the threshold amounts.

Over the years, experts have debated whether or not the way in which the poverty threshold is calculated should be changed. Currently the calculation only accounts for pretax income and does not include noncash benefits and tax transfers, which, especially in recent years, have comprised larger portions of the assistance package to those who are low-income.[5] For example, food stamps and the Earned Income Tax Credit could provide a combined amount of assistance worth an estimated $5,000 for working adults with children who earn approximately $12,000 a year.[6] If noncash benefits were included in a calculation of the poverty threshold, the number and percentage of individuals at or below the poverty line could change. In 1995, a National Academy of Sciences (NAS) panel recommended that changes be made to the threshold to count noncash benefits, tax credits, and taxes; deduct certain expenses from income such as child care and transportation; and adjust income levels according to an area's cost of living.[7] In response, the Census Bureau published an experimental poverty measure in 1999 using the NAS recommendations in addition to its traditional measure but, to date, Census has not changed the official measure.[8]

[4]The U.S. Department of Health and Human Services (HHS) establishes poverty guidelines that are similar to the poverty thresholds but are used by HHS and other agencies for administering programs, such as determining program eligibility.

[5]Congressional Research Service, *Poverty in the United States: 2005* (Washington, D.C.: Aug. 31, 2006).

[6]Danzinger, Sheldon, "Fighting Poverty Revisited: *What Did Researchers Know 40 Years Ago? What Do We know Today?*" Dec. 4, 2006.

[7]For a summary of the NAS panel recommendations see Congressional Research Service Report 95-539, *Redefining Poverty in the United States: National Academy of Science Panel Recommendations*, by Thomas R. Gabe (archived) (Washington, D.C.: 1995).

[8]U.S. Census Bureau, *Poverty among Working Families: Findings from Experimental Poverty Measures* (Washington, D.C.: Sept. 2000).

U.S. Poverty Rates

In 2005, close to 13 percent of the total U.S. population—about 37 million people—were counted as living below the poverty line, a number that essentially remained unchanged from 2004. Poverty rates differ, however, by age, gender, race, and ethnicity and other factors. For example,

- Children: In 2005, 12.3 million children, or 17.1 percent of children under the age of 18, were counted as living in poverty. Children of color were at least three times more likely to be in poverty than those who were white: 34.2 percent of children who were African- American and 27.7 percent of children who were Hispanic lived below the poverty line compared to 9.5 percent of children who were white.[9] African-American children represented 15.2 percent and Hispanic children represented 19.9 percent of all children under the age of 18 in 2005.
- Racial and ethnic minorities: African-Americans and Hispanics have significantly higher rates of poverty than whites. In 2005, 24.9 percent of African-Americans and 22 percent of Hispanics lived in poverty compared to 8.3 percent for whites. African-Americans made up 12.5 percent of the total population while Hispanics accounted for 14.7 percent.
- Elderly: The elderly have lower rates of poverty than other groups. For example, 10.1 percent of adults aged 65 or older lived in poverty. The elderly represented 12.1 percent of the total U.S. population in 2005.

Poverty rates also differ depending on geographical location and for urban and nonurban areas. Poverty rates for urban areas were double those in suburbs, 17 percent compared to 9.3 percent. Poverty rates in the South were the highest at 14 percent; the West had a rate of 12.6 percent, followed by the Midwest with 11.4 percent and the Northeast at 11.3 percent.[10]

[9]Beginning in March 2003, the Census Bureau allowed survey respondents to identify themselves as belonging to one or more racial groups. In prior years, respondents could select only one racial category. Consequently, poverty statistics for different racial groups for 2002 and after are not directly comparable to earlier years' data. The term "blacks and white" refers to persons who identified with only one single racial group. The term "Hispanic" refers to individuals' ethnic, as opposed to racial, identification. Hispanics may be of any race.

[10]Congressional Research Service, *Poverty in the United States: 2005* (Washington, D.C.: Aug. 31, 2006).

The Role of the Federal Government

The U.S. government has a long history of efforts to improve the conditions of those living with severely limited resources and income. Presidents, Congress, and other policymakers have actively sought to help citizens who were poor, beginning as early as the 1850s through the more recent efforts established through welfare reform initiatives enacted in 1996.

Over the years, the policy approaches used to help low-income individuals and families have varied. For example, in the1960s federal programs focused on increasing the education and training of those living in poverty. In the 1970s, policy reflected a more income-oriented approach with the introduction of several comprehensive federal assistance plans. More recently, welfare reform efforts have emphasized the role of individual responsibility and behaviors in areas such as family formation and work to assist people in becoming self-sufficient. Although alleviating poverty and the conditions associated with it has long been a federal priority, approaches to developing effective interventions have sometimes been controversial, as evidenced by the diversity of federal programs in existence and the ways in which they have evolved over time.

Currently, the federal government, often in partnership with the states, has created an array of programs to assist low-income individuals and families. According to a recent study by the Congressional Research Service (CRS), the federal government spent over $400 billion on 84 programs in 2004 that provided cash and noncash benefits to individuals and families with limited income. These programs cover a broad array of services: Examples include income supports or transfers such as the Earned Income Tax Credit and TANF; work supports such as subsidized child care and job training; health supports and insurance through programs like the State Children's Health Insurance Program (SCHIP) and Medicaid; and other social services such as food, housing, and utility assistance. Table 1 provides a list of examples of selected programs.

Table 1: Selected Examples of Federal Cash and Noncash Assistance to Low-Income Families and Individuals, Fiscal Year 2004

Purpose	Program	Federal cash outlay	Program description
Cash aid	Temporary Assistance for Needy Families (TANF)	$10.4 billion[a]	Permits a state to give ongoing basic cash aid to families that include a minors or a pregnant woman. Work and other requirements must be met.
	Earned Income Tax Credit (EITC)	$37.9 billion[b]	Provides a refundable credit to workers with and without children.
Food and nutrition	Food Stamp Program	$27.2 billion[c]	Provides certain allotments to individuals for purchasing of food items, based upon the individual's level of eligibility/need.
	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)	$4.5 million	Provides benefits for low-income mothers, infants, and children considered to be at "nutritional risk."
Medical	Medicaid	$176 billion	Provides payments to health care providers in full or via co-pay for eligible low-income families and individuals and for long-term care to eligible individuals who are aged or disabled.
	State Children's Health Insurance Program (SCHIP)	$4.6 billion[a]	Provides federal matching funds for states and territories to provide health insurance to targeted low-income children.
Educational	Federal Pell Grant Program	$12 billion	Provides assistance to undergraduate students who meet a certain needs test and are enrolled in an eligible institution of postsecondary education.
	Head Start	$6.8 billion[a]	Provides comprehensive services to targeted low-income children. Services include educational, medical, dental, nutritional, and social services.
Housing	Section 8 Low-Income Housing Assistance	$22.4 billion	Provides rental assistance through vouchers or rental subsidies to eligible low-income families or single persons.
Services	Child Care and Development Block Grant (CCDBG)	$6.9 billion	Provides funding to low-income parents for child care.
	Social Services Block Grant (SSBG) (Title XX)	$1.7 billion	Provides funding to assist states in providing social services to eligible low-income individuals or families.
Jobs	Job Corps	$1.5 billion	Provides no-cost training and education to low-income individuals ages 16-24 while providing a monthly allowance payment.
Energy	Low-Income Home Energy Assistance Program (LIHEAP)	$1.9 billion	Provides assistance to low-income home owners and renters to help meet energy needs such as heating and cooling.

Source: For a full list of federal programs, see Cash and Noncash Benefits for Persons with Limited Income: Eligibility Rules, Recipient and Expenditure Data, FY2002-FY2004; Washington D.C. 2006.

[4]Federal outlay figures in table 1 are from fiscal year 2004, as reflected in the CRS report from which they are taken, sourced above. Some exceptions apply and are noted. The TANF figure, $10.4 billion, is the estimated total of federal and state expenditures combined for only TANF cash aid in fiscal year 2004. This figure does not include other combined federal and state funding for the following: TANF child care, estimated at $2.5 billion in fiscal year 2004; TANF work programs and activities, estimated at $2.2 billion in fiscal year 2004; and TANF services estimated at $6.3 billion in fiscal year 2004.

[5]EITC federal outlay total of $37.9 billion is for fiscal year 2003 as reported in GAO, Means Tested Programs: Information on Program Access Can Be an Important Management Tool, GAO-05-221 (Washington, D.C. March 2005).

[6]For more on the Food Stamp Program, see GAO-05-839R, (Washington, D.C.: June 30, 2005).

[7]For more on SCHIP federal outlay figure of $4.6 billion, see GAO-05-839R.

[8]Head Start federal outlay total of $6.8 billion is for fiscal year 2005.

Economic Research Links Poverty with Adverse Outcomes for Individuals Such as Poor Health and Crime

Economic research suggests that individuals living in poverty face an increased risk for adverse outcomes, such as poor health, criminal activity, and low participation in the workforce. The adverse outcomes that are associated with poverty tend to limit the development of skills and abilities individuals need to contribute productively to the economy through work, and this in turn, results in low incomes. The relationship between poverty and outcomes for individuals is complex, in part because most variables, like health status, can be both a cause and a result of poverty. The direction of the causality can have important policy implications. To the extent that poor health causes poverty, and not the other way around, then alleviating poverty may not improve health.

Individuals Living in Poverty Experience Higher Rates of Adverse Health Outcomes, in Part because of Limited Access to Health Care, Environmental Hazards, and Risky Behaviors

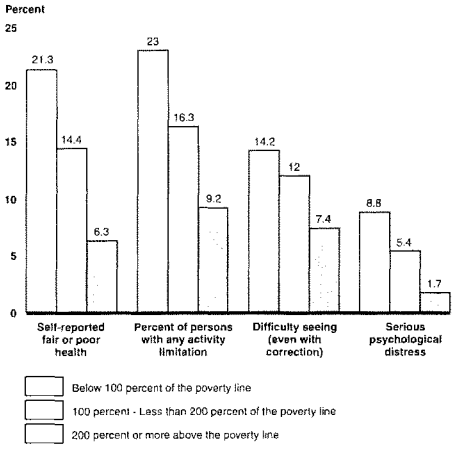
Health outcomes are worse for individuals with low incomes than for their more affluent counterparts. Lower-income individuals experience higher rates of chronic illness, disease, and disabilities, and also die younger than those who have higher incomes.[11] As reported by the National Center on Health Statistics, individuals living in poverty are more likely than their affluent counterparts to experience fair or poor health, or suffer from conditions that limit their everyday activities (fig.1). They also report higher rates of chronic conditions such as hypertension, high blood pressure, and elevated serum cholesterol, which can be predictors of more acute conditions in the future. Life expectancies for individuals in poor families as compared to nonpoor families also differ significantly. One study showed that individuals with low incomes had life expectancies 25 percent lower than those with higher incomes.[12] Other research

[11]Centers for Disease Control and Prevention, *Health, United States, 2006; 1998* (Hyattsville, Maryland).

[12]Deaton, Angus, "Policy Implications of The Gradient of Health and Wealth," *Health Affairs*, Vol. 21., No.2, March 2002.

suggests that an individual's household wealth predicts the amount of functionality of that individual in retirement.[13]

Figure 1: Selected Health Indicators by Poverty Status

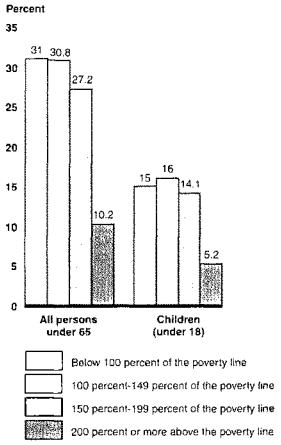


Source: National Center for Health Statistics, *Health, United States, 2006 with Chartbook on Trends in the Health of Americans* (Hyattsville, Maryland: 2006).

Research suggests that part of the reason that those in poverty have poor health outcomes is that they have less access to health insurance and thus less access to health care, particularly preventive care, than others who are nonpoor. Very low-income individuals were three times as likely not to have health insurance than those with higher incomes, which may lead to reduced access to and utilization of health care (fig. 2).

[13]Smith, James, and Raynard Kington, "Demographic and Economic Correlates of Health in Old Age." *Demography*, Vol. 34, No. 1, 1997.

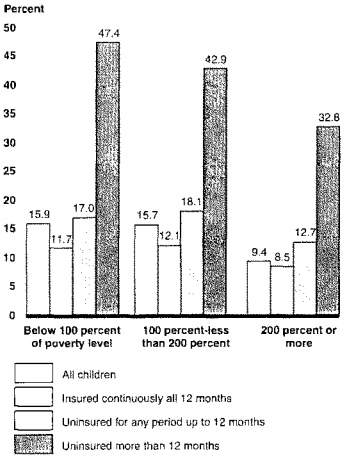
Figure 2: Percentage of Population with No Health Insurance (Private or Medicaid) by Poverty Status



Source: National Center for Health Statistics, *Health, United States, 2006 with Chartbook on Trends in the Health of Americans* (Hyattsville, Maryland: 2006)

Data show that those who are poor with no health insurance access the health system less often than those who are either insured or wealthier when measured by one indicator of health care access: visits to the doctor. For example, data from the National Center on Health Statistics show that children in families with income below the poverty line who were continuously without any type of health insurance were three to four times more likely to have not visited a doctor in the last 12 months than children in similar economic circumstances who were insured (fig. 3). Research also suggests that a link between income and health exists independent of health insurance coverage. Figure 3 also shows that while children who are uninsured but in wealthier families visit the doctor fewer times than those who are insured, they still go more often than children who are uninsured but living in poverty.

Figure 3: No Visits to Any Health Provider in the Past 12 Months (Children under 18 Years of Age) by Level of Insurance



Source: National Center for Health Statistics. *Health, United States, 2006 with Chartbook on Trends in the Health of Americans* (Hyattsville, Maryland: 2006).

Some research examining government health insurance suggests that increased health insurance availability improves health outcomes. Economists have studied the expansion of Medicaid, which provides health insurance to those with low income. They found that Medicaid's expansion of coverage, which occurred between 1979 and 1992, increased the availability of insurance and improved children's health outcomes. For example, one study found that a 30 percentage point increase in eligibility for mothers aged 15-44 translated into a decrease in infant mortality of 8.5 percent.[11] Another study looked at the impact of health insurance coverage

[11]Currie, Janet, and Jonathan Gruber, "Saving Babies: The Efficacy and Cost of Recent Changes in the Medicaid Eligibility of Pregnant Women," *The Journal of Political Economy*, Vol. 104, No. 6, December 1996.

through Medicare and its effects on the health of the elderly and also found a statistically significant though modest impact.[15] There is some evidence that variations in health insurance coverage do not explain all the differences in health outcomes. A study done in Canada found improvements in children's health with increases in income, even though Canada offers universal health insurance coverage for hospital services, indicating that health insurance is only part of the story.[16]

Although there is a connection among poverty, having health insurance, and health outcomes, having health insurance is often associated with other attributes of an individual, thus making it difficult to isolate the direct effect of health insurance alone. Most individuals in the United States are either self-insured or insured through their employer. If those who are uninsured have lower levels of education, as do individuals with low income, differences in health between the insured and uninsured might be due to level or quality of education, and not necessarily insurance.[17]

Another reason that individuals living in poverty may have more negative health outcomes is because they are more likely to live and work in areas that expose them to environmental hazards such as pollution or substandard housing. Some researchers have found that because poorer neighborhoods may be located closer to industrial areas or highways than more affluent neighborhoods, there tend to be higher levels of pollution in

[15]Card, David, et. al., "The Impact of Nearly Universal Insurance Coverage on Health Care Utilization and Health: Evidence from Medicare" National Bureau of Economic Research, Working Paper 10365. NBER, March 2004.

[16]Currie, Janet, and Mark Stabile, "Socioeconomic Status and Child Health: Why Is the Relationship Stronger for Older Children." *American Economic Review*, Vol. 93, No. 5, December 2003.

[17]Additionally, differences in individual health outcomes can sometimes be explained by other factors that may be associated with poverty, but are difficult to detect, such as risk aversion.

lower-income neighborhoods.[18] The Institute of Medicine concluded that minority and low-income communities had disproportionately higher exposure to environmental hazards than the general population, and because of their impoverished conditions were less able to effectively change these conditions.[19]

The link between poverty and health outcomes may also be explained by lifestyle issues associated with poverty. Sedentary life-style: the use of alcohol and drugs; as well as lower consumption of fiber, fresh fruits, and vegetables are some of the behaviors that have been associated with lower socioeconomic status.[20] Cigarette smoking is also more common among adults who live below the poverty line than among those above it, about 30 percent compared to 21 percent.[21] Similarly, problems with being overweight and obese are common among those with low family incomes, although most prevalent in women: Women with incomes below 130 percent of the poverty line were 50 percent more likely to be obese than those with incomes above this amount.[22] Figure 4 shows that people living

[18]While much of the specific biological mechanism by which air pollution might affect health is still unknown, some recent research by economists has noted a link between pollution and health, especially for infants. Currie and Neidell (2005) find that the decrease in the level of carbon monoxide in California in the 1990s had a significant effect on reducing infant mortality. See Currie, Janet, and Matthew Neidell, "Air Pollution and Infant Health: What Can We Learn From California's Recent Experience?" *Quarterly Journal of Economics*, 120 (3), 2005. Similarly, Chay and Greenstone (2003) find that the reduction in total suspended particulates due to the 1970 Clean Air Act had a significant impact on infant mortality. See Chay, Kenneth, and Michael Greenstone, "Air Quality, Infant Mortality, and the Clean Air Act of 1970." National Bureau of Economic Research, Working Paper No. 10053. NBER, 2003.

[19]Institute of Medicine, Committee on Environmental Justice, "Toward Environmental Justice: Research, Education, and Health Policy Needs", (Washington, D.C.: 1999), p.6.

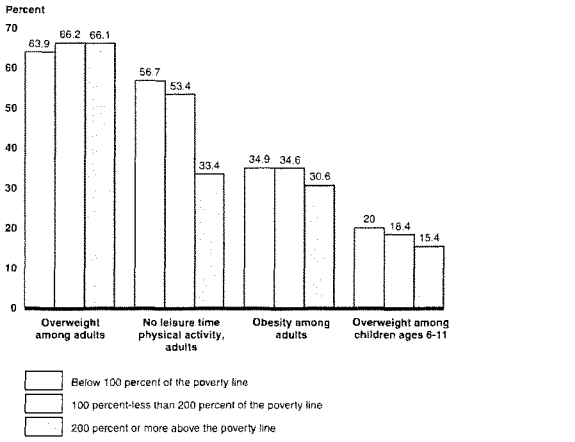
[20]Adler, Nancy E., and Katherine Newman, "Socioeconomic Disparities in Health: Pathways and Policies." *Health Affairs*, Vol. 21 No. 2, 2002. See also Deaton, Angus. "Policy Implications of the Gradient of Health and Wealth." *Health Affairs*, Vol. 21, No.2: 2002.

[21]Centers for Disease Control and Prevention, *Tobacco Use among Adults–United States, 2005. Morbidity and Mortality Weekly Report* , 2006; 55(42): 1145-1148. Some research suggests that part of the reason why smoking rates are higher may be peer effects, especially among youth smokers. See DeCicca, Phillip, Donald Kenkel, and Alan Mathios, "Racial Difference in the Determinants of Smoking Onset." *Journal of Risk and Uncertainty*. Boston: 2000. Vol. 21, Iss. 2/3; p311. Other studies have shown that educational attainment can affect smoking use as well. See DeCicca, Philip, Donald Kenkel, and Alan Mathios,"Putting Out the Fires: Will Higher Taxes Reduce the Onset of Youth Smoking?" *Journal of Political Economy*. Chicago 2002.Vol.110, Iss.1; p. 144.

[22]U.S. Public Health Service, *Surgeon General's Call To Action to Prevent and Decrease Overweight and Obesity 2001*, Washington, DC, pp. 13-14.

in poverty are less likely to engage in regular, leisure-time physical activity than others and are somewhat more likely to be obese, and children in poverty are somewhat more likely to be overweight than children living above the poverty line. In addition, there is also evidence to suggest a link among poverty, stress, and adverse health outcomes, such as compromised immune systems.[23]

Figure 4: Percentage of Population Who Have a Sedentary Lifestyle, Are Overweight, or Are Obese, by Poverty Status



Source: National Center for Health Statistics, *Health, United States, 2006 with Chartbook on Trends in the Health of Americans* (Hyattsville, Maryland: 2006).

[23]While access to care, behavior, and environmental factors are some of the most commonly offered reasons for the relationship between poverty and health, recent literature has suggested other alternative theories, of which there is less of a research tradition. These include the effect of short exposures to health shocks as a result of poverty, such as poor nutrition or increased adrenalin due to higher levels of stress, and psycho-social stress that leads to problems with the immune system. See Smith, James P., "Healthy Bodies and Thick Wallets: The Dual Relation between Health and Economic Status." *The Journal of Economic Perspectives*, Vol. 13, No. 2, 1999.

While evidence shows how poverty could result in poor health, the opposite could also be true. For example, a health condition could result, over time, in restricting an individual's employment, resulting in lower income. Additionally, the relationship between poverty and health outcomes could also vary by demographic group. [24] Failing health, for example, can be more directly associated with household income for middle-aged and older individuals than with children, since adults are typically the ones who work.

Economic Research Shows an Association between Poverty and Crime

Just as research has established a link between poverty and adverse health outcomes, evidence suggests a link between poverty and crime. Economic theory predicts that low wages or unemployment makes crime more attractive, even with the risks of arrest and incarceration, because of lower returns to an individual through legal activities.[25] While more mixed, empirical research provides support for this. For example, one study shows that higher levels of unemployment are associated with higher levels of property crime, but is less conclusive in predicting violent crime.[26] Another study has shown that both wages and unemployment affect crime, but that wages play a larger role.[27]

Research has found that peer influence and neighborhood effects may also lead to increased criminal behavior by residents. Having many peers that engage in negative behavior may reduce social stigma surrounding that behavior.[28] In addition, increased crime in an area may decrease the

[24]It is not clear whether these adverse outcomes occur with greater frequency among all individuals living in households below the poverty line or only among those experiencing extreme poverty; those who experience poverty during critical development stages, such as infancy or early childhood; or those who experience long bouts of poverty.

[25]Criminal behavior has been measured by reports to the police in an area, self-reported crime by individuals in surveys or arrests, as well as other measures. See also Freeman, Richard, "Why Do So Many Young American Men Commit Crimes and What Might We Do About It?" *Journal of Economic Perspectives*, Vol. 10, No. 1: Winter 2006.

[26]Raphael, Steven, and Rudolf Winter-Ebner, "Identifying the Effect of Unemployment on Crime." *Journal of Law and Economics*, Vol. XLIV. 2001.

[27]Gould, Eric D., Bruce A. Weinberg, and David B. Mustard, "Crime Rates and Local Labor Market Opportunities in the United States: 1979-1997. *Review of Economics and Statistics*, 84 (1): 2002.

[28]Katz, Lawrence F., Jeffrey R. Kling, and Jeffrey B. Liebman, "Moving to Opportunity in Boston: Early Results of a Randomized Mobility Experiment." *Quarterly Journal of Economics*, May 2001.

chances that any particular criminal activity will result in an arrest. Other research suggests that the neighborhood itself, independent of the characteristics of the individuals who live in it, affects criminal behavior.[29] One study found that arrest rates were lower among young people from low-income families who were given a voucher to live in a low-poverty neighborhood, as opposed to their peers who stayed in high-poverty neighborhoods. The most notable decrease was in arrests for violent crimes; the results for property crimes, however, were mixed, with arrest rates increasing for males and decreasing for females.[30]

Adverse Outcomes, Such as Poor Health and Low Educational Attainment, Lead to Reduced Participation in the Labor Market

Regardless of whether poverty is a cause or an effect, the conditions associated with poverty limit the ability of low-income individuals to develop the skills, abilities, knowledge, and habits necessary to fully participate in the labor force, in turn leading to lower incomes. According to 2000 Census data, people aged 20-64 with income above the poverty line in 1999 were almost twice as likely to be employed as compared to those with incomes below it.[31] Some of the reasons for these outcomes include educational attainment and health status.

[29]However, a challenge that researchers face is that, almost by definition, many individuals share the same characteristics in a neighborhood. Therefore, it is difficult to determine whether it is the characteristic of the individual or the neighborhood that is the source of the behavior.

[30]Http://www.huduser.org/publications/fairhsg/MTODemData.html and http://www.hud.gov/prodesc/mto.cfm . Some economists have used data from the Moving-to-Opportunity experiment as a way to attribute causality. Moving-to-Opportunity is a research demonstration in which a number of families, chosen randomly, within five public housing authorities were given housing vouchers to be used in low-poverty neighborhoods. Another group of families acted as the control, and were not given the vouchers. Using these data, some economists have compared the outcomes for children whose families received the vouchers and those that did not. To some extent, the results have confirmed that neighborhood, independent of individual characteristics, affects criminal behavior, but the results have also been mixed. Using data from the randomized housing experiment, Ludwig, Duncan, and Hirschfeld (2001) found that the housing vouchers reduced violent arrests by teens, but may have increased the number of property arrests. Kling, Ludwig, and Katz (2005) also used the Moving-to-Opportunity data, but looked for differential effects by gender. The authors found that for females, there were large reductions in the amount of arrests for both property and violent crime, when compared to those for the control group. For males, there were reductions in violent arrests, but proportionally smaller than the drops for females. In addition, there were significant increases in the rate of property arrests.

[31]U.S. Census Bureau, *Employment Status: 2000, Census 2000 Brief* (Washington, D.C., August 2003), p.4

Poverty is associated with lower educational quality and attainment, both of which can affect labor market outcomes. Research has consistently demonstrated that the quality and level of education attained by lower-income children is substantially below those for children from middle- or upper-income families. Moreover, high school dropout rates in 2004 were four times higher for students from low-income families than those in high-income families.[32] Those with less than a high school degree have unemployment rates almost three times greater than those with a college degree, 7.6 percent compared to 2.6 percent in 2005. And the percentage of low-income students who attend college immediately after high school is significantly lower than for their wealthier counterparts: 49 percent compared to 78 percent.[33]

A significant body of economic research directly links adverse health outcomes, which are also associated with low incomes, with the quality and quantity of labor that the individual is able to offer to the workforce. Many studies that have examined the relationship among individual adult health and wages, labor force participation, and job choice have documented positive empirical relationships among health and wages, earnings, and hours of work.[34] Although there is no consensus about the exact magnitude of the effects, the empirical literature suggests that poor health reduces the capacity to work and has substantive effects on wages, labor force participation, and job choice, meaning that poor health is associated with low income.

[32]National Center for Education Statistics, U.S. Department of Education, *Dropout Rates in the United States: 2004*, (Washington, D.C. November 2006), p. 4.

[33]Choy, Susan, "College Access and Affordability," Education Statistics Quarterly, Vol. 1, Issue 2, Topic: Postsecondary Education.

[34]Several methodological challenges exist in this literature: For example, many of these findings could reflect the effect of income on health rather than vice versa. In addition, results are highly sensitive to the measures of health that are used, with self-reported health status subject to several forms of bias, some of which could overstate the relationship between income and health, and others of which could understate the relationship. For example, individuals who have reduced their hours of work or left the labor force may be more likely to report poor health, in order to justify their reduced labor supply or because government programs provide incentives to report disability; this would lead to an upward bias in the estimated relationship between income and health. On the other hand, it is possible that higher-income individuals, who on average have greater health care utilization, may be more likely to be diagnosed with certain conditions simply because of their greater access to health care. This would lead to a downward bias in the estimated relationship between income and health.

Research also demonstrates that poor childhood health has substantial effects on children's future outcomes as adults. Some research, for example, shows that low birth weight is correlated with a low health status later in life. Research also suggests that poor childhood health is associated with reduced educational attainment and reduced cognitive development. Reduced educational attainment may in turn have a causal effect not only on future wages as discussed above but also on adult health if the more educated are better able to process health information or make more informed choices about their health care or if education makes people more "future oriented" by helping them think about the consequences of their choices. In addition, some research shows that poor childhood health is predictive of poor adult health and poor adult economic status in middle age, even after controlling for educational attainment.

Economic Research Suggests a Negative Association between Poverty and Economic Growth

The economic literature suggests that poverty not only affects individuals but can also create larger challenges for economic growth. Traditionally, research has focused on the importance of economic growth for generating rising living standards and alleviating poverty, but more recently it has examined the reverse, the impact of poverty on economic growth. In the United States, poverty can impact economic growth by affecting the accumulation of human capital and rates of crime and social unrest. While the empirical research is limited, it points to the negative association between poverty and economic growth consistent with the theoretical literature's conclusion that higher rates of poverty can result in lower rates of growth.

Research has shown that accumulation of human capital is one of the fundamental drivers of economic growth.[35] Human capital consists of the

[35]Economic models that consider human capital to be a fundamental driver of economic growth are commonly referred to as endogenous growth models, although the more traditional neoclassical model has also been augmented to include the role of human capital. Endogenous growth theory posits technological growth as occurring through dynamics inside the model. Although there are several competing models, crucial importance in each is given to the production of new technologies and human capital. While the major point these models emphasize is that human capital is the driving force behind growth, the actual modeling of the relationship is still a controversial issue in the economic literature. Some growth models assert that the driving force behind economic growth is the rate of accumulation of human capital, in which the rate of economic growth is proportional to the rate of accumulation of human capital. Another approach considers that high levels of human capital, as embodied in the level of the educational attainment of the workforce, increases the capacity of individuals to innovate (discover new technology) or to adopt new technology.

skills, abilities, talents, and knowledge of individuals as used in employment. The accumulation of human capital is generally held to be a function of the education level, work experience, training, and healthiness of the workforce.[36] Therefore, schooling at the secondary and higher levels is a key component for building an educated labor force that is better at learning, creating, and implementing new technologies. Health is also an important component of human capital, as it can enhance workers' productivity by increasing their physical capacities, such as strength and endurance, as well as mental capacities, such as cognitive functioning and reasoning ability. Improved health increases workforce productivity by reducing incapacity, disability, and the number of days lost to sick leave, and increasing the opportunities to accumulate work experience. Further, good health helps improve education by increasing levels of schooling and scholastic performance.

The accumulation of human capital can be diminished when significant portions of the population have experienced long periods of poverty, or were living in poverty at a critical developmental juncture. For example, recent research has found that the distinct slowdown in some measures of human capital development is most heavily concentrated among youth from impoverished backgrounds. When individuals who have experienced poverty enter the workforce, their contributions may be restricted or minimal, while others may not enter the workforce in a siguificant way. Not only is the productive capability of some citizens lost, but their purchasing power and savings, which could be channeled into productive investments, is forgone as well.

In addition to the effects of poverty on human capital, some economic literature suggests that poverty can affect economic growth to the extent that it is associated with crime, violence, and social unrest. According to some theories, when citizens engage in unproductive criminal activities they deter others from making productive investments or their actions force others to divert resources toward defensive activities and expenditures. The increased risk due to insecurity can unfavorably affect

[36]In general, economists regard expenditures on education, training, medical care, and so on as investments in human capital. Collectively, theoretical growth models suggest economic growth results from improvements in human capital as embodied in the skills and experience of the labor force; from expansion of physical capital in the form of plant and equipment; and from progress in science, engineering, and management that generates technological advance. While many variables have been empirically tested, only a few have been accepted as being statistically significant in explaining growth. The role of human capital is now almost universally regarded as being indispensable in this respect.

investment decisions—and hence economic growth—in areas afflicted by concentrated poverty. Although such theories link poverty to human capital deficiencies and criminal activity, the magnitude of their impact on economic growth for an economy such as the United States is unclear at this time.[37] In addition, people living in impoverished conditions generate budgetary costs for the federal government, which spends billions of dollars on programs to assist low-income individuals and families. Alleviating these conditions would allow the federal government to redirect these resources toward other purposes.

While economic theory provides a guide to understanding how poverty might compromise economic growth, empirical researchers have not as extensively studied poverty as a determinant of growth in the United States. Empirical evidence on the United States and other rich nations is quite limited, but some recent studies support a negative association between poverty and economic growth. For example, some research finds that economic growth is slower in U.S. metropolitan areas characterized by higher rates of poverty than those with lower rates of poverty.[38] Another study, using data from 21 wealthy countries, has found a similar negative relationship between poverty and economic growth.[39]

Concluding Observations

Maintaining and enhancing economic growth is a national priority that touches on all aspects of federal decision making. As the nation moves forward in thinking about how to address the major challenges it will face

[37]Human capital deficits experienced by some impoverished individuals cannot always be attributed to experience of poverty. In some cases, low education attainment and poor health, although associated with poverty, may actually be caused by some other factor that is also responsible for poverty. In this case, poverty would be a symptom rather than a cause (i.e., poor health, poor choices, or addiction may erode human capital potential and cause poverty). Similarly, most poor people do not commit crimes, and those that do may be motivated by forces unrelated to their incomes.

[38]The relationship is not always statistically significant in all regions. Statistical insignificance in some cases might be more attributable to data issues such as sample size or multicollinearity rather than an indication of nonrelationship between poverty and income growth in various regions. See S. Dev Bhatta, "Are Inequality and Poverty Harmful for Economic Growth," *Journal of Urban Affairs*, 22 (3-4): 2001. This study provides, arguably, a better comparison group than cross-country studies, since metropolitan statistical areas in the United States are at relatively similar stages of development.

[39]Voitchovsky, S., "Does the Profile of Income Inequality Matter for Economic Growth? Distinguishing between the Effects of Inequality in Different Parts of the Income Distribution." *Journal of Economic Growth*, Vol.10.: 2005.

in the twenty-first century, the impact of specific policies on economic growth will factor into decisions on topics as far ranging as taxes, support for scientific and technical innovation, retirement and disability, health care, education and employment. To the extent that empirical research can shed light on the factors that affect economic growth, this information can guide policymakers in allocating resources, setting priorities, and planning strategically for our nation's future.

Economists have long recognized the strong association between poverty and a range of adverse outcomes for individuals, and empirical research, while limited, has also begun to help us better understand the impact of poverty on a nation's economic growth. The interrelationships between poverty and various adverse social outcomes are complex, and our understanding of these relationships can lead to vastly different conclusions regarding appropriate interventions to address each specific outcome. Furthermore, any such interventions could take years, or even a generation, to yield significant and lasting results, as the greatest impacts are likely to be seen among children. Nevertheless, whatever the underlying causes of poverty may be, economic research suggests that improvements in the health, neighborhoods, education, and skills of those living in poverty could have impacts far beyond individuals and families, potentially improving the economic well-being of the nation as a whole.

This concludes my statement, Mr. Chairman. I would be happy to respond to any questions that you or other members of the committee may have.

Contact and Acknowledgments

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Preserving Homeownership: Foreclosure Prevention Initiatives

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CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The foreclosure rate in the United States has been rising rapidly since the middle of 2006. Losing a home to foreclosure can hurt homeowners in many ways; for example, homeowners who have been through a foreclosure may have difficulty finding a new place to live or obtaining a loan in the future. Furthermore, concentrated foreclosures can drag down nearby home prices, and large numbers of abandoned properties can negatively affect communities. Finally, the increase in foreclosures may destabilize the housing market, which could in turn negatively impact the economy as a whole.

There is a broad consensus that there are many negative consequences associated with rising foreclosure rates. Both Congress and the Bush and Obama Administrations have initiated efforts aimed at preventing further increases in foreclosures and helping more families preserve homeownership. On February 18, 2009, President Obama announced the Making Home Affordable program, which aims to modify the loans of borrowers who are in danger of default or foreclosure. Other foreclosure prevention initiatives established prior to the creation of the Obama Administration's foreclosure prevention plan include the expired *FHASecure* program and the ongoing Hope for Homeowners program, both of which allowed troubled borrowers to refinance their loans into new mortgages backed by the Federal Housing Administration (FHA); Fannie Mae's and Freddie Mac's Streamlined Modification Plan, which has since been replaced by Making Home Affordable; and a program put in place by the Federal Deposit Insurance Corporation (FDIC) to help troubled borrowers with loans that had been owned by IndyMac Bank before it was taken over by the FDIC. Several states and localities have initiated their own foreclosure prevention efforts, as have private companies including Bank of America, JP Morgan Chase, and Citigroup. A voluntary alliance of mortgage lenders, servicers, investors, and housing counselors has also formed the HOPE NOW Alliance to reach out to troubled borrowers.

Additional efforts to address foreclosures are included in P.L. 111-22, the Helping Families Save Their Homes Act of 2009, signed into law by President Obama on May 20, 2009. The law makes changes to the Hope for Homeowners program and establishes a safe harbor for servicers who engage in certain loan modifications.

While many observers agree that slowing the pace of foreclosures is an important policy goal, there are several challenges associated with foreclosure mitigation plans. These challenges include implementation issues, such as deciding who has the authority to make mortgage modifications, developing the capacity to complete widespread modifications, and assessing the possibility that homeowners with modified loans will nevertheless default again in the future. Other challenges are related to the perception of fairness, the problem of inadvertently providing incentives for borrowers to default, and the possibility of setting an unwanted precedent for future mortgage lending.

This report describes the consequences of foreclosure on homeowners, outlines recent foreclosure prevention plans implemented by the government and private organizations, and discusses the challenges associated with foreclosure prevention. It will be updated as events warrant.

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Introduction and Background

The foreclosure rate in the United States has been rising rapidly since around the middle of 2006. The large increase in home foreclosures since that time has negatively impacted individual households, local communities, and the economy as a whole. Consequently, an issue before Congress is whether to use federal resources and authority to help prevent further increases in home foreclosures and, if so, how to best accomplish this objective. This report details the impact of foreclosure on homeowners. It also describes recent attempts to preserve homeownership that have been implemented by the government and private lenders, and briefly outlines current proposals for further foreclosure prevention activities. It concludes with a discussion of some of the challenges inherent in designing foreclosure prevention initiatives. This report will be updated as events warrant.

Foreclosure refers to formal legal proceedings initiated by a mortgage lender against a homeowner after the homeowner has missed a certain number of payments on his or her mortgage.[1] When a foreclosure is completed, the homeowner loses his or her home, which is either repossessed by the lender or sold at auction to repay the outstanding debt. In general, the term "foreclosure" can refer to the foreclosure process or the completion of a foreclosure. This report deals primarily with preventing foreclosure completions.

In order for the foreclosure process to begin, two things must happen: a homeowner must fail to make a certain number of payments on his or her mortgage, and a lender must decide to initiate foreclosure proceedings rather than pursue other options (such as offering a repayment plan or a loan modification). A borrower that misses one or more payments is usually referred to as being delinquent on a loan; when a borrower has missed three or more payments, he or she is generally considered to be in default. Lenders can choose to begin foreclosure proceedings after a homeowner defaults on his or her mortgage, although lenders vary in how quickly they begin foreclosure proceedings after a borrower goes into default. Furthermore, the rules governing foreclosures, and the length of time the process takes, vary by state.

Recent Market Trends

Home prices rose rapidly throughout some regions of the United States beginning in 2001. Housing has traditionally been seen as a safe investment that can offer an opportunity for high returns, and rapidly rising home prices reinforced this view. During this housing "boom," many people decided to buy homes or take out second mortgages in order to access their increasing home equity. Furthermore, rising home prices and low interest rates contributed to a sharp increase in people refinancing their mortgages; for example, between 2000 and 2003, the number of refinanced mortgage loans jumped from 2.5 million to over 15 million.[2] Around the same time, subprime lending, which generally refers to making mortgage loans to individuals with credit scores that are too low to qualify for prime rate mortgages, also began to increase, reaching a peak between 2004 and 2006. However, beginning in 2006 and 2007, home sales started to

[1] For a more detailed discussion of the foreclosure process and the factors that contribute to a lender's decision to pursue foreclosure, see CRS Report RL34232, *The Process, Data, and Costs of Mortgage Foreclosure*, coordinated by Darryl E. Getter.

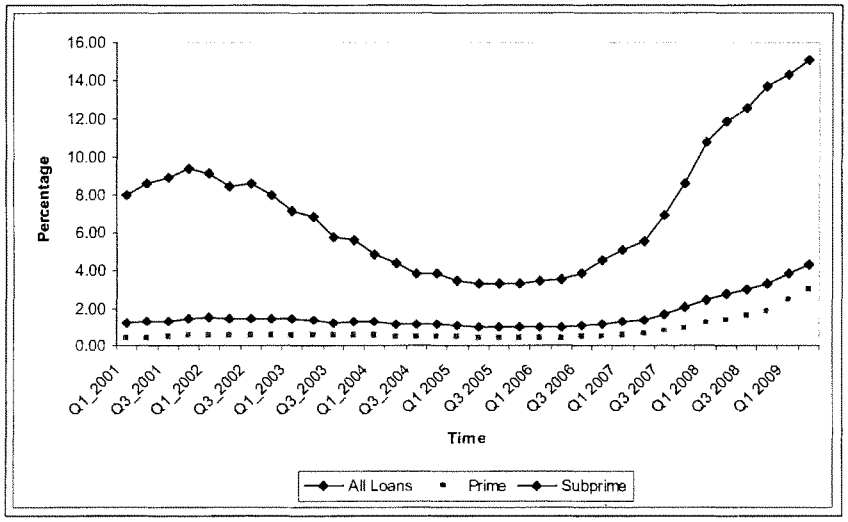
[2] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *An Analysis of Mortgage Refinancing, 2001-2003*, November 2004, p.1, http://www.huduser.org/Publications/pdf/MortgageRefinance03.pdf.

decline, home prices stopped rising and began to fall in many regions, and the rates of homeowners becoming delinquent on their mortgages or going into foreclosure began to increase.

The percentage of home loans in the foreclosure process in the U.S. has been rising rapidly since the middle of 2006. Although not all homes in the foreclosure process will end in a foreclosure completion, an increase in the number of loans in the foreclosure process is generally accompanied by an increase in the number of homes on which a foreclosure is completed. According to the Mortgage Bankers Association, an industry group, about 1% of all home loans were in the foreclosure process in the second quarter of 2006. By the second quarter of 2009, the rate had quadrupled to over 4%.

The foreclosure rate for subprime loans has always been higher than the foreclosure rate for prime loans. For example, in the second quarter of 2006, just over 3.5% of subprime loans were in the foreclosure process compared to less than 0.5% of prime loans. However, both prime and subprime loans have seen similar increases in the foreclosure rate over the past several quarters. Like the foreclosure rate for all loans combined, the foreclosure rates for prime and subprime loans have both more than quadrupled, with the rate of subprime loans in the foreclosure process increasing to over 15% in Q1 2009 and the rate of prime loans in the foreclosure process increasing to 3% over the same time period. According to the Congressional Budget Office (CBO), observers expect the high rate of foreclosures to continue throughout 2009 and beyond.[3] **Figure 1** illustrates the trend in the rate of mortgages in the foreclosure process over the past several years.

Figure 1. Percentage of Loans in Foreclosure by Type of Loan



Source: Figure created by CRS using data from the Mortgage Bankers Association.

[3] Statement of Douglas W. Elmendorf, Director, Congressional Budget Office, testimony before the U.S. Congress, Senate Committee on the Budget, *Federal Response to the Housing and Financial Crisis*, 111th Cong., 1st sess., January 28, 2009, p. 17, http://cbo.gov/ftpdocs/99xx/doc9971/01-28-FinancialMarkets_Testimony.pdf.

Notes: The Mortgage Bankers Association (MBA) is one of several organizations that reports delinquency and foreclosure data, but it does not represent all mortgages. MBA estimates that its data cover about 80% of outstanding first-lien mortgages on single-family properties.

Impacts of Foreclosure

Losing a home to foreclosure can have a number of negative effects on a household. For many families, losing a home means losing the household's largest store of wealth. Furthermore, foreclosure can negatively impact a borrower's creditworthiness, making it more difficult for him or her to buy a home in the future. Finally, losing a home to foreclosure can also mean that a household loses many of the less tangible benefits of owning a home. Research has shown that these benefits include increased civic engagement that results from having a stake in the community, and better health, school, and behavioral outcomes for children.[4]

Some homeowners might have difficulty finding a place to live after losing their home to foreclosure. Many will become renters. However, some landlords may be unwilling to rent to families whose credit has been damaged by a foreclosure, limiting the options open to these families. There can also be spillover effects from foreclosure on current renters. Renters living in units facing foreclosure may be required to move, even if they are current on their rent payments. As more homeowners become renters and as more current renters are displaced when their landlords face foreclosure, pressure on local rental markets may increase, and more families may have difficulty finding affordable rental housing. Some observers have also raised the concern that a large increase in foreclosures could increase homelessness, either because families who lost their homes have trouble finding new places to live or because the increased demand for rental housing makes it more difficult for families to find adequate, affordable units.

If foreclosures are concentrated, they can also have negative impacts on communities. Many foreclosures in a single neighborhood may depress surrounding home values.[5] If foreclosed homes stand vacant for long periods of time, they can attract crime and blight, especially if they are not well-maintained. Concentrated foreclosures also place pressure on local governments, which can lose property tax revenue and may have to step in to maintain vacant foreclosed properties.

The Policy Problem

There is a broad bipartisan consensus that the recent rapid rise in foreclosures is having negative consequences on households and communities. For example, Representative Spencer Bachus, Ranking Member of the House Committee on Financial Services, has said that "[i]t is in everyone's best interest as a general rule to prevent foreclosures. Foreclosures have a negative

[4] For example, see Donald R. Haurin, Toby L. Parcel, and R. Jean Haurin, *The Impact of Homeownership on Child Outcomes*, Joint Center for Housing Studies, Harvard University, Low-Income Homeownership Working Paper Series, October 2001, http://www.jchs.harvard.edu/publications/homeownership/liho01-14.pdf, and Denise DiPasquale and Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, National Bureau of Economic Research, NBER Working Paper 6363, Cambridge, MA, January 1998, http://www.nber.org/papers/w6363.pdf?new_window=1.

[5] For a review of the literature on the impact of foreclosures on nearby house prices, see Kai-yan Lee, *Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review*, Federal Reserve Bank of Boston, Community Affairs Discussion Paper, No. 2008-01, September 2008, http://www.bos.frb.org/commdev/pcadp/2008/pcadp0801.pdf.

impact not only on families but also on their neighbors, their property value, and on the community and local government."[6] Senator Chris Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, has described an "overwhelming tide of foreclosures ravaging our neighborhoods and forcing thousands of American families from their homes."[7]

There is less agreement among policymakers about how much the federal government should do to prevent foreclosures. Proponents of enacting government policies and using government resources to prevent foreclosures argue that, in addition to being a compassionate response to the plight of individual homeowners, such action may prevent further damage to home values and communities that can be caused by concentrated foreclosures. Supporters also suggest that preventing foreclosures may help stabilize the economy as a whole. Opponents of government foreclosure prevention programs argue that foreclosure prevention should be worked out between lenders and borrowers without government interference. Opponents also express concern that people who do not really need help, or who are not perceived to deserve help, will unfairly take advantage of government foreclosure prevention programs. They argue that taxpayers' money should not be used to help people who can still afford their loans but want to get more favorable terms, people who may be seeking to pass their losses on to the lender or the taxpayer, or people who knowingly took on mortgages that they could not afford.

Despite the concerns surrounding foreclosure prevention programs, and disagreement over the proper role of the government in preserving homeownership, Congress and the executive branch have both recently taken actions aimed at preventing foreclosures. Many private companies and state and local governments have also undertaken their own foreclosure prevention efforts. This report describes why so many households are currently at risk of foreclosure, outlines recent government and private initiatives to help homeowners remain in their homes, and discusses some of the challenges inherent in designing successful foreclosure prevention plans.

Why Might a Household Find Itself Facing Foreclosure?

There are many reasons that a household might fall behind on its mortgage payments. Some borrowers may have simply taken out loans on homes that they could not afford. However, many homeowners who believed they were acting responsibly when they took out a mortgage nonetheless find themselves facing foreclosure. The reasons households might have difficulty making their mortgage payments include changes in personal circumstances, which can be exacerbated by macroeconomic conditions, and features of the mortgages themselves.

Changes in Household Circumstances

Changes in a household's circumstances can affect its ability to pay its mortgage. For example, a number of events can leave a household with a lower income than it anticipated when it bought its home. Such changes in circumstances can include a lost job, an illness, or a change in family structure due to divorce or death. Families that expected to maintain a certain level of income

[6] Representative Spencer Bachus, "Remarks of Ranking Member Spencer Bachus During Full Committee Hearing on Loan Modifications," press release, November 12, 2008, http://bachus.house.gov/index.php?option=com_content&task=view&id=160&Itemid=104.

[7] Senator Chris Dodd, "Dodd Statement on Government Loan Modification Program," statement, November 11, 2008, http://dodd.senate.gov/?q=node/4620.

may struggle to make payments if a household member loses a job or faces a cut in pay, or if a two-earner household becomes a single-earner household. Unexpected medical bills or other unforeseen expenses can also make it difficult for a family to stay current on its mortgage.

Furthermore, sometimes a change in circumstances means that a home no longer meets a family's needs, and the household needs to sell the home. These changes can include having to relocate for a job or needing a bigger house to accommodate a new child or an aging parent. Traditionally, households that needed to move could usually sell their existing homes. However, the recent decline in home prices in many communities nationwide has left some homeowners "underwater," meaning that borrowers owe more on their homes than the houses are worth. This limits homeowners' ability to sell their homes if they have to move; many of these families are effectively trapped in their current homes and mortgages because they cannot afford to sell their homes at a loss.

The risks presented by changing personal circumstances have always existed for anyone who took out a loan, but deteriorating macroeconomic conditions, such as falling home prices and increasing unemployment, have made families especially vulnerable to losing their homes for such reasons. The fall in home values that has left some homeowners owing more than the value of their homes not only traps those people in their current homes; it also makes it difficult for homeowners to sell their homes in order to avoid a foreclosure, and it increases the incentive for homeowners to walk away from their homes if they can no longer afford their mortgage payments. Along with the fall in home values, another recent macroeconomic trend has been increasing unemployment. More households experiencing job loss and the resultant income loss have made it difficult for many families to keep up with their monthly mortgage payments.

Mortgage Features

Borrowers might also find themselves having difficulty staying current on their loan payments due in part to features of their mortgages. In the last several years, there has been an increase in the use of alternative mortgage products whose terms differ significantly from the traditional 30-year, fixed interest rate mortgage model.[8] While borrowers with traditional mortgages are not immune to delinquency and foreclosure, many of these alternative mortgage features seem to have increased the risk that a homeowner will have trouble staying current on his or her mortgage. Many of these loans were structured to have low monthly payments in the early stages and then adjust to higher monthly payments depending on prevailing market interest rates and/or the length of time the borrower held the mortgage. Furthermore, many of these mortgage features made it more difficult for homeowners to quickly build equity in their homes. Some examples of the features of these alternative mortgage products are listed below.

Adjustable-Rate Mortgages

With an adjustable-rate mortgage (ARM), a borrower's interest rate can change at predetermined intervals, often based on changes in an index. The new interest rate can be higher or lower than the initial interest rate, and monthly payments can also be higher or lower based on both the new

[8] For a fuller discussion of these types of mortgage products and their effects, see CRS Report RL33775, *Alternative Mortgages: Causes and Policy Implications of Troubled Mortgage Resets in the Subprime and Alt-A Markets*, by Edward V. Murphy.

interest rate and any interest rate or payment caps.[9] Some ARMs also include an initial low interest rate known as a teaser rate. After the initial low-interest period ends and the new interest rate kicks in, the monthly payments that the borrower must make may increase, possibly by a significant amount.

Adjustable-rate mortgages make economic sense for some borrowers, especially if interest rates are expected to go down in the future. ARMs can help people own a home sooner than they may have been able to otherwise, or make sense for borrowers who cannot afford a high loan payment in the present but expect a significant increase in income in the future that would allow them to afford higher monthly payments. Furthermore, the interest rate on ARMs tends to follow short-term interest rates in the economy; if the gap between short-term and long-term rates gets very wide, it might make sense for borrowers to choose an ARM even if they expect interest rates to rise in the future. Finally, in markets with rising property values, borrowers with ARMs may be able to refinance their mortgages to avoid higher interest rates or large increases in monthly payments. However, if home prices fall, refinancing the mortgage or selling the home to pay off the debt may not be feasible, and homeowners can find themselves stuck with higher mortgage payments.

Zero-Downpayment or Low-Downpayment Loans

As the name suggests, zero-downpayment and low-downpayment loans require either no downpayment or a significantly lower downpayment than has traditionally been required. These types of loans make it easier for homebuyers who do not have a lot of cash up-front to purchase a home. This type of loan may be especially useful in areas where home prices are rising more rapidly than income, because it allows borrowers without enough cash for a large downpayment to enter markets they could not otherwise afford. However, a low- or no-downpayment loan also means that families have little or no equity in their homes in the early phases of the mortgage, making it difficult to sell the home or refinance the mortgage in response to a change in circumstances if home prices decline. Such loans may also mean that a homeowner takes out a larger mortgage than he or she would otherwise.

Interest-Only Loans and Negative Amortization Loans

With an interest-only loan, borrowers pay only the interest on a mortgage—but no part of the principal—for a set period of time. This option increases the homeowner's monthly payments in the future, after the interest-only period ends and the principal amortizes. These types of loans limit a household's ability to build equity in its home, making it difficult to sell or refinance the home in response to a change in circumstances if home prices are declining.

With a negative amortization loan, borrowers have the option to pay less than the full amount of the interest due for a set period of time. The loan "negatively amortizes" as the remaining interest is added to the outstanding loan balance. Like interest-only loans, this option increases future monthly mortgage payments when the principal and the balance of the interest amortizes. These

[9] Even if the interest rate remains the same or decreases, it is possible for monthly payments to increase if prior payments were subject to an interest rate cap or a payment cap. This is because unpaid interest that would have accrued if not for the cap can be added to the principal loan amount, resulting in negative amortization. For more information on the many variations of adjustable rate mortgages, see The Federal Reserve Board, *Consumer Handbook on Adjustable Rate Mortgages*, http://www.federalreserve.gov/pubs/arms/arms_english.htm#drop.

types of loans can be useful in markets where property values are rising rapidly, because borrowers can enter the market and then use the equity gained from rising home prices to refinance into loans with better terms before payments increase. They can also make sense for borrowers who currently have low incomes but expect a significant increase in income in the future. However, when home prices stagnate or fall, interest-only loans and negative amortization loans can leave borrowers with negative equity, making it difficult to refinance or sell the home to pay the mortgage debt.

Alt-A Loans

Alt-A loans are mortgages that are similar to prime loans, but for one or more reasons do not qualify for prime interest rates. One example of an Alt-A loan is a low-documentation or no-documentation loan. These are loans to borrowers with good credit scores but little or no income or asset documentation. Although no-documentation loans allow for more fraudulent activity on the part of both borrowers and lenders, they may be useful for borrowers with income that is difficult to document, such as those who are self-employed or work on commission. Other examples of Alt-A loans are loans with high loan-to-value ratios or loans to borrowers with credit scores that are too low for a prime loan but high enough to avoid a subprime loan. In all of these cases, the borrower is charged a higher interest rate than he or she would be charged with a prime loan.

Many of these loan features may have played a role in the recent increase in foreclosure rates. Some homeowners were current on their mortgages before their monthly payments increased due to interest rate resets or the end of option periods. Some built up little equity in their homes because they were not paying down the principal balance of their loan or because they had not made a downpayment. Stagnant or falling home prices in many regions also hampered borrowers' ability to build equity in their homes. Borrowers without sufficient equity find it difficult to take advantage of options such as refinancing into a more traditional mortgage if monthly payments become too high or selling the home if their personal circumstances change.

Types of Loan Workouts

When a household falls behind on its mortgage, there are options that lenders or servicers[10] may be able to employ as an alternative to beginning foreclosure proceedings. Some of these options, such as a short sale and a deed-in-lieu of foreclosure,[11] allow a homeowner to avoid the foreclosure process but still result in a household losing its home. This section describes methods

[10] Mortgage lenders are the organizations that make mortgage loans to individuals. Often, the mortgage is managed by a separate company known as a servicer; servicers usually have the most contact with the borrower, and are responsible for actions such as collecting mortgage payments, initiating foreclosures, and communicating with troubled borrowers. Finally, many mortgages are repackaged into mortgage-backed securities (MBS) that are sold to institutional investors. Servicers are usually subject to contracts with mortgage lenders and MBS investors that may limit their ability to undertake loan workouts or modifications; the scope of such contracts and the obligations that servicers must meet vary widely.

[11] In a short sale, a household sells its home for less than the amount it owes on its mortgage, and the lender generally accepts the proceeds from the sale as payment in full on the mortgage even though it is taking a loss. A deed-in-lieu of foreclosure refers to the practice of a borrower turning the deed to the house over to the lender, which accepts the deed as payment of the mortgage debt.

of avoiding foreclosure that allow homeowners to keep their homes; these options generally take the form of repayment plans or loan modifications.

Repayment Plans

A repayment plan allows a delinquent borrower to become up-to-date on his or her loan by paying back the payments he or she has missed, along with any accrued late fees. This is different from a loan modification, which changes one or more of the terms of the loan (such as the interest rate). Under a repayment plan, the missed payments and late fees may be paid back after the rest of the loan is paid off, or they may be added to the existing monthly payments. The first option increases the time that it will take for a borrower to pay back the loan, but his or her monthly payments will remain the same. The second option may result in an increase in monthly payments. Repayment plans may be a good option for homeowners who experienced a temporary loss of income but are now financially stable. However, since they do not generally make payments more affordable, repayment plans are unlikely to help homeowners with unaffordable loans avoid foreclosure in the long term.

Principal Forbearance

Principal forbearance means that a lender or servicer removes part of the principal from the portion of the loan balance that is subject to interest, thereby lowering borrowers' monthly payments by reducing the amount of interest owed. The portion of the principal that is subject to forbearance still needs to be repaid by the borrower in full, usually after the interest-bearing part of the loan is paid off or when the home is sold. Because principal forbearance does not actually change any of the loan terms, it resembles a repayment plan more than a loan modification.

Principal Write-Downs/Principal Forgiveness

A principal write-down is a type of mortgage modification that lowers borrowers' monthly payments by forgiving a portion of the loan's principal balance. The forgiven portion of the principal never needs to be repaid. Because the borrower now owes less, his or her monthly payment will be smaller. This option is costly for lenders but can help borrowers achieve affordable monthly payments, as well as increase the stake borrowers have in their homes and therefore increase their desire to stay current on the mortgage and avoid foreclosure.[12]

Interest Rate Reductions

Another form of loan modification is when the lender voluntarily lowers the interest rate on a mortgage. This is different from a refinance, in which a borrower takes out a new mortgage with a lower interest rate and uses the proceeds from the new loan to pay off the old loan. Unlike refinancing, a borrower does not have to pay closing costs or qualify for a new loan to get an interest rate reduction, which makes interest rate reductions a good option for borrowers who owe

[12] Historically, one impediment to principal forgiveness has been that borrowers were required to claim the forgiven amount as income, and therefore had to pay taxes on that income. Congress recently passed legislation that excludes mortgage debt forgiven before January 1, 2013 from taxable income. For more information about the tax treatment of principal forgiveness, see CRS Report RL34212, *Analysis of the Tax Exclusion for Canceled Mortgage Debt Income*, by Mark P. Keightley and Erika K. Lunder.

more on their mortgages than their homes are worth. With an interest rate reduction, the interest rate can be reduced permanently, or it can be reduced for a period of time before increasing again to a certain fixed point. Lenders can also freeze interest rates at their current level in order to avoid impending costly interest rate resets on adjustable rate mortgages. Interest rate modifications are relatively costly to the lender, but they can be effective at reducing monthly payments to an affordable level.

Extended Loan Term/Extended Amortization

Another option for lowering monthly mortgage payments is extending the amount of time over which the loan is paid back. While extending the loan term increases the total cost of the mortgage for the borrower because more interest will accrue, it allows monthly payments to be smaller because they are paid over a longer period of time. Most mortgages in the U.S. have an initial loan term of 25 or 30 years; extending the loan term from 30 to 40 years, for example, could result in a lower monthly mortgage payment for the borrower.

Recent Foreclosure Prevention Initiatives

The federal government, state and local governments, and private companies have all implemented a variety of plans to attempt to slow the recent increase in foreclosures. This section describes a number of recent foreclosure prevention initiatives.

Making Home Affordable

On February 18, 2009, President Obama announced the Making Home Affordable (MHA) program, aimed at helping homeowners who are having difficulty making their mortgage payments avoid foreclosure.[13] (The program details originally referred to the program as the Homeowner Affordability and Stability Plan, or HASP. Further program details released on March 4, 2009, began referring to the plan as Making Home Affordable.) This plan is part of the Administration's broader economic recovery strategy, along with the Financial Stability Plan (an administrative initiative aimed at shoring up the financial system) and the American Recovery and Reinvestment Act of 2009 (enacted legislation (P.L. 111-5) aimed at stimulating the economy).[14]

Making Home Affordable includes three main parts. The first two parts of the plan allow certain homeowners to refinance or modify their mortgages. The third part of the plan provides additional financial support to Fannie Mae and Freddie Mac.

[13] More information on the Administration's housing plan can be found at http://www.financialstability.gov/roadtostability/homeowner.html.

[14] For more information on the Financial Stability Plan, see http://www.financialstability.gov/docs/fact-sheet.pdf. For more information on the American Recovery and Reinvestment Act of 2009, see CRS Report R40537, *American Recovery and Reinvestment Act of 2009 (P.L. 111-5): Summary and Legislative History*, by Clinton T. Brass et al.

Home Affordable Refinance

The first part of MHA is the Home Affordable Refinance Program (HARP). HARP allows homeowners with mortgages owned or guaranteed by Fannie Mae or Freddie Mac to refinance into loans with more favorable terms even if they owe more than 80% of the value of their homes. Generally, borrowers who owe more than 80% of the value of their homes have difficulty refinancing and therefore cannot take advantage of lower interest rates. By allowing borrowers who owe more than 80% of the value of their homes to refinance their mortgages, the plan is meant to help qualified borrowers lower their monthly mortgage payments to a level that is more affordable. Originally, qualified borrowers were eligible to refinance under this program if they owed up to 105% of the value of their homes. On July 1, 2009, the Administration announced that it is expanding the program to include borrowers who owe up to 125% of the value of their homes.

In addition to having a mortgage owned or guaranteed by Fannie Mae or Freddie Mac, a borrower must have a mortgage on a single-family home, live in the home as his or her primary residence, and be current on the mortgage payments in order to be eligible for this program. Rather than targeting homeowners who are behind on their mortgage payments, this piece of the MHA plan targets homeowners who have kept up with their payments but have lost equity in their homes due to falling home prices. Borrowers can apply for this part of the plan until June 2010.

The Administration estimates that the refinancing part of Making Home Affordable will help between four and five million homeowners. According a report from the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac had refinanced over 60,000 loans with loan-to-value ratios above 80% as of July 31, 2009.[15]

Home Affordable Modifications

The second part of MHA is the Home Affordable Modification Program (HAMP). This part of the program encourages servicers to provide mortgage modifications for troubled borrowers in order to reduce the borrowers' monthly mortgage payments to no more than 31% of their monthly income. In order to qualify, a borrower must have a mortgage on a single-family residence that was originated on or before January 1, 2009, must live in the home as his or her primary residence, and must have an unpaid principal balance on the mortgage that is no greater than the Fannie Mae/Freddie Mac conforming loan limit in high-cost areas ($729,750 for a one-unit property). Furthermore, the borrower must currently be paying more than 31% of his or her income toward mortgage payments, and must be experiencing a financial hardship that makes it difficult to remain current on the mortgage. Borrowers need not already be delinquent on their mortgage in order to qualify.

Servicers participating in the modification program will conduct a "net present value test" on eligible mortgages that compares the expected returns to investors from doing a loan modification to the expected returns from pursuing a foreclosure. If the expected returns from a loan modification are greater than those from foreclosure, servicers will reduce borrowers' payments to no more than 38% of monthly income, primarily using interest rate reductions but also using term extensions, principal forbearance, and principal forgiveness as needed. The government will

[15] Federal Housing Finance Agency, "Refinance Report: August 2009," August 13, 2009, available at http://www.fhfa.gov/webfiles/14764/FHFARefiRpt81309F.pdf.

then match the lender dollar for dollar to reduce borrowers' payments from a 38% mortgage debt-to-income ratio (DTI) to a 31% DTI. Servicers can reduce interest rates to as low as 2%. The new interest rate must remain in place for five years; after five years, if the interest rate is below the market rate at the time the modification agreement was completed, the interest rate can rise by one percentage point per year until it reaches that rate. Borrowers must make modified payments on time during a three-month trial period before the modification is considered complete.

The Home Affordable Modification Program is voluntary, but the government will provide incentives for participation. Servicers will receive an incentive payment for each successful loan modification, an additional payment for modifications made for borrowers who are not yet delinquent, and a "pay for success" payment for up to three years if the borrower remains current after the modification. The borrower can also receive an incentive payment (in the form of principal reduction) for up to five years if he or she remains current after the modification is finalized. Lenders or investors can receive incentive payments for loans modified before a borrower becomes delinquent. Companies that receive funding through the Troubled Assets Relief Program (TARP) or the Financial Stability Plan (FSP) after the announcement of MHA will be required to participate in HAMP.

Since the program's announcement, the government has announced several additional details.[16] These details include the following:

- Second Liens: Many borrowers have second mortgages on their homes. Second mortgages can cause problems for loan modification programs because (1) modifying the first lien may not reduce households' total monthly mortgage payments to an affordable level if the second mortgage remains unmodified, and (2) holders of primary mortgages are often hesitant to modify the mortgage if the second mortgage holder does not agree to re-subordinate the second mortgage to the first mortgage. In order to address the issue of second liens, the government will share some of the costs of reducing borrowers' payments on second mortgages, and will offer lenders and borrowers smaller "pay for success" incentive payments for successfully modified second mortgages. In certain situations, lenders can also choose to extinguish second mortgages in exchange for a one-time payment from the government.
- Short sales and deeds-in-lieu of foreclosure: When a borrower is minimally eligible for MHA but does not ultimately qualify for a modification, the government will offer incentive payments to servicers who use short sales and deeds-in-lieu of foreclosure as alternatives to foreclosures. Borrowers can also receive incentive payments to help with relocation expenses when they successfully complete a short sale or deed-in-lieu of foreclosure. In order to attempt to streamline the process of short sales and deeds-in-lieu of foreclosure, the government will also provide standardized documentation and processes for servicers to use.

[16] For more information on the additional Making Home Affordable program details described here, see "Making Home Affordable Program Update," April 28, 2009, at http://www.financialstability.gov/docs/042809SecondLienFactSheet.pdf, and "Making Home Affordable Update: Foreclosure Alternatives and Home Price Decline Protection Incentives," May 14, 2009, at http://www.treas.gov/press/releases/docs/05142009FactSheet-MakingHomesAffordable.pdf.

- Home Price Decline Protection: To encourage modifications even in markets where home prices are continuing to fall, lenders or investors will be eligible for Home Price Decline Protection incentive payments for successful modifications in areas with declining home prices. The incentive payments will be calculated according to the home price decline in the quarters prior to the loan modification in the area where the home is located and the average price of a home in that area. Total home price decline protection incentive payments will not exceed $10 billion.
- Hope for Homeowners Program: The MHA program will require participating servicers to screen borrowers for eligibility for the Hope for Homeowners program (described later in this report) and to use that program for borrowers who qualify. Servicers who modify loans using Hope for Homeowners, and lenders who originate new loans under the program, will be eligible for incentive payments similar to those offered under Making Home Affordable.

HAMP will exist until December 31, 2012. The Administration estimates that HAMP will cost $75 billion. Of this amount, $50 billion will come from TARP funds and $25 billion will come from Fannie Mae and Freddie Mac.[17]

The Administration expects HAMP to help three to four million homeowners. As of July 31, 2009, the Treasury Department reported that over 406,500 trial modification offers had been extended and, of these, over 235,000 trial modifications had begun.[18] Treasury intends to release monthly reports detailing the number of loan modifications made under HAMP and the progress made by individual servicers.

Support for Fannie Mae and Freddie Mac

The third piece of the Administration's housing plan provides additional financial support for Fannie Mae and Freddie Mac in an effort to maintain low mortgage interest rates. The Department of the Treasury will increase its Preferred Stock Purchase agreements from $100 billion to $200 billion for both Fannie Mae and Freddie Mac, and will increase the size of their portfolios by $50 billion each. The funding for the increased preferred stock purchases was authorized by the Housing and Economic Recovery Act of 2008 (P.L. 110-289).

Hope for Homeowners

Congress created the Hope for Homeowners program in the Housing and Economic Recovery Act of 2008 (P.L. 110-289), which was signed into law on July 30, 2008. The program, which is voluntary on the part of both borrowers and lenders, offers certain borrowers the ability to refinance into new mortgages insured by FHA if their lenders agree to certain loan modifications.

[17] Department of the Treasury, Section 105(a) Troubled Assets Relief Program Report to Congress for the Period February 1, 2009 to February 28, 2009, p. 1, available at http://treasury.gov/initiatives/eesa/docs/105aReport_03062009.pdf.

[18] U.S. Department of the Treasury, "Making Home Affordable Program: Servicer Performance Report Through July 2009," August 4, 2009, available at http://www.treas.gov/press/releases/docs/MHA_public_report.pdf.

The Hope for Homeowners program began on October 1, 2008, and will remain in place until September 30, 2011. In order to be eligible for the program, borrowers must meet the following requirements:

- The borrower must have a mortgage that originated on or before January 1, 2008.
- The borrower's mortgage payments must have been more than 31% of their gross monthly income as of March 1, 2008.
- The borrower must not own another home.
- The borrower must not have intentionally defaulted on his or her mortgage, and he or she must not have been convicted of fraud during the last ten years under either federal or state law.
- The borrower must not have provided false information to obtain the original mortgage.

Under Hope for Homeowners, the lender agrees to write the mortgage down to a percentage of the home's currently appraised value, and the borrower receives a new loan insured by the FHA. The home must be reappraised by an FHA-approved home appraiser in order to determine its current value, and the lender absorbs whatever loss results from the write-down. The new mortgage is a 30-year fixed-rate mortgage with no prepayment penalties, and may not exceed $550,440. Any second lien-holders are required to release their liens, and homeowners pay upfront and annual mortgage insurance premiums. When the homeowner sells or refinances the home, he or she is required to share between 50% and 100% of the proceeds with HUD depending on the length of time that passes between the time the borrower enters the program and when he or she sells the home. After one year, 100% of the equity in the home and any home value appreciation is shared with FHA, while after five years, only 50% is shared with FHA.

Under the original terms of the program, the lender was required to write the loan down to 90% of the home's currently appraised value. The upfront and annual mortgage insurance premiums were set at 3% and 1.5%, respectively, and second lien-holders were compensated for releasing their liens with a share of any future profit from the home's eventual sale.

On November 19, 2008, HUD announced three changes to Hope for Homeowners in order to simplify the program and encourage participation.[19] These changes did the following: (1) increased the maximum loan-to-value ratio of the new loan to 96.5% of the home's currently appraised value, instead of the original 90%, in order to minimize losses to lenders; (2) allowed lenders to increase the term of the mortgage from 30 to 40 years in order to lower borrowers' monthly payments; and (3) offered an immediate payment to second lien-holders, instead of a share in future profits, in return for their agreement to relinquish the lien.

Recent legislative and administrative developments made further attempts to increase participation in Hope for Homeowners. On May 20, 2009, President Obama signed into law P.L. 111-22, the Helping Families Save Their Homes Act of 2009. This law changes the Hope for Homeowners program by allowing reductions in both the upfront and annual mortgage insurance premiums that borrowers pay; allowing servicers to receive incentive payments for each loan they

[19] The authority to make these changes to Hope for Homeowners was granted in P.L. 110-343, the Emergency Economic Stabilization Act of 2008. The decision to make the changes was ultimately made by the Board of Hope for Homeowners, which includes the Secretary of HUD and the Secretary of the Treasury, among others.

successfully refinance using Hope for Homeowners; and allowing HUD to reduce its share in any future home price appreciation and giving HUD the authority to share its stake in the home's future appreciation with the original lender or a second lien-holder. The law also places the Hope for Homeowners program under the control of the Secretary of HUD and limits eligibility for the program to homeowners whose net worth does not exceed a certain threshold.

The CBO originally estimated that up to 400,000 homeowners could be helped to avoid foreclosure over the life of the program.[20] As of mid-July 2009, the program had received 949 applications and 50 new mortgages had closed.[21] Some have suggested that more borrowers and lenders have not used Hope for Homeowners because the program is too complex. The legislative and administrative changes described above were intended to address some of the obstacles to participating in the program.

The Obama Administration has issued guidance for servicers on using Hope for Homeowners together with the Making Home Affordable program. This guidance requires servicers who are participating in the Making Home Affordable program to screen borrowers for eligibility for Hope for Homeowners and to use that program for qualified borrowers. The Administration's guidance also offers incentive payments to servicers who make modifications under Hope for Homeowners, and to lenders who originate new loans under the program.

Other Government Initiatives

In addition to Making Home Affordable and Hope for Homeowners, a number of other programs have been created by federal, state, and local governments to attempt to stem the rise in foreclosures and help more homeowners remain in their homes. Although some of these programs are now obsolete, many continue to operate. This section describes other recent federal programs and briefly outlines some state and local foreclosure prevention efforts.

FHASecure

FHASecure was a temporary program announced by the Federal Housing Administration (FHA) on August 31, 2007, to allow delinquent borrowers with non-FHA adjustable-rate mortgages (ARMs) to refinance into FHA-insured fixed-rate mortgages.[22] The new mortgage helped borrowers by offering better loan terms that either reduced a borrower's monthly payments or helped a borrower avoid steep payment increases under his or her old loan. *FHASecure* expired on December 31, 2008.

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[20] Congressional Budget Office, Cost Estimate, *Federal Housing Finance Regulatory Reform Act of 2008*, June 9, 2008, p. 8, http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate_Housing.pdf.

[21] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Preserving Homeownership: Progress Needed to Prevent Foreclosures*, 111th Cong., 1st sess., July 16, 2009, hearing transcript available at http://www.cq.com/display.do?dockey=/cqonline/prod/data/docs/html/transcripts/congressional/111/congressionaltranscripts111-000003168396.html@committees&metapub=CQ-CONGTRANSCRIPTS&searchIndex=0&seqNum=8, and the Federal Housing Administration, *FHA Outlook*, July 1-15, 2009, available at http://www.hud.gov/offices/hsg/comp/rpts/ooe/olcurr.pdf. Of the 50 loans that had closed under Hope for Homeowners as of July 16, 2009, only one had been insured by FHA.

[22] FHA already offered refinancing options for homeowners who were current on their existing fixed- or adjustable-rate mortgages and continued to do so after the adoption of *FHASecure*.

To qualify for *FHASecure*, borrowers originally had to meet the following eligibility criteria:

- The borrower had a non-FHA ARM that had reset.
- The borrower became delinquent on his or her loan due to the reset, and had sufficient income to make monthly payments on the new FHA-insured loan.
- The borrower was current on his or her mortgage prior to the reset. (Some borrowers with a minimum amount of equity in their homes could still be eligible for the program even if they had missed payments prior to the reset.)
- The new loan met standard FHA underwriting criteria and was subject to other standard FHA requirements (including maximum loan-to-value ratios, mortgage limits, and up-front and annual mortgage insurance premiums).

In July 2008, FHA expanded its eligibility criteria for the program, and borrowers had to meet the following revised eligibility requirements:

- The borrower became delinquent on his or her non-FHA ARM because of an interest rate reset or another extenuating circumstance, and had sufficient income to make monthly payments on the new FHA-insured loan.
- The borrower had no more than two payments that were thirty days late, or one payment that was sixty days late, in the twelve months preceding the interest rate reset or other extenuating circumstance.
- If the loan-to-value ratio on the FHA-insured mortgage was no higher than 90%, the borrower may have had no more than three payments that were thirty days late, or one payment that was ninety days late, prior to the interest rate reset or other extenuating circumstance.
- Borrowers with interest-only ARMs or option ARMs must have been delinquent due to an interest rate reset only (and not other extenuating circumstances), and must have been current on their mortgages prior to the reset; the revised eligibility criteria did not apply to these borrowers.
- The new loan met standard FHA underwriting criteria and was subject to other standard FHA requirements (including maximum loan-to-value ratios, mortgage limits, and up-front and annual mortgage insurance premiums).

FHASecure expired on December 31, 2008. In the months before its expiration, some housing policy advocates called for the program to be extended; however, HUD officials contended that continuing the program would be prohibitively expensive, possibly endangering FHA's single-family mortgage insurance program. HUD also points to the Hope for Homeowners program as filling the role that *FHASecure* did in helping households avoid foreclosure.[23] Supporters of extending *FHASecure* argued that the statutory requirements of Hope for Homeowners may offer less flexibility in the face of changing circumstances than *FHASecure*, which could have been more easily amended by HUD.

[23] HUD Mortgagee Letter 08-41, "Termination of *FHASecure*," December 19, 2008, available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2008ml.cfm.

When *FHASecure* expired at the end of 2008, about 4,000 loans had been refinanced through the program.[24] Critics of the program point to the relatively stringent criteria that borrowers had to meet to qualify for the program as a possible reason that more people did not take advantage of it.

IndyMac Loan Modifications

On July 11, 2008, the Office of Thrift Supervision in the Department of the Treasury closed IndyMac Federal Savings Bank, based in Pasadena, California, and placed it under the conservatorship of the Federal Deposit Insurance Corporation (FDIC). In August 2008, the FDIC put into place a loan modification program for holders of mortgages either owned or serviced by IndyMac that were seriously delinquent or in danger of default, or on which the borrower was having trouble making payments because of interest rate resets or a change in financial circumstances.

The IndyMac program offers systematic loan modifications to qualified borrowers in financial trouble. The systematic approach means that all loan modifications follow the same basic formula to identify qualified borrowers and reduce their monthly payments in a uniform way. Such an approach is meant to allow more modifications to happen more quickly than if each loan was modified on a case-by-case basis.

In order to be eligible for a loan modification, the mortgage must be for the borrower's primary residence and the borrower must provide current income information that documents financial hardship. Furthermore, the FDIC will conduct a net present value test to evaluate whether the expected future benefit to the FDIC and the mortgage investors from modifying the loan is greater than the expected future benefit from foreclosure.

If a borrower meets the above conditions, the loan is modified so that he or she has a mortgage debt-to-income ratio of 38%, meaning that the borrower's monthly mortgage payments (including principal, interest, taxes, and insurance) cannot exceed 38% of his or her monthly income. The goal is to lower a borrower's monthly payments to a level that is sustainable based on the borrower's current income. The 38% DTI can be achieved by lowering the interest rate, extending the period of the loan, forbearing a portion of the principal, or a combination of the three. The interest rate is set at the Freddie Mac survey rate for conforming mortgages, but if necessary it can be lowered for a period of up to five years in order to reach the 38% DTI; after the five-year period, the interest rate rises by no more than 1% each year until it reaches the Freddie Mac survey rate.

FDIC Chairman Sheila Bair estimates that about 13,000 loans were modified under this program while IndyMac was under the FDIC's conservatorship.[25] The FDIC completed a sale of IndyMac to OneWest Bank on March, 19, 2009. OneWest will continue the loan modification program, subject to the terms of a loss-sharing agreement with the FDIC.[26]

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[24] Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019," January 2009, available at http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf.

[25] Remarks by FDIC Chairman Sheila Bair to the National Association of Realtors Midyear Legislative Meeting and Trade Expo, Washington, D.C., May 12, 2009. A transcript of these remarks is available at http://www.fdic.gov/news/news/speeches/chairman/spmay1209.html.

[26] Federal Deposit Insurance Corporation, "FDIC Closes Sale of IndyMac Federal Bank, Pasadena, California," press release, March 19, 2009, http://www.fdic.gov/news/news/press/2009/pr09042.html.

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac[27] are playing key roles in the Making Home Affordable program, described in an earlier section. In addition, they have undertaken a number of other efforts to help troubled borrowers with mortgages owned or guaranteed by Fannie or Freddie, and to help tenants in foreclosed properties that they own. These efforts have included the Streamlined Modification Plan (SMP), a mortgage modification plan that was implemented in December 2008 but has since been replaced by Making Home Affordable; foreclosure moratoria while the SMP was put into place; and offering month-to-month leases to qualified renters living in foreclosed properties so that they can remain in their homes.

Streamlined Modification Plan

On November 11, 2008, James Lockhart, the director of the Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac, announced a new Streamlined Modification Program that Fannie, Freddie, and certain private mortgage lenders and servicers planned to undertake.[28] Fannie Mae and Freddie Mac had helped troubled borrowers through individualized loan modifications for some time, but the SMP represented an attempt to formalize the process and set an industry standard. The SMP took effect on December 15, 2008, but has since been replaced by the Making Home Affordable plan, announced in February 2009 and described in an earlier section of this report.

In order for borrowers whose mortgages were owned by Fannie Mae or Freddie Mac to be eligible for the SMP, they had to meet the following criteria:

- The mortgage must have originated on or before January 1, 2008.
- The mortgage must have had a loan-to-value ratio of at least 90%.
- The home must have been a single-family residence occupied by the borrower, and it must have been the borrower's primary residence.
- The borrower must have missed at least three mortgage payments.
- The borrower must not have filed for bankruptcy.

Mortgages insured or guaranteed by the federal government, such as those guaranteed by FHA, the Veterans' Administration, or the Rural Housing Service, were not eligible for the SMP.

The SMP shared many features of the FDIC's plan to modify troubled mortgages held by IndyMac. Borrowers who qualified for the program had to provide income information that was

[27] Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that were chartered by Congress to provide liquidity to the mortgage market. Rather than make loans directly, the GSEs buy loans made in the private market and either hold them in their own portfolios or securitize and sell them to investors. The GSEs were put under the conservatorship of FHFA on September 7, 2008. For more information on the GSEs in general, see CRS Report RL33756, *Fannie Mae and Freddie Mac: A Legal and Policy Overview*, by N. Eric Weiss and Michael V. Seitzinger, and for more information on the conservatorship, see CRS Report RS22950, *Fannie Mae and Freddie Mac in Conservatorship*, by Mark Jickling.

[28] The private mortgage lenders and servicers who participated in the Streamlined Modification Program are primarily members of the HOPE NOW Alliance, a voluntary alliance of industry members that formed to help homeowners avoid foreclosure. The HOPE NOW Alliance, and its involvement with the SMP, is described in detail in this report.

current within the last 90 days to the mortgage servicer. Based on this updated income information, borrowers' monthly mortgage payments were lowered so that the household's mortgage debt-to-income ratio was 38% (not including second lien payments). After borrowers successfully completed a three-month trial period (by making all of the payments at the proposed modified payment amount), the loan modification automatically took effect.

In order to reach the 38% mortgage debt-to-income ratio, servicers were required to follow a specific formula. First, the servicer capitalized late payments and accrued interest (late fees and penalties were waived). If this resulted in a DTI of 38% or less, the modification was complete. If the DTI was higher than 38%, the servicer could extend the term of the loan to up to forty years from the effective date of the modification. If the DTI was still above 38%, the interest rate could be adjusted to the current market rate or lower, but to no less than 3%. Finally, if the DTI was still above 38% after the first three steps were taken, servicers could offer principal forbearance. The amount of the principal forbearance would not accrue interest and was non-amortizing, but would result in a balloon payment when the loan was paid off or the home was sold.

Negative amortization was not allowed under the SMP, nor were principal forgiveness or principal write-downs. In order to encourage participation in the SMP, Fannie Mae and Freddie Mac paid servicers $800 for each loan modification completed through the program. If the SMP did not produce an affordable payment for the borrower, servicers were to work with borrowers in a customized fashion to try to modify the loan in a way that the homeowner could afford.

Fannie Mae and Freddie Mac completed over 51,000 loan modifications between January 2009 and April 2009, when Fannie and Freddie stopped using the SMP and began participating in the Making Home Affordable program instead.[29] However, it is unclear how many of these loan modifications were done specifically through the SMP.

Foreclosure Moratoria

On November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and evictions between November 26, 2008, and January 9, 2009, in order to have time to reach out to borrowers who might be eligible for loan modifications under the SMP. Fannie later extended its moratorium through March 31, 2009, and Freddie extended its moratorium through April 1, 2009.

Renter Policies

In January 2009, Fannie Mae and Freddie Mac each announced policies to allow qualified renters living in foreclosed single-family properties owned by Fannie or Freddie, respectively, to remain in their homes under new month-to-month leases.[30] Freddie Mac's policy also allows qualified former owner-occupants to remain in foreclosed homes as renters under new month-to-month leases.

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[29] Federal Housing Finance Agency, "Foreclosure Prevention Report: April 2009," July 15, 2009, available at http://www.fhfa.gov/webfiles/14588/April_Foreclosure_Prevention71509F.pdf.

[30] For more information, see "Fannie Mae Announces National REO Rental Policy," press release, January 13, 2009, at http://www.fanniemae.com/newsreleases/2009/4581.jhtml?p=Media&s=News+Releases, and "Freddie Mac Extends Eviction Suspension Until March, Launches Rental Option for Foreclosed Borrowers, Tenants," press release, January 30, 2009, at http://www.freddiemac.com/news/archives/servicing/2009/20090130_reo-rental.html.

Federal Reserve

On January 27, 2009, the Federal Reserve announced the Homeownership Preservation Policy.[31] This plan provides guidelines to prevent foreclosures on residential mortgages that the Federal Reserve Banks hold, own, or control subject to Section 110 of the Emergency Economic Stabilization Act of 2008 (EESA), such as mortgage assets that they may receive as collateral for lending to troubled banks.

In order to be eligible for a loan modification under the Homeownership Preservation Policy, a borrower must be at least sixty days delinquent (although the Fed may make exceptions for households experiencing circumstances that are likely to result in their becoming at least sixty days delinquent). If the expected net present value of a loan modification is greater than the expected net present value of foreclosure, the Fed will modify mortgages by reducing the interest rate, extending the loan term, offering principal forbearance or principal forgiveness, or changing other loan terms. The modified mortgage must have a fixed interest rate, a term of no more than forty years, and result in a mortgage debt-to-income ratio of no more than 38% for the borrower. The Fed must also have a reasonable expectation that the borrower will be able to repay the modified loan. If the borrower's mortgage debt is greater than 125% of the current estimated value of the property, the Fed will prioritize principal reductions over other types of loan modifications where possible.

This policy applies to whole mortgages that the Federal Reserve Banks hold, own, or control. In the case of securitized mortgages in which the Fed has an interest, the Fed will encourage servicers to undertake similar loan modifications and support their efforts to do so.

Foreclosure Counseling Funding to NeighborWorks America

Another federal effort to slow the rising number of foreclosures has been to appropriate additional funding for housing counseling. In particular, Congress has recently appropriated funding specifically for foreclosure mitigation counseling to be administered by NeighborWorks America, a non-profit created by Congress in 1978 that has a national network of community partners.[32] NeighborWorks traditionally provides housing counseling to homebuyers and homeowners through its network organizations, and also trains other non-profit housing counseling organizations in foreclosure counseling.

The Consolidated Appropriations Act, 2008 (P.L. 110-161) appropriated $180 million for NeighborWorks to distribute for foreclosure mitigation counseling, which it has done by setting up the National Foreclosure Mitigation Counseling Program (NFMCP).[33] NeighborWorks competitively awards the funding to qualified housing counseling organizations.[34] Congress

[31] Details of the Homeownership Preservation Policy can be found on the Federal Reserve's website at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090130a1.pdf.

[32] Each year, Congress appropriates funding to HUD to distribute to certified housing counseling organizations to undertake various types of housing counseling, including pre-purchase counseling and post-purchase counseling. Congress also appropriates funding to NeighborWorks each year for neighborhood reinvestment activities, including housing counseling. The recent funding appropriated specifically for foreclosure mitigation counseling is separate from both of these other usual appropriations.

[33] For more information on the National Foreclosure Mitigation Counseling Program, see the NeighborWorks website at http://www.nw.org/network/nfmcp/default.asp#info.

[34] HUD-approved housing counseling intermediaries, state housing finance agencies, and NeighborWorks (continued...)

directed NeighborWorks to award the funding with a focus on areas with high default and foreclosure rates on subprime mortgages. The Housing and Economic Recovery Act of 2008 (P.L. 110-289) appropriated an additional $180 million for NeighborWorks to distribute through the NFMCP, $30 million of which was to be distributed to counseling organizations to provide legal help to homeowners facing delinquency or foreclosure. The Omnibus Appropriations Act, 2009 (P.L. 111-8) included $50 million for NeighborWorks to distribute through the NFMCP.

Foreclosure Mitigation Efforts Targeted to Servicemembers

The federal government has made a number of efforts to prevent foreclosures specifically among members of the Armed Forces. The Servicemembers Civil Relief Act (P.L. 108-189), which became law on December 19, 2003, prohibits foreclosure completions on properties owned by servicemembers during a period of military service or within ninety days of the servicemember's return from military service. [35] The law also prohibits evictions of active servicemembers or their dependents, subject to certain conditions. The Housing and Economic Recovery Act of 2008 (P.L. 110-289) temporarily extended the prohibition on foreclosure completions from ninety days to nine months after a servicemember's return from military service, until the end of 2010, and also directed the Secretary of Defense to develop a foreclosure counseling program for members of the Armed Forces returning from active duty abroad.

State and Local Initiatives

In addition to federal efforts to prevent foreclosures, a number of state and local governments have implemented their own programs aimed at helping homeowners stay in their homes. Some of these efforts include supporting voluntary or mandatory pre-foreclosure counseling initiatives, imposing foreclosure moratoria, providing short-term loans to help homeowners at risk of foreclosure, enacting stronger reporting requirements on lenders' loan modification efforts, and initiating legal actions. Many states and localities have also implemented educational efforts to reach out to troubled homeowners.

According to the Pew Charitable Trusts Center on the States, as of April 2008, twenty states have laws or regulations involving foreclosure mitigation, 24 states have statewide counseling efforts, 13 states have a foreclosure intervention hotline, and 9 states have developed loan funds to help homeowners refinance into more affordable mortgages or to provide short-term loans to borrowers facing foreclosure. Furthermore, at least 14 states have created foreclosure prevention task forces to attempt to address the problem of rising foreclosure rates.[36]

(...continued)

organizations are eligible to receive funds through the NFMCP.

[35] This law is a revision of the Soldiers' and Sailors' Civil Relief Act of 1940 (P.L. 76-861), which itself was a revision of the Soldiers' and Sailors' Civil Relief Act of 1918 (P.L. 65-103). Both earlier laws also included foreclosure protections for members of the military on or recently returned from active duty.

[36] The Pew Charitable Trusts Center on the States, *Defaulting on the Dream: States Respond to America's Foreclosure Crisis*, April 2008, http://www.pewcenteronthestates.org/uploadedFiles/PCS_DefaultingOnTheDream_Report_FINAL041508_01.pdf.

Private Initiatives

While the government has initiated the mortgage modification programs described above, a number of private mortgage lenders and servicers have voluntarily attempted to implement their own foreclosure prevention initiatives. Many private lenders have engaged in ongoing individual loan modifications for some time, but have recently launched more targeted programs to help troubled borrowers. This section describes some of these programs in order to provide illustrative examples of private sector initiatives to prevent foreclosures; it is not intended to be a comprehensive list of private foreclosure prevention efforts.

HOPE NOW Alliance

The HOPE NOW Alliance is a voluntary alliance of mortgage servicers, lenders, investors, counseling agencies, and others that formed in October 2007. The alliance is a private sector initiative created with the encouragement of the federal government to engage in active outreach efforts to troubled borrowers. Member organizations identify borrowers who may have difficulty making loan payments before they become seriously delinquent on their mortgages, and work with such borrowers to work out loan modifications that can keep the borrowers in their homes. When the alliance was first announced, eleven mortgage servicers were involved; by November 2008, twenty-seven servicers had become member organizations.

HOPE NOW Alliance members have undertaken several initiatives to help troubled homeowners. One such initiative the alliance has supported is a hotline, operated by the Homeownership Preservation Foundation, that connects borrowers to HUD-approved housing counselors who can help homeowners contact their servicers and work out a plan to avoid foreclosure. The hotline serves as a first point of contact for troubled borrowers, and both HUD and non-profit organizations such as NeighborWorks America advocate its use.[37]

HOPE NOW also encourages its lenders and servicers to coordinate their efforts to modify mortgages. On December 6, 2007, the HOPE NOW Alliance announced a streamlined plan that would allow servicers to freeze the interest rate on certain subprime ARMs for borrowers who were current on their mortgages but would not be able to afford higher payments after their rates reset. While the plan received assurances from the government that the modifications would not affect certain accounting or tax issues surrounding securitized loans, servicers who went forward with modifications could not be certain that investors would not mount legal challenges.[38] Most recently, HOPE NOW announced on November 11, 2008 that most of its servicers would participate in the SMP (described earlier in this report), with the idea that the plan would create a new industry-wide approach to mortgage modifications.

According to HOPE NOW's own reports, the alliance expected to prevent 2.2 million foreclosures and complete almost 950,000 loan modifications in 2008 through these efforts.[39]

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[37] The phone number for the HOPE NOW Alliance hotline is 888-995-HOPE (4673).

[38] For more information on the tax and accounting issues surrounding this plan, see CRS Report RL34372, *The HOPE NOW Alliance/American Securitization Forum (ASF) Plan to Freeze Certain Mortgage Interest Rates*, by David H. Carpenter and Edward V. Murphy.

[39] The HOPE NOW Alliance, "HOPE NOW Projects Big Increases in Foreclosure Prevention Successes in 2009," press release, Dec. 22, 2008, available online at http://www.hopenow.com/press_release/files/HOPE%20NOW%202008%20Year%20End%20-%20November%20Data%20Release.pdf.

However, some of these prevented foreclosures are the result of solutions other than loan modifications. These other solutions could include repayment plans, under which it is possible that some borrowers could end up with higher, not lower, monthly payments, and which may not substantially reduce the risk that these homeowners will eventually end up in default or foreclosure. They could also involve short sales or deeds-in-lieu-of-foreclosure, in which the homeowner avoids the foreclosure process but still loses the home.

Bank of America

On October 6, 2008, Bank of America announced a loan modification program for homeowners whose mortgages are serviced by Countrywide. (Countrywide was acquired by Bank of America on July 1, 2008.)[40] The program became effective December 1, 2008, and targets borrowers who are seriously delinquent, or in danger of becoming seriously delinquent, on their mortgages due to loan features such as interest rate resets.

The Bank of America program aims to reduce borrowers' mortgage debt to no more than 34% of gross monthly income for the first year of the modification. Subsequent rises in the interest rate or other loan terms are structured in a way that minimizes payment shock to the borrower. Types of loan modifications can include using the Hope for Homeowners program, described above, to help homeowners refinance into FHA-insured mortgages; reducing the interest rate; and reducing the principal balance on option-ARMs. Eligibility for the program is limited to primary residences.

In addition to its own foreclosure prevention efforts, Bank of America is a participating servicer in the Administration's Making Home Affordable plan.

JP Morgan Chase

On October 31, 2008, JP Morgan Chase announced an expansion of its foreclosure prevention efforts.[41] This expansion includes reaching out to borrowers before they begin to miss payments, and conducting a systematic review of all of the mortgages held by Chase to ascertain which borrowers might be eligible for loan modifications. Chase will offer troubled borrowers a combination of reductions in their interest rate and principal forbearance, and will review each mortgage before it enters the foreclosure process to ensure that eligible borrowers were offered loan modifications. Chase specifically excludes negative amortization as a loan modification option. Chase also announced that it would not begin any foreclosures while the expanded program was being implemented.

In order to be eligible for a loan modification, borrowers must have a mortgage that is owned by Chase, Washington Mutual, or EMC. (EMC and Washington Mutual were acquired by JP Morgan Chase in March 2008 and September 2008, respectively.) If a borrower's mortgage is serviced,

[40] Bank of America, "Bank of America Announces Nationwide Homeownership Retention Program for Countrywide Customers," press release, October 6, 2008, http://newsroom.bankofamerica.com/index.php?s=press_releases&item=8272.

[41] JP Morgan Chase, "Chase Further Strengthens Robust Programs to Keep Families in Homes," press release, October 31, 2008, http://files.shareholder.com/downloads/ONE/514430481x0x245621/b879b4eb-40e0-43f8-8614-6f2113759d0c/344473.pdf.

but not owned, by one of these companies, the investors must give permission for the loan to be modified. To be eligible, borrowers must occupy the home as their primary residence.

In addition to its own foreclosure prevention efforts, JP Morgan Chase is a participating servicer in the Administration's Making Home Affordable plan.

Citigroup

On November 11, 2008, Citigroup announced that it was streamlining its existing mortgage modification program in the mold of the IndyMac loan modification model.[42] Under the streamlined program, Citigroup uses a formula to arrive at a certain mortgage payment-to-income ratio, and then uses a combination of interest rate reductions, extensions of the loan term, or forgiveness of part of the principal in order to reach that ratio. Citigroup also announced the Citi Homeowner Assistance program, in which it pledged to reach out to borrowers who were not yet delinquent on their mortgages but who were in danger of falling behind on their loan payments. Through this program, Citigroup plans to concentrate its efforts on geographic areas that are especially economically hard-hit, such as those areas experiencing steep home price declines or rapid rises in unemployment. Finally, Citigroup has announced a foreclosure moratorium in order to give it more time to reach out to borrowers and complete loan modifications.

Currently, these programs are in effect for mortgage loans that Citigroup owns. Citi is working with investors to expand the program to includes mortgages that are serviced, but not owned, by Citigroup.

On March 3, 2009, Citigroup announced an expansion to its Homeowner Assistance Program targeted at borrowers who recently became unemployed.[43] Borrowers with mortgages that are both owned and serviced by CitiMortgage and who are currently unemployed may be eligible to make reduced mortgage payments for three months. An eligible borrower must be at least 60 days delinquent or in foreclosure, must live in the home as his or her primary residence, and must meet certain other eligibility requirements.

In addition to its own foreclosure prevention efforts, CitiMortgage is a participating servicer in the Administration's Making Home Affordable plan.

Other Foreclosure Prevention Proposals

Some observers argue that the programs outlined above, which have already been implemented by various government and private organizations, have not been effective enough at stopping the rising foreclosure rate and keeping people in their homes. This section briefly outlines some existing proposals for further action to help prevent foreclosures.

[42] Citigroup, "Citi Announces New Preemptive Initiatives to Help Homeowners Remain in Their Homes," press release, November 11, 2008, http://www.citigroup.com/citi/press/2008/081111a.htm.

[43] Citigroup, "Citi Expands Homeowner Assistance Program to Help Recently Unemployed Borrowers Stay in Their Homes," press release, March 3, 2009, http://www.citigroup.com/citi/press/2009/090303a.htm.

Changing Bankruptcy Law

One method that has been suggested to help more homeowners remain in their homes is to amend bankruptcy law to allow a judge to order a mortgage loan modification as part of a bankruptcy proceeding. Bankruptcy judges currently have the authority to modify or reduce other types of outstanding debt obligations, including mortgages on second homes and vacation homes, but this authority does not extend to mortgages on primary residences. Opponents of such a change do not want judges to have such broad power to amend a contract after the fact. They argue that allowing these "cramdowns" would make lenders more hesitant to make mortgage loans in the future, since the threat of a loan being modified in this way could make mortgage lending more risky. Supporters of amending bankruptcy law say that, in addition to helping a borrower in bankruptcy avoid foreclosure through a court-mandated loan modification, such a change might also encourage lenders to work with borrowers to modify loans before the bankruptcy process begins in the first place.

Provisions to amend bankruptcy law to allow judges to modify mortgages on primary residences were included in H.R. 1106, the Helping Families Save Their Homes Act of 2009, which passed the House on March 5, 2009. However, bankruptcy provisions were not included in the Senate's version of the bill, S. 896, which passed the Senate on May 6, 2009. A modified version of the Senate bill was signed into law (P.L. 111-22) on May 20, 2009 without the cramdown provision. (For a description of recent legislative proposals to amend bankruptcy law to allow judges to order mortgage modifications, see CRS Report RL34301, *The Primary Residence Exception: Legislative Proposals in the 111th Congress to Amend the Bankruptcy Code to Allow the Strip Down of Certain Home Mortgages*, by David H. Carpenter.)

Foreclosure Moratorium

Some advocates have called for placing a temporary moratorium on foreclosure completions. Proponents of this idea argue that placing a freeze on foreclosure completions would give homeowners and lenders more time to work out sustainable loan modifications that would allow homeowners to remain in their homes and turn troubled mortgages back into performing loans that benefit the lenders. Opponents of a foreclosure moratorium argue that the government should not interfere with the right of a lender to complete foreclosure proceedings against a borrower who has defaulted on his or her loan. They note that delaying foreclosure proceedings through a foreclosure moratorium could result in greater losses for the lender if the ultimate outcome is still a foreclosure and the home's price has fallen further in the interim.

Fannie Mae, Freddie Mac, and some private lenders have instituted temporary foreclosure moratoria while they put foreclosure prevention programs in place. While a wider foreclosure moratorium had widely been considered a radical idea until recently, the severity of the increase in foreclosures and its impact on the economy has led some to give the idea serious consideration. (For an analysis of the economic principals behind a foreclosure moratorium, see CRS Report RL34653, *Economic Analysis of a Mortgage Foreclosure Moratorium*, by Edward V. Murphy. For an analysis of the legal issues involved, see CRS Report RL34369, *Constitutional Issues Relating to Proposals for Foreclosure Moratorium Legislation That Affects Existing Mortgages*, by David H. Carpenter.)

Issues and Challenges Associated with Preventing Foreclosures

There are several challenges associated with designing successful programs to prevent foreclosures. Some of these challenges are practical and concern issues surrounding the implementation of loan modifications. Other challenges are more conceptual, and are related to questions of fairness and precedent. This section describes some of the most prominent considerations involved in programs to preserve homeownership.

Who Has The Authority to Modify Mortgages?

In recent years, the practice of lenders packaging mortgages into securities and selling them to investors has become more widespread. This practice is known as securitization, and the securities that include the mortgages are known as mortgage-backed securities (MBS). When mortgages are sold through securitization, several players become involved with any individual mortgage loan, including the lender, the servicer, and the investors who hold shares in the MBS. The servicer is usually the organization that has the most contact with the borrower, including receiving monthly payments and initiating any foreclosure proceedings. However, servicers are usually subject to contracts with investors which limit the activities that the servicer can undertake and require it to safeguard the investors' profit. One major question facing foreclosure prevention programs, therefore, is who actually has the authority to make a loan modification. Contractual obligations may limit the amount of flexibility that servicers have to modify loans in ways that could arguably yield a lower return for investors. In some cases, loan modifications can result in less of a loss for investors than foreclosure; however, servicers may not want to risk having investors challenge their assessment that a modification is more cost-effective than a foreclosure. This problem can be especially salient in streamlined programs in which large numbers of loans are modified at once. With such streamlined programs, the cost-effectiveness of loan modifications depends on questions such as how many loans would have likely ended up in foreclosure without the modification, making it more difficult to say whether wholesale loan modifications are in the best interest of investors.

One possible way to partially address the question of who can modify mortgages is to provide a safe harbor for servicers. In general, a safe harbor protects servicers who engage in certain mortgage modifications from lawsuits brought by investors. While proponents of a safe harbor believe that a safe harbor is necessary to encourage servicers to modify more mortgages without fear of legal repercussions, opponents argue that a safe harbor infringes on investors' rights and could even encourage servicers to modify mortgages that are not in trouble if it benefits their own self-interest. P.L. 111-22, the Helping Families Save Their Homes Act of 2009, provides a safe harbor for servicers who modify mortgages consistent with the Making Home Affordable program guidelines or by using the Hope for Homeowners program. The legislation specifies that the safe harbor does not protect servicers or individuals from liability for any fraud committed in their handling of the mortgage or the mortgage modification.

Volume of Delinquencies and Foreclosures

Another issue facing loan modification programs is the sheer number of delinquencies and foreclosure proceedings underway. Lenders and servicers have a limited number of employees to

reach out to troubled borrowers and find solutions. Contacting borrowers—some of whom may avoid contact with their servicer out of embarrassment or fear—and working out large numbers of individual loan modifications can overwhelm the capacity of the lenders and servicers who are trying to help homeowners avoid foreclosure. Streamlined plans that use a formula to modify all loans that meet certain criteria may make it easier for lenders and servicers to help a greater number of borrowers in a shorter amount of time. However, streamlined plans are more likely to run into the contractual issues between servicers and investors described above.

Possibility of Re-Default

Another major challenge associated with loan modification programs is the possibility that a homeowner who receives a modification will nevertheless default on the loan again in the future. This possibility is especially problematic if the home's value is falling, because in that case delaying an eventual foreclosure reduces the value that the lender can recoup through a foreclosure sale. Data released quarterly by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) show that over 40% of loans modified in the first quarter of 2008 were 30 or more days delinquent again three months after the modification, and 53% were 30 or more days delinquent six months after the modification. The same data show that a smaller percentage of modified loans were 60 or more days delinquent: over 23% of loans were 60 or more days delinquent three months after the modification, and nearly 37% were 60 or more days delinquent six months after the modification.[44] Re-default rates follow the same general pattern for loans modified in later quarters of 2008.

Opponents of aggressive loan modification programs point to these data as evidence that loan modifications are not effective at preventing foreclosures. However, proponents of such programs argue that the definition of loan modification used in these data is overly broad, and that many of the modifications did not actually result in lower monthly payments for the borrower.[45] These supporters believe that loan modifications that focus on creating truly affordable payments for troubled borrowers will exhibit lower rates of re-default.

The OCC and the OTS have begun to include data in their quarterly report that show re-default rates for loans modified in 2008 according to whether the loan modification increased monthly payments, decreased monthly payments, or left monthly payments unchanged. These data show that, six months after modification, the re-default rate for loan modifications that resulted in monthly payments being reduced by 20% or more was slightly over 24%. This compares to a re-default rate of nearly 29% for loans where monthly payments were reduced by between 10% and 20%; just over 36% for loans where payments were reduced by less than 10%; over 54% for loans where payments remained unchanged; and 50% for loans where monthly payments increased. While loan modifications that lower monthly payments do appear to perform better than modifications that increase monthly payments or leave them unchanged, a significant number of these loans *still* become delinquent again after the loan modification.[46]

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[44] Office of the Comptroller of the Currency and Office of Thrift Supervision, "OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009," June 30, 2009, pp. 27-28, available at http://files.ots.treas.gov/4820471.pdf.

[45] Remarks by FDIC Chairman Sheila Bair to the New America Foundation conference "Did Low-Income Home Ownership Go Too Far?": Washington, D.C. , December 17, 2008. A transcript of these remarks is available at http://www.fdic.gov/news/news/speeches/archives/2008/chairman/spdec1708.html.

[46] Office of the Comptroller of the Currency and Office of Thrift Supervision, "OCC and OTS Mortgage Metrics (continued...)

Fairness Issues

Opponents of some foreclosure prevention plans argue that it is not fair to help homeowners who have fallen behind on their mortgages while homeowners who have been scraping by to stay current receive no help. Others argue that borrowers who got in over their heads, particularly if they intentionally took out mortgages that they knew they could not afford, should face consequences. Supporters of loan modification plans point out that many borrowers go into foreclosure for reasons outside of their control, and that some troubled borrowers may have been victims of deceptive, unfair, or fraudulent lending practices. Furthermore, a case can be made that foreclosure prevention programs are necessary not only out of compassion for the homeowner, but because foreclosures can create problems for other homeowners in the neighborhood by dragging down property values or putting a strain on local governments.

To address these concerns about fairness, some loan modification programs reach out to borrowers who are struggling to make payments but are not yet delinquent on their mortgage. Most programs also specifically exclude individuals who provided false information in order to obtain a mortgage.

Incentives

Another challenge is that loan modification programs may provide an incentive for borrowers to intentionally miss payments or default on their mortgage in order to qualify for a loan modification that provides more favorable mortgage terms. While many of the programs described above, including Hope for Homeowners, specifically require that a borrower must not have intentionally missed payments on his or her mortgage in order to qualify for the program, it can be difficult to prove a person's intention. Programs that are designed to reach out to distressed borrowers before they miss any payments, as well as those who are already delinquent, may minimize the incentive for homeowners to intentionally fall behind on their mortgages in order to receive help.

Precedent

Some opponents of government efforts to provide or encourage loan modifications argue that changing the terms of a contract retroactively sets a troubling precedent for future mortgage lending. These opponents argue that if lenders believe that they could be forced to change the terms of a mortgage in the future, they will be less likely to provide mortgage loans in the first place or will only do so at higher interest rates to counter the perceived increase in the risk of not being repaid in full. Most existing programs attempt to address this concern by limiting the program's scope. Often, these programs apply only to mortgages that originated during a certain time frame, and end at a pre-determined date.

(...continued)

Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009," June 30, 2009, p. 32, available at http://files.ots.treas.gov/4820471.pdf.

Appendix. Comparison of Recent Federal Foreclosure Prevention Initiatives

Table A-1. Features of Selected Programs

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
Making Home Affordable: Home Affordable Modification Program (HAMP)	Borrower has a mortgage held by any participating lender or servicer Borrower is experiencing a financial hardship leading to difficulty making mortgage payments or is already delinquent Borrower occupies home as his/her primary residence Mortgage originated on or before January 1, 2009 Unpaid principal balance is no higher than $729,750 for a one-unit property (this is the Fannie Mae/Freddie Mac conforming loan limit for high cost areas; higher limits apply for two- to four-unit properties)	Lenders and servicers will contact eligible borrowers, but borrowers are encouraged to contact their servicers as well Servicer modifies mortgage to achieve 38% DTI, primarily using interest rate reduction Government matches further reductions to achieve 31% DTI Government will make incentive payments to servicers for making modifications, and to both borrowers (in the form of principal reduction) and servicers if the borrower remains current on the new loan	Announced February 18, 2009 Program began on March 4, 2009 Estimated to be able to help between 3 and 4 million homeowners As of July 31, 2009, 406,542 trial modification offers had been extended, and of these, 235,247 trial modifications were currently underway

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
HOPE for Homeowners	Borrower has a non-FHA mortgage and lender agrees to participate Borrower is at risk of default or foreclosure Borrower occupies home as his/her primary residence Borrower has experienced financial hardship and has total monthly mortgage payments higher than 31% of gross monthly income Mortgage originated on or before January 1, 2008, and at least 6 payments have been made Borrower does not have a fraud conviction in the last 10 years, has not intentionally defaulted, and did not provide false information to obtain original mortgage	Borrower contacts lender to determine eligibility Borrower refinances into FHA-insured fixed rate mortgage for no more than 96.5% of home's currently appraised value (mortgage may not exceed $550,440) Lender absorbs loss resulting from write-down in mortgage value Borrower shares equity in home with FHA when the home is sold Borrower pays up-front and annual mortgage insurance premiums Second lien-holders release their liens in exchange for an upfront payment	Active; began October 1, 2008, and slated to expire September 30, 2011 As of July 16, 2009, 949 applications had been received and 50 loans had closed out of about 400,000 homeowners that were originally estimated could be served
FDIC IndyMac modificatons	Borrower has a loan owned or serviced by IndyMac Borrower is (1) seriously delinquent or *in* danger of default, or (2) having trouble making mortgage payments due to interest rate resets or changes in financial circumstances Borrower occupies home as his/her primary residence Borrower provides current income information documenting financial hardship Loan modification meets "net present value test," meaning that the loan modification must be less costly for FDIC than foreclosure	FDIC contacts eligible borrowers, but also encourages troubled homeowners to contact FDIC or IndyMac to see if they qualify Mortgages are systematically modified to achieve monthly payments of no more than 38% of borrowers' monthly income Achieves 38% mortgage debt-to-income ratio by a combination of lowering the interest rate, extending the loan term, or forbearing part of the principal	Active; announced July 11, 2008 Served about 13,000 homeowners while under FDIC conservatorship; program expected to continue under IndyMac's new owner, OneWest Bank

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
FHASecure	Borrower had a non-FHA ARM Borrower was delinquent due to an interest rate reset or other extenuating circumstances Borrower occupied home as his/her primary residence Borrower had sufficient income to pay new loan Borrower missed no more than a minimum number of payments prior to reset or onset of extenuating circumstances (or had sufficient equity in the home)	Borrower contacted lender to determine eligibility Borrower refinanced into new, fixed-rate, FHA-insured mortgage Borrower's new loan met standard FHA underwriting criteria Borrower met other standard *FHA* requirements, such as paying FHA insurance premiums	Announced August 31, 2007. Expired Dec. 31, 2008 Estimated to have served about 4,000 homeowners
Fannie Mae and Freddie Mac Streamlined Modification Plan	Borrower had a loan owned by Fannie Mae or Freddie Mac Borrower had missed three or more monthly payments Borrower occupied home as his/her primary residence Mortgage loan-to-value ratio was at least 90% Mortgage originated on or before January 1, 2008 Borrower was not in active bankruptcy	Borrower contacted lender to determine eligibility Mortgages were systematically modified to achieve 38% mortgage debt-to-income ratio Modification followed the following steps, in order, as necessary to achieve 38% DTI: (1) capitalize late payments and accrued interest; (2) extend loan term for up to four years from modification date; (3) adjust interest rate to no lower than 3%; (4) principal forbearance. Servicers received payment for each modification completed	Began December 15, 2008. Replaced by Making Home Affordable in March 2009 Fannie and Freddie completed 51,115 loan modifications between January 2009 and April 2009; however, it is unclear how many of these modifications are attributable to the SMP

Program/Initiative	Basic Eligibility Requirements	Program Details	Status
Federal Reserve Homeownership Preservation Policy	Borrower has a loan held, owned, or controlled by a Federal Reserve Bank Borrower is at least 60 days delinquent, or is experiencing circumstances making it likely that he or she will become 60 days delinquent Loan modification meets "net present value test," meaning that the loan modification must be less costly for the Fed than foreclosure Reasonable likelihood that borrower can repay new loan	Fed contacts eligible borrowers Mortgages are modified to achieve a DTI of no more than 38% using interest rate reductions, loan term extensions, principal forbearance, principal forgiveness, or other changes to loan terms Modified loan has a fixed interest rate and loan term of no more than 40 years	Announced January 27, 2009

Source: Table created by CRS.

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Economic Needs of Asian Americans and Pacific Islanders in Distressed Areas:
Establishing Baseline Information

Paul Ong and Doug Miller
University of California, Los Angeles
in collaboration with
National Coalition for Asian Pacific American Community Development

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1533

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EXECUTIVE SUMMARY

In spite of a long history of marginalization of and discrimination against Asian-Pacific Americans (APAs), there has been little policy-oriented research focusing on disadvantaged APA neighborhoods. This report seeks to provide baseline statistics for 17 poor APA neighborhoods across the United States as well as insights from a survey of community-based organizations.

The baseline neighborhood profiles reveal a diversity of neighborhood characteristics:

- Neighborhood populations range in size from about 1,000 to 50,000 APAs.
- APAs are a majority in some neighborhoods. In others, they live in shared urban and rural spaces.
- Some neighborhood APA populations are predominantly of a single ethnic group, while others are a mixture of two or more Asian and Pacific Islander groups.
- Employment opportunities vary significantly across neighborhoods.

In spite of substantial variation across the neighborhoods, some common features are seen:

- Most neighborhoods are immigrant communities; consequently, many neighborhood residents are linguistically isolated.
- Educational attainment is lower than for the general population.
- Neighborhood residents are likely to have low earnings.
- Most neighborhood residents commute out of their immediate neighborhoods.
- Neighborhood residents are less likely to own their own homes than the general population.

The responses from the CBO survey mirror the findings of the neighborhood profiles and provide perspectives from community experts. The key results of the survey are as follows:

- Underemployment (i.e., low wages, part-time or intermittent employment, lack of benefits, etc.) is a more critical issue than joblessness or lack of nearby employment. Lack of community healthcare resources and external pressure in the form of neighborhood gentrification also common neighborhood problems.
- In agreement with the neighborhood profiles, linguistic isolation is seen as the most critical barrier to employment.
- Lack of affordable housing leads to a high housing cost burden and overcrowding.

The CBOs identified several programmatic and strategic priorities when asked to allocate funds to improve the quality of life in their neighborhoods. The top two programmatic areas are

- The creation of affordable housing and
- Employment related services.

While the CBOs would allocate about half of the funds for direct services, they would allocate the rest to building community and organizational components.

The CBOs were also asked to identify barriers to community economic development. Some barriers were external to the communities and organizations, while others were internal. The top two external barriers are

- Inadequate funding and resources and
- Inadequate governmental support.

The top two internal barriers are

- Inadequate fund-raising capacity and
- Inadequate staff training.

INTRODUCTION

Overview: This report presents the results of a joint effort between the National Coalition for Asian Pacific American Community Development (National CAPACD), the UCLA Asian American Studies Center (AASC), and UCLA's Ralph and Goldy Lewis Center for Regional Policy Studies. It examines the spatial characteristics associated with Asian-Pacific Americans (APAs) living in economically distressed neighborhoods and provides needed baseline information for the Economic Development Administration (EDA) and other federal departments that are developing economic development programs aimed at APA communities.

For the purposes of our report, APA neighborhoods are defined as clusters of census tracts with significant APA populations located in low-wage areas. Our neighborhood profiles have identified APA communities in all geographic areas of the United States, with diverse ethnic constitutions in a range of economic environments. Some communities have developed recently while other communities have existed for many generations. Several of the profiled communities are located in areas with extremely high urban residential densities; others are located in sparsely populated agricultural areas. Some of the neighborhoods are populated by a single ethnic group that constitutes a majority of all residents in the area. Other neighborhoods are characterized by a significant presence of Asian-Pacific Americans within shared urban and rural spaces.

In spite of this diversity, some common features are seen between the communities. In almost every case, these neighborhoods are characterized by a high degree of linguistic isolation, low educational attainment, and largely immigrant populations. Rates of home ownership are generally lower than for other APAs in the region, as well as the region as a whole.

The neighborhoods that we have profiled are representative of the broad range of experiences of Asian-Pacific Americans within the United States. These study areas are illustrative examples that highlight some of the characteristics of poor APAs. Due to the scope of this project, we have been forced to select only a small fraction of all APA neighborhoods. In some cases, the decision to choose between study areas separated by only a few miles has meant the difference between including one ethnic group over another. Nevertheless, we have made an effort to identify what we feel are the most significant low-income APA neighborhoods in the United States.

The majority of our study areas are located in the western United States. Eight are in California, two are in Hawaii, and one is in Washington. Study areas in other regions include three on the eastern seaboard (New York and Massachusetts), two in the Midwest (Illinois and Minnesota), and one in the South (Louisiana). Chinese are the most prevalent group identified in this study, followed by Southeast Asians (Vietnamese, Cambodians, and Hmongs), and Koreans. In the Pacific Islander study areas, native Hawaiians are the most prevalent group. However, a substantial number of Filipinos and Samoans also reside in these areas.

Background: The richness of American society is embodied in its diversity as people from all over the world have come to the United States seeking opportunity and a better life in this country. Asian-Pacific Americans are no exception to this pattern.

Asians have been an integral part of this nation since at least the mid-1800s when the Chinese ventured in large numbers to California as a part of the Gold Rush, but that

migration came to a halt with the enactment of the 1882 Chinese Exclusion Act (Saxton 1971). There were subsequent waves of immigration from Japan, the Philippines, and other Asian countries, and each wave was met with anti-Asian hostility and restrictive immigration legislation (Chan 1991). Those who did make it into America were forced to take menial jobs and live in separate quarters. Large-scale immigration resumed only after the elimination of racially biased immigration quotas in 1965.

The history of Pacific Islanders is tied to European and United States expansion into the Pacific Ocean. Indigenous Pacific Islanders were incorporated through the establishment of American colonies and territories. Europeans first landed in Samoa in 1722, followed by a period of competition for control by Britain, Germany, and the United States. An 1899 treaty divided the territory between Germany and the United States. Western contact with Hawaii occurred in 1778, followed by a period of increasing American influence and power. The Kingdom of Hawaii was overthrown in 1873. Under colonial rule, the indigenous populations were decimated, their culture and language suppressed, and their land appropriated by others. One consequence of the colonization has been the migration of Pacific Islanders to the mainland of the United States.

Through a combination of immigration and natural increases, the APA population has grown tremendously in the last few decades, from about one and a half million in 1970 to about eleven million in 2000. The APA population is projected to grow to twenty million by 2020 (Ong and Hee 1993; U.S. Bureau of the Census 2001).

While some contemporary APA communities have prospered, others face significant economic development challenges as APAs are amongst the richest and poorest, the best educated and least educated of all Americans (Jiobu 1996; Cheng and Yang 1996; Ong and Hee 1994; Ong 2000). Many of the most disadvantaged live in inner-city ethnic enclaves which share common problems with African American and Latino communities, but that also have unique characteristics (Ong and Umemoto 1994; Ong et al. 1993 and 1999; Urban Institute 2000). For many enclave residents, the problem is low-wage work rather than unemployment (Hum 2000; Ong 1984). While entrepreneurship is higher than for other groups, most Asian businesses are very marginal, offering at best low-wage jobs (Bonacich and Light 1988). In addition to the skill deficits that characterize all low-income communities, many APAs must also overcome language and cultural barriers. Despite the existence of these problems, APAs have been underrepresented in the community-development field, due partly to a lack of internal capacity and due partly to non-APAs not taking APA issues seriously (Sirola, Ong and Fu 1998). The economic development challenges facing these enclaves are further complicated by a lack of policy-oriented research.

The rest of this report provides the baseline data to help inform policy on the economic issues affecting poor APA neighborhoods. The following sections are organized into three major parts: Part 1 describes the methodology and data used for this report, Part 2 profiles Asian neighborhoods, part 3 profiles Hawaiian/Pacific Islander neighborhoods, part 4 discusses the responses from our survey of community-based organizations serving APA communities, and part 5 includes our recommendations.

PART I: METHODOLOGY AND DATA

Data Sources: For this study, we develop demographic and economic profiles of 17 low-income APA neighborhoods and communities to explore their commonalties and differences. We relied primarily on 1990 and 2000 census data. The most important data sets were the 1990 STF-1 (summary tape file 1) and 2000 SF-1 (summary file 1) data (100% counts) as well as the 1990 STF-3 (weighted sample data) and CTPP (census transportation planning package). Employment information was obtained from the 2000 American Business Information data set at the census tract and block group levels. Information about personal income was obtained at the zip-code level using 1998 Internal Revenue Service data. Information about public housing assistance was obtained from 1998 data from the Department of Housing and Urban Development (HUD). Wherever possible, we selected information that was disaggregated by race or ethnicity. Some variables (e.g., nativity) were not broken out by race, and therefore we report statistics for the general population in these cases.

Neighborhood Selection: To select the neighborhoods for this study we undertook a nationwide analysis of census tracts using the 2000 SF-1 data set. From this, we identified areas in which there were high concentrations of APAs. Since we were interested in the most significant groups of poor APAs, we restricted our study to metropolitan statistical areas (MSAs) with at least 20,000 APAs. Among these MSAs, we looked for at least four census tracts with APAs making up at least 25% of their populations. Next, we used 1998 IRS income data aggregated to zip codes to identify areas where there was a high proportion of people either claiming the earned income tax credit, or earning less than $10,000 in 1998. The results of this process are shown in Table 1.1.

Table 1.1 Tract Concentrations of APAs in Metropolitan Statistical Areas (MSA)

MSA Name	Total MSA Tracts	Total APA Population	MSA Percent APA	No. Tracts 25%-50% APA	No. Tracts 50%-100% APA	No. Tracts APA Low Inc.	Total APA Pop Low Inc. Tracts
Large MSAs							
Los Angeles - Long Beach, CA	2,054	1,282,786	13	230	78	235	466,883
New York, NY	2,515	956,185	10	241	51	228	355,010
Honolulu, HI	217	644,817	74	11	183	86	268,950
Orange County, CA	577	436,333	15	71	15	57	120,134
Sacramento, CA	366	184,899	11	43	0	27	47,068
San Francisco, CA	382	441,070	25	96	53	23	45,459
Small / Medium MSAs							
Chicago, IL	1,877	429,517	5	30	8	30	43,463
Houston, TX	780	244,772	6	22	0	19	42,481
San Diego, CA	605	314,709	11	55	8	26	41,900
Oakland, CA	489	467,018	20	100	22	26	40,576
Seattle-Bellevue-Everett, WA	527	278,906	12	23	6	17	36,231
Stockton-Lodi, CA	121	79,685	14	16	1	16	32,815
San Jose, CA	341	470,622	28	112	43	16	30,525
Jersey City, NJ	158	63,514	10	16	1	13	17,932
Minneapolis-St.Paul, MN-WI	746	141,365	5	15	1	14	17,215
Philadelphia, PA-NJ	1,330	196,124	4	9	3	11	15,119
Middlesex-Somerset-Hunterdon, NJ	265	140,113	12	27	3	8	14,796
Boston, MA-NH	702	186,912	5	8	2	5	10,206
Lowell, MA-NH	65	24,999	8	6	1	7	9,956
Fresno, CA	177	77,889	8	4	0	4	7,680
Yolo, CA	37	20,466	12	4	0	4	6,655
Ann Arbor, CA	170	24,859	4	4	0	4	4,502

Note: Includes MSAs with over 20,000 APAs and at least 4 Tracts over 24% APA.

From the list in Table 1.1, we automatically chose the six MSAs with the largest populations of APAs, which we designated "large" MSAs. From the remaining sixteen MSAs, we chose an additional five "small and medium" areas to incorporate based on the input of our academic and community advisory committee (see Appendix A). These additional five MSAs were selected to provide geographic and ethnic diversity. The selected MSAs are also regions with a significant number of APA-owned businesses, as seen in Table 1.2. The MSAs included Chicago, Houston, Seattle, Stockton, Minneapolis, and Lowell. Houston was subsequently excluded because it did not contain a neighborhood that met all of our selection criteria. Houston was replaced by New Orleans. Given the unique position of Native Hawaiians and other Pacific Islanders, we chose study areas in Hawaii based on consultation with Hawaiian activists and experts, and with representatives from the Department of Native Hawaiian Homelands. Comments made at the 2002 National CAPACD conference were used to select the Samoan area in San Francisco.

Table 1.2 APA-Owned Businesses (1997)

	Firms Total	Sales ($1000) Total	Jobs Total	Firms per 100 APAs	Sales ($1000) Per 100 APAs	Jobs per 100 APAs
Chicago, IL	32,733	13,244,106	67,868	9.5	38	19.6
Los Angeles-Long Beach, CA	114,462	55,113,170	309,469	10.4	50	28.1
Lowell, MA-NH	653	195,382	N.A.	3.2	10	N.A.
Minneapolis-St. Paul, MN-WI	4,661	1,576,802	14,176	4.4	15	13.3
New Orleans, LA	3,210	701,788	5,331	12.0	26	19.9
Orange County, CA	44,840	14,888,741	135,466	12.7	42	38.5
Sacramento, CA	10,409	1,503,746	9,346	7.5	11	6.8
San Francisco, CA	35,427	12,456,194	123,354	9.2	33	32.2
Seattle-Bellevue-Everett, WA	16,625	5,945,585	31,759	8.0	29	15.3
Stockton-Lodi, CA	2,577	664,499	15,410	4.0	10	24.0

Within MSAs, we narrowed our selection down to a few neighborhoods. Some of these areas were obvious, such as the Chinatowns in New York and San Francisco. Others were more subjective and were selected in an attempt to represent a diversity of ethnic groups. The selection process was iterative, with refinements being made as we obtained successive information from census and other data sets. Throughout the selection process, we consulted with the academic and community advisory committee to refine the selection of neighborhood boundaries. This selection of illustrative neighborhoods is in no way an exhaustive study of all poor APA neighborhoods in the United States.

One problem in defining neighborhoods relates to reliance upon census boundaries. Frequently, the neighborhood boundaries used by community residents and community-based organizations do not match census-defined boundaries. In addition, neighborhoods are subject to constant change and redefinition as their compositions change, and as they are subject to external pressures. In many cases, it is impossible to even reach a community consensus on boundaries. Sometimes, the boundaries are predetermined by non-APA ethnic groups that were the previous residents, or by the designations imposed by local government agencies. For all of these reasons, the territory of the neighborhoods presented in this report should be considered approximate.

One final issue associated with neighborhood boundaries stems from changes in census boundaries between 1990 and 2000. This problem tends to affect established central city areas less than other areas, and generally results in only minor differences. However, in two cases (Stockton, Filipino area and San Francisco, Samoan area) the differences were considerable and preclude comparison between the two years.

For each identified neighborhood, we produced a number of comparison statistics including total population, major racial breakdowns, population density, employment density, housing ownership, poverty rates, commuting patterns, nativity, educational attainment, average hourly wages, and linguistic isolation. Wherever possible, these statistics were produced for both 1990 and 2000. Unfortunately, production of these statistics was complicated by the release schedule of 2000 census data. Many variables (e.g., earnings, linguistic isolation) are not available on the census releases to date; in such cases we rely on 1990 data. A technical supplement has also been prepared that contains maps and basic statistics for each of the neighborhoods. The following sections present a comparison of the neighborhoods. Asian enclaves are first presented, followed by a section on the two Hawaiian areas and the Samoan neighborhood.

PART II: ASIAN NEIGHBORHOOD PROFILES

Demographic Composition: The study neighborhoods vary considerably in both overall population, as well as APA population. The largest overall neighborhoods are Los Angeles' Koreatown (108,240 – total, all races) and the Jackson Heights area of Queens in New York (76,825 – total, all races). The smallest neighborhood in the study was the Seattle study area (6,260 – total, all races). In terms of APA population, New York's Chinatown is clearly the largest with almost 50,000 documented APAs, compared with only about 3,000 APAs in the Cambodian study area in Stockton. In some cases APA residents constitute the majority of the population (in New York's Chinatown 74% of residents were APAs). However, in most of the neighborhoods, APAs constituted less than half of the population. Often, APAs lived with other minorities, but in many cases, APAs were also living with a substantial white population (See Table 2.3).

Figure 2.1 Neighborhood Size, All Races

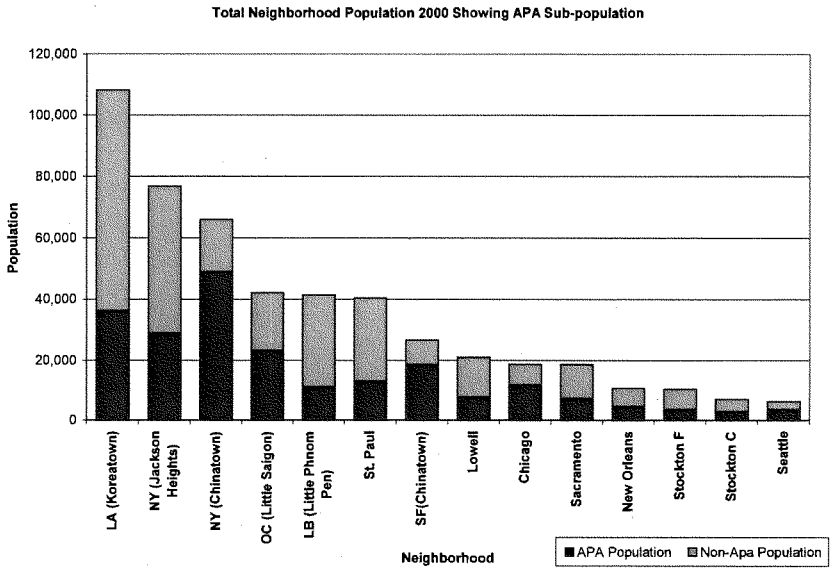


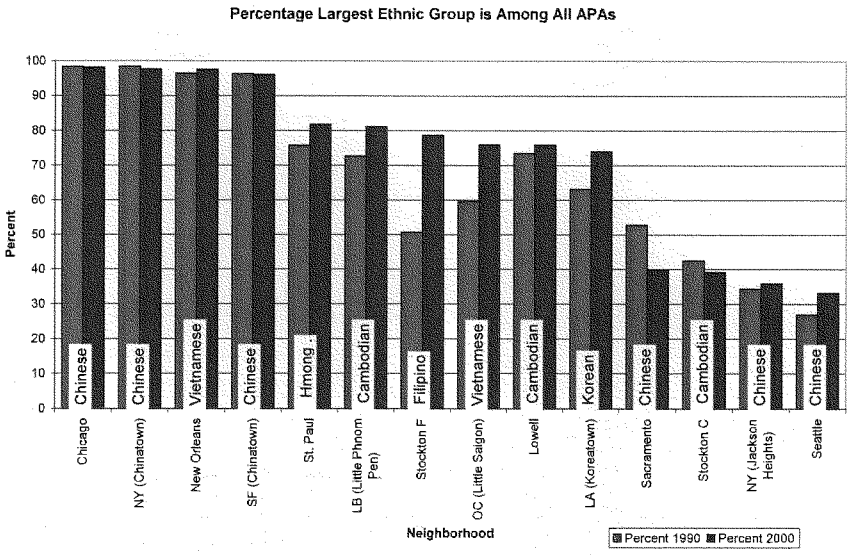
Table 2.1 Major Racial Breakdowns

		Population	APA%	Black%	Latino%	N.H. White%	Other%
Chicago	1990	16,041	52	3	11	33	<1
	2000	18,751	64	2	10	23	1
Long Beach	1990	43,513	30	18	37	14	1
(Little Phnom Pen)	2000	41,416	27	14	51	5	3
Los Angeles	1990	97,905	32	9	44	14	1
(Koreatown)	2000	108,240	34	6	50	9	2
Lowell	1990	20,196	21	3	10	65	<1
	2000	20,961	37	4	12	43	3
New Orleans	1990	10,607	44	45	1	9	<1
	2000	10,699	44	51	1	3	1
New York City	1990	62,895	70	6	12	11	<1
(Chinatown)	2000	66,053	74	5	11	9	1
New York City	1990	62,470	40	4	39	17	1
(Jackson Heights)	2000	76,825	38	2	48	8	4
Orange County	1990	35,914	35	1	18	45	1
(Little Saigon)	2000	42,092	55	1	21	21	2
Sacramento	1990	16,566	33	18	16	32	2
	2000	18,739	39	14	22	20	5
Saint Paul	1990	35,064	22	12	4	59	3
	2000	40,470	33	20	10	34	4
San Francisco	1990	27,517	75	1	1	22	<1
(Chinatown)	2000	26,710	70	1	2	26	1
Seattle	1990	6,251	46	33	3	15	3
	2000	6,260	59	23	5	8	4
Stockton	1990	7,046	52	9	11	28	<1
(Cambodian)	2000	7,001	43	15	19	20	2
Stockton	1990	4,348	50	17	27	4	1
(Filipino)*	2000	10,386	36	18	32	11	4

*Boundaries for the Stockton Filipino area changed dramatically between 1990 and 2000 – statistics are not comparable across years.

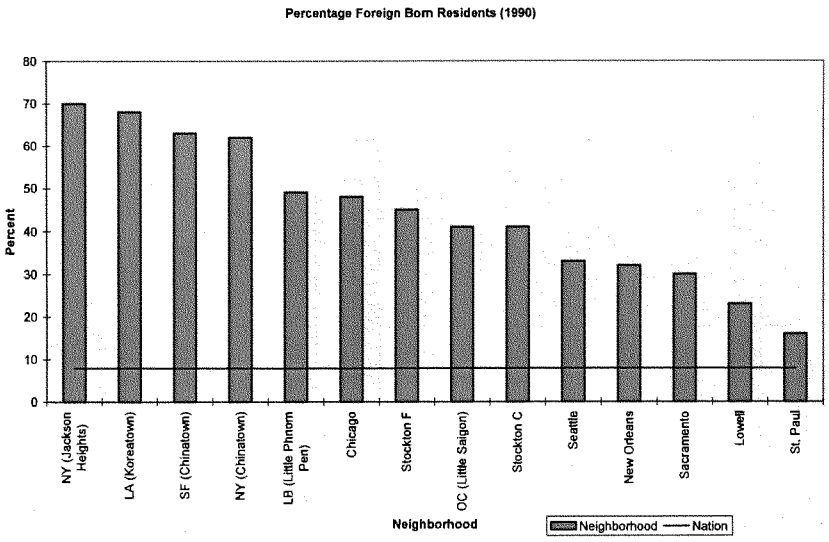
Within most neighborhoods, a single APA ethnic group constituted over half of all APAs living there. In four neighborhoods, a single ethnic group was responsible for almost 100% of all the APAs. In the ten years between 1990 and 2000, most of the neighborhoods saw an increase in the proportion of the most common ethnic group (Figure 2.2). Although, this seems to simply imply that most ethnic neighborhoods are becoming mono-ethnic, the situation is probably more complex. For example, in the Seattle neighborhood, the second most common ethnic group switched from Filipinos to Vietnamese, with the increase in Vietnamese population happening at a rate much higher than the increase in Chinese population. Even in cases like New York's Chinatown, where Chinese are almost 100% of all APAs, the apparent stability between censuses might mask a change in the regional origins of recent immigrants.

Figure 2.2 Ethnic Diversity



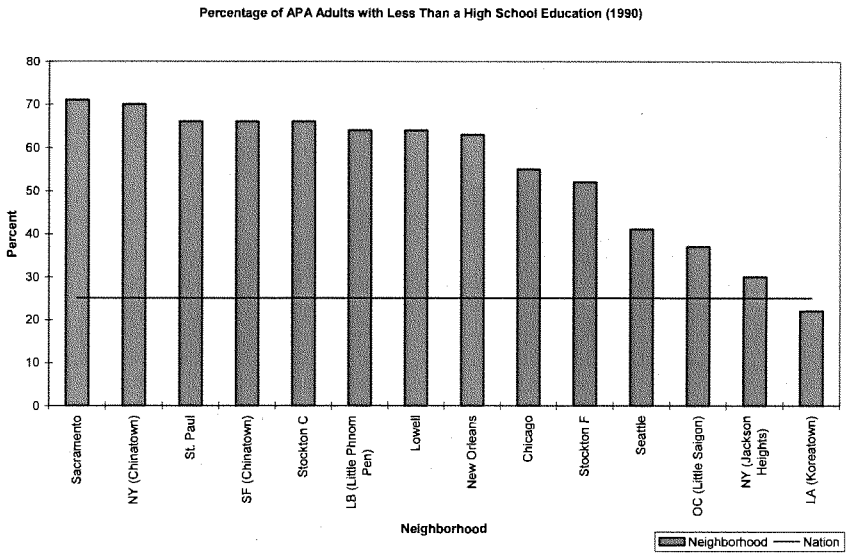
Salient Characteristics: All of the study areas have rates of foreign birth considerably higher than the national average. It is important to stress that these low-income APA communities are made up of substantial numbers of recent immigrants. Figure 2.3 compares the neighborhood rates of foreign birth against the national average. In many of these neighborhoods, the rate of foreign birth among only APAs is probably much higher than the figure shown, since these statistics represent all neighborhood residents.

Figure 2.3 Foreign Birth, All Races



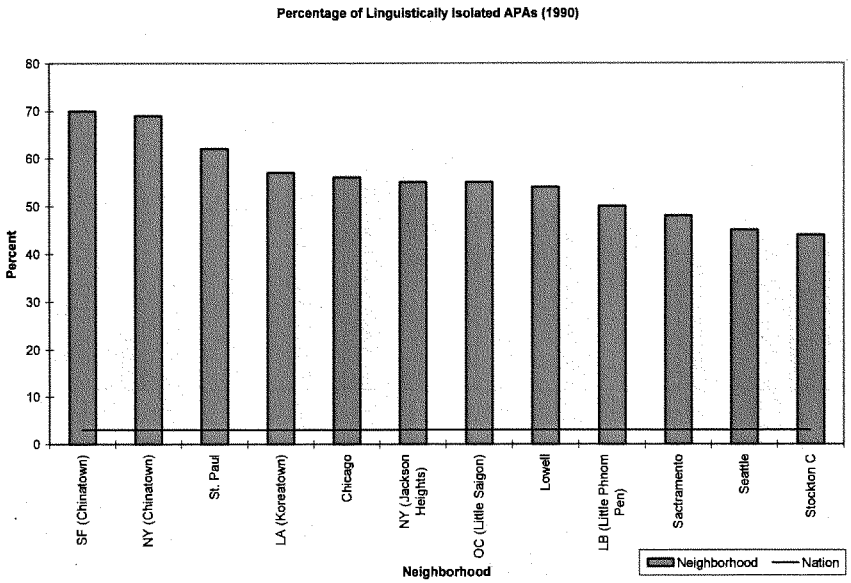
The largely immigrant populations have barriers to economic advancement due to deficiencies in marketable job skills and poor language skills. Using high school education as a proxy for job skills, Figure 2.4 shows that, out of our study areas, only Los Angeles' Koreatown has an APA high school completion rate matching the national average. For an overwhelming majority of the neighborhoods, the percent without a high school education is two to threee times higher than the national average.

Figure 2.4 APAs with less than High School Education.



Along with an educational deficit, many have an English language deficiency, not uncommon in immigrant communities. Linguistic isolation (i.e., the inability to communicate in English) implies a greater reliance on jobs within the ethnic community where language does not represent a barrier to work. The rate of linguistic isolation among APAs is well above the national rate of linguistic isolation for all races in all of our Asian study areas (Figure 2.5).

Figure 2.5 APA Linguistic Isolation



Economic Status of Residents: Employment rates in some neighborhoods are quite high, though in others the employment rate among APAs is well below the national average among all races. Figure 2.6 shows employment rates for 1990 for all of the Asian study areas. The lowest rates of employment are in neighborhoods with high percentages of Southeast Asians. Unfortunately, even in neighborhoods with high employment rates, the hourly wage earned by workers is often very low, even controlling for regional differences in pay rates. Figure 2.7 shows a comparison of neighborhood average wages as a percentage of regional hourly wages (based on 1990 census data for all races). New York City's Chinatown is by far the worst, with hourly wages only 50% of the regional average. Low employment rates and wages translate into high poverty rates. Figure 2.8 shows the 1989 poverty rates (from the 1990 census) relative to the national rate. Six of the Asian neighborhoods had rates that were at least three times higher. All of the others had rates noticeably higher than the national average.

Figure 2.6 Employment Rate Among APAs (1990)

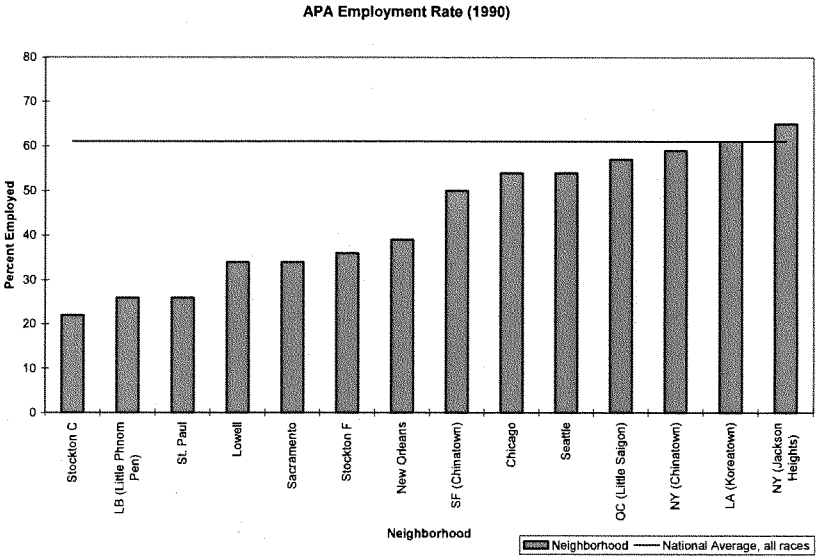


Figure 2.7 Hourly Wages, All Races (1990)

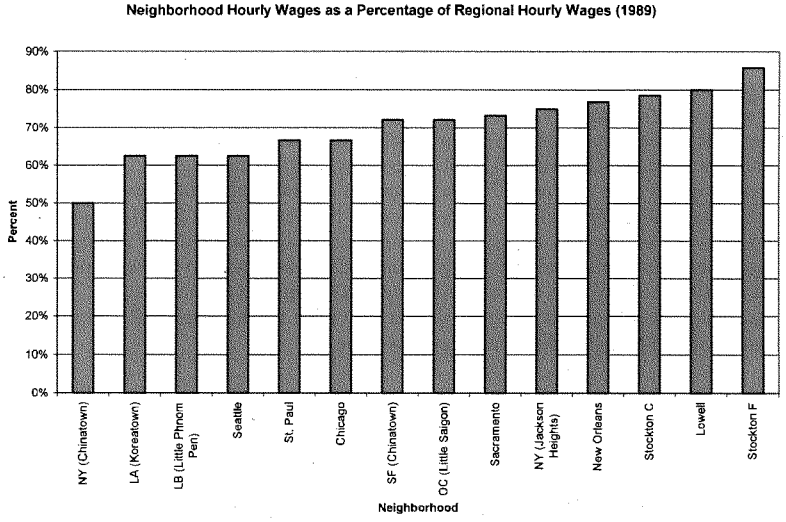
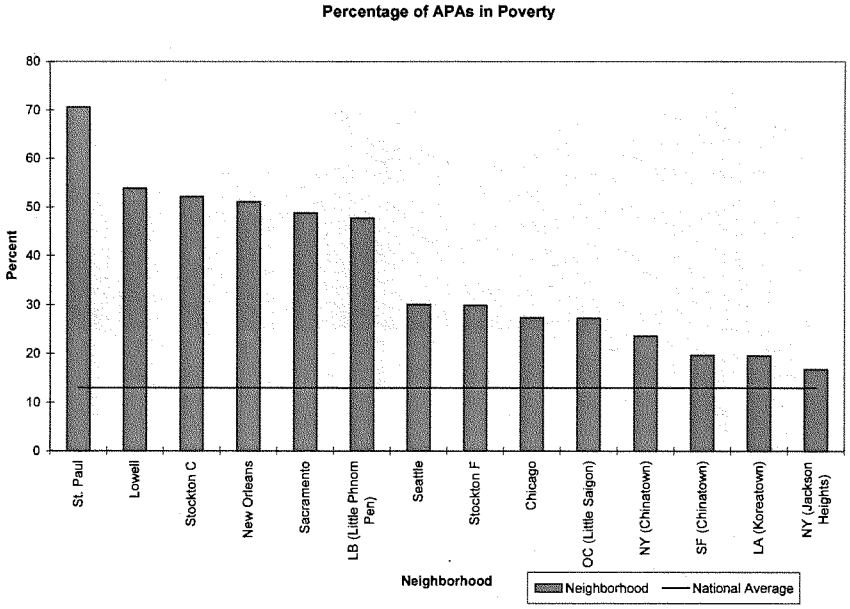


Figure 2.8 APAs in Poverty (1989)



Because of the low economic status of the vast majority of neighborhood residents, most are renters. This means that the residents have few assets in the form of home equity. Despite low incomes, most of the Asian neighborhoods have few subsidized housing units as shown in Figure 2.10.

Figure 2.9 APAs in Rental Housing

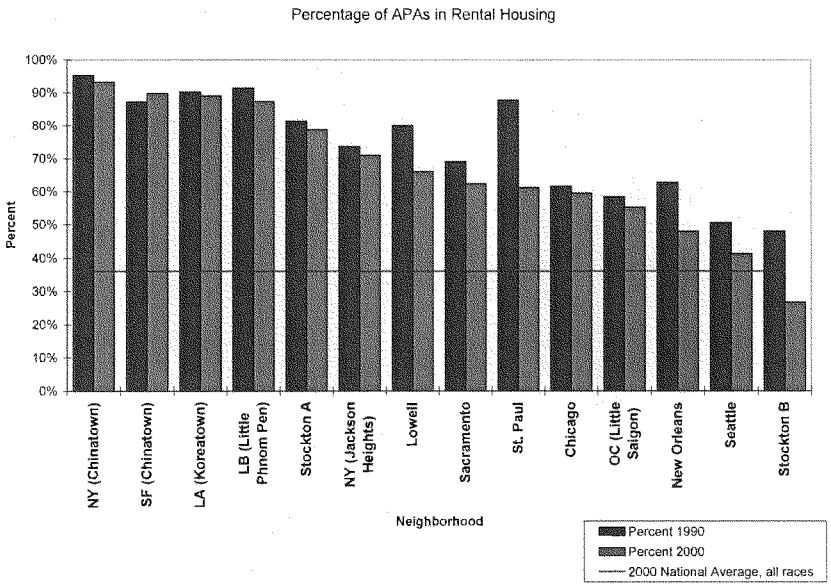
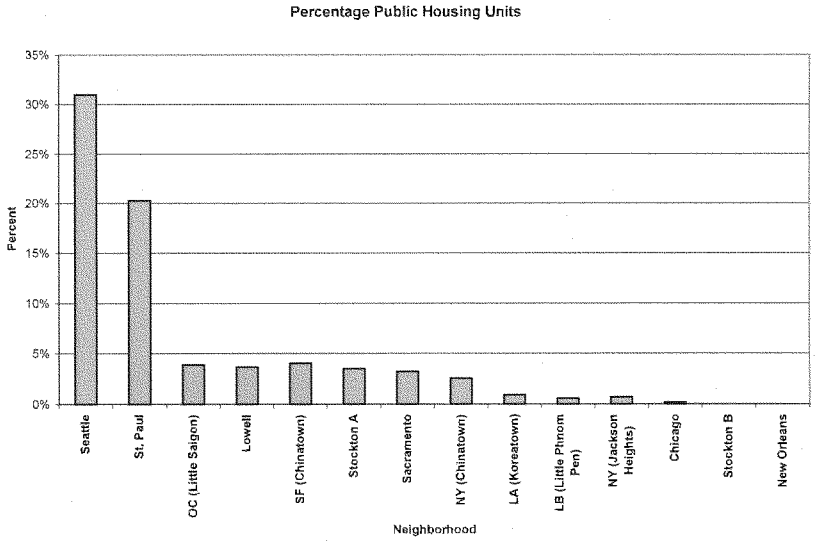
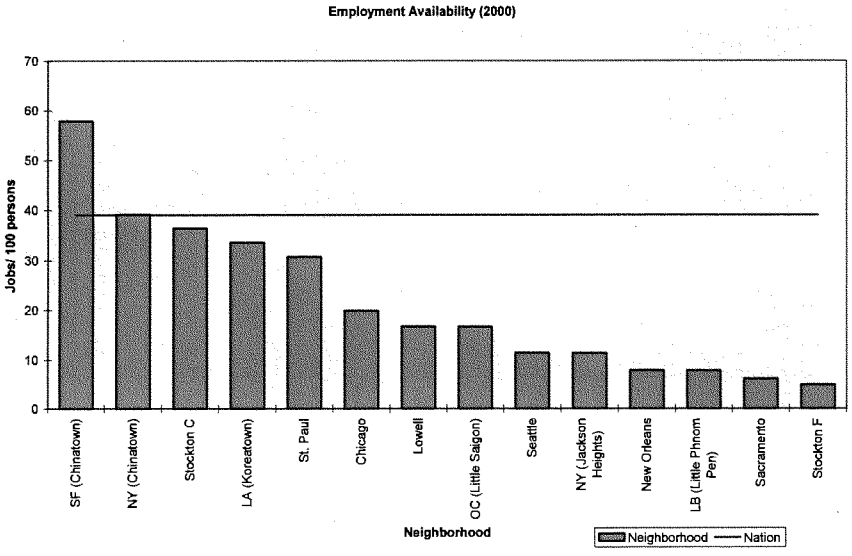


Figure 2.10 Percentage of All Housing Units Either Public Housing or Receiving Section 8 Support



Economic Base: Asian enclaves are often depicted as having a vibrant ethnic economy, and while that is true for some, it is not an accurate depiction for most. Figure 2.11 displays the number of private sector jobs per 100 residents in the neighborhoods. Relative to the national average (jobs/100 persons), only San Francisco's Chinatown has a higher ratio, indicating that it is a relatively job rich area. New York's Chinatown has a job ratio equal to the national average, and the enclave's ratio is probably higher after adjusting for the number of unreported jobs in the informal sector. While jobs are available in these two neighborhoods, many of the jobs, particularly in Asian-owned businesses, are concentrated in the low-wage sector (restaurants, small retailing, garment assembly). The next three neighborhoods (Stockton Cambodian study area, Los Angeles Koreatown, and St. Paul) have a ratio close to the national average. If one factors in possible informal jobs in the Asian neighborhoods, these neighborhoods exhibit what some call a jobs-housing balance — that is the relative number of jobs is roughly proportional to the number of workers. However, as we will see later, the picture is far more complex. The remaining nine neighborhoods are distinctly job poor, with ratios considerably lower than the national average.

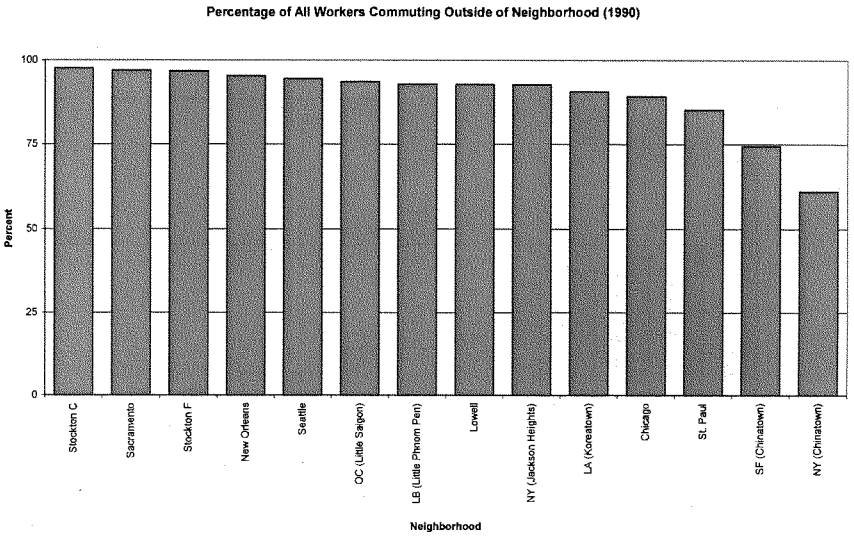
Figure 2.11 Neighborhood Job Density



Although some neighborhoods support employment within the ethnic community and within the neighborhood, census commuting data indicate that most study-area residents commute out of their immediate neighborhoods in order to find work. In dense

urban areas this is less likely to be the case (e.g., New York), but even in these cases, the majority work outside their neighborhood. Jobs strictly within the enclaves are more likely to represent a higher share of low-wage jobs than in the region as a whole. Finding employment in the larger economy is also a common feature for neighborhoods with a so-called jobs-housing balance. In agricultural areas, almost 100% of neighborhood residents commute out of the immediate area to work (e.g., Stockton). These patterns clearly show that residents are not isolated in the enclave economy. Moreover, the neighborhood economy is not reliant solely on enclave workers. The majority of the jobs in these neighborhoods are held by those living outside of the neighborhood. The bottom line is that Asian neighborhoods are not self-contained, isolated subeconomies. Unfortunately, these enclaves do experience the myriad of economic problems cited earlier.

Figure 2.12 Commute Out of Neighborhood



PART III: NATIVE HAWAIIAN AND PACIFIC ISLANDER PROFILES

Pacific Islanders represent a special subset of the APAs profiled in this study. On the mainland, there are few communities of Pacific Islanders of sufficient size to be included in our list of study areas. However, major portions of the state of Hawaii are occupied by Native Hawaiians and, to a large extent, other Pacific Islander and Asian groups. To better understand poverty among Pacific Islanders, we selected two study areas in Hawaii and one study area in San Francisco. Large fractions of the Hawaiian study areas are Native Hawaiian Homelands.

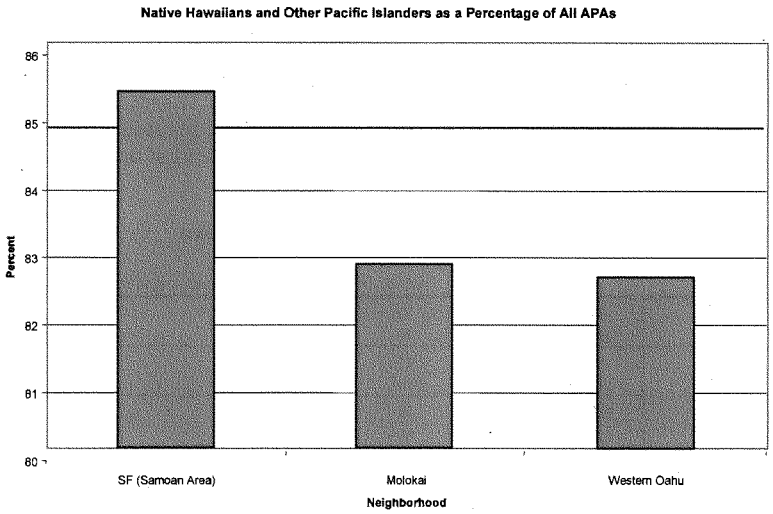
Table 3.1 Major Racial Breakdowns, Hawaii and San Francisco

		Population	APA%	Black%	Latino%	N.H. White%	Other%
Western Oahu	1990	29203	75	2	6	17	1
	2000	34030	70	1	7	8	15
Molokai	1990	6717	81	<1	2	17	1
	2000	7404	74	<1	3	14	10
San Francisco	1990	8383	12	80	4	3	1
(Samoan Area)*	2000	4649	16	74	4	2	3

*Boundaries for the San Francisco Samoan area changed dramatically between 1990 and 2000 – statistics are not comparable across years.

Demographic Composition: Our Hawaiian and Pacific Islander study areas range in size between the Western Oahu study area (34,030 total population, all races) and the San Francisco Samoan area (4,649 total population, all races). Although the geographic area covered by the San Francisco Samoan area is comparable with many of the Asian neighborhoods, both of the Hawaiian study areas are much larger, in the case of Molokai, by two orders of magnitude. The Samoan study area covers only about one square mile, compared with 42 square miles on Oahu, and 280 square miles on Molokai. In both of the Hawaiian study areas, APAs constitute the majority, while in the San Francisco area, APAs are only about 16% of the population. All three areas contain a high proportion of Native Hawaiians and Pacific Islanders when compared with all APAs living within the study area (Figure 3.1). Both Hawaiian sites contain several Native Hawaiian Homelands, areas held in trust by the state of Hawaii. Roughly a third of the Native Hawaiians in the two study areas reside in Native Hawaiian Homelands.

Figure 3.1 APA Ethnic Diversity in Hawaiian/Pacific Islander Study Areas.



Salient Characteristics: The two Hawaiian study areas and the San Francisco Samoan area differ from the Asian neighborhoods that we profiled in several significant ways. Unlike the Asian neighborhoods, the proportion of foreign-born residents is lower than in the region as a whole and is in line with the national average for all races (about 8%). This is not surprising, given that Native Hawaiians and other Pacific Islanders are indigenous populations to the State of Hawaii and the American Samoan territory. In Hawaii, persons of Asian descent are more likely to have been in the United States for several generations due to historical migration of Asian agricultural workers (chiefly Filipino) in the early 20th century.

Figure 3.2 APAs with less than a High School Education, Hawaiian/Pacific Islander Study Areas

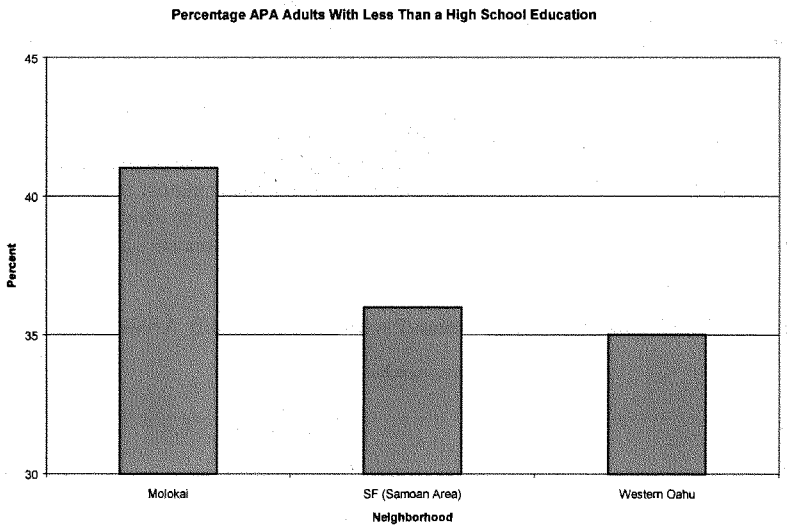
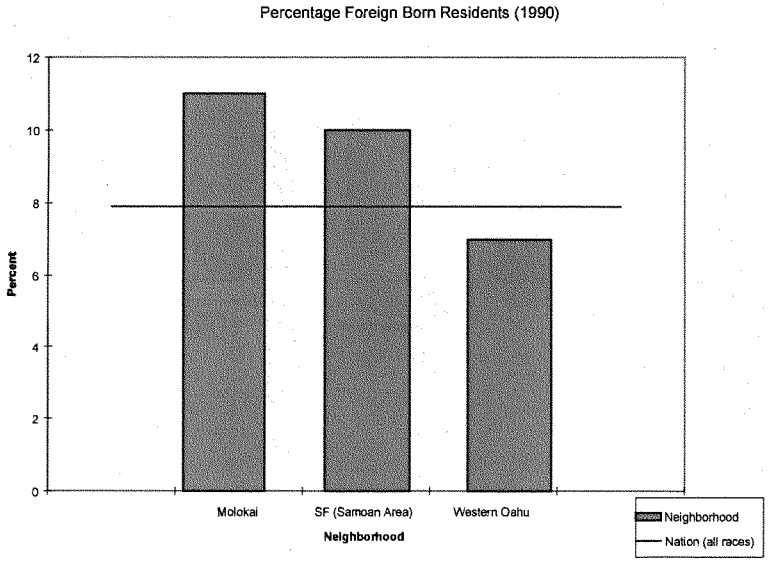


Figure 3.3 Foreign Birth, All Races, Hawaiian/Pacific Islander Study Areas



Educational attainment is, as in the Asian study areas, lower than for the general population. Linguistic isolation rates are lower for the core study areas than for the surrounding regions, and only slightly higher than the national average. Housing among APAs is relatively more likely to be owned by residents than by the population as a whole.

Economic Status of Residents: The employment rates in the two Hawaiian study areas are close to the national average for all races, with the rate on Molokai matching the average, and the rate in the Oahu study area falling slightly below the national average. However, in the San Francisco study area, the employment rate is almost 20% below the national rate. Hourly wages in the two Hawaiian study areas are both about 79% of the regional average, while the wages in the San Francisco Samoan area are only about 67% of the regional average.

Figure 3.4 Employment Rates, Hawaiian/Pacific Islander Study Areas

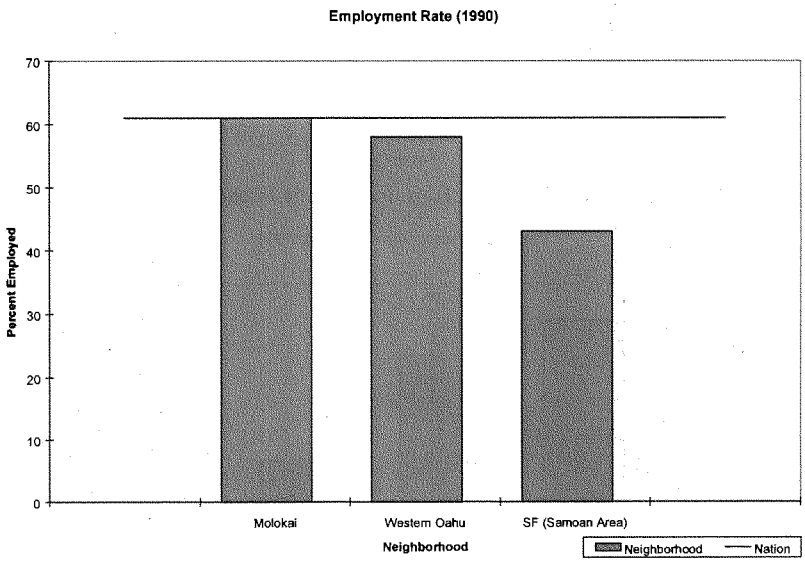


Figure 3.5 Hourly Wages, All Races (1989)

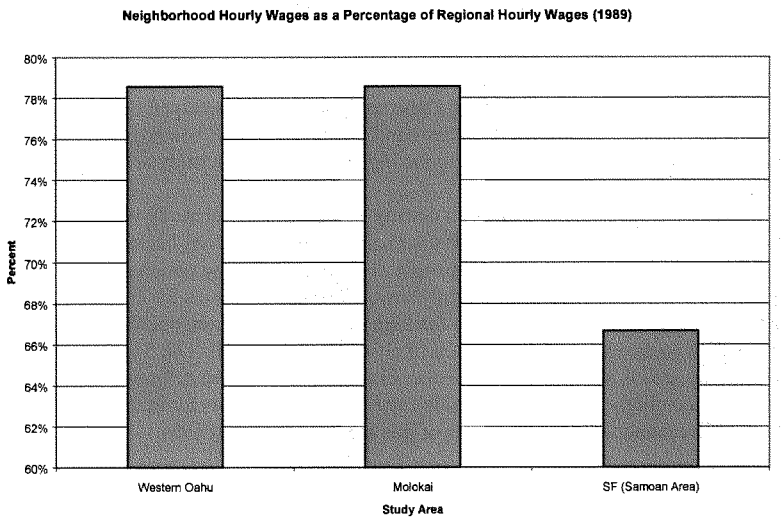
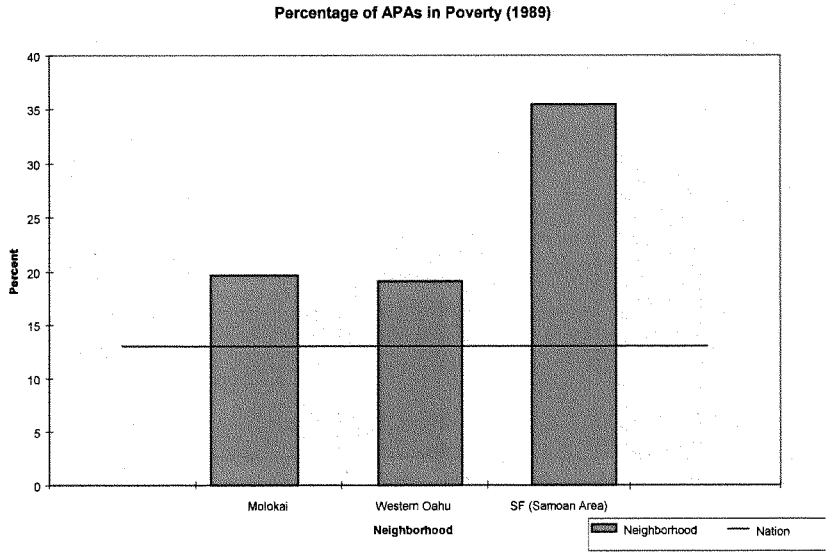


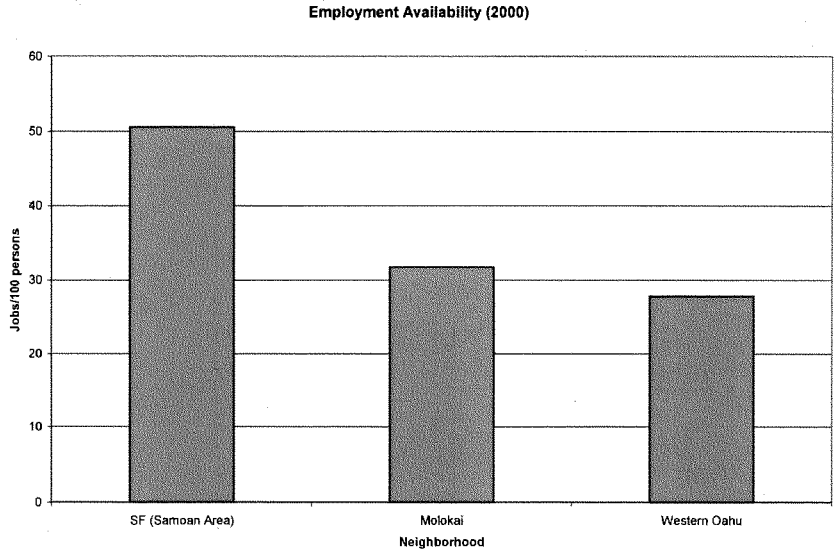
Figure 3.6 APAs in Poverty, Hawaiian/Pacific Islander Study Areas (1989)



Housing in the Hawaiian study areas is much more likely to be owned than rented, which sets these areas apart from most of the other neighborhoods included in this study (Molokai only 34% rent, Oahu 33% rent). In part, this can be traced to the large areas designated as Hawaiian Homelands, which is in effect a program to encourage housing ownership among Native Hawaiians. Nevertheless, 1% of the housing units on Molokai and 9% of housing units in the Oahu study area either received Section 8 funds or were public housing units. On the other hand, the rate of rental housing in the Samoan neighborhood in San Francisco is among the highest of all of our study areas at 89%.

Economic Base: The lowest job density of any area in our study was found on Molokai, which averages less than 4 jobs per square mile. However, because residential density is also low, the ratio of jobs to people is comparable to the national average for this area, with the Oahu study area slightly lower. The opportunities for employment within these study areas compares with the high group of Asian neighborhoods. In these two Hawaiian areas, many of the jobs are likely to be agricultural. The San Francisco Samoan study area is second only to the San Francisco Chinatown neighborhood. In spite of this seemingly high job availability, the low employment rate in this area suggests a disconnect between residents of this area and the ready jobs.

Figure 3.7 Study Area Job Density, Hawaiian/Pacific Islander Study Areas



PART IV: CBO PERCEPTIONS OF PROBLEMS AND PRIORITIES

Introduction: Because the statistical neighborhood profiles presented in the previous sections rely on the limited available data collected by the census, we supplement the analysis with an organizational survey of Community Based Organizations (CBOs). The intent of the survey is to tap grassroots knowledge of the nature of economic problems, community priorities and economic development challenges and strategies in various neighborhoods throughout the nation. The survey targets the directors and practitioners of APA CBOs engaged in economic development activities in distressed APA neighborhoods. The survey instrument was developed by staff at UCLA's Ralph and Goldy Lewis Center for Regional Policy Studies in collaboration with the National CAPACD, and reviewed and approved by UCLA's Institutional Review Board (IRB) for compliance with human-subject protections.

The survey analysis is based on a series of closed-ended questions focused on three general areas: the severity of problems in APA neighborhoods, the programmatic and strategic priorities of the CBO, and the primary barriers and challenges to community economic development. Appendix B includes the questions analyzed for this report.

The first group of questions gathers information on the CBOs' perceptions of the severity of neighborhood problems, with a particular focus on employment and housing. Each question in this section included eight to fourteen problems or barriers and respondents were asked to rank the relative severity of each (Very Severe, Moderately Severe, Not Severe, and Don't know). The three questions in this section include:

1. Please rate the severity of the following problems in the neighborhoods your organization serves (e.g., joblessness, under-employment, lack of childcare).
2. Please rate the severity of the following barriers to employment in the neighborhood served by your organization (e.g., low education, lack of English proficiency, lack of experience).
3. Please rate the severity of the following housing problems in the neighborhoods your organization serves (e.g., housing discrimination, lack of affordable housing).

The second group of questions is used to determine the CBOs' economic and community development priorities. Rather than asking respondents for their subjective judgment about the level of priority or for an ordinal ranking, we designed a unique method to quantify priorities. We placed a dollar value on the responses by asking the respondents to allocate funds by programmatic areas and strategic approaches. Moreover, we asked respondents to make the allocations relative to community needs rather than the needs of their organization, an approach we believe will minimizes biases due to self interest. The two questions are:

1. If you were awarded a $5 million grant to improve the quality of life for your entire neighborhood, how would you allocate the dollars by program area?
2. If you were awarded a $5 million grant, how would you allocate the dollars by community development strategy?

The first question includes fifteen items (e.g., provide job training, provide affordable childcare) and an "other" category. Respondents were asked what percent of the $5 million they would allocate to each programmatic area. The second question includes five strategic approaches (direct services, advocacy/planning, grassroots organizing, organizational capacity building, and other), and the respondents were asked what percent of the $5 million they would allocate to each strategic approach area.

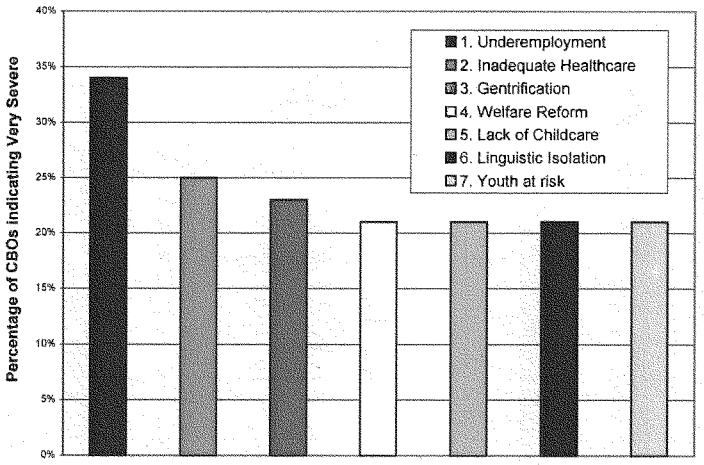
The final group of questions is used to examine the challenges facing CBOs pursuing economic and community development priorities. The first question focuses on factors external to the organization and includes twelve items (e.g., inadequate funding/resources). The second question focuses on factors internal to the organization and includes nine items (e.g., staff training needs). The respondents were asked to check all that apply.

1. What are your greatest external barriers/challenges to the provision of economic development activities?
2. What are your greatest internal barriers/challenges to the provision of community economic development activities?

The survey was sent by mail. The sample frame was drawn from membership lists maintained by National CAPACD and directors from other national APA organizations. The sample included organizations engaged in community development, economic development, work force development, and business development. A total of 312 surveys were sent; three were returned because the organizations no longer exist or moved without forwarding addresses. As of June 19, 2002, 60 completed surveys were returned.

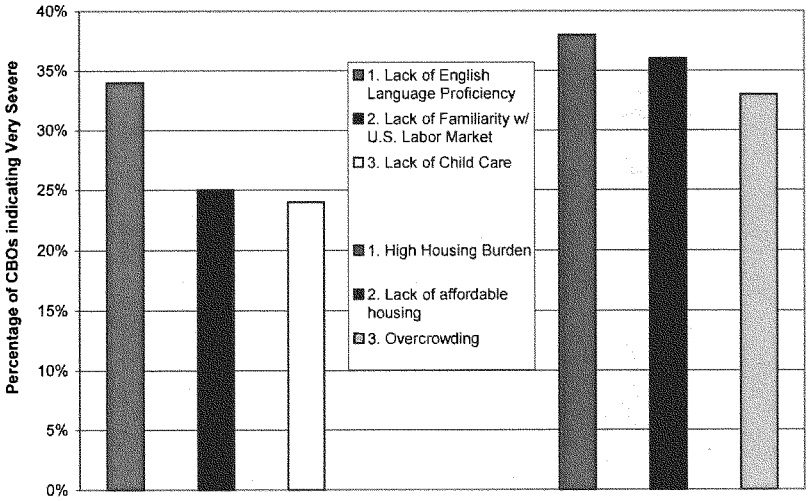
Severity of Problems: Figure 4.1 lists the seven neighborhood problems most frequently cited as being "very severe." The figure presents the percentage of CBOs indicating that the problems are "very severe." The top problem is "underemployment," which includes low wages, part-time and contingent employment, and limited benefits. Interestingly, relatively few respondents indicated that "joblessness" or a "lack of nearby jobs" is a severe problem. These responses are consistent with the results of the neighborhood profiles, which indicated that jobs are available within or nearby many APA neighborhoods. The responses from the CBOs indicate that the jobs held by residents are less than desirable. The second ranked neighborhood problem is a "lack of access to quality health care." This is likely related to a lack of employer-provided health insurance, but is probably also due to a paucity of linguistically and culturally competent health care.

Figure 4.1 Top Seven Neighborhood Problems



The third most cited problem is "Threats from gentrification pressures or major development projects." Many APA neighborhoods are located near central business districts and are not perceived as areas to be avoided. Their locations offer access to job centers, tourism, and other nearby facilities and services. Unfortunately, these same factors make these neighborhoods potentially attractive for outside investments. The fourth through seventh ranked problems received the same number of "very severe" responses: the impacts of welfare reform, linguistic isolation, a lack of childcare, and youth involvement in at-risk activities. Three of these items are related with family-oriented issues, indicating that community development should not only address economic concerns but also broader social concerns.

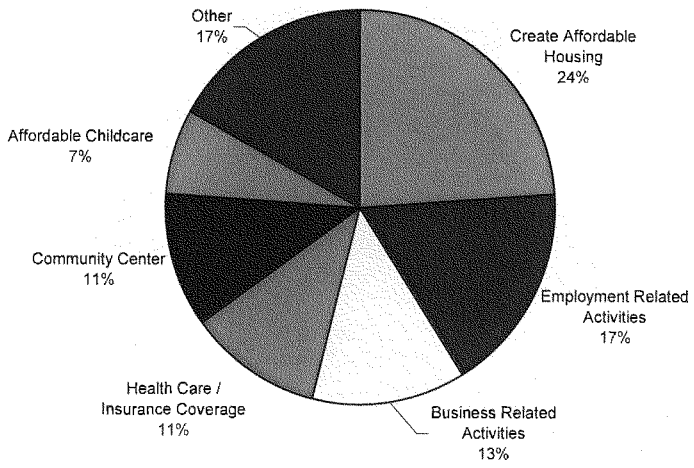
Figure 4.2 Top Employment and Housing Problems



The first set of bars in Figure 4.2 lists the three employment barriers most frequently cited as being "very severe." The top problem is a lack of English-language proficiency. This is consistent with the statistical analysis of census data, which shows that many of these neighborhoods are predominantly immigrant communities characterized by linguistic isolation. According to CBOs, the language barrier is by far the most daunting hurdle to meaningful employment. The second employment problem is a lack of familiarity with the U.S. labor market, and this is also associated with the immigrant characteristic of these communities. The third most cited employment barrier is a lack of child care. While the existence of extended families is often cited as one of the strengths of APA populations, the responses from the CBOs indicate that extended families are not an adequate substitute for formal childcare services.

The second set of bars in Figure 4.2 lists the three housing problems most frequently cited as being "very severe." The top two problems are closely related and rooted in the high cost of housing (relative to the economic means of neighborhood residents). The top problem is a high housing burden, which is defined as paying over a third of income for housing and utilities. This is correlated with a lack of affordable housing, which ranks second among the respondents. Not only is the housing burden high, but according to the CBOs much of the housing is overcrowded, defined as two or more persons per bedroom.

Figure 4.3: Programmatic Priorities



Programmatic and Strategic Priorities: Figure 4.3 depicts how the CBOs would allocate a $5 million grant by programmatic areas. The percentages reported are the mean value for that program area, and some items are collapsed to facilitate reporting. The greatest proportion of funds, nearly one-quarter, would be allocated to creating affordable housing. Only slight variations existed based on the CBOs perceptions of the severity of the housing problem. Those stating that a high housing burden and a lack of affordable housing are severe problems allocated a quarter of the grant, while those stating that neither a high housing burden nor a lack of affordable housing is a severe problem allocated about a fifth of the grant.

The CBOs allocated between a quarter and a third of the funds to two programmatic areas addressing economic conditions. On average, about one sixth of the funds would be allocated to programs designed to help workers increase wages, provide training and worker placement, and assist those required to transition from welfare to work. The CBOs stating that underemployment is a very severe problem in their neighborhood allocated slightly more than the remaining CBOs. But even the latter group allocated nearly an eighth of the grant to employment-related activities. Along with efforts to help workers, CBOs would also support programs to assist businesses in their neighborhoods. Approximately one-eighth of the grant would go to efforts that help businesses acquire capital and training. Slightly more than a tenth of the grant would go to building a community center and an equal amount would go to providing affordable health care and/or affordable health insurance. The balance of the grant (about a quarter of the total) is divided among various social and educational activities.

Figure 4.4 Strategic Priorities

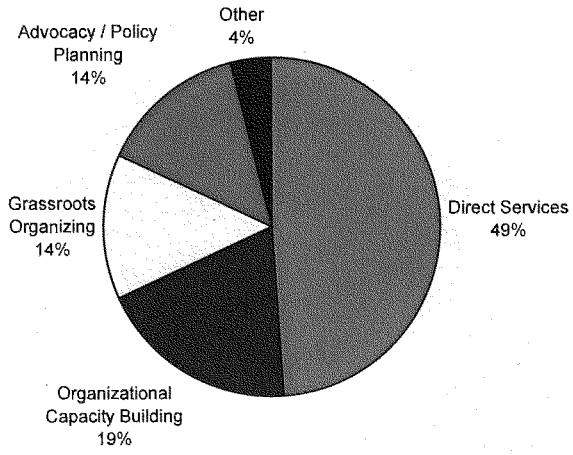
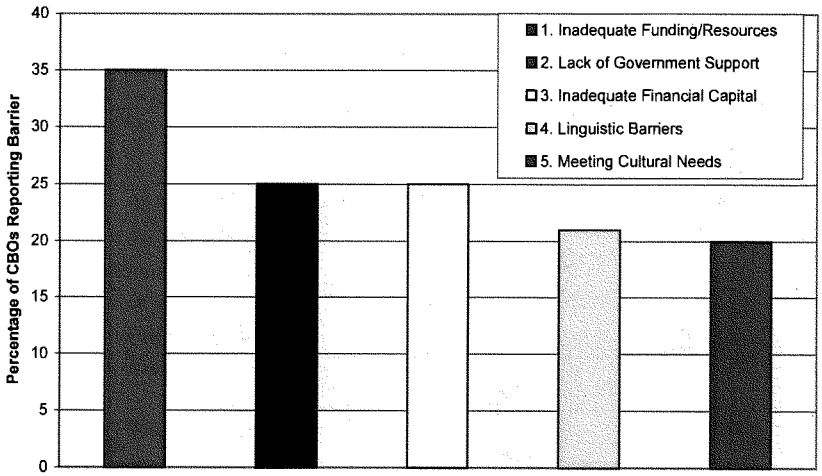


Figure 4.4 depicts how the CBOs would allocate a $5 million grant by strategic approaches. On the average, nearly half would go to funding direct services, such as employment training, housing, and commercial development. What is surprising is the allocation to strategies that would enhance the community capacity. Nearly a fifth of the funds would go to building organizational capacity. This suggests that there is a shortage of social capital that can be utilized to promote community and economic development. A part of this is directed to improving the delivery of direct services; however, the allocation to the other two areas indicates a strong desire to strengthen the community's ability to influence decisions in arenas outside the APA neighborhoods. Over a quarter of the funds would go equally to supporting grassroots organizing and to advocacy and policy planning. One interpretation of the emphasis on capacity building is that many of the CBOs feel that they can strategically serve their neighborhoods by shaping policies and increasing the community's share of external resources. While the survey does not provide any direct data to confirm this hypothesis, the interpretation is consistent with what CBOs perceive as major challenges and barriers to the provision of economic development, which is discussed below.

Figure 4.5 Top External Barriers/Challenges to CED

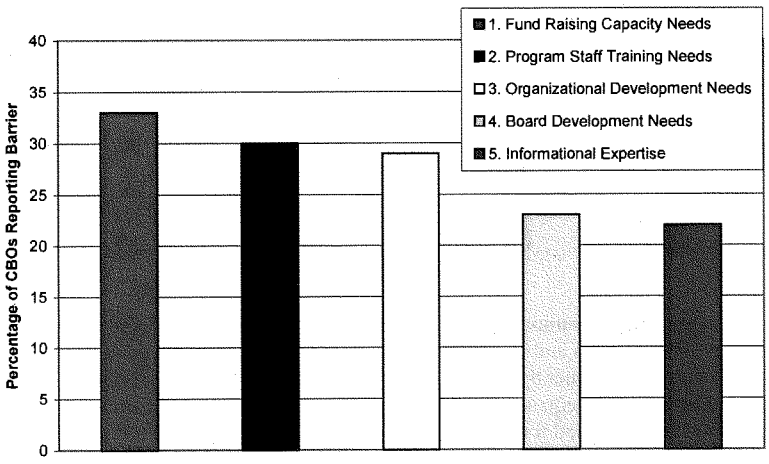


Community-Economic Development Challenges: Figure 4.5 depicts the five greatest external barriers and challenges to the provision of economic development activities. The most frequently cited barrier is inadequate funding and resources. Two-thirds of those with inadequate funding and resources also stated that they had inadequate capital, a problem that tied for second place as the most cited external barrier/challenge. The problem appears to be rooted in inadequate support from the public sector. Two-thirds of those with inadequate funding and resources stated that a lack of government support was a problem, which tied for second place as the most cited barrier/challenge. The fourth and fifth most cited external problems are closely related: the cultural and linguistic needs of diverse ethnic groups. Many CBOs operate in bilingual/bicultural and multilingual/multicultural environments. There is a significant but not perfect overlap in the responses to these two items, indicating that when the problems occur, they appear simultaneously in most but not all communities. Both problems are rooted in the large immigrant population in these neighborhoods; however, even Pacific Islanders who are indigenous populations face cultural and linguistic issues.

Figure 4.6 depicts the five greatest internal barriers and challenges to the provision of economic development activities. (Internal refers to factors within the organization.) The most frequently cited problem is inadequate fund-raising capacity. Not surprisingly, this problem is related to being underfunded. Nine out of ten with inadequate funding and resources have a need to improve their fund-raising capacity. The second most cited barrier or challenge is inadequate staff training. Many CBOs are unable to offer competitive wage and benefit packages, so it is difficult to recruit and retain staff with the desired expertise and experience. Moreover, even the highly

educated staff members require training to master the details of their profession and to stay current with ever-changing legislation, regulations, policies, and program requirements. The need for organizational development is a close third in the CBOs' ranking. There is a need to enhance the organizations' abilities to act strategically. This applies to both staff members and board members. A part of that development includes board development, which ranks fourth. The problem that ranked fifth is a need for informational expertise, a problem tied to inadequate technology. Two out of three with a need for informational expertise also have inadequate technology.

Figure 4.6 Top Internal Barriers/Challenges to CED



PART V: CONCLUSION:

The profiles of 17 poor APA neighborhoods reveal diverse neighborhood characteristics, including variations in economic base, size, and ethnic composition. In spite of substantial differences, some common features are seen. Most neighborhoods are linguistically isolated immigrant communities with low educational attainment, and low earnings. The responses from the CBO survey mirror the findings of the neighborhood profiles. Respondents suggested that language and cultural barriers are important barriers to employment. Underemployment is a larger problem than joblessness. Affordable housing is scarce in many areas.

The CBOs identified several programmatic and strategic priorities when asked to allocate funds to improve their neighborhoods. The top programmatic areas are the creation of affordable housing and allocations for employment related services. The CBOs allocate about half of the funds for direct services, and the rest to building community and organizational capacity. The CBOs also identified barriers to community economic development, which included inadequate external funding and governmental support. Internal barriers included inadequate fund-raising capacity and inadequate staff training.

The baseline statistics presented in this report represent a starting point for future policy-oriented research on disadvantaged Asian-Pacific Americans neighborhoods. Given that this report provides only baseline data for a few select neighborhoods, we see a crucial need for further research. In particular, we recommend the following:

1. Additional analysis based on upcoming census releases for 2000, especially the SF-3 and CTPP releases.
2. Requests for data and statistics from APA neighborhoods not in the study need to be accommodated. One option is to train CBO staff members so the organizations can perform their own analyses.
3. Additional data should be collected from CBOs, particularly those that did not participate in the CBO survey for this report.

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APPENDIX A: ADVISORY COMMITTEE MEMBERS

Community Advisory Committee:

- Paige Barber: President/CEO, Nanakuli Neighborhood Housing Services, Kailua, Hawai'i.
- Kerry Doi: President/CEO, Pacific Asian Consortium in Employment, Los Angeles, California.
- Lynette Jung Lee: Executive Director, East Bay Asian Local Development Corporation, Oakland, California.
- Ben Warnake: Acting Managing Director, Renaissance Loan Fund, New York, New York.

Academic Advisory Committee:

- Tarry Hum, Assistant Professor, Urban Studies, Queens College, New York.
- Davianna McGregor, Associate Professor, Ethnic Studies, University of Hawai'i, Manoa.
- Michael Omi, Associate Professor, Asian American & Ethnic Studies, University of California, Berkeley.
- Lois Takahashi, Associate Professor, Urban Planning, University of California, Los Angeles.

APPENDIX B: QUESTIONS FROM A/PI CBO SURVEY:

Severity of Problems:

Please rate the severity of the following problems in the neighborhoods your organization serves.

	Very Severe	Moderately Severe	Not Severe	Don't know
Joblessness				
Impacts of Welfare Reform				
Underemployment (low wages, part time/ contingent, limited benefits)				
Lack of access to quality healthcare				
Lack of access to quality K-12 education				
Lack of access to transportation				
Lack of nearby jobs				
Lack of childcare				
Struggling neighborhood business				
Linguistic Isolation				
Lack of community based orgs.				
Lack of culturally or linguistically competent services				
Youth involvement in at risk activities				
Threats from gentrification pressures or major development projects				

Please rate the severity of the following barriers to employment in the neighborhood served by your organization.

	Very Severe	Moderately Severe	Not Severe	Don't know
Lack of Employment experience				
Low Educational Attainment				
Lack of English Language Proficiency				
Lack of familiarity with the U.S. Labor Market				
Lack of access to job training & education for adults				
Lack of access to transportation				
Lack of nearby jobs				
Lack of child care				

Please rate the severity of the following housing problems in the neighborhoods your organization serves.

	Very Severe	Moderately Severe	Not Severe	Don't know
Housing discrimination				
Lack of decent affordable housing				
High housing burden – (over 1/3 of income for housing and utilities)				
Overcrowding (more than 2 people per bedroom)				
Substandard housing conditions				
Lack of elderly nursing homes or assisted living				
Lack of emergency housing or domestic violence shelters				
Lack of homebuyer assistance programs				
Predatory mortgage lending				

Programmatic and Strategic Priorities:

If you were awarded a 5 million-dollar grant to improve the quality of life for your entire neighborhood, how would you allocate the dollars by program area?

Program Area	**Allocation by %**		**Program Area**	**Allocation by %**
Create affordable housing			Increase Political participation	
Increase wages			Affordable Health care/insurance coverage	
Provide Job training			Provide affordable Childcare	
Create a Job Placement center			Improve public Transportation	
Provide Business development capital			Improve schools Education/GED training	
Provide Business training			Food insecurity	
Provide Technical/ Computer training			Improve Welfare to work programs	
Other(s) *Specify:*			Build a community center	

If you were awarded a 5 million-dollar grant, how would you allocate the dollars by community development strategy?

Community Development Strategy	**Allocation by %**
Direct Services (such as employment training, housing and commercial development).	
Advocacy/Policy planning	
Grassroots organizing	
Organizational Capacity Building	
Other(s) *Specify:*	

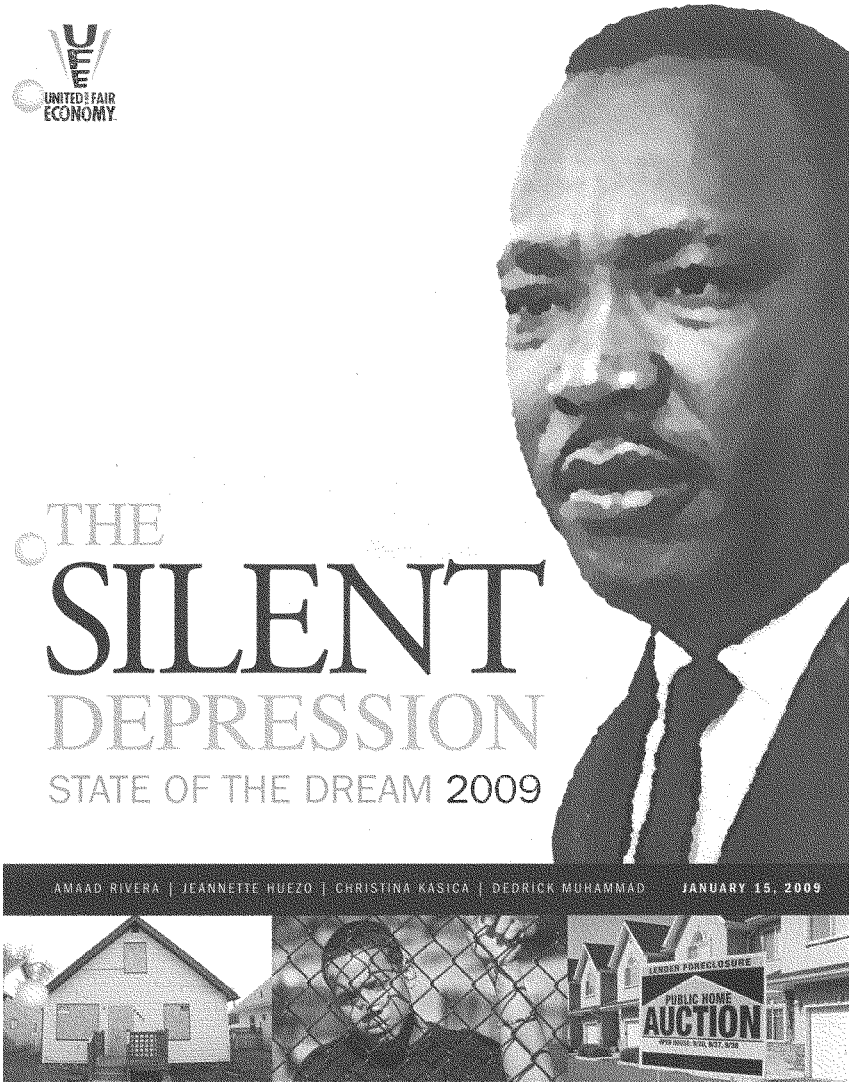
CED Challenges:

What are your greatest **external** barriers/challenges to the provision of economic development activities?

Barriers/Challenges	**Check all that apply**
Inadequate funding/resources	
Inadequate financial capital	
Lack of affordable professional services, e.g. architects, contractors	
Non-conducive policy environment	
Lack of government support	
Lack of statewide or nationwide information/data	
Meeting cultural needs of diverse ethnic groups	
Meeting Linguistic barriers of diverse ethnic groups	
Non-responsiveness of the media	
Legal restrictions to advocacy	
Access to training	
Others *(Specify)*	

What are your greatest **internal** barriers/challenges to the provision of community economic development activities?

Barriers/Challenges	**Check all that apply**
Program staff training needs	
Organizational development needs (e.g. strategic planning)	
Informational expertise	
Technology needs	
Board development needs	
Staff cultural competency needs	
Fund raising capacity needs	
Lack of community visibility	
Other(s) *Specify*	


UNITED FOR A FAIR ECONOMY
THE
SILENT
DEPRESSION
STATE OF THE DREAM 2009
AMAAD RIVERA | JEANNETTE HUEZO | CHRISTINA KASICA | DEDRICK MUHAMMAD
JANUARY 15, 2009
LENDER FORECLOSURE
PUBLIC HOME
AUCTION

State of the Dream 2009: **THE SILENT DEPRESSION**

By Amaad Rivera, Jeannette Huezo, Christina Kasica (D2D Fund)
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United for a Fair Economy is a national, independent, nonpartisan, 501(c)(3) non-profit organization. UFE raises awareness that concentrated wealth and power undermine the economy, corrupt democracy, deepen the racial divide, and tear communities apart. We support and help build social movements for greater equality.

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State of the Dream 2009: **THE SILENT DEPRESSION**

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State of the Dream 2009: **EXECUTIVE SUMMARY**

As we celebrate the 80th birthday of Dr. Martin Luther King, Jr., we know that 2009 will be an historic year, with the inauguration of the first African American president and the deepening of what is likely to be the most serious fiscal crisis since the Great Depression.

Many American Blacks today are already experiencing a silent economic depression that, in terms of unemployment, equals or exceeds the Great Depression of 1929. Almost 12% of Blacks are unemployed; this is expected to increase to nearly 20% by 2010. Among young Black males aged 16-19, the unemployment rate is 32.8%, while their white counterparts are at 18.3%.

Overall, 24% of Blacks and 21% of Latinos are in poverty, versus 8% of whites.

In the corporate world, we are seeing the highest executive pay and the biggest bailouts in history. CEO pay is 344 times that of the average worker.* The riches of the few mask the deepening recession in the working class and the depression in communities of color.

Extreme economic inequality (which the U.S. experienced in the 1920s and is again experiencing now) is often a key indicator of recession and/or depression. The Black depression of today may well foreshadow the depth and length of the recession the whole country entered in December 2007.

A deep recession would see median family income decline by 4%. Thirty-three per cent of Blacks and 41% of Latinos would drop out of the middle class. The overall national rate would be 25%.

Economically, Blacks and Latinos have suffered disproportionately because of structural racism and the web of policies that evolved from it. Eliminating the racial wealth divide is an essential step toward eliminating institutional racism. A comprehensive economic policy could deal a knockout blow to structural racism and raise awareness of individual racism. The path forward abounds with possibilities for shrinking the racial wealth divide and further healing the racism that still afflicts our nation.

If we institute systemic wealth-building programs that help everyone; if we repair and reinvigorate the decimated watchdog policies governing all aspects of home ownership; if we target 2009 economic stimulus programs to investment, not investment in tax breaks for the rich, but in the building blocks of the American dream – affordable housing, education, job creation, and savings among low- and middle-income people – we will make strides toward a more balanced economy.

Our nation's economic policies have enabled the top 10% to accumulate 68% of the wealth, while sheltering the wealthy from sharing the nation's risks. The children of the wealthy are not marching off to war because their economic alternatives are bleak. The rising cost of medical care does not require American millionaires and billionaires to cut back on food in order to pay medical bills. Thousands of additional layoffs will not harm the financial security of those in the owning class.

Fairer policies would share the risks of our entrepreneurial economy by helping balance the economic burdens among all of us, rather than piling them onto people of color, the poor,

*Sarah Anderson and others, "Executive Excess 2008: How Average Taxpayers Subsidize Runaway Pay," Institute for Policy Studies and United For a Fair Economy, 2008. http://www.faireconomy.org/files/executive_excess_2008.pdf

and the middle class. Revoking the tax deduction for expensive second and third houses, ending offshore tax havens and policies that make it profitable to ship American jobs overseas, and calling – with a united voice – for those in the upper quintile of income and wealth to participate more fully in bearing the burden of fixing the economy would spread the risks more fairly.

Fairer policies would support low-cost mortgages, better and cheaper medical care for those making less than $200,000 a year, strengthening Social Security, and freezing or raising wealth taxes like capital gains and the estate tax.

Finally, we need to recommit ourselves, via policy and our unified voices, to affirmative action. We need recognition of and apology for the U.S.'s centuries of slavery and segregation. We need a commitment by the nation and its communities to acknowledge and repudiate the institutional and individual racism – epitomized by today's Black depression – that still pervades our society.

With such actions we can move forward. The economic path behind us is collapsing in rubble. Looking backward, we can freeze in fear, or we can turn toward a future whose economic health and fairness we jointly create.

State of the Dream 2009: The Silent Depression explains the mechanisms that helped create the racialized economic depression, explores how this crisis affects individuals and communities of color, and proposes comprehensive policy solutions to this crisis.

State of the Dream 2009: **KEY FINDINGS**

Income and the State of the Economy

- Although the National Bureau of Economic Research did not announce until December 1, 2008 that the U.S. has been in a recession, it has been apparent to many that this country has been in a growing recession for more than a year. People of color have been in a recession for nearly five years and have entered a depression during the current economic crisis. (pp. 10, 21, 24)
- The Black unemployment rate is currently 11.9%. Among young Black males age 16-19, unemployment is 32.8%. (pp. 10, 11)
- The median household incomes of Blacks and Latinos are $38,269 and $40,000, respectively, while the median household income of whites is $61,280. (pp. 18, 19)
- People of color are disproportionately poor in the United States. Blacks and Latinos have poverty rates of 24% and 21% respectively, compared to a 10% poverty rate for whites. (p. 18)
- A deep recession would see median U.S. family income decline by 4% and Black income decrease by 6%. Thirty-three percent of Blacks and 41% of Latinos would be in danger of falling out of the middle class into poverty compared to 25% nationally. (pp. 6, 14)

Housing

- Since United for a Fair Economy published *State of the Dream 2008: Foreclosed* in January 2008, estimates of foreclosures from late 2008 to the end of 2009 have increased from 1.1 million to 2.2 million and the estimated total loss of housing wealth for homeowners has increased from $2.2 trillion to $2.7 trillion. (p. 48)
- In 2006, 18 million households spent more than 50% of their income on housing. That number has since surged by almost 4 million. (p. 22)
- In nearly half of low-income households, after housing costs are paid, families have only $257 a month left for food, $29 for clothing, and $9 for medical care. (p. 22)

Mobility

- Children born in the bottom 20% only have a 1% chance of reaching the top 5% of income earners. (p. 6)
- In 2006, more than 68.6% of funds in government programs designed to increase economic mobility were directed toward the top 10% of income earners. We recommend more federal asset-building funds be directed toward Individual Development Accounts and financial education for people in the bottom 40%. (p. 28)

- People of color are more likely to be poor (24.5%), remain poor (54%), and move back into poverty from any income class status than their white counterparts. (pp. 6, 7, 8, 9)

Wealth

- Nearly 30% of Blacks have zero or negative worth, versus 15% of whites. (p. 24)
- Only 18% of people of color have retirement accounts, compared to 43.4% of their white counterparts. (p. 23)
- On the *median*, for every dollar of white wealth, people of color have 15 cents. On *average*, people of color have 8 cents for every dollar of white wealth. (p. 28)

Structural Racism and Policy

- Concentrated poverty creates barriers to economic and educational mobility. Blacks and Latinos are twice as likely to live in these areas as whites. (pp. 33, 34, 35)
- U.S Census Bureau should change its measurement of poverty in time for the 2010 census. The current method underestimates the numbers of the most marginalized. These gaps give policymakers an inaccurate view of the scope of the problems of poverty. (p. 33)
- We urge the National Bureau of Economic Research (NBER) to integrate into indicators of recession measures for wealth inequality, asset accumulation, income inequality, employer-based benefits versus employee-based benefits, and the various types of unemployment. This will help bring economic problems to the forefront and help end the crisis of silence about the true state of the dream. (p. 52)

State of the Dream 2009: **INTRODUCTION**

Beyond Recession

There is a silent Black depression in the U.S. and has been for the last year. This depression is exacerbated by the recession that communities of color have been experiencing for the past 5–7 years and that one scholar simply named "Black America's permanent recession."[1] The Black unemployment rate is currently 11.9%[2] and is expected to increase to nearly 29%, a level unmatched in over 20 years. Among young Black males age 16–19, unemployment is 32.8%[3], a rate not seen by any population since the Great Depression. In any other population, this rate of unemployment would generate disturbing news headlines about an economic depression. But there has been no recognition of this depression by the Congress, the President, or the mainstream news media. There has been no bailout, no aid package, no rules changed to reverse this disaster.

This year, we have experienced several historic events, not least of which is the groundbreaking presidential election that has advanced the first Black person to the presidency. But we are also now experiencing the greatest financial crisis in the U.S. since the Great Depression. It is the catastrophic economic effects, particularly the ones that are hurting people of color, that are going unmentioned, unnoticed and most problematically, unaddressed.

Today, a perfect storm of structural racism, deregulation and lack of comprehensive economic public policy is raging around us. The middle class has now been affected, along with those already facing economic danger, such as older people on fixed incomes. Consumer spending has fallen precipitously; food sells at inflated prices, fuel and heating costs are high, and health care is becoming less and less affordable, even for those with full-time jobs. The subprime mortgage crisis, which has been hurting poor people for years now, is flooding communities with foreclosed properties, bankrupt businesses, and skyrocketing crime rates These troubles are now affecting the bottom three quintiles, nearly two-thirds of people in this country, or approximately 180 million people. Yet communities of color entering this new crisis were already in an economic recession, and entering this new crisis has plunged them into an economic depression; they are beginning this new journey already weighed down with a big burden. Moreover, these communities are doubly hampered because they experience the current overall financial crisis in addition to historic and contemporary structural racism. During economic booms, people of color typically benefit much less than their white counterparts. And during economic downturns, especially those that reach the level of a recession or depression, people of color are disproportionately – and severely – affected.

> "...In the human rights revolution, if something isn't done, and in a hurry, to bring the colored peoples of the world out of their long years of poverty, their long years of hurt and neglect, the whole world is doomed..."
>
> **Martin Luther King, Jr., 1968**
> "I See the Promised Land," speech delivered in Memphis, Tennessee on the eve of his assassination.

As economists continue to debate amongst themselves how to technically define the state of our economy, everyday people are experiencing record levels of unemployment, underemployment, reduced work benefits, high healthcare costs and exorbitant prices

for energy. Ironically, while these costs and economic burdens are at their highest points in recent history, they have been occurring alongside historically high profits for a small percentage of individuals and corporations in the country. Our current economic state is a powerful representation of our overall economic policy, as numerous indicators of inequality are at the highest they have ever been in our country's history.

In recent years, we have seen stagnation in income and disastrous declines in wealth in communities of color. Individual and family wealth in these communities continues to decline at rates unseen in the recent past. Even more problematic is that only half of all households in communities of color have assets to lose; the other half had no assets to begin with.[4] This economic downturn is sabotaging the ability of these communities to accumulate assets, but assets are essential to weathering the storms of economic downturns. With little or no access to this essential protection, these communities are nearly defenseless against the economic disasters recklessly caused by wealthy individuals and corporations.

In addition, regardless of the yo-yo ("You're On Your Own") economic rhetoric of public policy officials, pundits, opinion leaders and the mainstream media, this crisis plagues entire communities, not just individuals, not just communities of color, and not just poor people. We are now seeing the decline of housing values, increases in school closings, across-the-board budget cuts, unaffordable higher education, and divestment from community-based assets like credit unions, small businesses, and public transportation.

While this economic crisis, particularly in communities of color, is severe, it offers a great historic opportunity. In the economic depression of 1929, our country recognized the need for investment in communities and individuals. The policies from that era fostered the growth of the largest middle class in history. The level of government investment in the development of community and individual assets was unprecedented, and many people today can attribute their economic success to that investment.

Investment in building and protecting assets was key to combating economic depression and to creating the prosperity of the 1940s, 1950s and 1960s that followed the Great Depression. Institutions such as labor unions, government programs like social security, and anti-trust legislation were all geared toward protecting low- and middle-income people from economic exploitation and helping them build personal assets. The GI Bill sent millions to college. Infrastructure projects – housing, schools, and roads – blossomed, putting millions to work and providing them a better quality of life.

Unfortunately, people of color were, for the most part, excluded from participating in these programs and benefiting from these policies due to the overt racism prevalent during those times[5]. Sadly, the nation at large took the civil rights work of the 1960s and reduced its holistic comprehensive analysis to a simplistic notion of personal or individual racism. The civil rights movement, and civil rights efforts since the founding of this country, recognized that inequity is rooted in societal institutions, aided and abided by personal forms of racism. Institutional racism is embedded in the structures (i.e., cultural, organizational, governmental and academic, etc.) of our society and manifests itself in the distribution, implementation and access to resources and opportunities.

More work challenging exploitation and fostering middle class prosperity remains to be done. In this new millennium, we need to add the elimination of institutional racism to the list. The same asset investment and policy change that supported the development of a largely white

post-World War II middle class must be used to eliminate the economic depression currently affecting communities of color.

The Racial Wealth Divide

While some progress has been made, ongoing racial disparities in income, job access and high-level job attainment show that more needs to be done. Likewise, we are seeing a continuing – and growing – asset gap, caused by historic and contemporary structural racism.[6] In the area of assets (i.e., housing, stocks, bonds and savings) people of color have been systematically limited and continue to suffer the consequences. Being the population with the least assets puts people of color at higher risk for many economic, health and social inequities. On average, people of color have 8 cents for every dollar of white wealth; on the median, they have 15 cents.[7] This current crisis, caused in part by predatory lending to communities of color, continues to erode the most accessible asset in communities of color: housing. We have watched this human-made disaster create racial disparities that remain unaddressed and may take generations to repair. We have a unique opportunity to shift the nation's policies to address the needs of all people and live up to our creed of equal opportunity for all.

Part and parcel of eliminating individual and institutional racism is elimination of the racial wealth divide. Comprehensive economic policy can deal a knockout blow to structural racism. Through culturally appropriate, collaborative and community-centered policies and practices, Martin Luther King, Jr.'s dream of equality and justice for all can fully come to fruition.

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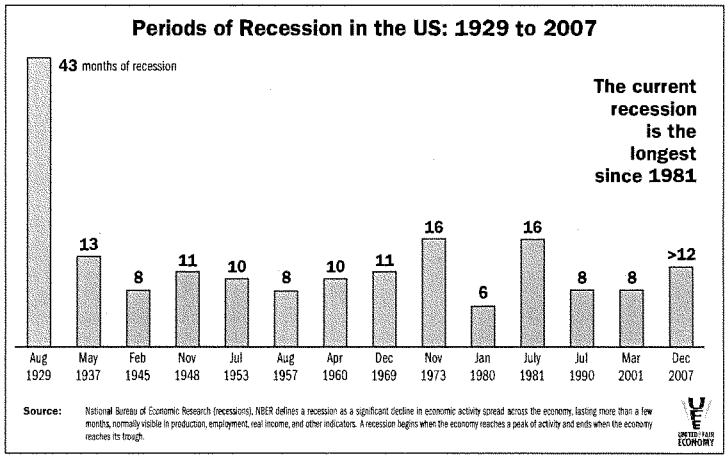
Chapter 1: **A DREAM DEPRESSED**

"The Constitution assured the right to vote, but there is no such assurance of the right of adequate housing, or the right to an adequate income. And yet in a nation which has a gross national product of 750 billion dollars a year, it is morally right to insist that every person has a decent house, an adequate education and enough money to provide basic necessities for one's family."

Martin Luther King, Jr., 1966
In an essay in *Ebony* magazine, "Nonviolence: The Only Road to Freedom"

Martin Luther King, Jr., and those who worked with him, fought for civil rights, the right to access fair housing, and most importantly, the right of economic opportunity for all people in this country. This included access to jobs, worker benefits, unionization, education and economic self-determination. Specifically, King understood that public policy is simultaneously the cause of and the solution to inequality in this country. While housing is the foundation of the American Dream, economic stability is its cornerstone. The idea that vast economic inequality will negatively affect us all was central to King's work.

What King knew intrinsically, and those who suffer the consequences of economic inequality know through experience, has now begun to surface in mainstream economics: the greater the economic inequality, the less our economy grows[8] Interestingly, the negative impact of economic inequality is understood to exist in most industrialized countries throughout the entire world.[9] Vast economic disparity, typically characterized by concentration of income and wealth, has been recognized as a key harbinger of economic recessions and depressions in our country's history.[10] This phenomenon was most notable in relation to the Great Depression of 1929. Currently, the U.S. is seeing the greatest economic inequality, particularly in income and wealth, since the Great Depression. While working class people in this country have been experiencing an economic recession, people of color are experiencing an economic depression.



The Current State of Affairs

In the United States, inequality affects large portions of the population, but due to systemic racism in our economy, inequality is drastically and disproportionally higher in communities of color. Economic inequality is an everyday reality for people in this country – in healthcare, food prices, unemployment, underemployment, income and wealth.

While other highly industrialized countries have begun to deal with this lack of equity, the United States has fallen far behind. The Gini Coefficient is a measurement of a country's economic inequality based on economic indicators such as income, economic mobility and wealth.[11] The Gini Coefficient "ranges from zero (perfect equality of income across households) to one (all income is concentrated at the very top of the income distribution)."[12]

Household Income Inequality in the OECD by Rank

	2000		1989
1.	**United States**	1.	**United States**
2.	United Kingdom	2.	United Kingdom
3.	Spain	3.	Ireland
4.	Italy	4.	Japan
5.	Ireland	5.	Switzerland
6.	Australia	6.	Australia
7.	Canada	7.	Italy
8.	France	7.	Spain
9.	Belgium	9.	France
10.	Switzerland	10.	Canada
11.	Austria	11.	Netherlands
12.	Denmark	12.	Germany
13.	Germany	13.	Denmark
13.	Sweden	14.	Belgium

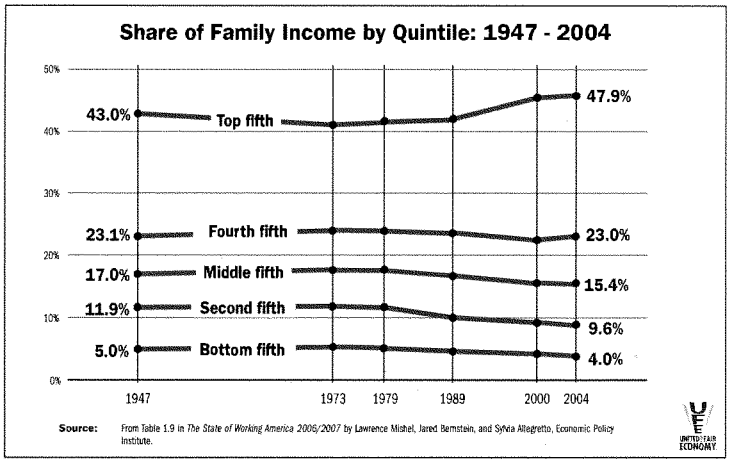
Source: Table 8.16, *The State of Working America 2006/2007*. The ranking is based on the Gini coefficient, an inequality measure that ranges from 0 (perfect equality, everyone has exactly the same income) and 1 (perfect inequality, one person has all the income while everyone else has zero income).

The United States has consistently had one of the highest Gini Coefficient rankings among comparable countries in the entire world. At times, we have had the worst rating. In 2004, the 20% of the population with the highest incomes claimed 48% of all family income in the U.S., 12 times the amount of income of the bottom 20%.[13] This degree of disparity has not been seen since the Great Depression of 1929.

When race is entered into the equation, the disparities increase. People of color are disproportionately represented in the poorest income quintiles in the United States. In 2006, Blacks and Latinos had poverty rates of 24% and 21% respectively, compared to a

"It is a trite yet urgently true observation that if America is to remain a first-class nation, it cannot have second-class citizens"

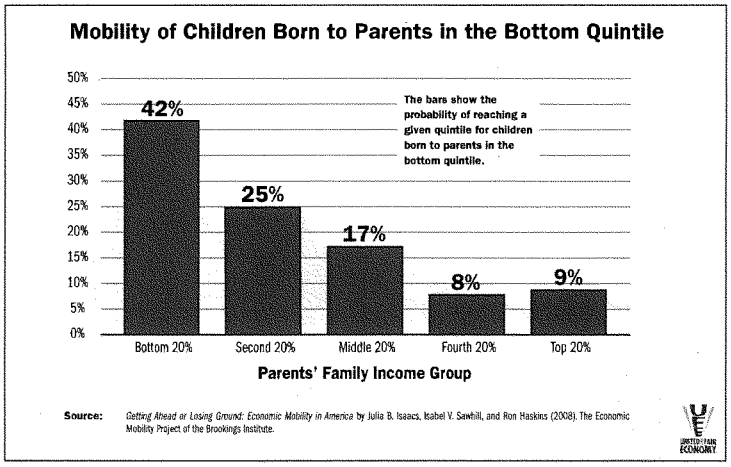
Martin Luther King, Jr., 1960
In a speech at the 50th Anniversary of the National Urban League, "The Rising Tide of Racial Consciousness"

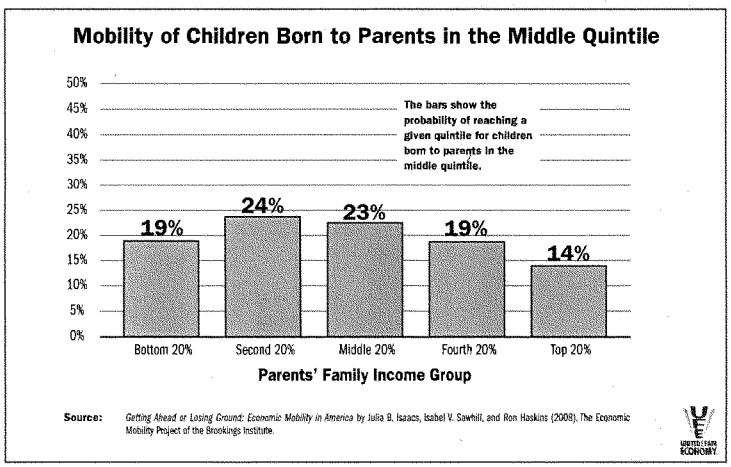


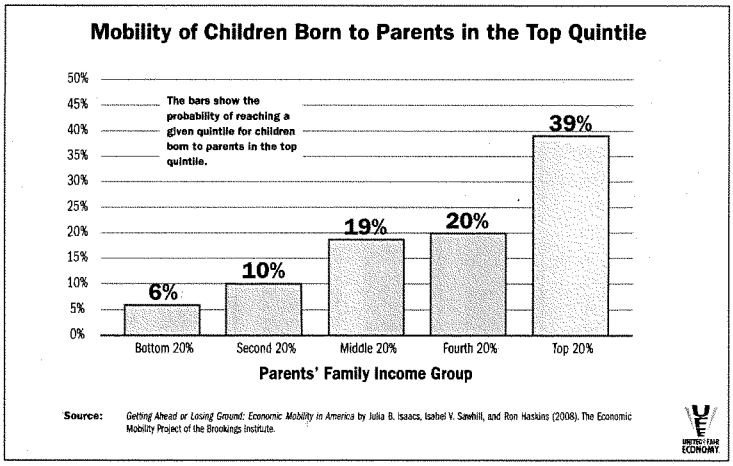
10% poverty rate for whites.[14] In the current recession, we are likely to see a roughly 4% reduction in median family income among all Americans, with people of color experiencing a greater decline. For example, Blacks will likely see their median family income decline by 6%, leaving a median family $2,400 poorer.[15]

Inequality is measured in a multitude of ways, many of which continue to paint a dismal picture of meritocracy in this country. Research comparing the United States to other countries of similar industrial status has shown that intergenerational mobility in the U.S. (between parents and their children) is among the lowest, and in some cases the worst among comparable countries.[16] According to research done by the Center for American Progress, titled Understanding Mobility in America, children born in the bottom 20% only have a 1% chance of reaching the top 5% of income earners, while a child born to high-income parents has 22 times the probability of reaching the top 5%. Even more disturbing, according to another study done by the Economic Mobility Project, 42% of those born in the bottom fifth of income earners will remain there, and an additional 42% will only make it to the lower-middle or middle class.[17] Another study paints an even darker image of the American "bootstrapping" dream, citing that "over three-quarters (76 percent) of children whose parents are in the top wealth quintile remain in the top half of the distribution by adulthood. Among this 76 percent, over half (55 percent) remain in the very top quintile."[18]

Similar to income inequality, mobility is exacerbated by race. Economists Samuel Bowles and Herbert Gintis have demonstrated that race is among the most important factors that determine the economic mobility of families and individuals.[19] Research also reveals that people of color (after controlling for other factors ranging from education to family composition) are less mobile than their white counterparts, and more likely to remain at the


Mobility of Children Born to Parents in the Bottom Quintile
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
42%
25%
17%
8%
9%
The bars show the probability of reaching a given quintile for children born to parents in the bottom quintile.
Bottom 20%
Second 20%
Middle 20%
Fourth 20%
Top 20%
Parents' Family Income Group
Source: Getting Ahead or Losing Ground: Economic Mobility in America by Julia B. Isaacs, Isabel V. Sawhill, and Ron Haskins (2008). The Economic Mobility Project of the Brookings Institute.


Mobility of Children Born to Parents in the Middle Quintile
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
19%
24%
23%
19%
14%
The bars show the probability of reaching a given quintile for children born to parents in the middle quintile.
Bottom 20%
Second 20%
Middle 20%
Fourth 20%
Top 20%
Parents' Family Income Group
Source: Getting Ahead or Losing Ground: Economic Mobility in America by Julia B. Isaacs, Isabel V. Sawhill, and Ron Haskins (2008). The Economic Mobility Project of the Brookings Institute.


Mobility of Children Born to Parents in the Top Quintile
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
The bars show the probability of reaching a given quintile for children born to parents in the top quintile.
6%
10%
19%
20%
39%
Bottom 20%
Second 20%
Middle 20%
Fourth 20%
Top 20%
Parents' Family Income Group
Source: Getting Ahead or Losing Ground: Economic Mobility in America by Julia B. Isaacs, Isabel V. Sawhill, and Ron Haskins (2008). The Economic Mobility Project of the Brookings Institute.
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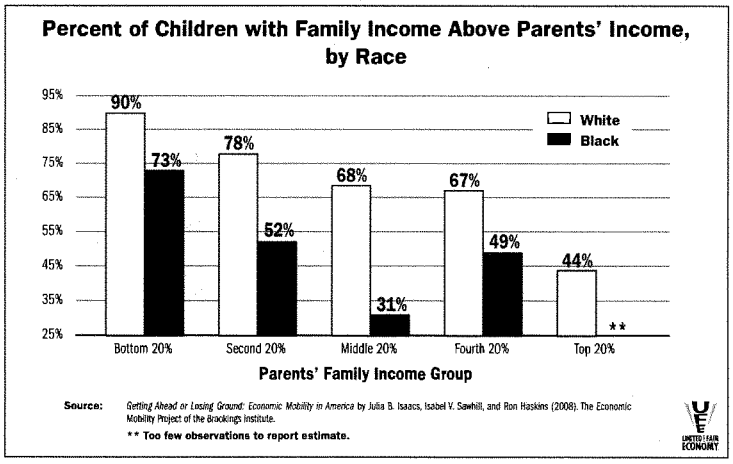

Percent of Children with Family Income Above Parents' Income, by Race
95%
85%
75%
65%
55%
45%
35%
25%
90%
73%
78%
52%
68%
31%
67%
49%
44%
**
White
Black
Bottom 20%
Second 20%
Middle 20%
Fourth 20%
Top 20%
Parents' Family Income Group
Source: Getting Ahead or Losing Ground: Economic Mobility in America by Julia B. Isaacs, Isabel V. Sawhill, and Ron Haskins (2008). The Economic Mobility Project of the Brookings Institute.
** Too few observations to report estimate.
UNITED FOR A FAIR ECONOMY

bottom of the income scale, generation after generation.[20] At each income level, "Blacks are less likely than whites to advance beyond their parents' income."[21]

The insecurity that inequality creates, and that has gone largely unaddressed, has help to create the recession and financial crisis we are now experiencing, and the economic depression that people of color are experiencing. The combined effect of concentration of income and lack of economic mobility is being felt throughout the country, particularly among communities of color. According to a joint study conducted by Demos and the Institute for Assets and Social Policy, "One in three (33 percent) African-American middle-income families and an alarming 41 percent of Latino middle-income families are at high risk of slipping out of the middle class. These figures are substantially higher than the national figure of one in four (25 percent)."[22]

Income is a telling measure of stability and security, as jobs are usually attached to other important economic benefits (e.g., healthcare and retirement accounts), but wealth is also an important indicator. Simply put, wealth is what you own minus what you owe. Income is like a river constantly flowing in and out, while wealth is a reservoir, helping weather the storm of economic uncertainty. Assets are typically categorized into to two types: financial (bonds, stocks, retirement accounts) and non- financial (homes and cars).

Currently, the top 10% of income earners own 68% of all wealth in the U.S.[23] In addition, the top 1% own 44% of all stocks and bonds, and the top 10% own over 84% of all stocks and bonds.[24] Assets and wealth are telling indicators of inequality, as they are key to economic stability and intergenerational mobility. According to the Corporation for Enterprise Development, "One fifth of the population does not possess enough liquid resources to survive three months at the poverty line without a job; many more lack sufficient liquid assets to put a down payment on a home, invest in two years at a community college or start a business."[25] Having little or no wealth to draw on deepens the impact of every economic downturn for many people of color.

Economic inequality is deeply connected to the growth of the economy. Vast disparities are also antithetical to the vision of a healthy democracy and equality of opportunity for everyone. Key indicators of economic inequality are income, mobility and wealth. Historically, the concentration of wealth and income among the few has predicted and described major economic downturns. Our current recession and economic downturn is unusual compared to others recessions, in that it has been accompanied by the largest disparity of wealth and income since the Great Depression. High levels of poverty and loss of wealth among people of color have existed alongside some of the highest profits ever recorded in history (e.g., Exxon). These profits in recent years, going to the very few, have masked the growing recession in the working class and the depression in communities of color.

Black and Brown Silent Depression

Despite the visibility of our current economic crisis, those who are most negatively affected by past, current, and future economic disasters are often the least visible. And while some have argued that this current economic downturn affects everyone, it does not do so equally. To understand the inextricable link between race and economics, one must take into account the historic and contemporary forms of racial discrimination that cause disproportional impacts on communities of color, often lasting generations. One scholar lamented that,

"Even when the national unemployment picture is good, the black unemployment rate is twice that of the white unemployment rate. This means that in what looks like good economic times nationally, most of black America is still experiencing a recession. When white America is in recession, black America is in an economic depression."[26]

Definitions of economic downturns, recessions and depressions vary for a multitude of reasons, ranging from political ideologies, to changes in data collection methodologies, to lack of historical data (e.g., some economic data such as race (Latinos) and unemployment has only been collected since 1973). They also differ among academic disciplines. The most popular and simplest definition describes a recession as two consecutive months of negative Gross Domestic Product (GDP).[27]

Gross Domestic Product
"[T]he market value of the final goods and services produced by labor and property located in the United States. GDP is equal to personal consumption expenditures (PCE) plus gross private domestic fixed investment plus change in private inventories plus government consumption expenditures and gross investment plus exports minus imports. Imports are subtracted in this calculation because they are already included in the other final-expenditure components."[28]

The National Bureau of Economic Research (NBER), the final word on the designation of a recession, defines it this way; "the NBER does not define a recession in terms of two consecutive quarters of decline in real GDP. Rather, a recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."[29]

A recession is typically identified during the closing period of recession or even afterwards. For example, the "Business Cycle Dating Committee at the NBER announced November 2001 as the end of the most recent recession – but it made this determination in July 2003, roughly a year and a half after the fact."[30] In other words, even in the face of alarming evidence, a recession or depression may not be declared "official" until it has been underway for quite some time, or has already ended. Despite overwhelming evidence of the financial crisis, NBER did not officially declare that the current recession had begun until a full year afterwards – in December 2008.[31]

A depression is defined as a long-term recession, but this too is ambiguous, as the lengths of these cycles continue to be contested.[32] While simplistic in its official definition, an economic depression affects broad societal sectors from schools systems and hospitals to large and small businesses. In addition, a wide range of economists and economic literature find that depressions are often characterized as a prolonged recession, high double-digit unemployment rates, structural economic weakness (e.g., bank failure, high foreclosures, stock market crashes) and the collapse of consumer confidence. In addition to factors such as unemployment and GDP, these systemic indicators in totality reflect a holistic and comprehensive understanding of devastating economic downturns.

For communities of color, the decline of economic activity has been disastrous and depression-like while remaining nearly invisible on a national level. Like Hurricane Katrina, this economic disaster is a reflection of historic systems of racial inequality having contemporary impacts. And like the response to that disaster, people of color have waited in silence despite the cries of help, and sadly some are still waiting.

Looking at this comprehensive definition of an economic depression we find that all of these measures apply for people of color. At nearly 11%, the unemployment rate for people

of color is at the highest it has been in years, and is predicted to reach 15.5% by 2010.[33] The level predicted for 2009 has already been surpassed, painting a dismal picture of unemployment in communities of color. In some states with high concentrations of people of color, unemployment levels have surpassed every previous record since the Great Depression. Youth of color ages 16–19 have an unemployment rate (seasonally adjusted) of 32% nationwide.[34] Industries with high numbers of people of color, such as construction, temporary work and service-based industries, have collapsed.

Underemployment, which is a more accurate measure of hardship than unemployment, is at its highest level at 11.8% since the creation of the measure in 1994.[35] Despite some productivity gains of workers in general, income inequality compounds other forms of structural economic inequality. The higher prices that communities of color pay for the same goods as their white counterparts, in almost every commercial domain, is often overlooked, misunderstood and/or knowingly ignored. This, in essence, turns waves of insecurity into tsunamis of economic desperation. National home foreclosure rates are now higher than during the Great Depression, and communities of color have rates nearly twice as high. These measures (unemployment, underemployment, and home foreclosure rates), plus the depressed level of economic activity plaguing people of color for the last 5–7 years, indicates that communities of color are experiencing a second Great Depression.

The current economic downturn is caused in large part by the unscrupulous practices of the finance and banking industry that created a faulty product called "subprime" or "high interest" loans. As stated earlier, an essential component of an economic depression is structural economic weakness; the subprime industry, aided by deregulation, was a significant contributor to our current structural weakness. These subprime loans were designed to fail in a way that increased profits for lenders, producing a total of $665 billion in profits in 2005.[36]

Similarly, during the late 1920s and the Great Depression, lax lending standards led to a housing and construction boom that later resulted in high foreclosure rates almost mirroring our current crisis. Furthermore, during the Great Depression debt increased as a result of increases in housing cost. This debt became problematic as the recession began, and the wealth and income of individuals and families became insufficient to meet the debt that was incurred. People with these loans had difficulty selling their property, as the decline in housing values ensured that the homes would be worth less than the entirety of the debt incurred by the seller. The property was no longer worth as much as the loan that was taken out to pay for it.[37]

As in today's recession, the Great Depression's mixture of stagnant wages, job losses and falling housing prices created by poor public policy made the foreclosure crisis the proverbial straw that broke the camel's back. However, a unique characteristic of the contemporary foreclosure crisis is its concentration among people of color. Disproportionately, people of color received subprime loans at higher rates than their white counterparts, and consequently are suffering relatively more. For example, in Chicago, African-Americans were 14 times more likely to receive a high-cost (subprime) loan than their white counterparts.[38] Upper income Latinos and Blacks/African-Americans were more likely to receive subprime loans than their white low-income counterparts.[39] While on a national level foreclosure rates are exceeding those of the Great Depression, they are nearly twice as high in communities of color.

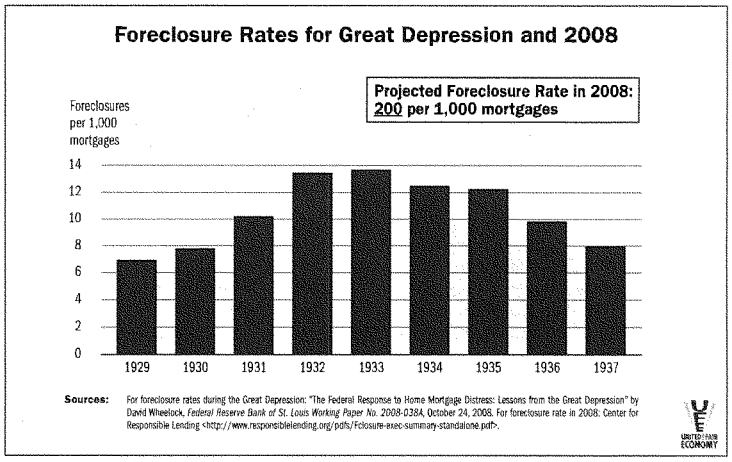
During the Great Depression, and until about 1941, the foreclosure rate was about 1% (10 per 1,000 mortgages).[40] Currently, the majority of the foreclosures in the country are stemming from subprime loans, and of these loans, the most toxic (due to their high foreclosure and default rates) are loans called Adjustable Rate Mortgages (ARMs). At the end of the third quarter of 2008, the foreclosure rate for prime ARMs was 1.77%. The foreclosure rate was 2.2% for fixed-rate subprime mortgages and 6.4% for subprime ARMs.[41] In 2007, there were approximately 6,027 foreclosures a day, totaling 2.2 million for the year.[42]

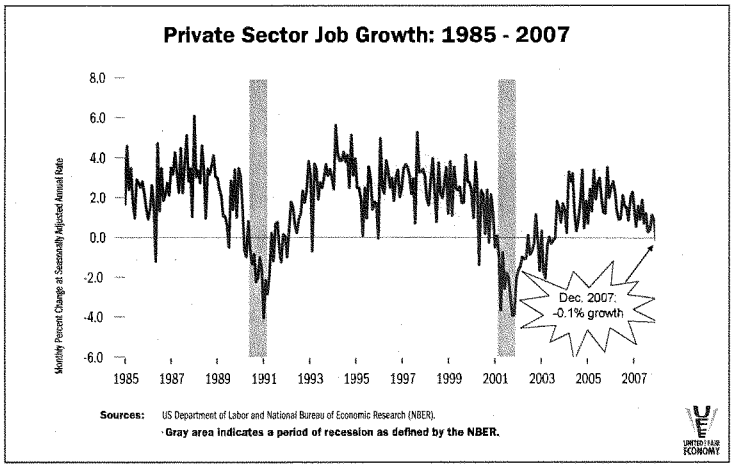
Adjustable-rate mortgages (ARMs) are loans with interest rates that change. ARMs often have lower monthly payments than fixed-rate mortgages for the first few years and then a variable rate that may be much higher. Loans called "3/27" or "2/28" ARMs have fixed interest rates for a few years (the first number) followed by a variable rate for the rest of the 30-year period (the second number).

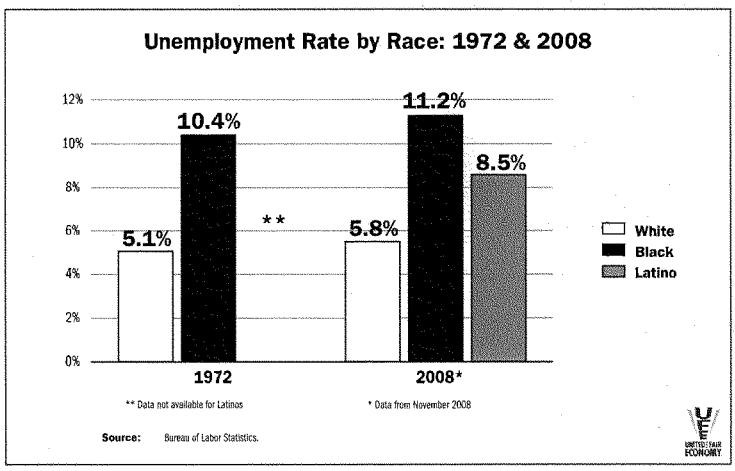
Comparing economic indicators, such as income, inequality, foreclosure rates, and unemployment, to the levels during previous recessions, it is odd that officials have been reluctant to call this a recession. The U.S. Congressional Joint Economic Committee has found that several key employment indicators provide a good signal of the onset of a recession. According to their research, comparing our current economic reality to past recessions, we reached the NBER benchmark for job losses in December 2007, accompanied by 8 months of continuous job losses starting in February 2008.[43]

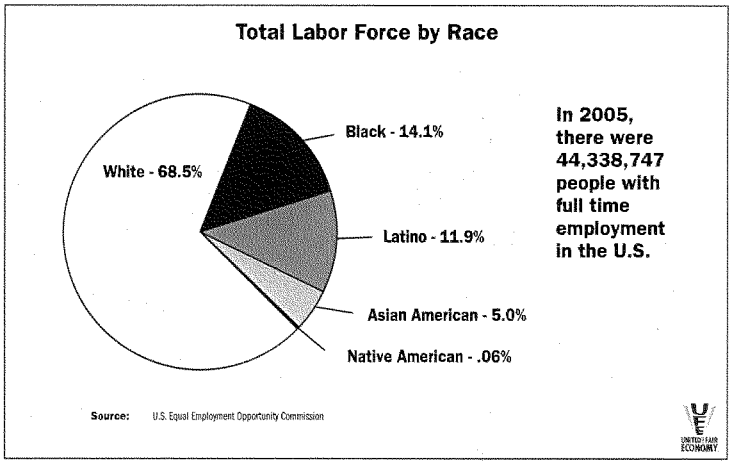
Unemployment rates are 10–11% for Blacks and 8–9% for Latinos[44] and are predicted to continue to grow until 2010, reaching towards 20% or more.[45] Furthermore, some cities with large communities of color are already experiencing high unemployment rates (as of October 2008) such as El Centro, California at 27.6% and Yuma, Arizona at 19.5%.[46]

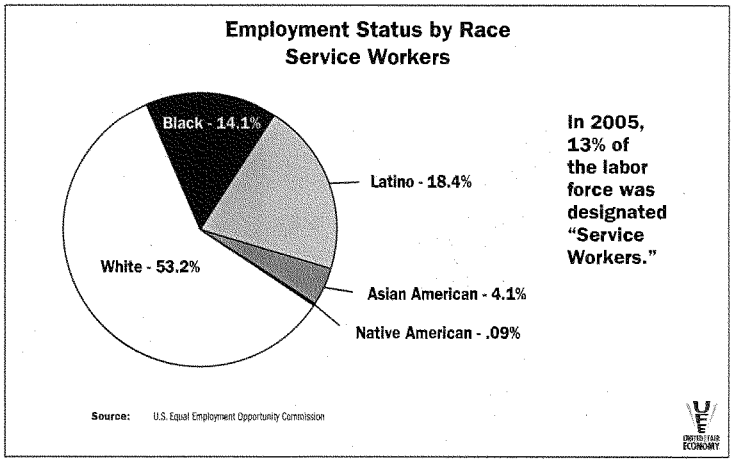
In September 2008, the Bureau of Labor Statistics reported, "The number of unemployed persons rose by 592,000 to 9.4 million in August, and the unemployment rate increased by

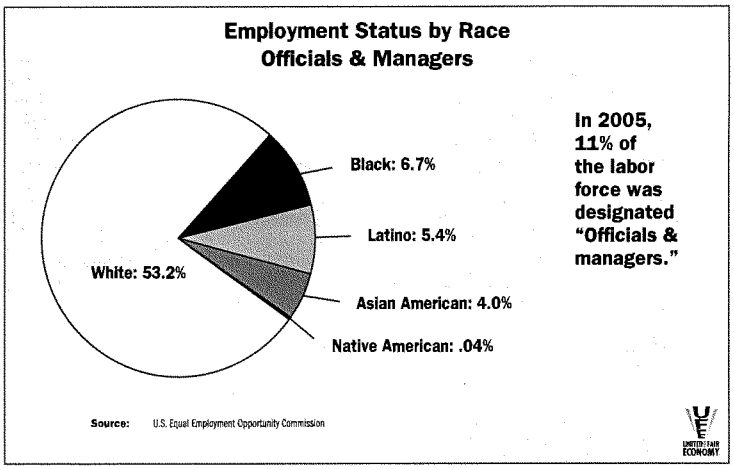



Private Sector Job Growth: 1985 - 2007
Monthly Percent Change at Seasonally Adjusted Annual Rate
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
Dec. 2007:
-0.1% growth
Sources: US Department of Labor and National Bureau of Economic Research (NBER).
Gray area indicates a period of recession as defined by the NBER.


Unemployment Rate by Race: 1972 & 2008
12%
10%
8%
6%
4%
2%
0%
5.1%
10.4%
**
5.8%
11.2%
8.5%
1972
2008*
White
Black
Latino
** Data not available for Latinos
* Data from November 2008
Source: Bureau of Labor Statistics.


Total Labor Force by Race
Black - 14.1%
White - 68.5%
Latino - 11.9%
Asian American - 5.0%
Native American - .06%
In 2005, there were 44,338,747 people with full time employment in the U.S.
Source: U.S. Equal Employment Opportunity Commission


Employment Status by Race
Service Workers
Black - 14.1%
Latino - 18.4%
White - 53.2%
Asian American - 4.1%
Native American - .09%
In 2005, 13% of the labor force was designated "Service Workers."
Source: U.S. Equal Employment Opportunity Commission



0.4 percentage points to 6.1 percent. Over the past 12 months, the number of unemployed persons has increased by 2.7 million and the unemployment rate has risen by 1.4 percentage points, with most of the increase occurring over the past 4 months."[47] According to EPI researchers, in November 2008: "Underemployment, a more comprehensive measure of the extent of weakness in the job market, rose to 12.5%, its highest level on record since the current series began in 1994, and more than four percentage points above its year-ago level."[48] Furthermore, unemployment rates often miscount, undercount or ignore completely "discouraged workers," individuals who are not counted in the labor force because they are not seeking a job, but are able to work. The employment rate often reflects a more accurate picture of those who do not have jobs. "Between 2000 and 2007, the employment rate for African Americans declined 2.4 percentage points. This drop in the employment rate shows a decline in the number of working African Americans that is more than three times that indicated by the change in the unemployment rate. Even at the employment rate peak in 2000, African Americans were less likely to be employed than Americans in general."[49] Similarly, in 2000 only 29.5% of African Americans teenagers (16–19 years of age) were employed, which dropped to 21.0% by 2007.[50]

Furthermore, while most industries have been suffering from declining job openings and mounting job losses, specific sectors have been especially hard hit. The industries most hurt have disproportionately large numbers of people of color. For example, the construction industry has been particularly devastated – with an unemployment rate of 7.4% in 2007 – and over 25% of employed Latinos work in this industry.[51] Industries such as "Food preparation and serving related occupations," and "Building and grounds cleaning and maintenance occupations," which employ the highest percentages of people of color, have some of largest unemployment rates.[52] The greatest unemployment rates are among those who have "temporary" work, which are overwhelmingly people of color. Of

the entire unemployed temporary workforce, 40–50% have only ever had temporary work. In other words, half of temporary workers have only had temporary work as their primary job. Temporary workers represent 30–40% of people of color unemployment, despite representing a smaller numerical amount of total workers in the country compared to their white counterparts.[53] Temporary workers are overwhelmingly people of color, and have some of the highest rates of unemployment. People of color are more likely to be unemployed, underemployed, and temporarily employed than their white counterparts. During a recession, the high concentration of people of color in these categories makes them especially vulnerable.

For some, these dire economic statistics may seem contrary to mainstream media rhetoric about the "economic growth" that we have been experiencing until recently. For many, growing GDP indicates economic stability and provides evidence contrary to an economic recession or depression. But working class families and people of color have experienced stagnant wages, rising inflation and relatively high unemployment for the last few years. It is true that wages and productivity were growing, but only for a relatively small group. According to the key findings of the Economy Policy Institute in a Policy Briefing titled *A Feeble Recovery*:

- "Of the 10 expansions since 1949, as measured from the end of the recession (trough) to the end of the expansion (peak), the expansion from 2001 through last year ranks last in average growth of GDP, investment, employment growth and employee compensation."
- "GDP growth in the latest expansion was a full 40% slower than the post-World War II average (2.9% versus 4.8% in previous expansions)."
- "Despite the tax changes that were promoted as incentives to increase investment, average growth in total investment over the latest expansion was less than half of the post-WWII average, and ranked last in this group."
- "Corporate profits were the only area of strength in the latest cycle, ranking 2nd strongest among the last ... 10 cycles."[54]

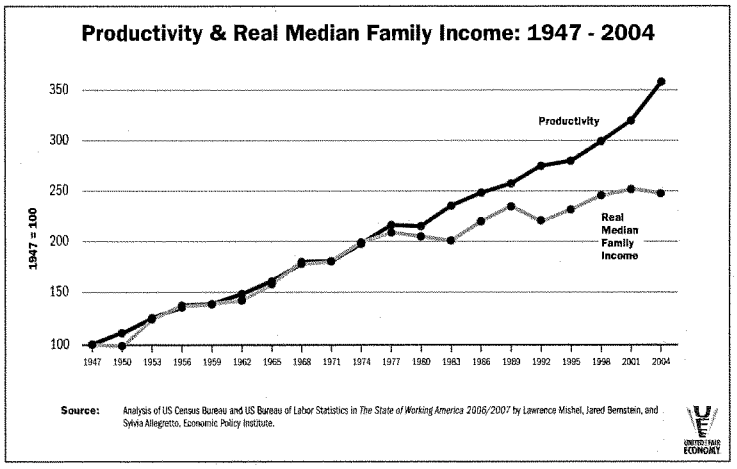
Other scholars, researchers and practitioners have agreed that the majority of people were left behind despite some minimal growth in the economy. In testimony delivered to the Congressional Committee on Health, Education, Labor and Pensions, Professor Eileen Applebaum, Director of the Center on Women and Work at Rutgers University, noted that:

> "In the boom years between 1995 and 2000, the cumulative increase in productivity was 13.2 percent. For the first time in more than two decades, real median family income increased apace, rising by 11.3 percent over that half decade and narrowing inequality ever so slightly as unemployment fell to 4 percent and labor markets tightened.
>
> Optimism that the U.S. was returning to shared prosperity began to take hold but these hopes were soon dashed. Productivity continued to rise strongly, growing at 3 percent a year between 2000 and 2005, but real family median income, which fell in the recession of 2001, failed to keep up. By 2005, real family median income still had not recovered to its pre-recession level [...] Personal saving fell from 2.9 percent of disposable income in the first half of 1999 to -0.9 percent in the first half of 2006 [...]

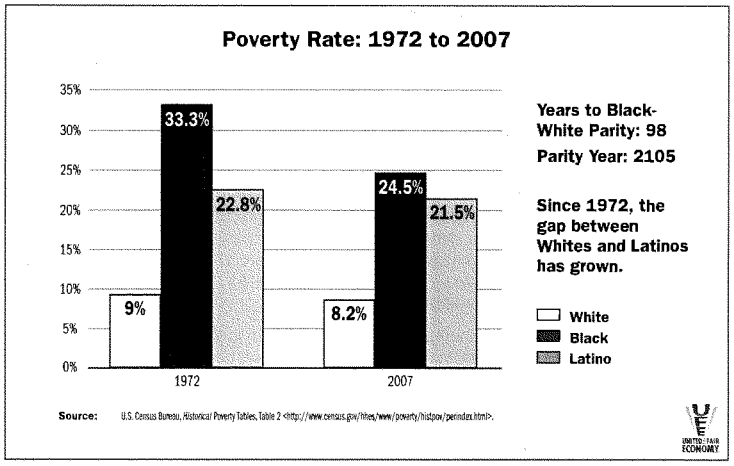
> Labor markets, once described as the arena in which employers and employees negotiated the distribution of a growing economic pie, are today viewed as a tournament, with few winners and many losers."[55]

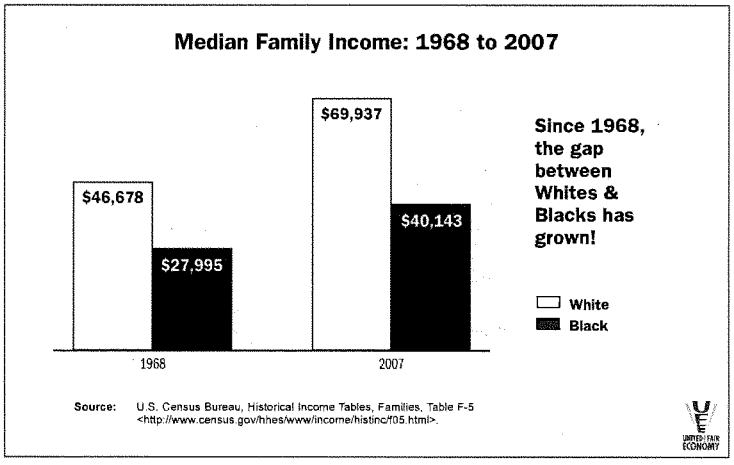
An expanding or booming economy typically leads to increased wages as access to jobs helps families and individuals to be economically mobile and stable. In other words, a growing economy produces jobs and productivity that should result in increased incomes for most people in this country. Yet, due to failed public policy and unaddressed structural racism, we are in the depths of a recession, and dealing with a depression in communities of color. Historically, productivity and growth often were tied together, but from 1973 to 2005, family income has grown at less than one-third the rate of productivity, with 2000–2004 representing the greatest difference between productivity and family income growth.[56] "From 2000 to 2007, although American workers were 19.2% more productive on average, the weekly wages for prime-aged workers declined by $1. The weekly wages for prime-aged African-American workers declined by $3."[57]

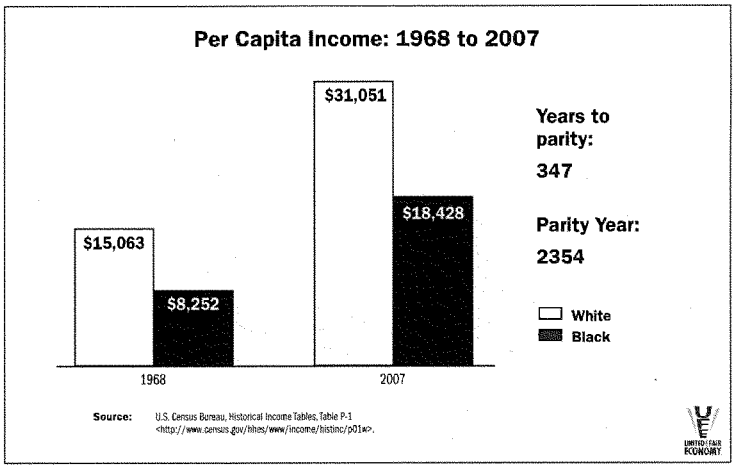
According to the NBER, another indicator of recession is the decline of income and wages. Current wages have grown stagnant and incomes have begun to decline. Race and class

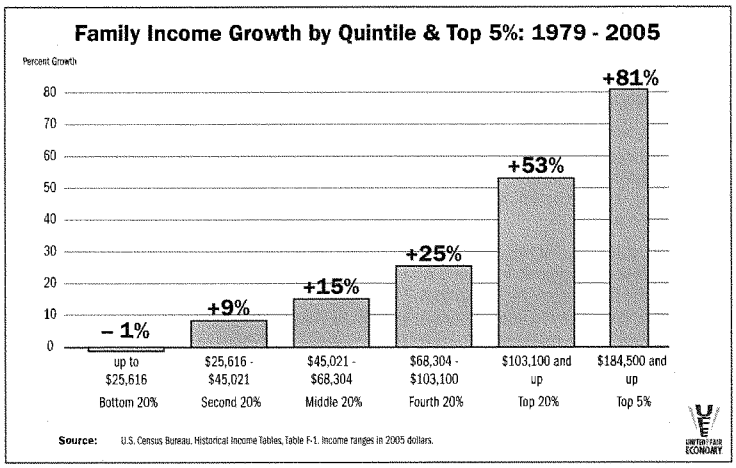


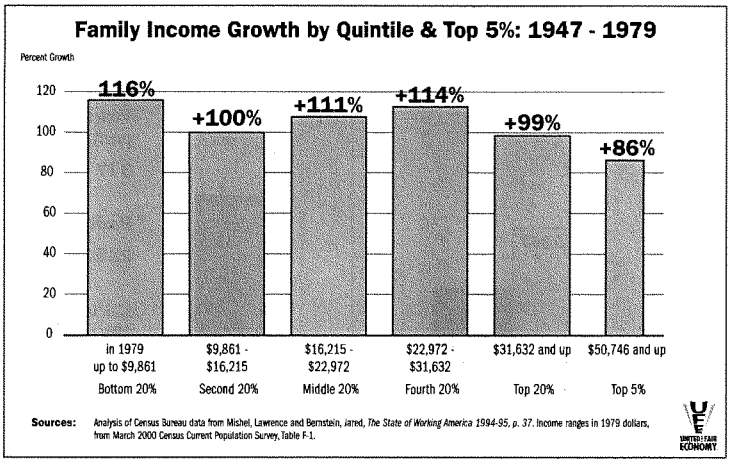
exacerbate both of these trends. As an example, in "1995, the poorest fifth of black families only earned on average 43.0% of what the poorest fifth of white families earned. Again, the economic growth of the late 1990s was a significant boom. The black/white average income ratio for the poorest fifth increased to 49.9% in 2000. By 2005, it had fallen back to 43.4%."[58]


Poverty Rate: 1972 to 2007
35%
30%
25%
20%
15%
10%
5%
0%
33.3%
22.8%
9%
24.5%
21.5%
8.2%
1972
2007
Years to Black-White Parity: 98
Parity Year: 2105
Since 1972, the gap between Whites and Latinos has grown.
White
Black
Latino
Source: U.S. Census Bureau, Historical Poverty Tables, Table 2 <http://www.census.gov/hhes/www/poverty/histpov/perindex.html>.


Median Family Income: 1968 to 2007
$46,678
$27,995
$69,937
$40,143
1968
2007
Since 1968, the gap between Whites & Blacks has grown!
White
Black
Source: U.S. Census Bureau, Historical Income Tables, Families, Table F-5
<http://www.census.gov/hhes/www/income/histinc/f05.html>.


Per Capita Income: 1968 to 2007
$15,063
$8,252
$31,051
$18,428
1968
2007
Years to parity:
347
Parity Year:
2354
White
Black
Source: U.S. Census Bureau, Historical Income Tables, Table P-1
<http://www.census.gov/hhes/www/income/histinc/p01ar>.


Family Income Growth by Quintile & Top 5%: 1979 - 2005
Percent Growth
80
70
60
50
40
30
20
10
0
– 1%
+9%
+15%
+25%
+53%
+81%
up to $25,616
Bottom 20%
$25,616 - $45,021
Second 20%
$45,021 - $68,304
Middle 20%
$68,304 - $103,100
Fourth 20%
$103,100 and up
Top 20%
$184,500 and up
Top 5%
Source: U.S. Census Bureau, Historical Income Tables, Table F-1. Income ranges in 2005 dollars.



As a country, we are seeing some of the greatest income inequality in history. The top 1% garnered the majority of income growth in the last economic boom in the 1990s.[59] More problematic is that 25.1% of all income in the United States goes to the top 1%, surpassing the percentage right before the Great Depression (23%). In addition, in 2006, the median household income of Blacks and Latinos is $38,269 and $40,000, respectively, while their white counterparts come in at $61,280.[60] Furthermore, Blacks and Latinos are more likely to be unemployed than their white counterparts, further expanding their income inequality. In short, Blacks and Latinos are more likely to be unemployed, in poverty, and when employed, make less money than their white counterparts.

The least amount of growth and the greatest income decline is within poor communities, which are disproportionately people of color. From 2000 to 2006, African-Americans saw their median income fall by 2.9% and Latinos saw a near 1% decline.[61] Furthermore, among Blacks, the poorest families lost the largest share of their income gains from the late 1990s.[62]

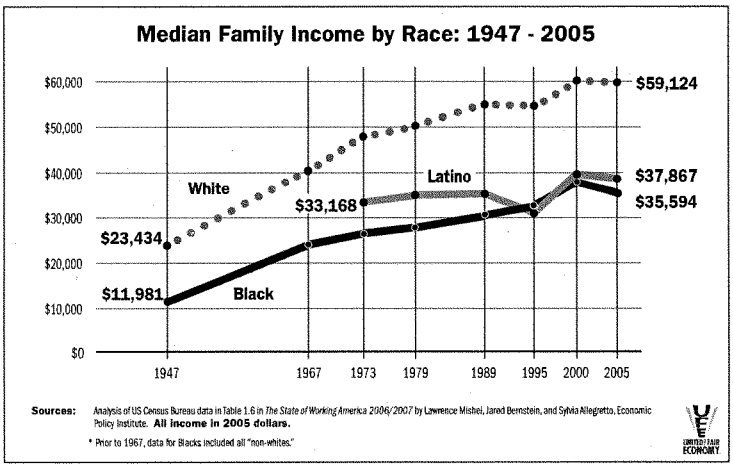
As stated earlier, incomes vary across race and gender, regardless of occupation. In addition, "Between the late 1970s and 2000, the hours worked per year by the average white family grew by 11 percent. In the same time frame, the hours worked by the average African-American/Black family increased by 15 percent and hours worked by the average Latino family increased by 14 percent. In 2000, middle income African- Americans/Black families actually worked the equivalent of nearly 12 full-time weeks more than white families to maintain the same income level."[63]

Now, as people across this country face major economic hardships related to income, people of color are starting with lower incomes for similar work, experiencing the greatest income

declines and highest unemployment. Additionally, for all people in this country, their income is buying fewer goods and services. As of August 2008, the inflation rate was 5.9%, higher than the inflation rates of the last two recessions.[64] Families and individuals are paying more for goods, effectively subjecting them to even greater economic instability. According to a July 2008 study by the Center for American Progress:

> "Higher prices for basic necessities exacerbate the pain of a weak labor market [...] In April 2008, the national average price of regular unleaded gasoline easily shattered an inflation-adjusted record that had stood since March 1981, and they have only continued to climb since then. According to the Energy Information Administration, the national average price for regular unleaded gasoline stood at $4.05 per gallon in June 2008, the most recent complete month for which the data are available. This is a 26.5 percent year-over-year increase, adjusted for inflation, and a painful 133.1 percent increase since March 2001.
>
> Related to the recent upsurge in the price of gasoline are increases in transportation costs, which were 11.4 percent higher in June 2008 than they were the previous June and 33.5 percent greater than they were in March 2001 [the last recession]. And then there's the cost of groceries [...] Nominal food prices increased overall by 5.3 percent between June 2007 and June 2008 – and by a notable 24.4 percent since March 2001 [...] Fuels and utilities cost 12.3 percent more in June 2008 than they did in the previous year, and a notable 48.1 percent more than in March 2001."[65]

Despite current changes in gas prices, poorer populations, who are disproportionately people of color, pay a much greater percentage of their income for everyday necessities,



such as food, than their wealthy counterparts. Data from the 2005 Consumer Expenditure Survey indicates that households earning $10,000 to $14,999 a year before taxes spent an average of 25 percent of their income on food. Households earning $15,000 to $19,999 a year before taxes spent 19 percent of their income on food in 2005, compared to a 9.8 percent average for all U.S. consumers.[66] These high percentages spent on basic goods by the lowest income groups carry through to housing, utilities, and transportation. In essence, working class people and people of color are making less, their incomes are growing less, and they are forced to spend a much greater portion of their income on essential goods and services.

The heavy burden of race and class continue to weigh down families and individuals through housing costs. According to the Joint Center for Housing Studies at Harvard University, "at last measure in 2006, 39 million households were at least moderately cost burdened (paying more than 30 percent of income on housing) and nearly 18 million were severely cost burdened (paying more than 50 percent). From 2001 to 2006, the number of severely burdened households alone surged by almost four million." In nearly half of low-income households, after housing costs are paid, families only have $257 a month left for food, $29 for clothing and $9 for health care.[67] With people of color heavily represented in these populations, rising costs, shrinking wages and a national economic recession are converging to create a perfect storm of economic depression for people of color.

In every major category defined by the NEBR, people of color and the poor are experiencing a recession empirically, and in many categories at rates we have not seen in decades or ever. Moreover, other issues are affecting the economics of these populations that are not reflected in the NBER calculations and that directly affect mobility and stability. Research studying the last three major recessions found that during recessions, the number of people without medical insurance increases, family incomes decrease, and poverty rates increase.[68] These are often clear indicators of a recession.

Looking at these indicators we are able to discern the economic realities of working class people and people of color. Race plays a dominant role in increasing the ranks of the uninsured, as well as in declines in family incomes and increases in poverty rates. Race is the strongest predictor of who will have the least insurance, the greatest decline in wages and the greatest likelihood of being poor.

Measures such as economic inequality, which are good predictors of economic depressions and recessions, are not considered when determining official recessions. Asset levels, which protect the finances of individuals, families and the country at large, and the loss of assets, are one of many economic indicators that are still not used to identify economic downturns.

Although asset ownership is not among the criteria for an economic recession or depression, assets are key to understanding the stability, mobility and current condition for families and individuals in this country since assets are used to weather the storms of economic hardships. As presented previously, we are seeing vast chasms between those with great amounts of wealth and those with fewer or no assets. The majority of people in this country have their wealth concentrated in their home, while the wealthiest individuals have a diversified portfolio of home and property ownership, stocks, bonds, inheritance, business ownership, etc. As with the majority of economic indicators, structural racism creates large gaps in wealth between people of color and their white counterparts. People of color have the fewest assets and the least amount of wealth. Housing is the central component of

wealth for most people in this country, and Blacks and Latinos have homeownership rates of 46.1% and 48% respectively compared to 77% of whites. Furthermore, people of color are more likely to have zero or negative net wealth.[69]

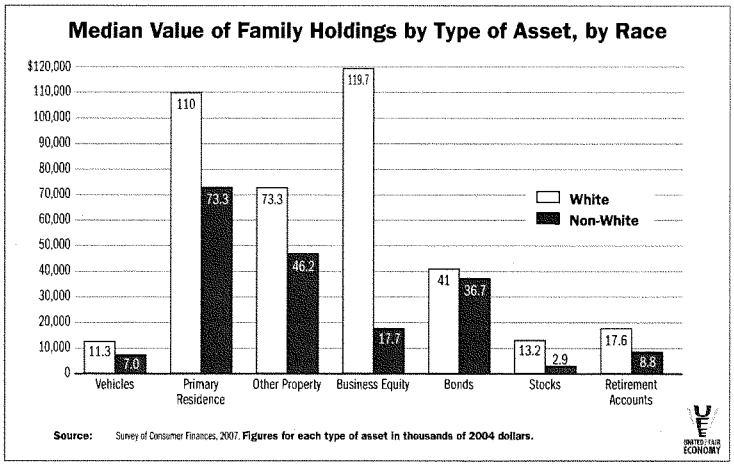
Assets, and the wealth they create, are the greatest predictor of intergenerational mobility and current stability. Studies not only show the importance of wealth on the economic ascendance of children, but also show that childhood wealth is a good predictor of those who will end up with wealth. One study that traced children over 20 years found that 58% of those in the top wealth quartile maintained their wealth status despite an overall rising median. Meanwhile, only 4% of the bottom quartile of the same age demographic rose to the top wealth quartile over the same time period. For people of color, the numbers are starker. Even those people of color in the top wealth quartile are affected by structural oppression, with only 22% remaining there after 20 years and nearly half (47%) going to the bottom half of wealth distribution. [70]

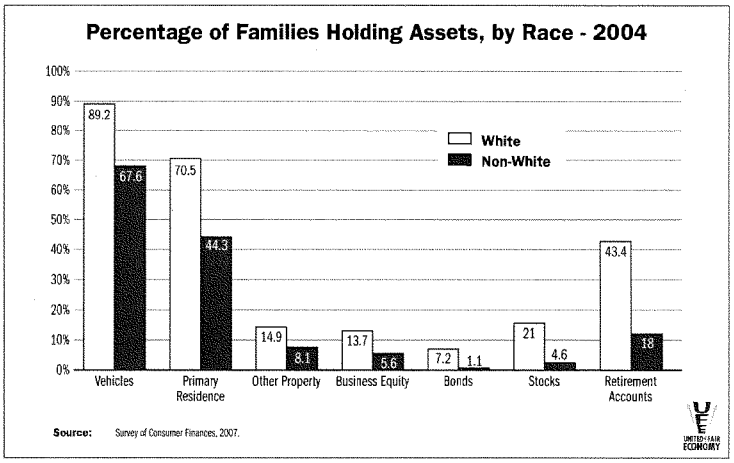
According to a study completed by Demos and the Institute on Assets and Social Policy, "ninety-five percent of African-Americans and 87 percent of Latino middle-class families do not have enough net assets to meet three quarters of their essential living expense for as little as three months" compared to the national average of 78% among middle-class families.[71] Wealth is not just a predictor of future wealth and income, but also of college attendance, neighborhood development and numerous health indicators,[72] which we will explore in Chapter 2.

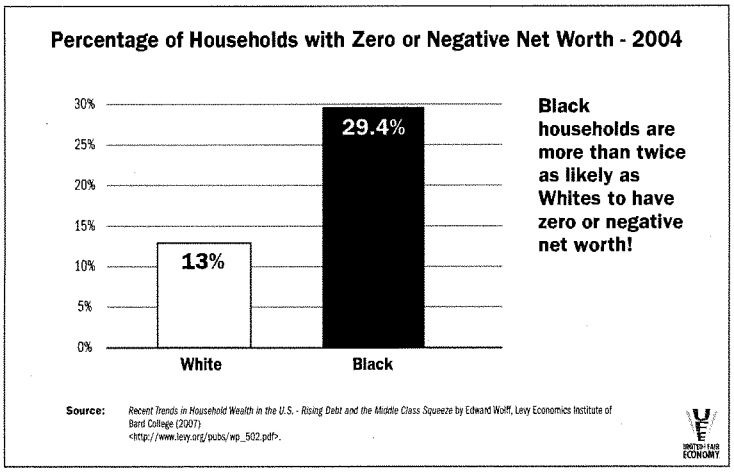
Composition of Household Wealth by Wealth Class - 2004

Asset	All Households	Top 1%	Next 19%	Middle 3 Quintiles
Principal residence	33.5	10.9	32.2	66.1
Liquid assets (bank deposits, money market funds, cash value of life insurance)	7.3	5.1	8.6	8.5
Pension accounts	11.8	5.3	16.0	12.0
Corporate stock, mutual funds, financial securities, personal trusts	17.0	26.9	16.3	4.2
Unincorporated business equity, other real estate	28.6	49.3	25.4	7.9
Miscellaneous assets	1.8	2.6	1.5	1.4
Total assets	100.0	100.0	100.0	100.0

Source: *Recent Trends in Household Wealth in the US: Rising Debt and the Middle-Class Squeeze* by Edward N. Wolff, The Levy Economics Institute of Bard College and Department of economics, New York University, 2007 <http://www.levy.org/pubs/wp_502.pdf>.


Median Value of Family Holdings by Type of Asset, by Race
$120,000
110,000
100,000
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
11.3
7.0
110
73.3
73.3
46.2
119.7
17.7
41
36.7
13.2
2.9
17.6
8.8
White
Non-White
Vehicles
Primary Residence
Other Property
Business Equity
Bonds
Stocks
Retirement Accounts
Source: Survey of Consumer Finances, 2007. Figures for each type of asset in thousands of 2004 dollars.


Percentage of Families Holding Assets, by Race - 2004
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
89.2
67.6
70.5
44.3
14.9
8.1
13.7
5.6
7.2
1.1
21
4.6
43.4
18
White
Non-White
Vehicles
Primary Residence
Other Property
Business Equity
Bonds
Stocks
Retirement Accounts
Source: Survey of Consumer Finances, 2007.

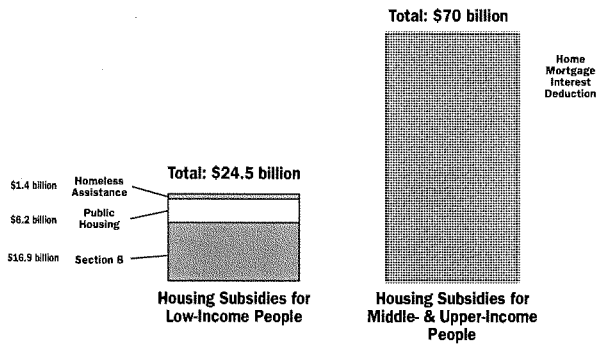


How Did We Get Here?

As stated earlier, these numbers and experiences are the result of a lack of comprehensive public policy. Before we can help develop a plan to alleviate these problematic issues that affect us all, we must understand the policies that helped shape and create this economic crisis. Dean Baker, Co-Director of the Center for Economic and Policy Research, summed it up well in his testimony to the House Ways and Means Committee, in which he said:

> "Specifically, the federal government pursued policies that tended to benefit corporations and better educated workers at the expense of most of the working population. There are many areas of public policy in which it is possible to identify an upper class bias. I will focus on four areas that I consider most important:
>
> 1) **Trade and Immigration**. The federal government has pursued policies in this area that had the effect of putting workers without college degrees in direct competition with low-paid workers in developing countries. At the same time, it has largely protected the most highly educated workers (e.g. doctors, lawyers, accountants) from the same sort of competition. The predicted results of this asymmetric opening of trade are the sort of upward distribution that we've seen over the last quarter of a century.
>
> 2) **Federal Reserve Board Policy**. The Federal Reserve Board has pursued an aggressive anti-inflation policy over the last quarter century, largely ignoring its legal mandate to target full employment, which is defined in the law as 4.0 percent unemployment. The Fed's main weapon for

Government Housing Assistance - 2005



Source: Joint Committee on Taxation; Department of Housing & Urban Development. All figures are for FY 2005.

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Share of Asset-Building Federal Tax Expenditures - 2006

Population Group by Income	Hope Credit	Lifetime Learning Credit	Student Loan Interest Deduction	Home Mortgage Interest Deduction	State & Local Property Tax Deduction	Self-Employed Health Insurance Deduction	Earned Income Tax Credit	Child & Dependent Care Credit	Preferential Rates on Capital Gains & Dividends	Tax Benefits of the Partial Exclusion for Social Security	Exclusions & Deductions for Retirement Savings	**All Select Federal Tax Expenditures Combined**
Bottom Quintile	0.8	1.1	0.4	0.0	0.0	0.2	27.7	0.0	0.0	1.1	0.1	**3.4**
Second Quintile	13.6	12.7	4.9	0.4	0.6	1.7	52.0	4.1	0.1	14.1	2.4	**8.0**
Middle Quintile	24.7	25.0	22.8	3.1	3.4	6.5	19.4	23.7	0.4	29.7	8.1	**7.7**
Fourth Quintile	34.1	35.5	29.7	14.9	17.6	15.0	0.6	30.8	2.0	36.1	17.2	**12.3**
Top Quintile	26.8	25.8	42.3	81.5	78.4	76.6	0.1	41.4	97.6	19.0	72.2	**68.6**
All	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	**100.0**

Source: How Much Does the Federal Government Spend to Promote Economic Mobility and for Whom? by Adam Carasso, Gillian Reynolds, and C. Eugene Steurle. Table 1: data from Urban-Brookings Tax Policy Center Microsimulation Model. The Economic Mobility Project of the Brookings Institute <www.urban.org/UploadedPDF/411610_economic_mobility.pdf>.

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controlling inflation is higher unemployment, which has the effect of putting downward pressure on wages. The workers who are most affected when the unemployment rate rises are those at the middle and bottom. Sales clerks and manufacturing workers are far more likely to be laid off in a downturn than doctors and lawyers. There is also an important racial dimension to this issue. If the overall unemployment rises by 2.0 percentage points because of the Fed's efforts to contain inflation, the unemployment rate for African Americans is likely to rise by 4 percentage points, while the unemployment rate for African American teens would rise by close to 12 percentage points.

3) **Labor-Management Policy**. In the last quarter century, corporations have become far more aggressive in confronting unions, especially in obstructing efforts to organize. It is now standard practice for management to simply fire any workers who are thought to be involved in an organizing drive. While firing workers for union activity is illegal, the sanctions are too small to discourage law breaking. Largely as a result of management hostility, unionization rates in the private sector have fallen to just above 7 percent from more than 20 percent back in 1980. De-unionization has systematically lowered wages for workers without college degrees.

4) **Corporate Governance**. For a variety of reasons, the factors that constrained the behavior of CEOs and top corporate management have largely broken down. As a result, these insiders have unprecedented ability to plunder corporations to serve their own interest. CEO pay for Fortune 500 companies now averages almost 300 times the pay of an

Minimum Wage vs. Living Wage - Massachusetts, 2008

	One Adult	One Adult, One Child	Two Adults	Two Adults, One Child	Two Adults Two Children
Living Wage (per/hour)	$11.75	$19.65	$15.48	$21.71	$26.11
Minimum Wage (per/hour)	$7.50	$7.50	$7.50	$7.50	$7.50

Minimum Wage vs. Living Wage - California, 2008

	One Adult	One Adult, One Child	Two Adults	Two Adults, One Child	Two Adults Two Children
Living Wage (per/hour)	$10.31	$19.06	$14.25	$21.02	$26.87
Minimum Wage (per/hour)	$7.50	$7.50	$7.50	$7.50	$7.50

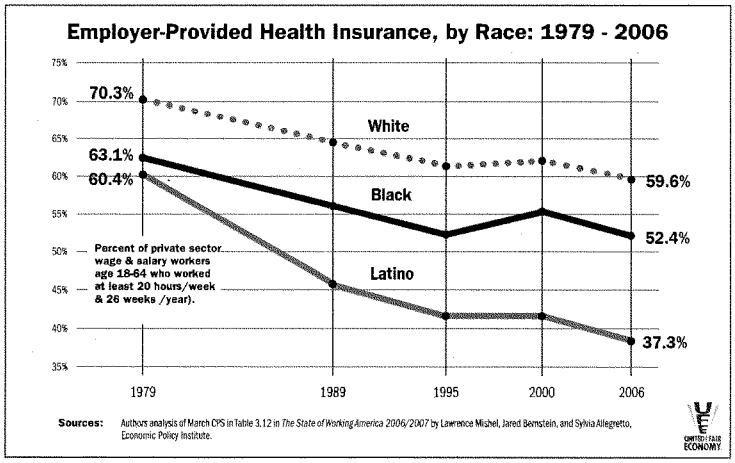
Source: Living Wage Calculator <http://www.livingwage.geog.psu.edu/>. The Living Wage shown is the hourly rate that an individual must earn to support their family, if they are the sole provider and are working full-time.

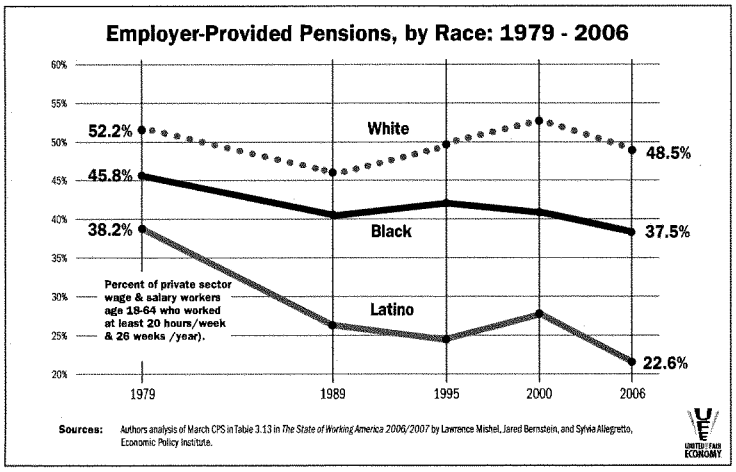
> average production worker. Such exorbitant salaries not only take away money from shareholders and workers, they also set benchmarks for the rest of the economy. As a result, it is now common for top executives in institutions like universities and non-profit hospitals and even private charities to earn salaries in the high six-figures."[73]

Continuing with the key points made by Dean Baker, U.S. government policy has shifted away from the more economically vulnerable of our population towards those with more money. No system of policies is more telling than tax policy and, overwhelmingly, U.S. tax policies have benefited those with assets and large incomes. A major example of this discrepancy is the Home Mortgage Interest Deduction, which effectively does not have any upper limits for the value of a home and costs the government close to $70 billion per year. In contrast, the housing assistance program, which helps low- to moderate-income families, costs only about $24.5 billion annually.[74]

From payroll taxes to personal income taxes, tax revenues have all shifted drastically in the last decade, and even more so within the last few years. Furthermore, increasing amounts of money go to the wealthy through tax expenditures (i.e., tax deductions that do not appear in the government's budget). In 2006, over 68.6% of funds in government programs that are designed to create mobility was directed towards the top 10%.[75]

This trend of the government supporting the wealthiest also holds true for assets, which are the key to economic mobility and stability. This is most evident in the subprime debacle, which undermined the central assets for most people in this country, particularly people of color, and led to the greatest loss of wealth in recent history for people of color. Interestingly, the only regulation to address this situation that has passed as of September 2008 is weak, containing a clause called "preemption" that effectively eliminates strong regulation policies




Employer-Provided Pensions, by Race: 1979 - 2006
60%
55%
50%
45%
40%
35%
30%
25%
20%
52.2%
White
48.5%
45.8%
Black
37.5%
38.2%
Latino
22.6%
Percent of private sector wage & salary workers age 18-64 who worked at least 20 hours/week & 26 weeks /year).
1979
1989
1995
2000
2006
Sources: Authors analysis of March CPS in Table 3.13 in The State of Working America 2006/2007 by Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, Economic Policy Institute.
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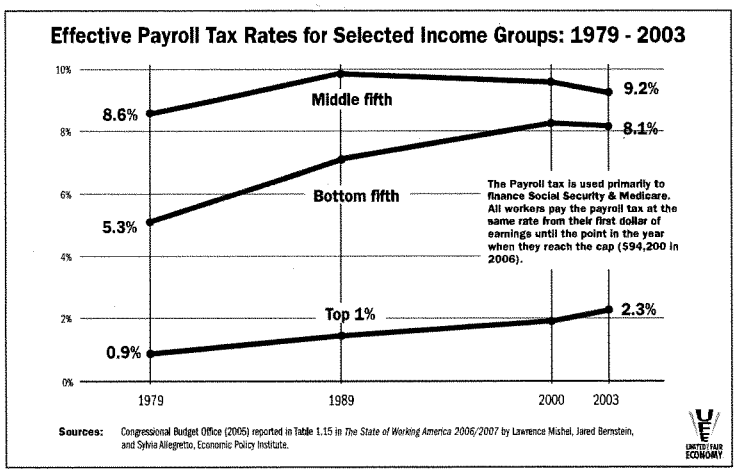
Effective Payroll Tax Rates for Selected Income Groups: 1979 - 2003
10%
8%
6%
4%
2%
0%
8.6%
Middle fifth
9.2%
8.1%
5.3%
Bottom fifth
The Payroll tax is used primarily to finance Social Security & Medicare. All workers pay the payroll tax at the same rate from their first dollar of earnings until the point in the year when they reach the cap ($94,200 in 2006).
Top 1%
2.3%
0.9%
1979
1989
2000
2003
Sources: Congressional Budget Office (2005) reported in Table 1.15 in The State of Working America 2006/2007 by Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, Economic Policy Institute.
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on the state level that provide protection from predatory lending now and in the future. Public policy officials have yet to pass comprehensive community-centered polices that address the growing racial wealth gap – a median wealth of 15 cents for people of color for every dollar of white wealth.[76] Reflecting the massive wealth concentrated among a few white people, on average, people of color have just 8 cents for 1 dollar of white wealth. And while this current crisis is disproportionately effecting people of color, particularly in the subprime housing disaster, which is well documented in *State of the Dream 2008: Foreclosed*, civil rights enforcement has been weak, and in some states non-existent.

Other government policies have also hindered economic solutions to our current crisis. Workers' benefits are frequently tied directly to jobs – jobs that may be lost in a recession. The minimum wage was finally increased after 10 years of struggle, but was not tied to inflation so the value of a minimum wage job continues to erode. Even states like California and Massachusetts, which hold two of the highest state minimum wages in the country (at 8 dollars an hour), do not protect the populations who are most vulnerable. Jobs held primarily by the poor and people of color offer the lowest wages and offer the fewest benefits. They do not cover essential living expenses. This perpetuates structural cycles of economic insecurity.

In addition, federal policies providing incentives for the outsourcing of work, which disproportionately affect low-wage workers, continue to be debated instead of ended. Current federal provisions allow U.S. companies to move their headquarters outside of the United States, effectively shifting and reducing their taxes, even though they continue to make their profits from people in this country. These provisions encourage the movement of jobs overseas, particularly manufacturing jobs, which disproportionately affects people of color and the working class.

Furthermore, the shift of benefits such as healthcare, dental, and retirement accounts, from employer sponsored to employee burden, has left the most vulnerable of society struggling.

Many of these current policies could also potentially create future insecurity. Due to limited resources, people of color have the least amount of money saved in banks and retirement accounts. They often must continue working well past the age of retirement to supplement their income and maintain a decent standard of living.

These policies continue to trap working class people in a recession, and communities of color in a depression. In addition to the erosion of sustaining policies, protections for those who are having financial difficulties have also shifted in favor of corporations. In 2005, bankruptcy laws were changed so that debt associated with medical bills and housing, the two most expensive items for families and often the cause of their economic woes, were no longer excluded. Now, in this struggling housing market, bankruptcy courts that might have provided a solution instead perpetuate the problem.

During this financial crisis, the government has, until recently, failed to pass extensions on unemployment insurance and temporary aid to needy families, but has simultaneously pumped out hundreds of billions of dollars in subsidies to corporations and industry professionals plus a $700 billion bailout for financial institutions. While some money was allocated for counseling people who faced home foreclosure, very little money was directly injected into communities to stabilize their human-created financial disasters.

Conclusion

To paraphrase an old adage "when America catches an economic cold, African Americans get fiscal pneumonia." As the impacts of the current recession for the entire country continue to mount and the disastrous depression effecting people of color deepens, we are beginning to see the serious consequences of extreme inequality. This country was built on the cornerstone of equity, and though the drafters of the Constitution were unable to see it implemented, as citizens of this country we are still charged with bringing it to fruition. Lately, we have failed at our job.

Advocates, practitioners and scholars have long recognized and publicized the overwhelmingly clear empirical evidence of the economic difficulties of people of color and of the lack of a holistic, comprehensive public policy that would improve their circumstances. Yet, we continue to see the cost of not addressing economic inequality and structural racism. These issues are not intractable: they were created, so they can also be eliminated. The costs of inequality are often much greater than first perceived. Nothing is more vivid than the tragic ongoing effect of millions of subprime mortgages being sold to consumers: our current financial crisis.

Ensuring equality of opportunity can help reshape our society and help lead us to a robust economy as it has in the past during some golden moments in our history. It was a dream of Martin Luther King, Jr. to enable all people to seek their own economic self-determination, and this dream can be a shining beacon in the world. We have a unique opportunity in history to build dreams instead of nightmares, to build on hard work instead of inequity, and to replace fear with the hope that all people, regardless of their skin color, can achieve the economic destinies they deserve.

Chapter 2: **CHAOS OR COMMUNITY?**

In Martin Luther King Jr's book, *Where Do We Go from Here: Chaos or Community?*, he articulated the inextricable economic link between the individual and the community. He warned of the consequences of ignoring the economic development of all communities and clearly discussed how economic inequality, exacerbated by structural racism, limits the economic futures of individuals and families.

"Even though we have a civil rights bill, the Negro is still at the bottom of the economic ladder, Even though we have a civil rights bill, the Negro is still smothering in an airtight cage of poverty in the middle of an affluent society...Even though we have a civil rights bill, the Negro is still confined to slums and ghetto..."

Martin Luther King, Jr., 1965
"A Long Way to Go"

While systematic individual incidents of racism – from hate crimes to pay inequity – still occur frequently in all aspects of society, where a person comes from and lives also plays a critical role in his or her economic future. Despite gains in some areas, the United States still remains incredibly segregated. "[T]he average white person in U.S. cities and suburbs lives in a neighborhood that is overwhelmingly white (about 84 percent) [...] The typical neighborhood for a white person is just 7.1 percent Black, 6.2 percent Asian, and 3.2 percent Latino."[77] In a society free from structural racism and economic inequality, communities based on ethnicity, shared values and culture could and should be celebrated. In an historical context, ethnic enclaves do help create economic stability for families and individuals. Yet, in the historical context, and even more problematically in the contemporary context, communities are confined by race and income. These constrictions dictate a particular set of economic resources, leaving entire communities vulnerable compared to their white counterparts. In essence, the whiter the community, the more access people in the community have to transportation, jobs, school, social mobility and healthcare.[78] This is what scholars often refer to as "place and opportunity."[79]

Too often, the devastating impacts of structural racism on communities of color go unnoticed and unaddressed. The ripple effects of these human-made economic disasters continue to drown entire communities for generations. As the empirical evidence continues to mount on the cost of racial discrimination to individuals, community effects often end up "beyond the radar" in contemporary policy debates. In communities of color, historical and contemporary forms of economic injustice materialize in both predictable and unpredictable ways. The impact of a singular major event of injustice is the proverbial rock thrown into a pond. Once the rock hits, the ripples go far and wide.

Due to systemic inequality, communities of color get the fewest benefits during economic booms, and experience the largest deficits in economic downturns. This economic structure, caused by policies that disproportionately affect people of color, continues to cause gaps in incarceration rates, neighborhood quality, housing affordability, job access, health, retirement, and educational attainment. These gaps maintain low economic mobility for entire communities. Measures of these gaps help paint a clear picture of the economic barriers that create cycles of economic instability for communities of color. Even our current economic crisis is due in part to the instability of an economy built on structural racism and growing class divisions. Indicators that measure these gaps, already alarming in the best of economic times, rise to epidemic levels in economic downturns.

Some argue that housing is simply a personal choice. Even though research shows that one of the largest reasons for white segregation from people of color is the view that the mere

presence of Blacks will cause the loss of property values,[80] considerable empirical evidence suggests that there is a more complex reason for segregation. The research demonstrates that public policy, poorly implemented regulations, racial discrimination, improper economic zoning, state and federal funding priorities and lack of affordable housing together create "geographies of opportunity" that reinforce racial and income divisions.[81]

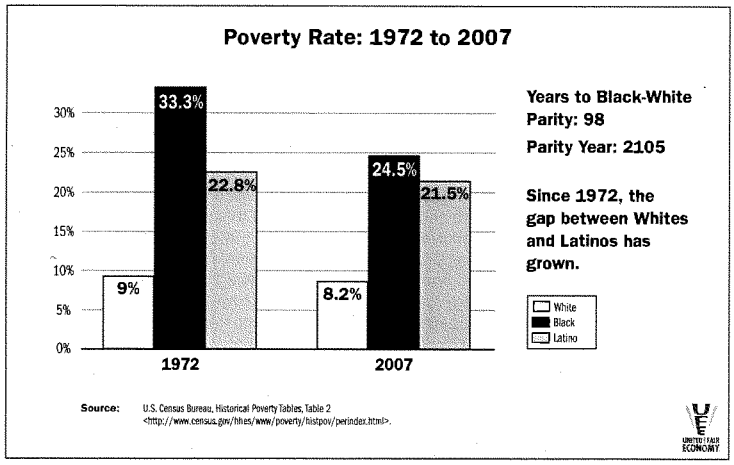
Ineffective policies, lackluster federal and state initiatives, and unaddressed structural racism often produce poverty. While disastrous to economies in general, concentrated poverty exacerbates economic inequality during economic downturns. Eight million households live in a concentrated high-poverty area, which is defined as an area with a 40% poverty rate.[82] Despite some gains in the 1990s that began erasing the strong lines of racial and income segregation that plague the United States, a 2008 study using the latest research found that "among 58 large metropolitan areas, rates of concentrated working poverty rose in 34 over the first half of the decade, while 24 showed decline."[83] Sadly, the small level of decline in high-poverty areas cannot be correlated to declines in poverty rates or incomes gains of the population. According to the most recent data, poverty has remained "level," at approximately 37 million people, for the country at large. However, the calculation used for the U.S. Census Bureau's poverty determination is being disputed for its lack of a comprehensive approach. The current poverty measure, which has remained the same for nearly 40 years, is based mostly on food expenditures, which underestimates economic indicators for the most marginalized, who often spend a large percentage of their incomes on utilities, rent and medical care. For example, in New York, adopting new policies that more accurately identified poor populations demonstrated a 23% poverty rate as compared to the federally calculated poverty rate for New York of 18.9%.[84] There have been small declines seen by the study in the metropolitan areas, but they can be attributed to undercounting and gentrification of urban areas. In other words, the grim reality is that America's communities are re-segregating by race and class.

Blacks and Latinos still disproportionately live in areas with concentrated poverty compared to their white counterparts. According to the most recent census data, Blacks and Latinos are five to six times more likely to live in an area of poverty than whites.[85] As an example of this national phenomenon, a study in the Boston Metropolitan Area found that "[p]oor blacks and Latinos are over twice as likely to live in high-poverty neighborhoods than are poor whites. Indeed, a substantial share of poor whites reside in largely middle-class, suburban neighborhoods, while most poor blacks and Latinos dwell in much higher-poverty, urban, racially-segregated neighborhoods. Incredibly, even Black and Latino households with incomes over $50,000 per year are twice as likely to live in high-poverty neighborhoods than are white households with incomes less than $20,000."[86]

"An individual has not started living until he can rise above the narrow confines of his individualistic concerns to the broader concerns of all humanity."

Martin Luther King, Jr., 1959
"The Measure of a Man"

While poverty has remained an issue for decades, we continue to ignore that race is one of the largest predictors of who is poor, who becomes poor, and who stays poor. During times of crisis, these inequalities create pockets of economic depressions that drown communities for generations. Empirical evidence continues to show over the long–term that regardless of income and family structure, race predicts the type of neighborhoods families are exposed to. Yet, the more problematic issue is the constant battling of families and individuals of


Poverty Rate: 1972 to 2007
30%
25%
20%
15%
10%
5%
0%
33.3%
22.8%
9%
24.5%
21.5%
8.2%
1972
2007
Years to Black-White Parity: 98
Parity Year: 2105
Since 1972, the gap between Whites and Latinos has grown.
White
Black
Latino
Source: U.S. Census Bureau, Historical Poverty Tables, Table 2 <http://www.census.gov/hhes/www/poverty/histpov/perindex.html>.
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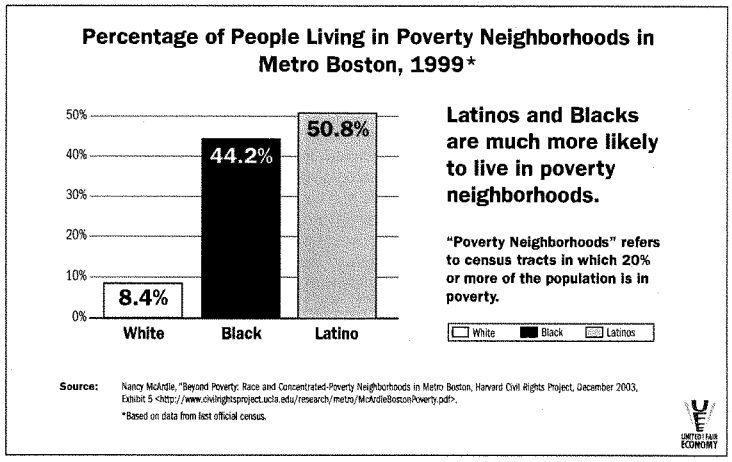
Percentage of People Living in Poverty Neighborhoods in Metro Boston, 1999*
50%
40%
30%
20%
10%
0%
8.4%
44.2%
50.8%
White
Black
Latino
Latinos and Blacks are much more likely to live in poverty neighborhoods.
"Poverty Neighborhoods" refers to census tracts in which 20% or more of the population is in poverty.
White
Black
Latinos
Source: Nancy McArdle, "Beyond Poverty: Race and Concentrated-Poverty Neighborhoods in Metro Boston, Harvard Civil Rights Project, December 2003, Exhibit 5 <http://www.civilrightsproject.ucla.edu/research/metro/McArdleBostonPoverty.pdf>.
*Based on data from last official census.
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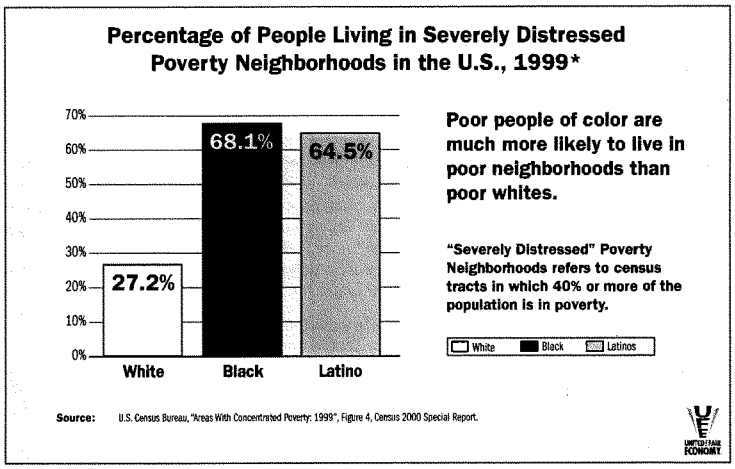


color to leave high poverty neighborhoods, only to find themselves falling back into the area in a relatively short period of time. People of color experience this "reemergence" into highly poor communities at vastly different rates than their white counterparts.[87] One study found that only 10% of whites experienced living in a highly poor neighborhood in a 10-year period.[88]

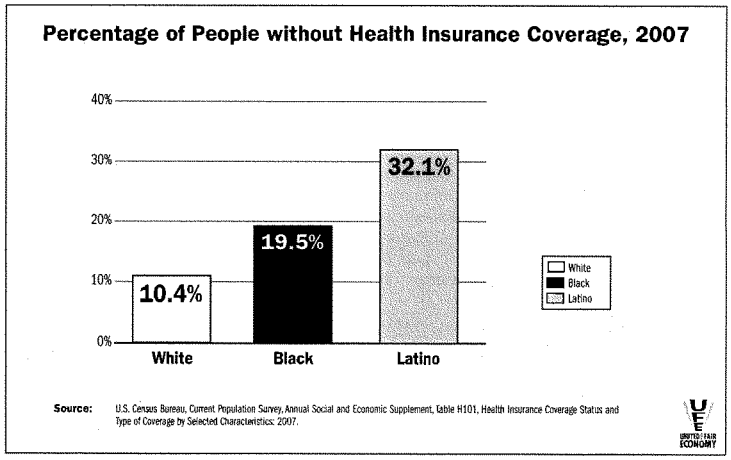
The depth and impact of poverty on individuals and families cannot be understated, yet it is the structural "silo-ing," the racial segregation of specific communities, that continues to destroy the economic futures of the people trapped in these communities. The concentration of poor and low-income people in communities creates structural barriers that maintain a nearly permanent population that remain poor and economically immobile. In communities with concentrated poverty, jobs are scarce and crime rates are high. Health problems abound and educational attainment does not. Schools are underfunded and usually underperforming. Access to transportation is difficult or non-existent. Community and individual assets are much lower than in other communities. With people of color being overrepresented in the lowest-income quintiles, the inequalities perpetuated ensure that economically marginalized areas remain for generations. Racial and economic segregation not only damages the future of those who experience it, but continues to be a crack in the foundation of our economy that serves to worsen economic downturns, affecting the entire country.

The Growing Community of Working Poor

It is well documented that low-income and poor individuals often work harder jobs, longer hours, and for less pay than their counterparts, despite the popular belief that these populations do not work. Most of those in this economic position are seeking work, but – due to structural inequality that drains good jobs from communities – the need, desire and ability

to work does not translate into a job. In 2006, 7.4 million people made up the "working poor," which means they worked for at least 27 weeks (over 6 months) of the year, but still lived below the federal poverty level. Blacks and Latinos are more than twice as likely to be considered working poor, compared to their white counterparts. The major problem for the working poor was not the inability to work, but what the Bureau of Labor Statistics calls "market problems." These problems typically fall into to three categories: unemployment, low earnings, or involuntary part-time employment. Most job opportunities available in heavily concentrated poor communities are part-time, temporary jobs. In 2006, the most recent data established that 83.6% of those who usually worked full-time experienced at least one labor market problem. The majority of the working poor (7 out of 10) reported low wages as being the most persistent problem.[89] A recent report states that the number of jobs with pay below the poverty threshold rose to 29.4 million, or 22% of all jobs, in 2006, from 24.7 million, or 19% of all jobs in 2002. [90] In other words, a person could work full-time all year and still have an income that would place them at or under the poverty threshold.

Community assets erode away as major industries leave urban centers with large low-income and poor populations. This impact is a double burden: the loss of a job removes individual financial assets and also reduces community assets from business investment (which helps support roads, schools, and hospitals). Public policy that continues to shift jobs from urban centers to rural or suburban spaces and provides incentives to move jobs abroad limits access to jobs for populations who lack the transportation and financial resources to relocate. In these poor communities, jobs that would provide long-term financial security, such as those in the manufacturing industry, are being replaced with service-industry jobs. This drastically changes the job landscape from one that, at best, would often have unions, upward job mobility and employer-based benefits, to one that lacks unions, features high turnover, and few to no employer-based benefits.[91] In particular, studies have found that



what academics term "spatial mismatch" affects people of color more than their white counterparts. In essence, the less industrialized and decentralized the metropolitan area, the less able people of color are to get access to jobs.[92] This is because even poor whites often have more economic resources and forms of social capital to follow the jobs than do their counterparts of color.

The absence of employer-sponsored benefits, particularly healthcare, maintains the already problematic level of health disparities these low-income communities experience. Abandoned buildings that were once industrial spaces now crowd poor urban centers, often called "brownfields." Some buildings still have lead paint plastered to their walls and contribute to giving people in poor communities and communities of color more health issues than people in any other communities. Furthermore, the pollution from industries that have been deregulated in an attempt to maintain their presence creates health disparities for generations.[93] These major environmental factors, combined with the population's relative inability to receive regular check-ups from hospital staff and to afford medications, immunization and vaccine shots, literally take years off the lives of people within these communities. People of color bear the burden of those costs disproportionately. In the documentary *Unnatural Causes*, the links between poverty, race, and location are clearly laid out. This documentary brings to light the role of stress due to job fluctuations, school issues, high crime, long commutes and insufficient public funding that affects the health of poor people and communities of color. It finds that even overweight white smokers will live longer than their people of color counterparts with the same habits, and in some instances will live longer than people of color who do not share the same habits.[94]

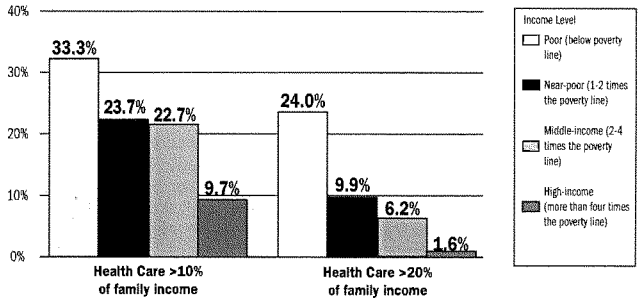
In addition, and perhaps even more problematically, a large percentage of this population do have some form of insurance, but it is inadequate to meet their needs, and limits their ability to qualify for government sponsored healthcare, which can cover more, and cost less. Of the underinsured, an estimated 73% had incomes equal to less than 200% the federal poverty level.[95] In other words, the poorest and sickest typically have inadequate to non-existent health coverage.

Furthermore, the poor, who are disproportionately people of color, pay more for healthcare, based on where they live, than their wealthy counterparts, and receive the least amount of healthcare resources.[96] Their wealthy counterparts can afford insurance that will negotiate with hospitals, pharmacies and other institutions to obtain the best prices. In poorer communities, due to the low numbers of insured, prices are defined and not negotiated. These "invisible" health problems affect their ability to even work the low-paying, low-mobility jobs available in their communities.[97]

Crime and the Community

Crime, which has been highly correlated with concentrations of poverty, has dual effects on high-poverty communities – physical/emotional and economic. The violence has long-lasting ripple effects. Robberies, murders, and violent crimes are higher in these neighborhoods, leading to lower longevity rates. Crime rates affect the value of homes, rental rates, and school safety for children. Crime, and the disproportionate number of crimes that the poor and people of color are convicted of, can severely hamper future earning potential, even for small crimes such as traffic violations. Poor people and people of color are

Percentage of Nonelderly Families with High Out-of-Pocket Health Care Costs, 2003



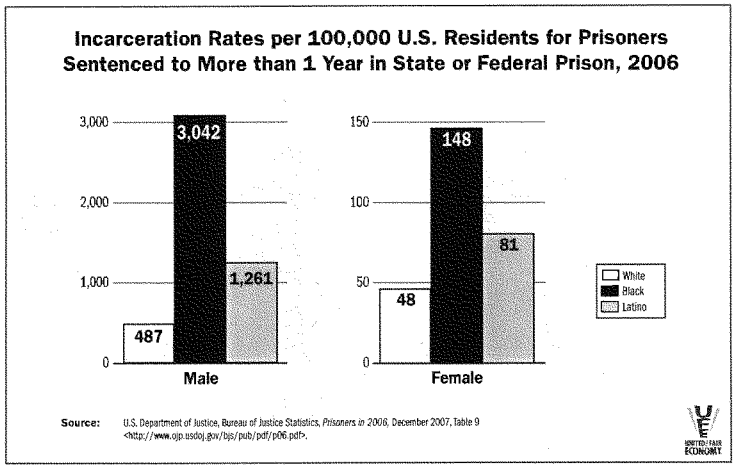
Source: Banthin & Bernard (2006) *Changes in Financial Burden for Healthcare*, JAMA (296), Table 2.

Average Jail Sentence in 2002, by Race

Offense	Whites	Blacks
Murder	213	240
Robbery	78	92
Burglary	37	44
Fraud	25	30
Drug Possession	20	23
Drug Trafficking	38	45

All statistics are for males only. Length of sentences are in months.

Source: Bureau of Justice Statistics, U.S. Department of Justice <http://www.ojp.usdoj.gov/bjs/welcome.html>.


Incarceration Rates per 100,000 U.S. Residents for Prisoners Sentenced to More than 1 Year in State or Federal Prison, 2006
3,000
2,000
1,000
0
3,042
1,261
487
Male
150
100
50
0
148
81
48
Female
White
Black
Latino
Source: U.S. Department of Justice, Bureau of Justice Statistics, Prisoners in 2006, December 2007, Table 9 <http://www.ojp.usdoj.gov/bjs/pub/pdf/p06.pdf>.
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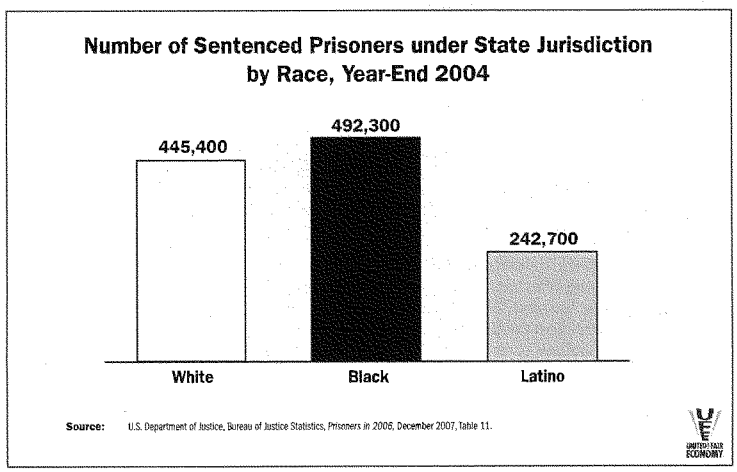
Number of Sentenced Prisoners under State Jurisdiction by Race, Year-End 2004
445,400
492,300
242,700
White
Black
Latino
Source: U.S. Department of Justice, Bureau of Justice Statistics, Prisoners in 2006, December 2007, Table 11.
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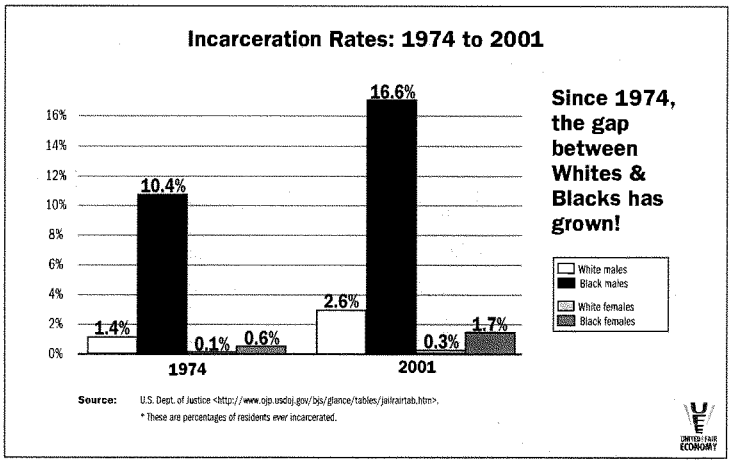


arrested more often and are given longer sentences for the same crimes than their white and wealthy counterparts.

People of color are disproportionately represented in the prison population. A Black boy has a 1 in 3 chance of going to prison in his lifetime and a Latino boy has a 1 in 6 chance.[98]

Arrest and imprisonment are just the beginning of the barriers for poor people and people of color. Often, having a criminal record, even if the crime was committed at an incredibly young age and was a relatively small offense, can create barriers to employment. Sadly, at times, the barriers are financial, such as not being able to post bail. Lacking funds for bail results in immediate imprisonment, regardless of innocence, and may later affect employment, housing and other needs.[99] These barriers can seem entirely overwhelming, and can result in individuals resorting to "criminal" behavior as a means to create income that leads to cycles of recidivism (i.e., the re-entry into prison). Rob Carmona, a self-identified ex-offender and substance abuser, before the U.S. Congress Joint Economic Committee, eloquently laid out the problem men of color face when they are dealing with "re-entry" into communities:

> "Black/Latino men live in communities of concentrated poverty. Beyond being affected by the social pressures described above, these communities are isolated from the economic mainstream and thus lack networks of employed people, access to the informal avenues most people use to hear about job openings, and working role models.
>
> Society at large tends to further distance Black/Latino men from the job market. There are long-standing stigmas about minority youth, young adults, and Black/Latino men as being poor performers on the job. Additionally, if these men are ex-offenders, there are additional barriers keeping them from

being considered for many types of employment. (Jobs or entire industries are out of reach, such as banking, law firms, jobs at airports, etc.) Many employers impose additional restrictions that go far beyond those imposed by law. Many employers will not hire former offenders even if they are legally permitted to do so, fearing problems among co-workers, liability problems, risk to property and image and reputation."[100]

Employers often discriminate based on criminal background checks for myriad reasons. Many employers do not know how to read or interpret the criminal background paperwork they are requesting, a problem exacerbated by the paperwork itself, which is often marred with mistakes, indicating the wrong crime, severity of the crime, or crimes that should not be listed.[101] The effects of incarceration are compounded by racial discrimination: a white applicant with a criminal background is more likely to get a position than the equivalent person of color without any criminal record.[102]

Case Studies

The following case studies look at two communities with concentrated poverty, the consequences of that poverty, and the ripple effects of ineffective public policy that does not address the nature of structural economic racism. These communities each have a large concentration of people of color, and the case studies reflect the complex nature of policies that maintain racial hierarchies, but which on the surface are seemingly "color-blind."

Springfield, Massachusetts Case Study: Employment

It is hard for residents of the case area to find a job – especially one that pays a living wage. Many residents in the community lack a high school diploma or college degree, limiting their employment opportunities. Moreover, there appears to be a mismatch between the kind of jobs people are trained for through government programs and the higher-wage jobs that provide a route out of poverty.

In particular, Springfield has experienced a spatial mismatch between residents' skill levels and available jobs. Between 1985 and 2000, most of the job growth has occurred in the metropolitan area, while the city of Springfield has lost jobs in industries such as manufacturing, construction, and finance. In contrast, most of the job growth in Springfield has been in the services sector. Aimee Griffin Munnings, executive director of the New England Black Chamber of Commerce, observed that residents "tend to have multiple jobs to survive because [the] service [industry] does not pay well." A recent study by the Pioneer Valley Planning Council confirms that Springfield's residents "are heavily concentrated in service and sales or office occupations." The report further noted although there are a number of jobs in health care and education, Springfield residents tend to be "serving in lower wage occupations in these industries."

The lack of higher-paying jobs in Springfield contributes to lower household incomes. The median household income in the case study area in 2000 stood at $18,804, less than half of the median household income of $41,206 of the Springfield Metropolitan Statistical Area (MSA). "How do you manage your life on minimum wage?" asked Leslie Lawrence, who works for MassDevelopment, an economic development agency. James Morton, president and CEO of Greater Springfield YMCA, echoed Lawrence's point, "In this community, livable-wage jobs are even harder to find than that baseline [minimum-wage] job."

The case study area's unemployment rate is also significantly higher than the region's and is especially high among specific subgroups. In 2000, the unemployment rate for the case study neighborhoods was 14%, compared with 5% for the Springfield MSA. The fastest growing population in the case study area, the Hispanic population, has the highest unemployment rate of all racial or ethnic groups, with 18% of Hispanic males and 24% of Hispanic females unemployed.

Skill-building and training programs are available to residents. Some are located close to the case study area; however, the training opportunities do not always match available job opportunities. The Massachusetts Career Development Institute in Springfield assists about 1,000 students per year in taking the General Educational Development Test (GED) or obtaining certification in a specific profession. But completion of the program does not necessarily mean that participants are entering professions with high-paying jobs. James Morton, former director of the institute, observed "frequently the demands of the job market change, yet it takes considerable time for training dollars to reach the field to provide the specific training needed to the meet the demand."

East Austin, Texas Case Study: Gentrification

Local residents saw gentrification coming 10 years ago, but it has accelerated over the past several years. "The market hit the east side of town like a hurricane," said Paul Hilgers. "There's not much you can do to stop the market forces." He pointed out the dilemma of gentrification – those moving have "great opportunities," he noted, but longtime residents do not.

Vacant lots and modest, run-down houses are selling at previously unheard-of prices, making them unaffordable for long-time residents. Locals see properties being flipped, and white-collar professionals without children are moving into expensive condos and houses that are newly renovated, expanded or brand-new. What has been largely a single-story landscape is going vertical. These developments have driven up land and house values exponentially.

As the face of housing in East Austin changes, the increase in housing values has led to a new affordability pressure, particularly among low-

income residents who remain in the community. Housing values in East Austin have increased an estimated 117% from 1999 to 2005 compared with the city's increase of just 30%. Increased property values are likely to affect renters, too. A 2007 report on East Austin published by the University of Texas School of Public Affairs states that "as property values increase, the problem [of affordability] for renters will only become worse."

The production and supply of affordable housing units falls far short of demand. In early 2007, 4,000 families were on the Section 8 waiting list. Even for those who are able to get vouchers, it is becoming increasingly difficult to find housing options near downtown that will accept them, forcing residents to find affordable housing farther away. As low- and moderate-income families move away from East Austin and become more dispersed, they are farther from the social services and social networks they depend on for their quality of life.

Rising property values have also led to difficulties for low-income homeowners facing increased property taxes. One couple explained that their property taxes have risen approximately $500 in each of the past three years. Although the associated house-price appreciation has increased homeowners' wealth on paper, their incomes have not increased at a commensurate rate that enables them to pay their property taxes. Moving elsewhere in the metropolitan area to "cash out" on their increase home equity is not always optimal. Other neighborhoods within Austin are also expensive, and cheaper locales are far from downtown and its employment opportunities and amenities.

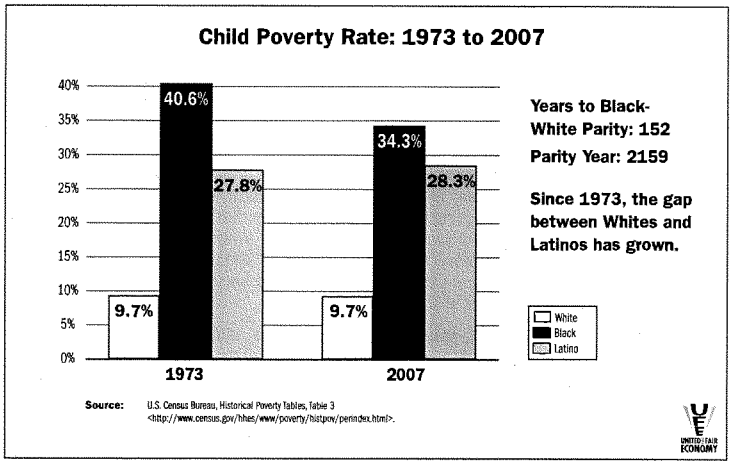
Increased property taxes have also affected people who have inherited a family home. Local resident M.H. Lopez, recently inherited a house from her mother who paid annual property taxes of $900. When her mother died and the house was reassessed to reflect its current market values, the property tax bill rose to $8,000.

For people like Ms. Lopez, being unable to afford staying in East Austin where their relatives' lives are centered is an issue that goes beyond the pocketbook. In 2005, Amanda Anderson inherited the home she grew up in. "Like the homes of many black families in East Austin, it holds special significance because [my] parents sacrificed to buy it in an era when banks made few loans to minorities," she explained.[103]

Children and Community Impacts

Children are often the most telling indicators of social inequities, as they often have to deal with the problems of economic and racial disparities without having contributed to their creation. It is through the lens of children that we see the communities we created are vastly separate and unequal.

For most people in this country, education is the tool with which to build an economic future, and the education of children is a top priority. In one study the question was asked, "If you


Child Poverty Rate: 1973 to 2007
40%
35%
30%
25%
20%
15%
10%
5%
0%
40.6%
27.8%
9.7%
34.3%
28.3%
9.7%
1973
2007
White
Black
Latino
Years to Black-White Parity: 152
Parity Year: 2159
Since 1973, the gap between Whites and Latinos has grown.
Source: U.S. Census Bureau, Historical Poverty Tables, Table 3
<http://www.census.gov/hhes/www/poverty/histpov/perindex.html>.
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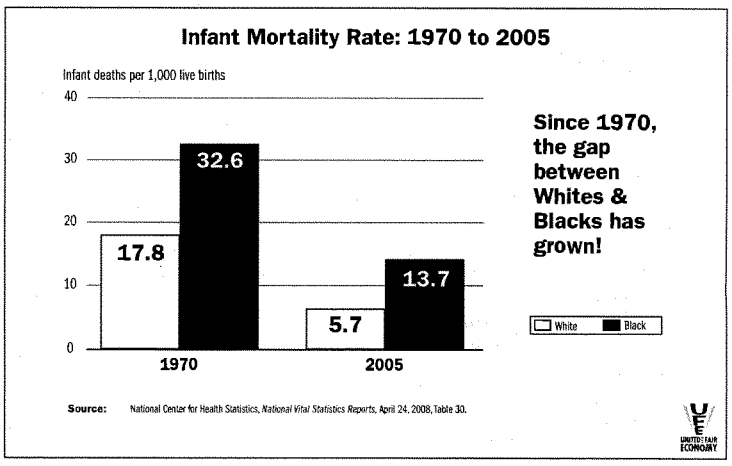
Infant Mortality Rate: 1970 to 2005
Infant deaths per 1,000 live births
40
30
20
10
0
32.6
17.8
13.7
5.7
1970
2005
White
Black
Since 1970, the gap between Whites & Blacks has grown!
Source: National Center for Health Statistics, National Vital Statistics Reports, April 24, 2008, Table 30.
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could choose one thing that can most help a young person succeed in the world today what would it be?" College education was the most highly selected. More Latinos (65%) and Blacks (47%) than whites (33%) felt that a college education was the most important factor to help young people succeed.[104] Schools play an important role in the life of a child, ranging from emotional development to predicting key economic destinies. According to empirical research the non-financial returns of education for individual and communities,are vast:

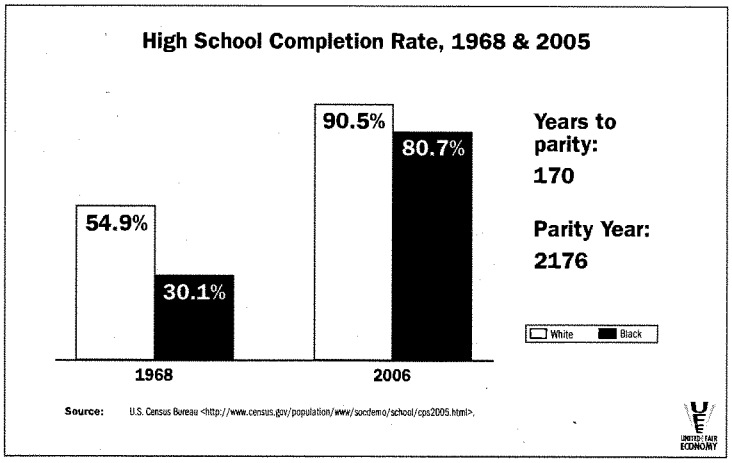
- Better health
- Greater life expectancy
- Clearer self-identity
- Lower crime rates
- Environmental benefits

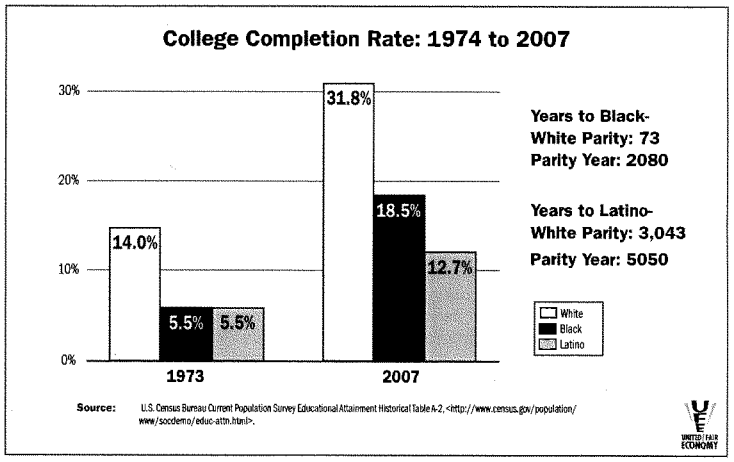
Where you live, your race, and your economic resources unequivocally are major determinants of childhood educational achievement and quality.[105]

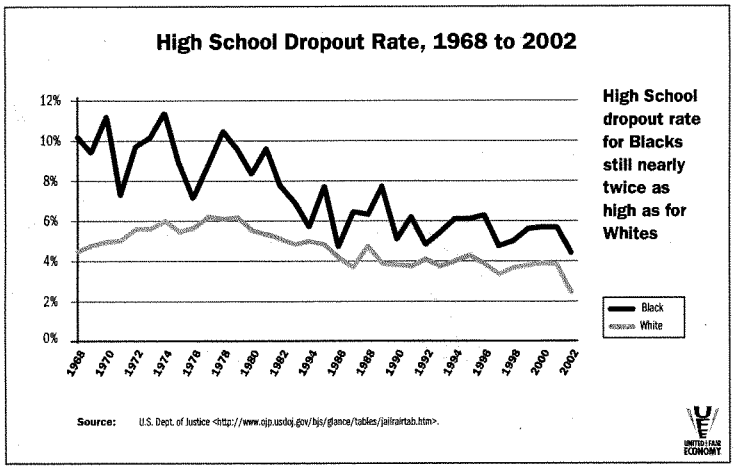
> "Middle-class schools have an adequate financial base (as measured against student needs) to provide small class size, modern equipment, and the like. Most studies find that low income students need considerably more spent on their education than middle-class students do in order to produce high levels of achievement, yet affluent districts spend a cost-adjusted $938 more per pupil, compared to high-poverty districts."[106]

Economic resources impact children until their adult years in a many ways. Recent studies show that, as inequality grows, high-income children's educational attainment and outcomes improve while outcomes for children of low-income families are lowered.[107] Furthermore, access to early education is often scarce or highly expensive, limiting the ability of low-income people and communities of color to access education for their children at an early age. Inequalities begin before formal schooling even starts.[108] The disparities also exist in the acquisition of advanced degrees. Ironically, even with higher test scores, low-income children are less likely than their wealthy counterparts to enter college.

The wealth and income of families and communities predict the type of quality education one has up until high school, and has a strong correlation with access and completion of formal college educational attainment. Because race is highly correlated with class status, people of color are more likely to be on the side of low-income, poor quality schools and low economic mobility. Education is tied to greater economic success including higher incomes and earnings, more stable employment and more stable family support and higher wealth.[109] In essence, these high poverty communities create vacuums of economic access for a large portion of this country, disproportionately affecting people of color. In Metropolitan Boston, 97% of the high concentrated minority schools have concentrated poverty.[110] In States like Ohio, the average Black attends a school with a poverty rate of 61–78% while their white counterparts attend schools with a poverty rate of 23–30%.[111] While some have claimed the inferiority of low-income students and their parents, families or communities, studies have found that low-income students attending middle-class schools perform higher, on average, than middle-class children attending high-poverty schools.[112] In Minneapolis, Minnesota, the racial segregation of schools is worse than it was in 1970, two years after race riots erupted throughout the city.[113] Due to this high correlation of class, schools with high numbers of people of color have fewer resources, lower test scores, lower graduation rates and fewer economic resources.


High School Completion Rate, 1968 & 2005
54.9%
30.1%
90.5%
80.7%
1968
2006
Years to parity:
170
Parity Year:
2176
White
Black
Source: U.S. Census Bureau <http://www.census.gov/population/www/socdemo/school/cps2005.html>.


College Completion Rate: 1974 to 2007
30%
20%
10%
0%
14.0%
5.5%
5.5%
31.8%
18.5%
12.7%
1973
2007
Years to Black-White Parity: 73
Parity Year: 2080
Years to Latino-White Parity: 3,043
Parity Year: 5050
White
Black
Latino
Source: U.S. Census Bureau Current Population Survey Educational Attainment Historical Table A-2, <http://www.census.gov/population/www/socdemo/educ-attn.html>.



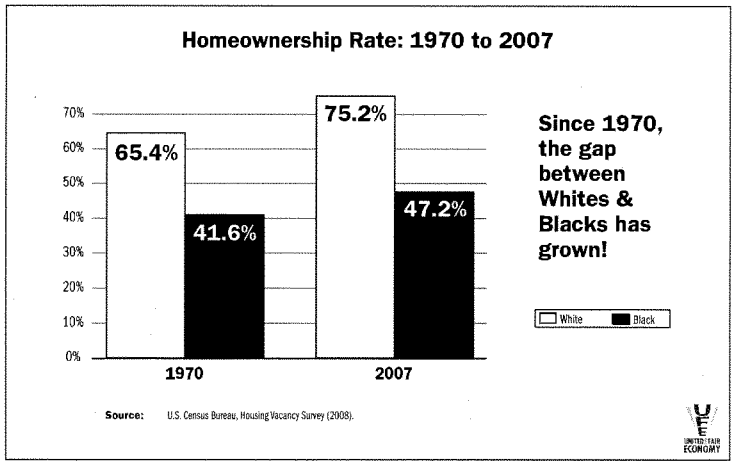
Children of color travel further to schools, have fewer formally qualified teachers, fewer school resources, and a higher level of discipline for the same issues in schools[114] than their white counterparts, regardless of income. Due to the economic realities that people of color are more likely to be poor, live in concentrated poverty, rent rather than own, and have access to fewer resources, these schools are almost created to fail and yet, at times, manage to barely stay afloat against all odds. The economy of these racial disparities is rooted in already stated limited job access for people of color, but also the value of the assets they possess. In other words, for most states, housing values determine the type of funding that schools receive. When communities of color, regardless of income, are less valued compared to their white counterparts, the schools suffer the consequences.

These issues of race and class in communities are often more complex than the assertion of individual blame placed upon them. The large disparities speak to the relationships among economic structures, such as: policies; the tax code; and legal enforcement that is absent, misused or insufficient.

"Unintended Consequences" and Foreclosure

Stagnant wages, nearly unprecedented income and wealth inequality, high unemployment, surging underemployment, inflation, and the absence of comprehensive, holistic community policy solutions have perpetuated the deepening recession for everyone in this country, and the economic depression for people of color.

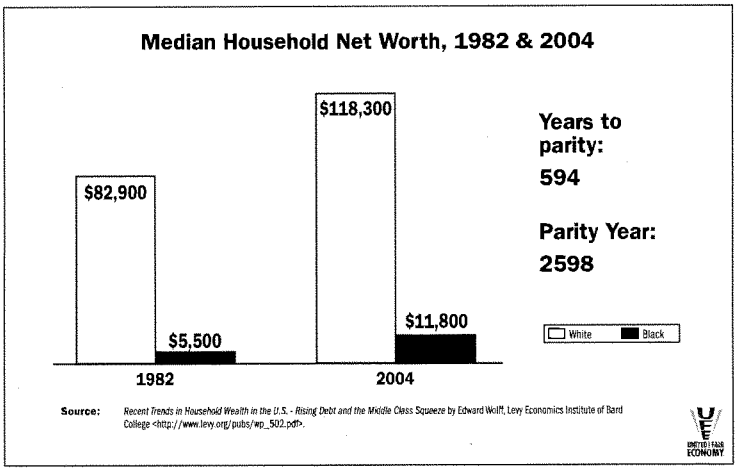
State of the Dream 2008: Foreclosed documented that the misguided policies of the last 10 years had created a black hole that was sucking the wealth out of our economy and causing

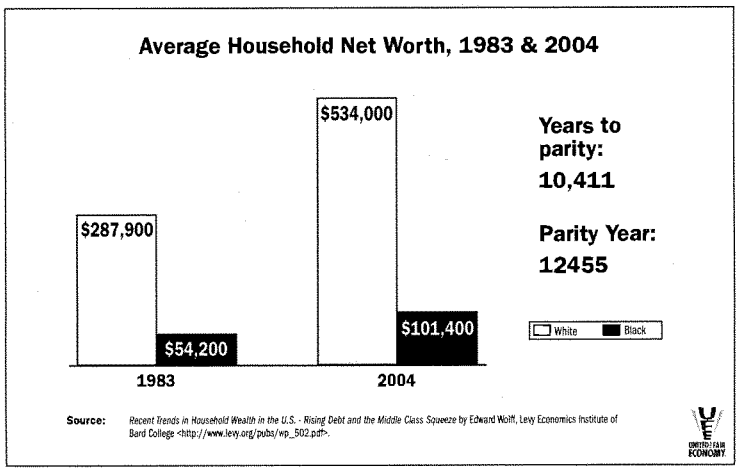


communities of color to suffer the largest loss of wealth in modern history. Since that report was issued in January 2008, estimates of foreclosures have increased from 1.1 million to 2.2 million[115] and the estimated loss of housing wealth has increased from nearly $2.2 trillion to $2.7 trillion.[116] In addition to those directly affected, this crisis continues to erode critical community assets from neighborhoods, towns, cities, states, and the entire country. The devastation of communities of color reflects the precarious economic nature of these communities due to historic and contemporary discrimination. But this vulnerability has been visible for years, and the devastation was preventable.

Housing value has continued to plummet, decreasing for both those directly foreclosed and those owning homes in the same neighborhoods. Analysts predict 40.6 million homes will experience an average $8,667 decrease in value due to failed predatory subprime loans made to their neighbors.[117] Communities of color, whose home values are already lower than their white counterparts and who received predatory loans at 2 to 5 times the rate of their white counterparts, have been hit particularly hard. In places such as the District of Columbia, which has a large population of color, The Center for Responsible Lending projects an average decrease in value of $18,930 per unit.[118]

The ripples of the faulty mortgages peddled in communities of color go further than just the decreased value of neighbors' housing, extending into the coffers of city governments. It is estimated that communities are losing $8.45 million dollars in tax revenue due to the foreclosure crisis.[119] These losses are especially high in communities with a large number of people of color, regardless of income status. Tax revenue in many communities with large numbers of "middle-class" income earners have been hit disproportionately harder than those with large numbers of low-wage income earners. With the loss of revenues, local and


Median Household Net Worth, 1982 & 2004
$82,900
$5,500
$118,300
$11,800
1982
2004
Years to parity:
594
Parity Year:
2598
White
Black
Source: Recent Trends in Household Wealth in the U.S. - Rising Debt and the Middle Class Squeeze by Edward Wolff, Levy Economics Institute of Bard College <http://www.levy.org/pubs/wp_502.pdf>.


Average Household Net Worth, 1983 & 2004
$287,900
$54,200
$534,000
$101,400
1983
2004
Years to parity:
10,411
Parity Year:
12455
White
Black
Source: Recent Trends in Household Wealth in the U.S. - Rising Debt and the Middle Class Squeeze by Edward Wolff, Levy Economics Institute of Bard College <http://www.levy.org/pubs/wp_502.pdf>.

state governments are heading for shortfalls and are planning spending cuts. Ironically, it is often essentials like school, health insurance, and other social services that are the first cut.

Overall, in 2008, 29 states were experiencing budget shortfalls, with a total deficit of over $48 billion.[120] California is predicted to slash its education budget by $4.8 billion in 2009.45 President Bush proposed reducing the national education budget by $3.2 billion by eliminating [121] key educational programs in the most recent budget session.[122] As a result of these federal and state-level budget crises, some communities across the country are moving to a 4-day school week. In other words, the best chance for people in impoverished communities to increase their opportunities is now being limited. While cuts are being made to the wealthiest schools, they are still providing high quality education. Cutbacks disproportionately affect schools of color, due to the precarious nature of funding associated with those schools and communities.

Conclusion

Empirical evidence continues to mount of the growth of a permanent "lower class" that is disproportionally made up of women and people of color. But more disturbing are the emotional stories of families and individuals who work hard and yet find themselves stuck while others pass them by. For the first time, large communities of young people may not make as much income as their parents. Generations of discrimination and economic marginalization have exacted a deep emotional toll. Martin Luther King, Jr. envisioned a world in which a person who is willing to work can find it, a person wanting a home can buy it, and a person wanting education can earn it, but we are still far from that dream.

Problematic government policies have created high poverty neighborhoods that restrict economic opportunities and mobility. Structural barriers limit job opportunities to low-wage offerings, poor healthcare hinders people in these communities from working, and criminal records restrict the job opportunities of even the most willing individuals. Economic assets are nearly non-existent in communities with concentrated poverty. While evidence of the existence of and brutality inflicted by these structural problems continues to grow, they continue to be unaddressed.

Still, our history reminds us that problems like this can be addressed. This moment presents us with a unique opportunity to recognize the failures of existing government policies and renew our covenant to make this country live up to the dreams of its people: that regardless of where you are from, you can go anywhere.

Chapter 3: **WHERE DO WE GO FROM HERE?**

As we celebrate the 80th birthday of Dr. Martin Luther King Jr., we have the first African American president of the United States and face the most serious economic crises the nation has seen in a generation. This historic moment is ripe with opportunity to reduce economic inequality and end the legacy of white racism that has contributed to today's racial wealth divide and so long stained this country.

Today, the wealthiest 10% of Americans own more than two-thirds of America's wealth. In the last 35 years, the richest 1% of Americans experienced a 62% drop in their federal income tax rate, while their incomes increased over 80%. In the same time period, low- and middle-income people saw their wages stagnate while payroll taxes, which fall most heavily on them, increased 25%. The average American has used debt to compensate for stagnant wages and increasing healthcare, education, energy, and other basic costs. Some on Wall Street bought and sold this debt, making billions for themselves, but leaving the economy of the nation in ruins.

"I am convinced that if we are to get on the right side of the world revolution, we as a nation must undergo a radical revolution of values. We must rapidly begin the shift from a "thing-oriented" society to a "person-orientated" society."

Martin Luther King, Jr., 1967
"A Time to Break Silence"

Today's recession, financial crisis, and subprime crisis all stem from the failure of our economy to sustain a strong and growing middle class. Over the last 30 years, middle-class and low-income Americans have seen their incomes stagnate, their savings disappear, and their net worth vastly dissipate. The Center for Economic and Policy Research estimates that, if home values decline by 20%, the median home owning household between the ages of 45–54 will see a 45% decline in wealth compared to their wealth in 2004 (The Housing Crash and the Retirement Prospects of Late Baby Boomers, Dean Baker and David Rosnick, June 2008). According to the S&P Case/Schiller 20-City Home Price Indices, as of August 2008 home prices have already declined by 15.9%.

"Let us be dissatisfied until the tragic wall that separates the outer city of wealth and comfort and the inner city of poverty and despair shall be crushed by the battering rams of the forces of justice."

Martin Luther King, Jr., 1967
"Where do we go from here?"

The roots of the financial crisis and the larger economic crisis are the government forsaking average Americans for the short-term interests of the economic elite, and the uninhibited greed and rampant speculation by some of the wealthiest Americans who now demand that the American public bail them out. Government has failed to adequately advocate and provide for those who worked hard and who increased the nation's level of productivity, but never saw a corresponding increase in wages.

As we usher in a new president, a new Congress and a new economic agenda, America must not look to solely redress the immediate problems of a down economy but also the longstanding problems of disenfranchised communities and growing inequality. The following are policies and ideas that, if implemented, would advance Dr. King's hopes and dreams, providing the country an opportunity to enact change all of America could believe in.

Understanding the Problem

Our current financial crisis is one of empirical severity and a crisis of silence. While some have sounded the alarm of economic inequality for years, the crisis has seemingly evaded our public policy discourse. This is due, in part, to our current instruments for measuring the economic health of communities, demographic populations, and the country at large.

Our current indications for recession do not take into account:

- Wealth inequality
- Asset measures
- Income inequality
- Employer-based benefits versus employee-based benefits
- Various types of unemployment (temporary workers, underemployed workers, multiple-job unemployment)

Other indicators, in their current formulation, often mask the depths of economic issues that affect the entire country. For example, the poverty measure does not account for fluctuations in income that poor populations and people of color experience throughout the year. In addition, arbitrary limits on the definition often indicate economic health that is, in fact, temporary. These arbitrary limits (e.g., asset limits) are also found in other government-based programs such as welfare and other benefit programs.

Developing a New Understanding of Wealth Creation

Wealth is not created through a sole individual and a "free" market system. Wealth is created by individual efforts, a well-regulated economy and the investment of public resources. The mythology of one person pulling themselves up by their bootstraps is pervasive and too often provides a false premise on which economic policy is subsequently based.

The struggle around economic policy is often over the distribution of mass public investment or access to public resources. Corporate America has historically used public resources and investments to generate much of its private profits. Because most forms of public wealth are poorly defined or poorly managed, many extractive industries such as fishing, oil, coal, mining, and timber take public wealth while paying little or nothing in return.

Private corporations siphon off wealth created by public and community investments for private gain. They often enlarge their profits by shifting costs off their balance sheets and onto the public ledger, which is done by externalizing costs such as pollution, infrastructure, and employee healthcare. Enormous profits are also made by corporate appropriation of publicly developed popular art, culture, internet content, and other goods that should be owned by the entirety of the country. Profits of this nature are often gleaned by placing publicly funded and developed knowledge under private ownership, and reaping the benefits of charging for its use. All this is done largely within the framework of the existing legal and economic belief systems.

Former Secretary of the Interior Walter Hickel quipped, "If you steal $10 from a man's wallet, you're likely to get into a fight, but if you steal billions from the commons, co-owned by him and his descendants, he may not even notice." A commonwealth perspective is important in looking at current wealth inequalities and solutions. There is a long and unseemly history of the U.S. government channeling common wealth to expand the individual wealth and opportunity of privileged whites.

Even before the existence of the United States as a nation, Europeans confiscated and enclosed land and natural resources from indigenous peoples, creating the base of wealth from which our modern economy derives. Similarly, the U.S. has repeatedly appropriated the natural resources and markets of foreign nations for its own benefit, oftentimes doing so through military interventions.

For hundreds of years, African people were shipped out of their native lands to be tools of wealth production in the U.S. Blacks were considered part of the wealth owned by whites. Black labor built wealth for white America, while their communities were later used as dumping grounds for the negative externalities produced by industrialization.

Domestically, we can also look back at the great "robber baron" fortunes of the industrial revolution that were based on white elites gaining free access to the nation's natural resources to exploit for personal enrichment. Great edifices and charitable institutions still carry the names of the individuals who cornered markets built on public resources including oil, timber, and minerals – as well as wealth derived from mass public investment such as railroads and capital markets.

While public wealth has often helped fuel the great wealth of private corporations, it has also has been used for the greater public good. The post-World War II housing boom was fueled by subsidized assistance to over 35 million Americans between 1948 and 1972. During these years, 11 million families bought homes and another 22 million improved their properties. The biggest beneficiary was de facto "whites only" suburbia, where half of all housing could claim Federal Housing Administration (FHA) or Veterans Administration (VA) financing in the 1950s and 1960s. The home mortgage interest and property tax deduction also disproportionately benefited suburban homeowners, and interstate highway construction served as an indirect subsidy, as it opened up inexpensive land for suburban commuters. Today, the children and grandchildren of GI Bill recipients benefit from intergenerational wealth transfers that enable them to purchase homes, attend private schools, and start businesses.

Central to the moral claim to eliminate the historical racial wealth divide is recognition that each of us has a birthright to a part of our inherited commons for our sustenance and livelihood. People chafe at the notion of "giving people something for nothing," yet our history is replete with providing public resources and investment for private and public use. Much of the economic success of this nation should be understood as coming from access to government programs and public investments. We must create and expand programs that broaden wealth and opportunity so that more than just a few wealthy individuals and corporations benefit from the collective public wealth of our nation.

Rebuilding the U.S. Homeownership Market

As highlighted in *State of the Dream 2008: Foreclosed*, leaving homeownership to the dictates and uncertainty of the private market has never adequately resulted in homeownership for most Americans. Whether it was the Homestead Act of 1862, the Servicemen's Readjustment Act of 1944 (otherwise known as the GI Bill), or the on-going mortgage insurance programs by the federal government, government subsidies have been a necessary component of growing homeownership. Recently, government policy has shifted from developing policy that would foster homeownership and protect homeowners to removing regulation from financial institutions. In the short term, this shift created great profits; the immense and rapid growth in profits was unsustainable, however, and has led to a collapse of the financial and housing sectors.

A deregulated mortgage lending industry, a federal fiscal policy that fed the unsustainable increase in home prices, and a cut in federal aid to low and moderate income housing has contributed to the bursting of a housing bubble and a massive loss of wealth for all Americans. Today housing policy needs to focus once again on strengthening homeownership, rather than allowing private industries to grossly enrich themselves though leveraging, speculation, and predatory lending.

Better Regulation of the Real Estate, Mortgage Lending, and Finance Industries

There needs to be a stronger national standard in home buying instead of the current complicated patch-quilt system of state and local regulations. A national standard would simplify the home buying process, thereby lessening costs of compliance. For years consumer groups have advocated to strengthen the Home Ownership Equity Protection Act (HOEPA), but this call has been successfully opposed by the mortgage lending industry concerned that strengthening HOEPA would limit the securitization of subprime loans. As the nation faces a recession sparked by the mass securitization of bad subprime loans, it is apparent that greater regulation of the mortgage lending industry would have been beneficial to the nation as a whole.

In response to the subprime mortgage crisis, the Federal Reserve has finally taken a few of the many steps advocated by consumer groups. The Federal Reserve approved a proposal to require mortgage companies to more clearly outline how customers will be able to make required payments, and to more clearly show the costs of loans that are often hidden in interest payments. This Federal Reserve plan is limited to only subprime loans, but should be expanded to all loans, as all Americans should have a more transparent home loan process. HOEPA should also be expanded to include contractors, appraisers, and other actors in real estate transactions.

Finally as we have learned, finance plays an incredibly important role in homeownership. Strengthening homeownership in America will also require great reforms in the financing industry; these reforms should include extending financial reserve requirements to new security categories, placing limits on leverage for all regulated financial institutions, regulating the packaging of loans, and regulating hedge funds and private equity in a comparable manner to banks.

Ending the Mortgage Interest Deduction Subsidy for the Wealthy

American taxpayers should not have to subsidize the homes of the richest 3% of US households, yet this is exactly what we do because of the unlimited mortgage interest deduction. Capping this deduction for households with incomes over $200,000 would generate $20 billion a year.

In 2005, President Bush's Advisory Panel on Tax Reform recommended making the mortgage interest deduction more progressive by converting it from a deduction to a tax credit. A tax credit assists all taxpayers, while tax deductions are used only by those who itemize their tax returns. Only a third of taxpayers find it beneficial to itemize, and upper-income taxpayers are the most frequent itemizers. Changing the existing mortgage interest deduction to a tax credit would maximize the number of beneficiaries, instead of further concentrating such benefits among the already wealthy.

Strengthening Programs Providing Low-Cost Credit

Providing high-cost loans to low- and moderate-income individuals with less than perfect credit can too often lead to unsustainable mortgage agreements, as demonstrated by the current subprime crisis. Low-interest mortgage loans are required for more of wealth-poor America. Vehicles such as low–interest, tax-free Mortgage Revenue Bonds (MRBs) that are sold to investors need to be greatly expanded so first-time homebuyers with low- and moderate income have the opportunity to access low-interest loans.

An Economic Stimulus for Affordable Homes

Over a trillion dollars has been set aside for those in Wall Street who, through grossly irresponsible leveraging, turned the problem of predatory lending into an economic crisis that brought an end to the investment banking industry as we knew it. Similar riches have not been invested in homeownership and job opportunities for middle class and lower-income Americans. In order to move the American economy out of the current recession, a bottom-up economic stimulus package focused on the real estate industry is required.

The government needs to stimulate the construction of affordable homes. In the private market, the primary motivating force is not just the drive to make a profit, but to make the largest profit possible. The higher profit margins that come with building expensive homes have made the affordable housing market less attractive for private home development companies. In some cases, the cost of building affordable homes is greater than the market value of these homes.

Government subsidy of private business through affordable housing tax credits will provide an economic incentive to get this important industry building homes that middle-class Americans seek and providing jobs lower-income Americans need. This tax credit would increase profit margins for private companies to build affordable housing, which would require the tax credit to close the "appraisal gap" and create a margin of profit.

In many communities throughout the country, local governments mandate that a certain percentage of all new housing construction be affordable. The federal government should consider requiring states, as a condition of receiving federal housing aid, to mandate a percentage of affordable and low-income housing in all new construction and renovations. This would not only increase moderate- and low-income housing, it would also help break up

the segregated areas of concentrated poverty, which provide a breeding ground for societal problems and dysfunction.

Investing in the Future of America

Investing in Job Creation

The National Urban League, in their Opportunity Compact announced in 2007, proposes an Urban Infrastructure Bank that would fund the repair and development of our schools, water systems, parks, roads, bridges, and community centers. There has also been much discussion about creating "green jobs" as America transforms its industry and lifestyle to better sustain the environment. Funding environmentally sustainable improvements to urban infrastructure would provide employment opportunities, strengthen America's infrastructure and provide for a more secure and stable world.

Organizations like Green For All have developed an agenda to create mass employment that corresponds to a scale-back in our fossil fuel energy use. Becoming more environmentally responsible not only provides an innovative platform from which new jobs can be generated, it will also help prevent a recurrence of the run-up in energy prices that so challenged the budgets of most Americans during the summer of 2008. "Green jobs" are not the only avenue for job creation, however. Organizations such as YouthBuild USA and Job Corps should be supported, as they have proven to be effective in turning many who would otherwise become economically disenfranchised into employed contributors to the economy.

Increasing federal investment in job creation benefits the economy as a whole. The Institute for Policy Studies report "Alternative Spending: Effects on Job Creation" notes that federal spending in construction and home weatherization is much more effective as a job stimulant than the standard conservative approach of tax cuts or military spending.

Investing in Wealth Development

To address the nationwide precipitous decline of wealth, a comprehensive national savings program is required. Matched saving programs like Individual Development Accounts (IDAs) and so-called "KidSave" accounts have, for years, been successfully tested on a small scale in the United States. It is time to broaden these programs nationwide. As the recent turmoil in the stock market and the rapid decline of home value has demonstrated, good old-fashioned savings accounts are still an essential part of a wealth portfolio and are the most secure during a time of economic downturn.

Programs like IDAs encourage and strengthen the savings of those Americans who are most vulnerable during recessionary periods. IDAs are saving accounts that provide matching funds to assist and provide greater incentive for lower income families to save and build wealth. Ideally, lower- and middle-income Americans would be eligible to receive matching funds for their IDA through partnerships between various community based organizations, government programs, and sometimes the private sector. Through such government investment, America could strengthen wealth development from the bottom up rather than predominantly from the top down.

Tying Wealth Programs to Financial Education

With wealth development must come wealth education or financial literacy. The 2002 Millennial Housing Commission reported that face-to-face counseling reduced defaults on home mortgages by up to 34%. This report also pointed out that financial education programs for low-income people are drastically inadequate. Only 120,000 to 150,000 individuals received pre-purchase education through Federal Housing and Urban Development-related programs out of the approximately 1 million low-income, first-time homebuyers.

The government should create wealth-building programs that require participation in wealth education. These wealth education programs will strengthen both the individual and national financial health. Wealth education will help individuals use the private market to their benefit. For example, studies have shown that up to 30% of those with high-cost subprime loans could have qualified for lower-cost mortgages (MHC report, p.17)

Spreading the Wealth

The primary beneficiaries of trickle-down economics over the last several decades will be disproportionately expected to fund the new bottom-up economy that will stabilize and strengthen the national economy. Since the time of Dr. King, the richest 1% of Americans has seen their incomes explode while the top federal income tax rate declined by half. Since 1980, taxes paid primarily by the wealthy have been cut dramatically: the estate tax rate decreased by 46%, and the capital gains tax rate decreased by 31%. Meanwhile, the payroll tax rate – which falls most heavily on working people – increased by 25%. Overall, the trend has been a shift of the tax burden off of the wealthy and onto middle- and low-income Americans. The progressive nature of our tax system has seriously eroded over the past several decades. It has been estimated by the American Enterprise Institute that a family of four earning $50,000 pays exactly the same 30% of its income on taxes as a family earning $150,000.

Hundreds of billions of dollars are required to remake the American economy into one where the majority of Americans can share in its prosperity. This money will have to come disproportionately from the wealthiest in society. To get us started, the Institute for Policy Studies has proposed the following tax policy reforms to generate new and desperately needed revenue.

Securities transaction tax: $100 billion a year

In this era of bursting economic bubbles, a small transaction tax will help put a break on the most rampant speculation. A penny on every $4 invested would generate $100 billion a year. Internationally taxes on stock transactions are already in use to discourage speculation.

Ending overseas corporate tax havens: $100 billion a year

Eliminating corporate tax havens that currently allow corporations to lessen, and sometimes avoid altogether, their fair share of the tax burden would generate an additional $100 billion a year.

Wealth tax surcharge on households with $10 million: $300 billion a year

Congress should institute a wealth tax surcharge of no more than 3 percent on households with net worth over $10 million. These multi-millionaires realized huge gains from the manipulation of capital markets and the asset bubbles that created the current crisis. The small number of households with over $10 million of wealth currently control over 20% of the nation's private wealth.

Eliminating the tax preference for capital gains: $95 billion a year

Only the wealthiest of Americans make significant income off of capital gains. These Americans pay a 15% tax rate on this income while a police officer can end up paying 35% tax rate on her or his income. The capital gains tax rate should reflect the progressive nature of the income tax rate and rise as capital gains increase. Taxing wealth and work at the same rates would generate $95 billion a year in revenue.

Progressive inheritance tax: $60 billion a year and more

President George Bush rolled back the estate tax as part of his road to creating record deficits. In 2010, the estate tax will disappear entirely causing a loss over $30 billion, before returning in 2011 to previous rates. Implementing a progressive estate tax on estates over $2 million – $4 million for a couple – could generate $60 billion a year in the short term and much more in the future.

Healthcare and Social Security

Healthcare

Our country faces a major crisis in health care. The United States spends more on health care than any other country, yet lags behind other industrialized countries in health insurance coverage, infant mortality and life expectancy. Americans of color are disproportionately affected by this national crisis. Though people of color make up only one-third of the US population, they are more than half of those uninsured.

In addition to the health risks increased by not having adequate health insurance, lack of insurance and insufficient insurance is a dangerous economic liability. A 2005 Harvard study points out that illness and medical bills contribute to almost half of all bankruptcies.

Comprehensive and universal healthcare for all Americans is critically needed. President Obama has promised to make health insurance "affordable and accessible" to all Americans. This is a promise Americans must ensure that he keeps, as it will strengthen both our healthcare system and the economy.

Social Security

Social Security has proven to be one of the most successful anti-poverty programs in US history. As the National Bureau of Economic Research notes, between 1960 and 1996 the poverty rate of the elderly has declined from 35% to 10%. The NBER also highlights how an increase in social security expenditures per capita correlates with a decrease in poverty for

the elderly. These facts, and the current recognition of the volatility of the stock market and even home value, re-enforces the need to make the public social security system stronger than ever before. In our current tax system only the first $90,000 of an individual's income contribute to social security. Most Americans do not make more than $90,000, so most have their entire income contributing to Social Security. Higher-income Americans have only part of their income contribute to Social Security; the highest-income people have an even smaller percentage of their income contribute to Social Security. A small reform that should take place immediately is the expansion to tax past the current exemption to $250,000.

A More Perfect Union: the Need for Affirmative Action

As the nation comes together to move the country past the current economic crisis, we should also use this opportunity to break up the concentrated poverty and legacy of disenfranchisement that has marginalized too many Americans. This requires us all to re-embrace affirmative action policies. Affirmative action has a successful history of making inroads for women, people of color, disabled and lower-income Americans. Throughout the world – from Finland to Brazil to India to South Africa and countless other countries – affirmative action polices for racial, ethnic, language, economic, gender, and other groups have been and continue to be effectively used to fight institutional and historic discrimination.

For all of its limitations, affirmative action has been one of the most successful and continuous diversity measures of the American government. A Center for Community Economic Development 2007 report highlights how affirmative action in public procurement helped minority- and women-owned businesses grow. The report also showed slower growth among minority- and women-owned businesses in states that repealed affirmative action polices. A rededication of affirmative action polices, coupled with broad-based, wealth-building policies, will significantly advance this nation towards the American promise of equal opportunity and the pursuit of happiness.

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ESSAY 11

The Subprime Meltdown: Disarming the "Weapons of Mass Deception"

By Stephanie J. Jones, J.D.
National Urban League Policy Institute

In the wake of the subprime meltdown, some politicians and commentators are perpetuating a dangerous myth: that minority and low-income borrowers and measures to expand their opportunities for homeownership, such as the Community Reinvestment Act (CRA), are responsible for the subprime crisis.[1] Although the facts prove otherwise, these persons are spreading this myth to shift blame away from where it lies to the people who were victimized by the breakdown in the system.

In fact, the crisis was triggered primarily by the actions of unregulated lenders not covered by the CRA who steered borrowers into the high-priced subprime market where even creditworthy borrowers were subjected to abusive terms that led many to financial ruin. Unregulated non-CRA financial services companies were the major originators of subprime loans in the years leading up to the subprime meltdown and it was Wall Street investors—not Fannie Mae and Freddie Mac—who were the major purchasers of subprime loans.

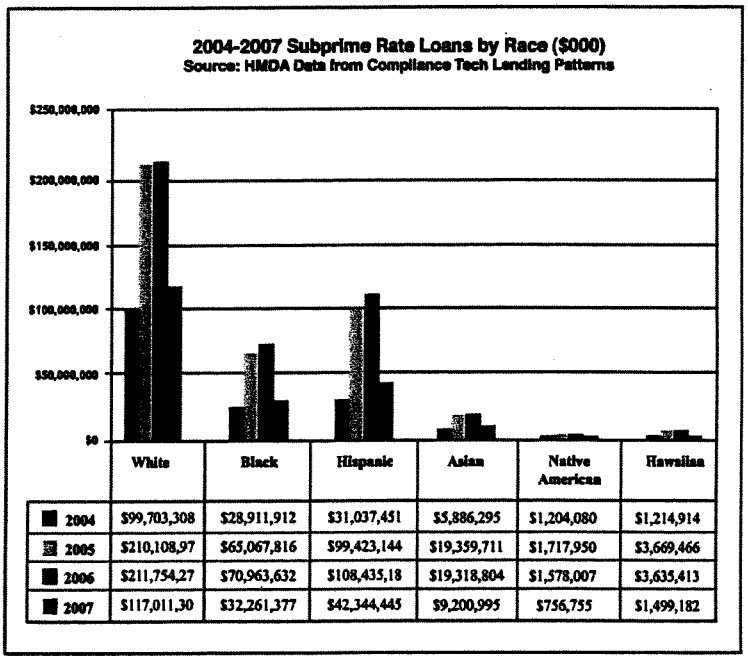
For years, the National Urban League and others warned that these lenders' predatory lending practices harmed borrowers, particularly in minority and low-income communities and urged that the Community Reinvestment Act and other regulations curtailing such practices be applied to these mortgage companies and other non-bank financial institutions. Unfortunately, our calls for stronger regulatory oversight and enforcement were ignored by Congress and the media. The irresponsible perpetuation of this dangerous

Myth: The majority of subprime loans were taken out by minority and low-income borrowers.

Fact: While minorities and low-income borrowers received a disproportionate share of subprime loans, the vast majority of subprime loans went to white and upper income borrowers.[5] In each year between 2004-2007, non-Hispanic whites had more subprime rate loans than all minorities combined.[6] (Figure 2)

African Americans and Hispanics were given subprime loans disproportionately compared with whites, according to ComplianceTech, and black borrowers are more than twice as likely to receive subprime loans than white borrowers are.[7]

Figure 2

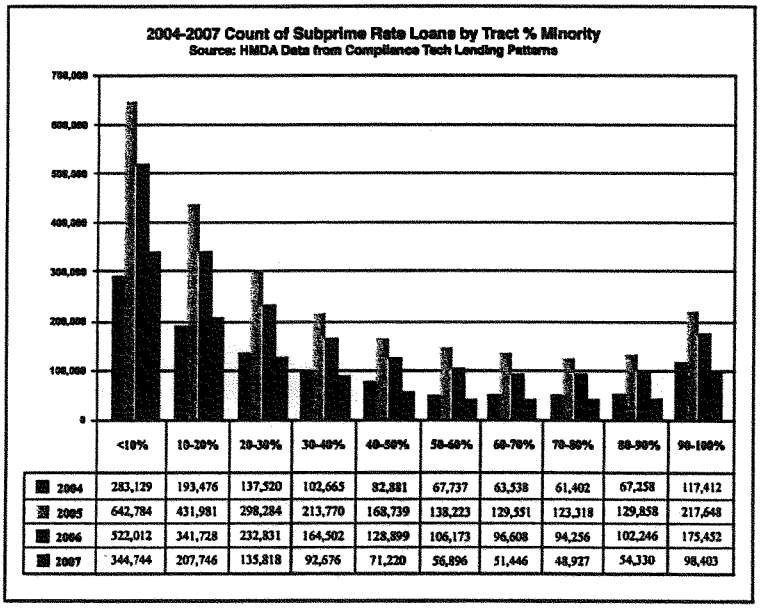


	White	Black	Hispanic	Asian	Native American	Hawaiian
2004	$99,703,308	$28,911,912	$31,037,451	$5,886,295	$1,204,080	$1,214,914
2005	$210,108,97	$65,067,816	$99,423,144	$19,359,711	$1,717,950	$3,669,466
2006	$211,754,27	$70,963,632	$108,435,18	$19,318,804	$1,578,007	$3,635,413
2007	$117,011,30	$32,261,377	$42,344,445	$9,200,995	$756,755	$1,499,182

Myth: Most subprime loans originated in minority communities.

Fact: As shown in Figure 4, The vast majority (approximately 60 percent) of subprime rate loans were originated in largely white census tracts, i.e., census tracts less than 30 percent minority.[9]

Figure 4



	<10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%
2004	283,129	193,476	137,520	102,665	82,881	67,737	63,538	61,402	67,258	117,412
2005	642,784	431,981	298,284	213,770	168,739	138,223	129,551	123,318	129,858	217,648
2006	522,012	341,728	232,831	164,502	128,899	106,173	96,608	94,256	102,246	175,452
2007	344,744	207,746	135,818	92,676	71,220	56,896	51,446	48,927	54,330	98,403

NOTES

[1] For example, October 5, 2008 edition of "This Week with George Stephanopoulos," commentator George Will stated:

In fact, much of the crisis we're in today is because the government set out to fiddle the market. That is we had regulation, in effect, with legislation that would criminalize as racism and discrimination if you didn't lend to unproductive borrowers. Fannie Mae and Freddie Mac existed to gibber – to rig the housing market because the market would not have put people into homes they could not afford." SOURCE: Nexis

More recently, the February 20, 2009 edition of MSNBC's Morning Joe talk show, featured the following colloquy between commentator Pat Buchanan, medical analuyst Nancy Snyderman and host Joe Scarborough:

BUCHANAN: The feds, Joe, the feds leaned on banks and threatened some of these banks, "You've got to make more loans," so the banks — and pushed them out — you gotta help, frankly, in minority communities. And they pushed them out and the guys put nothing down and stuff, and then the banks sell the loans off to Fannie and Freddie.

SCARBOROUGH: And that's what happened. Banks made bad loans. They sold it to Fannie and Freddie. Fannie and Freddie sold it to Wall Street.

DR. NANCY SNYDERMAN: That's right.

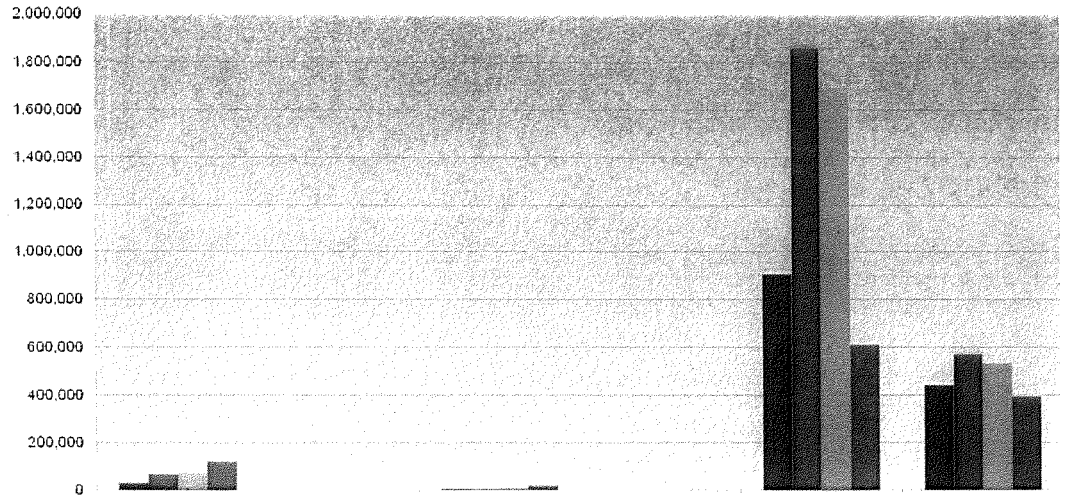
SCARBOROUGH: They turned it into securities, chopped it up, sent it around the world, and here we are with the Dow Jones at its lowest rate since 1932. SOURCE: Media Matters for America, http://mediamatters.org/items/200902200006

Among other things, these examples demonstrate the need for diversity on news analyst shows called for in *Sunday Morning Apartheid (State of Black America 2007)* since it is unlikely that such comments would go unchallenged – and perhaps would not even be made – in a more racially diverse discussion.

[2] Testimony of Marc H. Morial before the Senate Committee on Banking, Housing and Urban Affairs, October 16, 2008.

[3] Home Mortgage Disclosure Act Data (HMDA) from ComplianceTech Lending Patterns.

2004-2007 Number of Subprime Rate Loans by Investor
Source: ComplianceTech-LendingPatterns

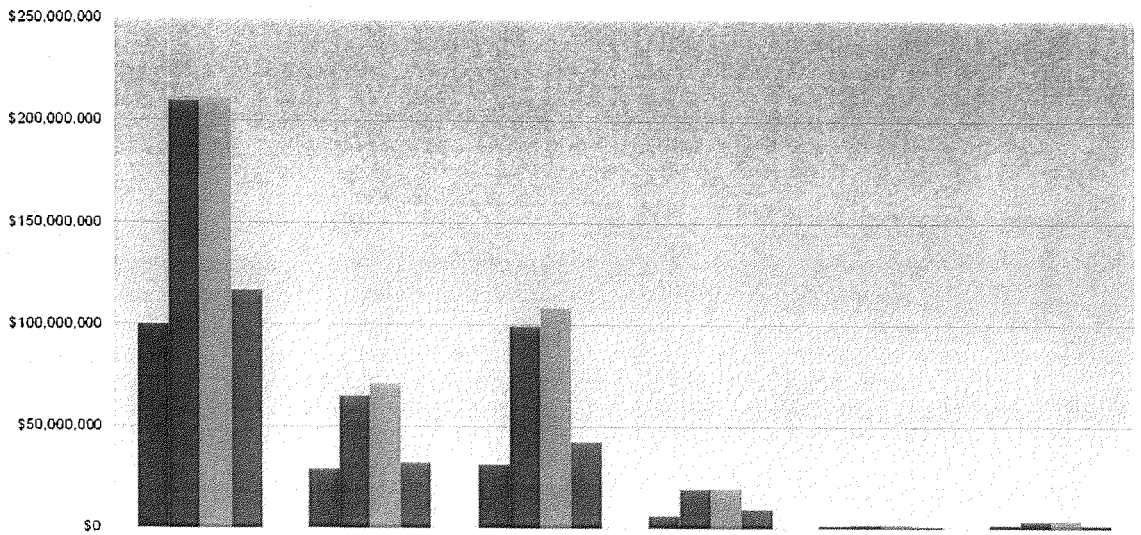


	Fannie Mae	Ginnie Mae	Freddie Mac	Farmer Mac	Non-Agency	Not Sold
2004	28,874	0	2,917	5	906,401	440,248
2005	64,739	0	3,345	99	1,864,17	573,237
2006	71,979	0	9,498	9	1,696,95	531,951
2007	118,860	0	22,121	4	610,659	396,696

1

2004 - 2007 Subprime Rate Loans by Race ($000)

Source: HMDA data from ComplianceTech LendingPatterns



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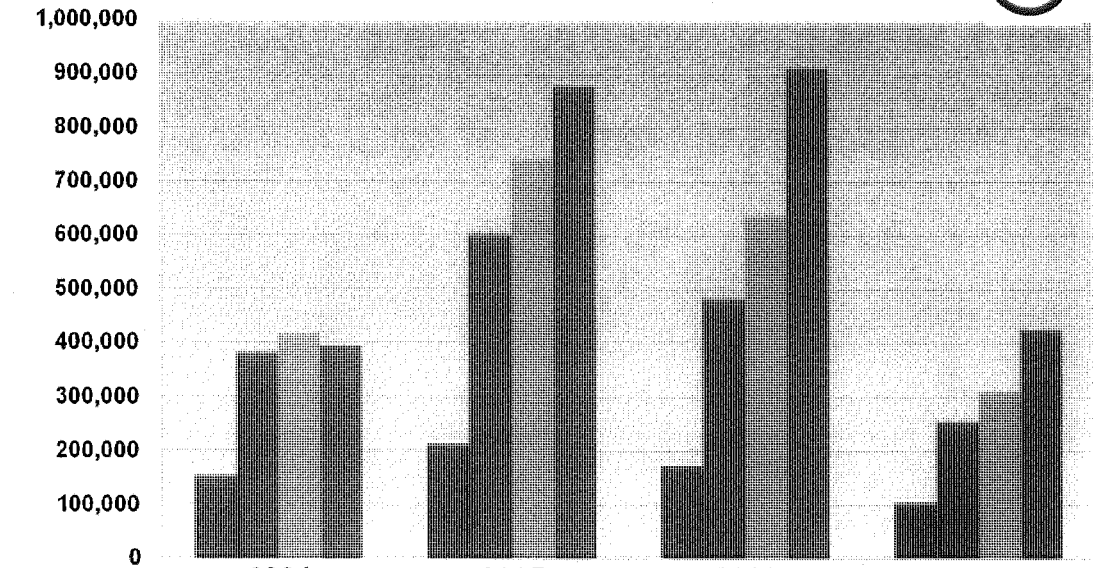
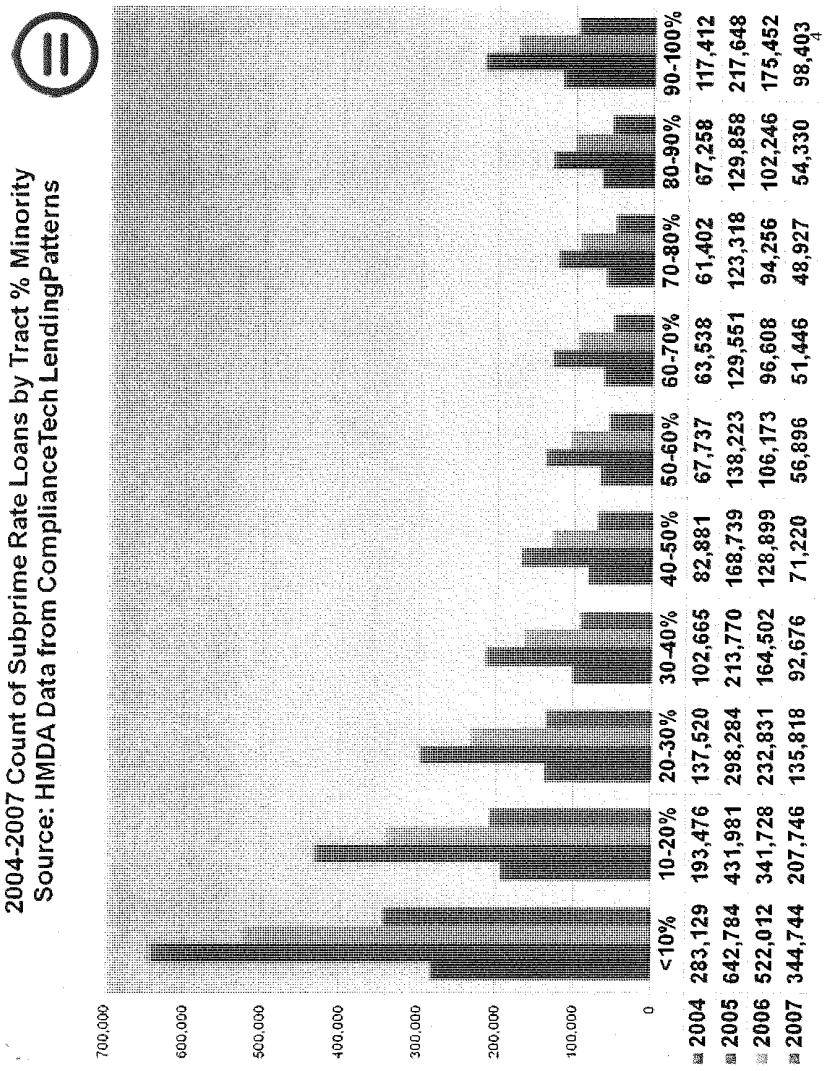
2007	$117,011,30	$32,261,377	$42,344,445	$9,200,995	$756,755	$1,499,182

2004-2007 Count of Subprime Rate Loans by Borrower Income
Source: HMDA Data from ComplianceTech LendingPatterns



	2004	2005	2006	2007
Low	155,697	213,599	173,593	103,848
Moderate	382,567	602,968	483,082	254,127
Middle	418,181	742,609	636,756	310,454
Upper	394,270	880,029	914,624	425,008


2004-2007 Count of Subprime Rate Loans by Tract % Minority
Source: HMDA Data from ComplianceTech LendingPatterns
700,000
600,000
500,000
400,000
300,000
200,000
100,000
0
<10% 10-20% 20-30% 30-40% 40-50% 50-60% 60-70% 70-80% 80-90% 90-100%
2004 283,129 193,476 137,520 102,665 82,881 67,737 63,538 61,402 67,258 117,412
2005 642,784 431,981 298,284 213,770 168,739 138,223 129,551 123,318 129,858 217,648
2006 522,012 341,728 232,831 164,502 128,899 106,173 96,608 94,256 102,246 175,452
2007 344,744 207,746 135,818 92,676 71,220 56,896 51,446 48,927 54,330 98,403