

Unequal Burden In Baltimore:

Income and Racial Disparities in Subprime Lending

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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 lending¹. 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

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.

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 follows¹⁶:

- **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

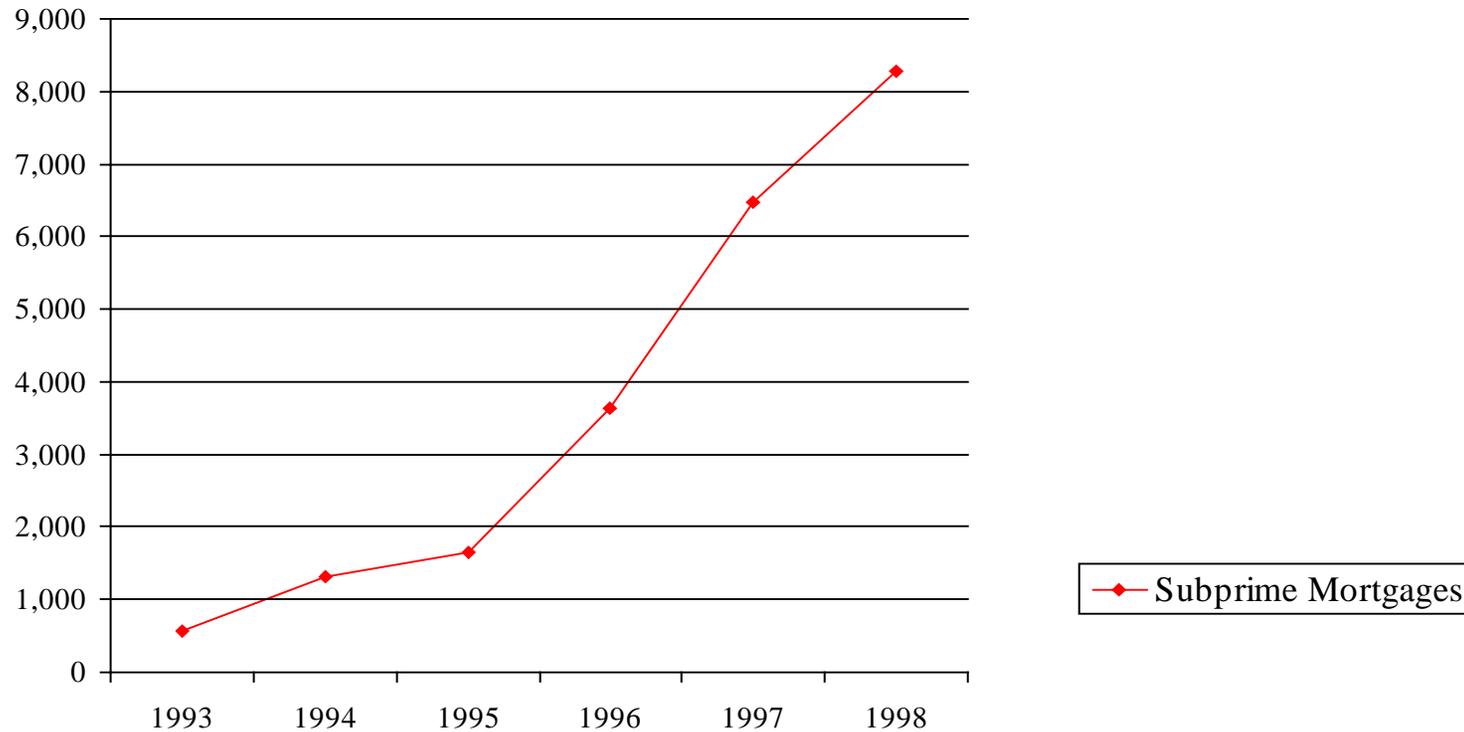
HUD's analysis of refinance mortgages originated in the Baltimore metropolitan area during 1998 clearly demonstrates the exponential growth in subprime lending and its growth for lower-income and, particularly, minority homeowners and communities. HUD analysis of foreclosures initiated in Baltimore City 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)

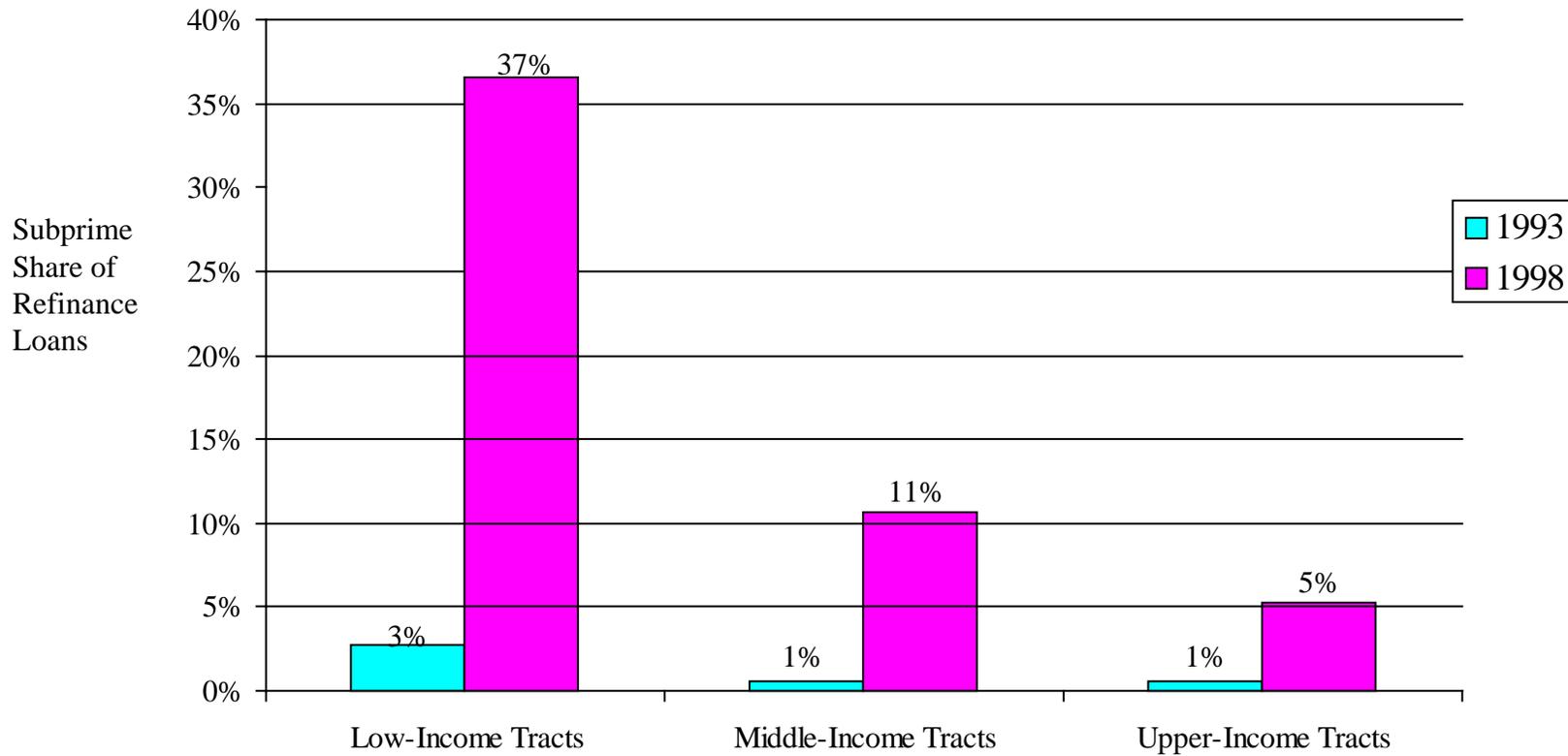
	1993	1994	1995	1996	1997	1998
Subprime Mortgages	555	1,311	1,651	3,648	6,464	8,268



Source: 1993-1998 HMDA Data

Figure 2

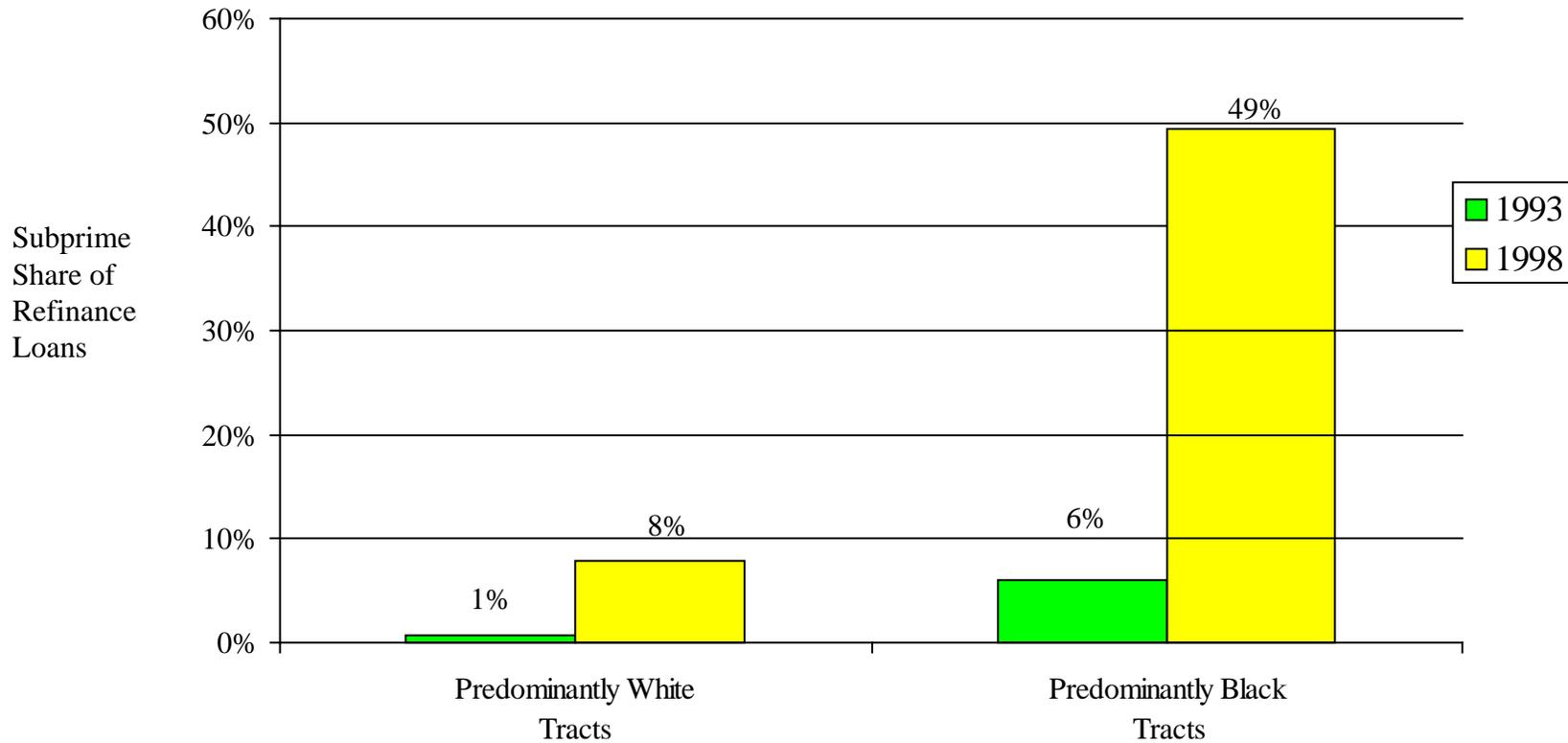
Subprime Share of Refinance Mortgages by Neighborhood Income (Baltimore Metropolitan Area)



Note: Low-Income Tracts: Not More than 80% AMI; Middle-Income Tracts: 80-120% AMI; Upper-Income Tracts: More than 120% AMI.

Figure 3

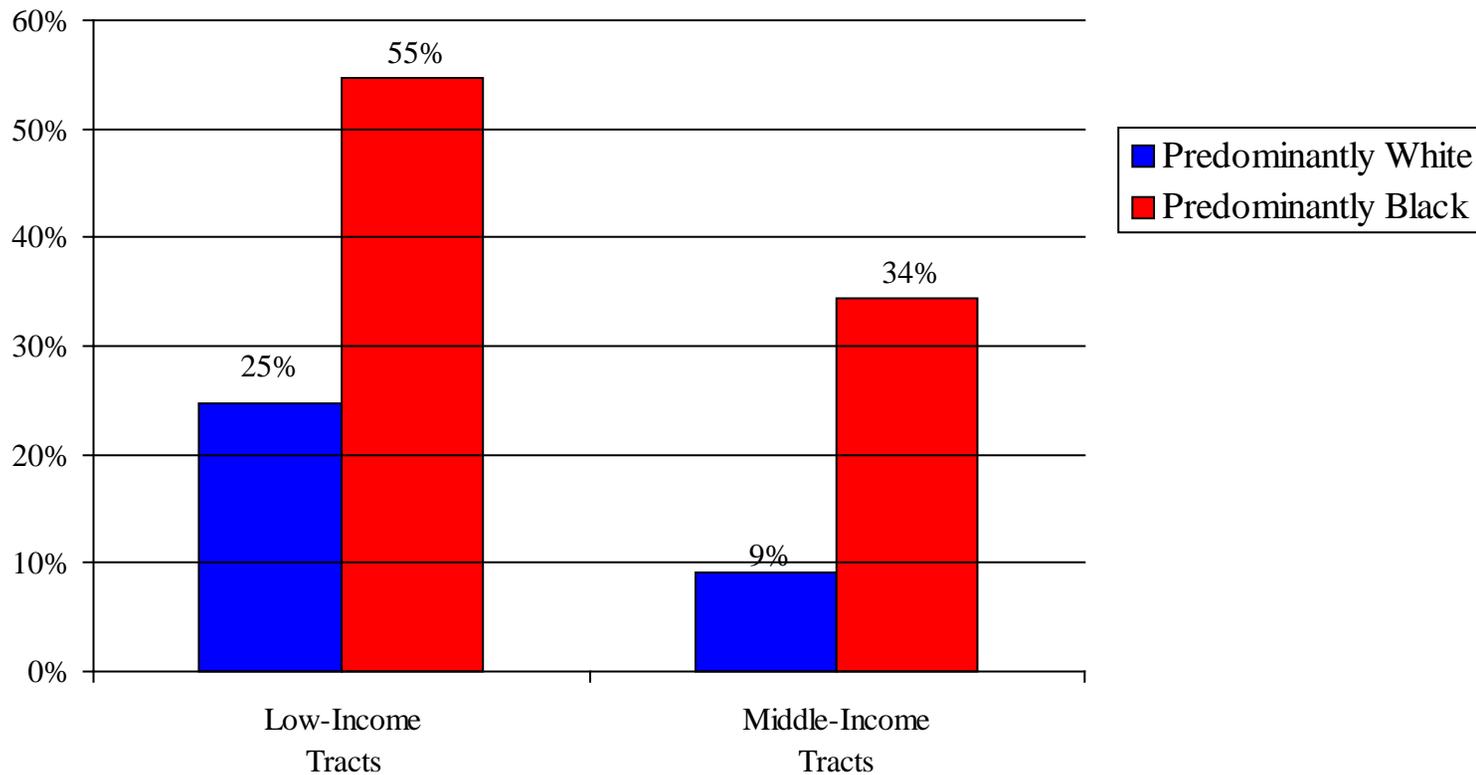
Subprime Share of Refinance Mortgages by Neighborhood Race (Baltimore Metropolitan Area)



Note: Predominantly White Tracts: At least 85% White; Predominantly Black Tracts: At least 75% Black.

Figure 4

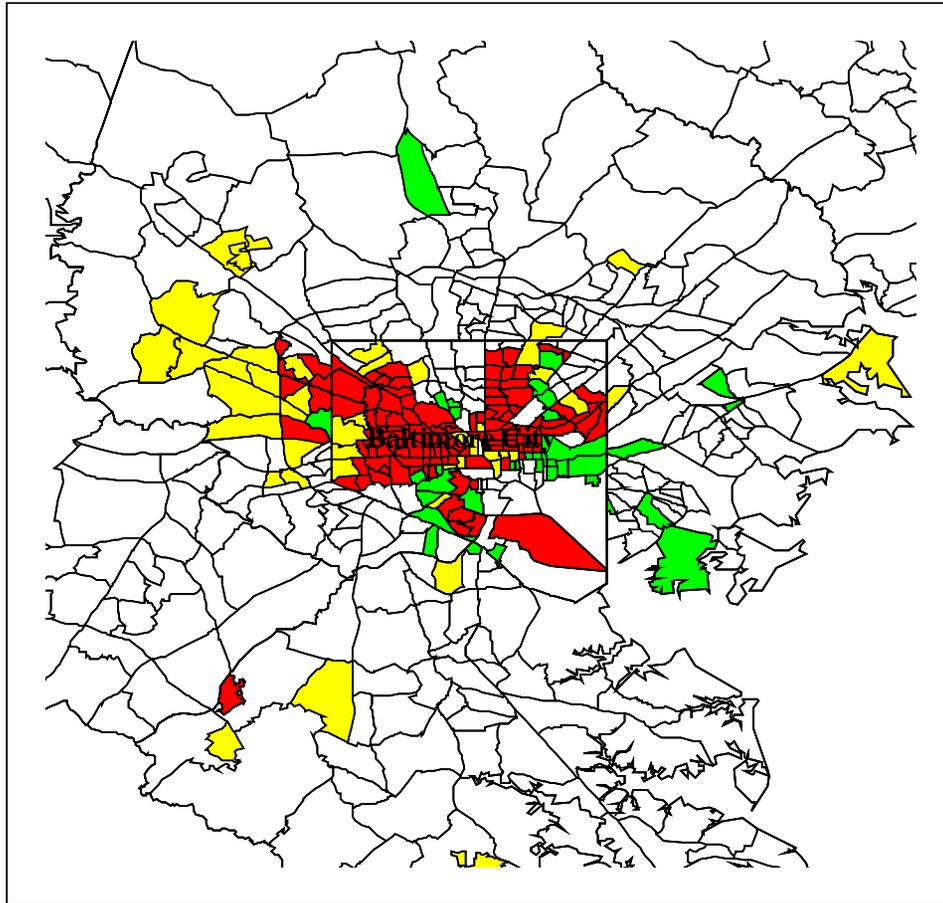
Subprime Share of 1998 Refinance Mortgages by Neighborhood Race and Income (Baltimore Metropolitan Area)



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.

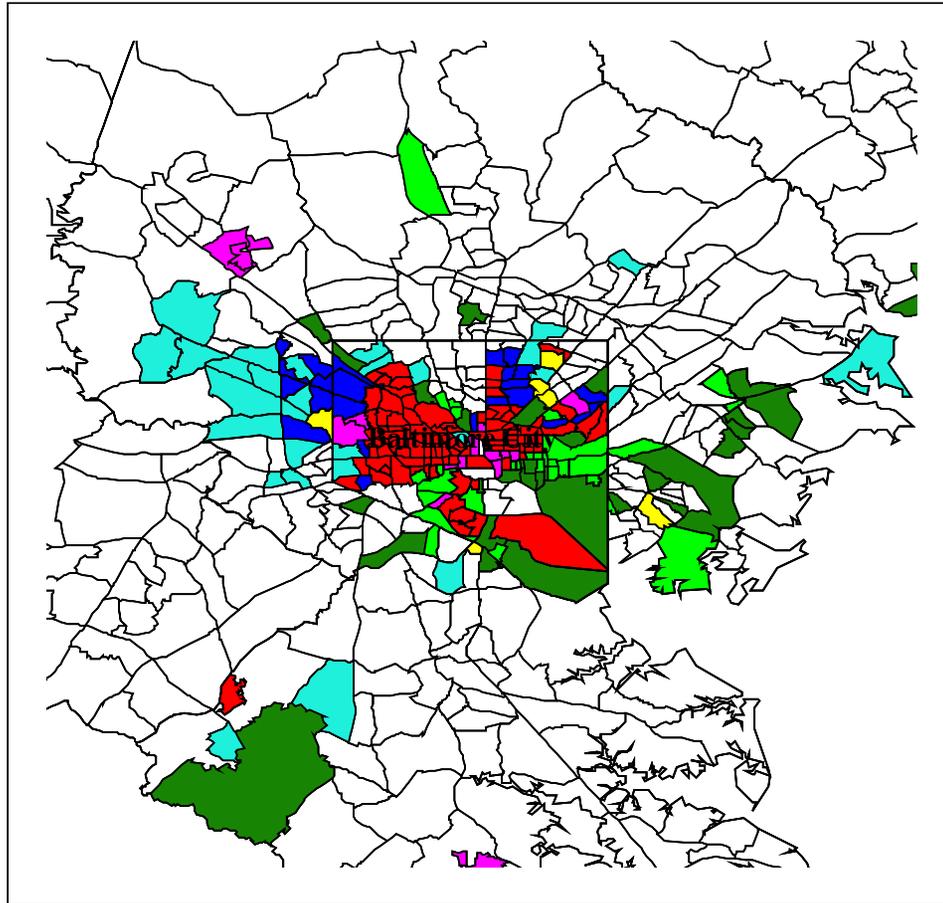
Black neighborhoods accounted for 13 percent of all refinances in the Baltimore metropolitan area but 36 percent of all subprime refinances.

- 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)

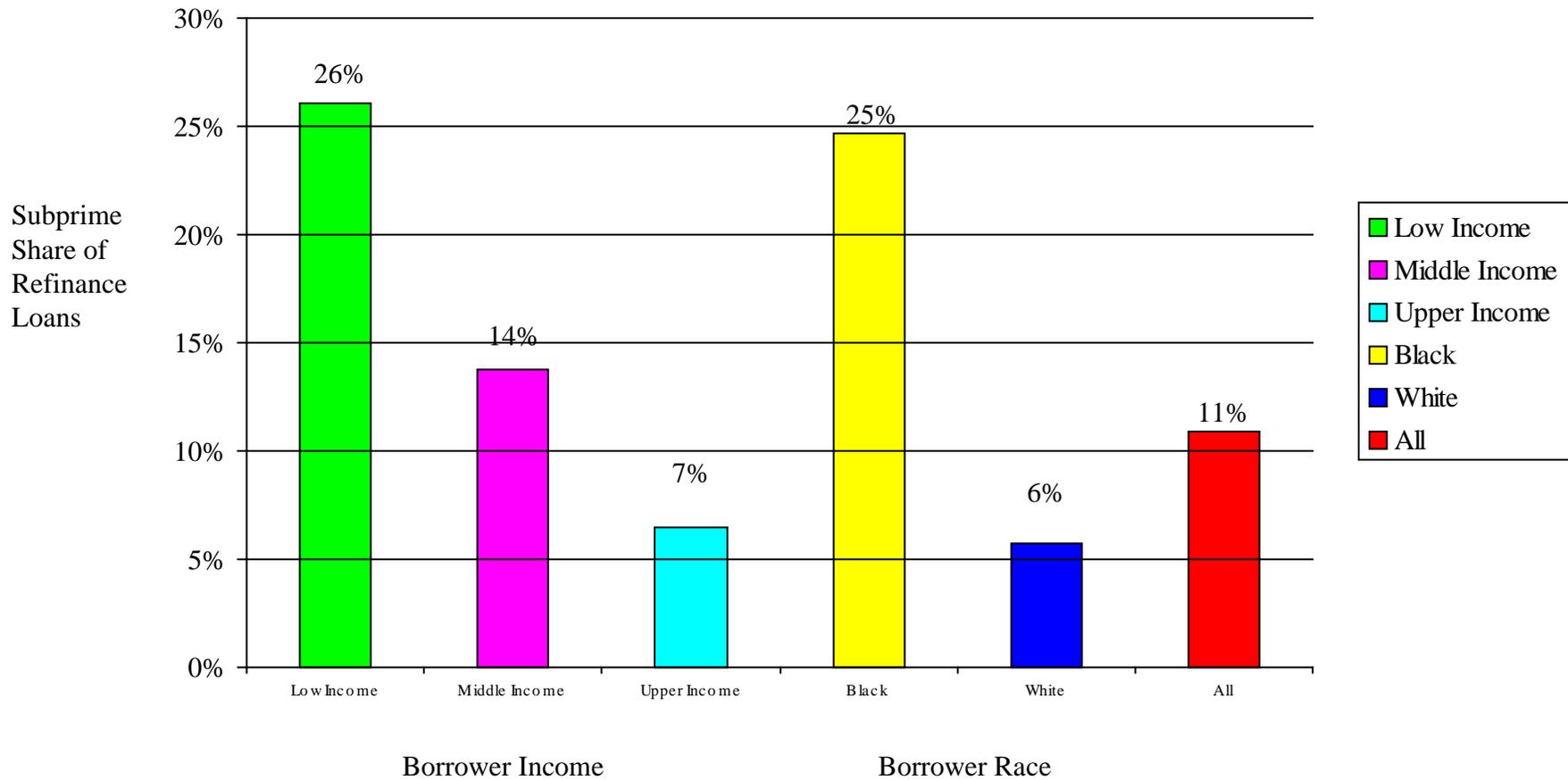
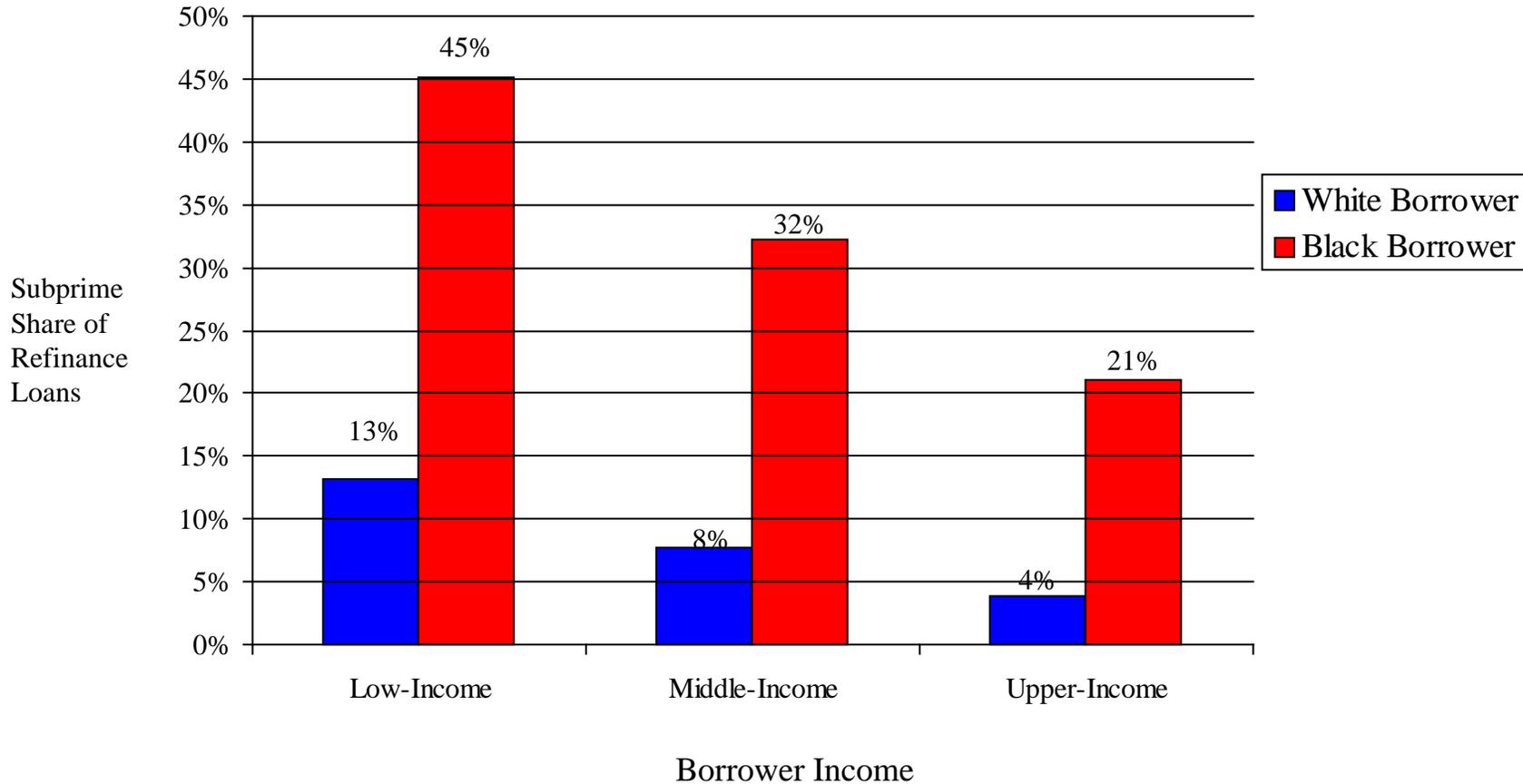


Figure 7

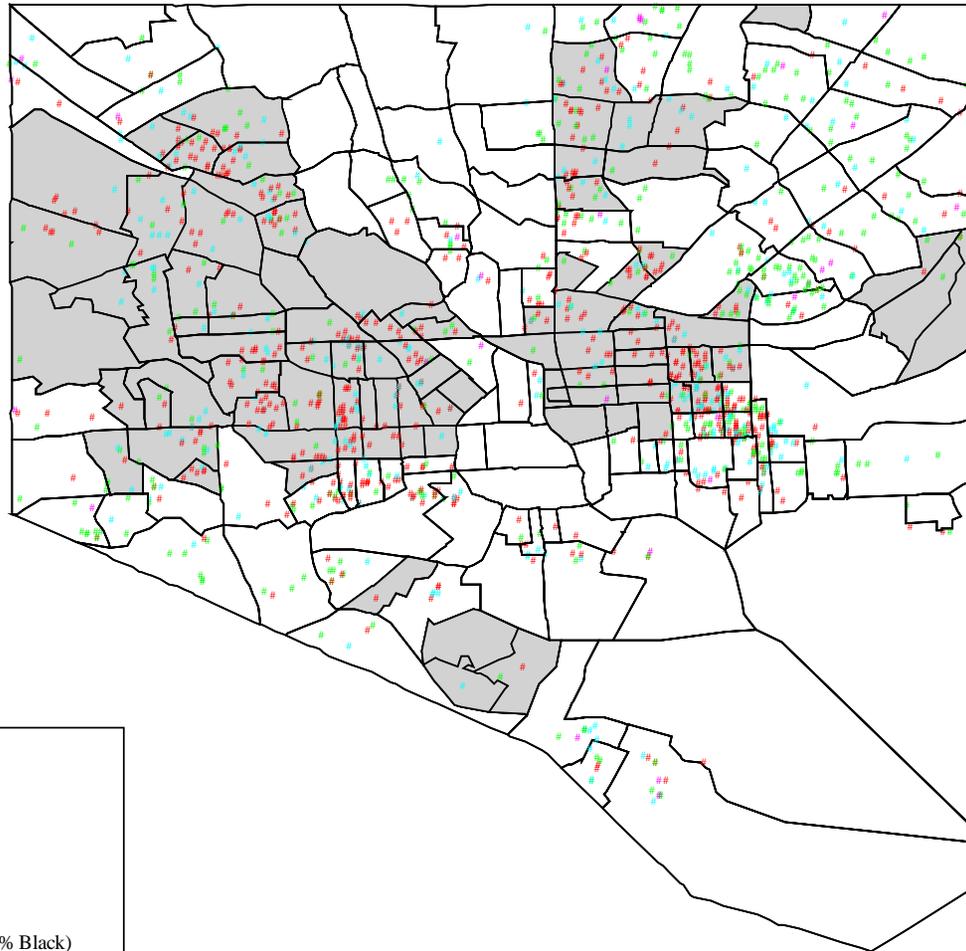
Subprime Share of 1998 Refinance Mortgages by Borrower Race and Income (Baltimore Metropolitan Area)



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

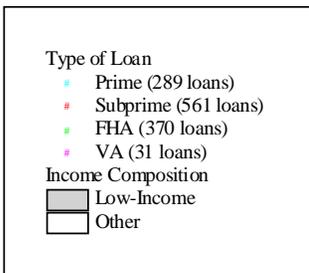
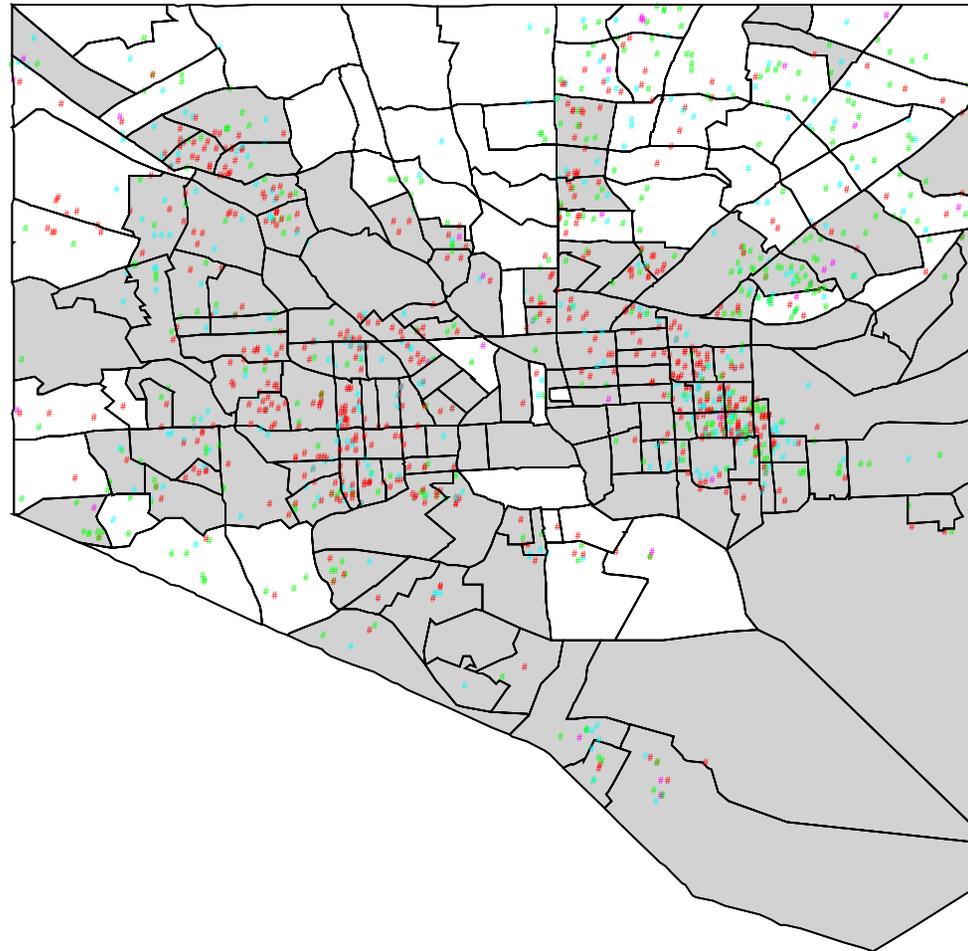


Figure 10

Subprime Share of Foreclosures and Originations in Low-Income Neighborhoods

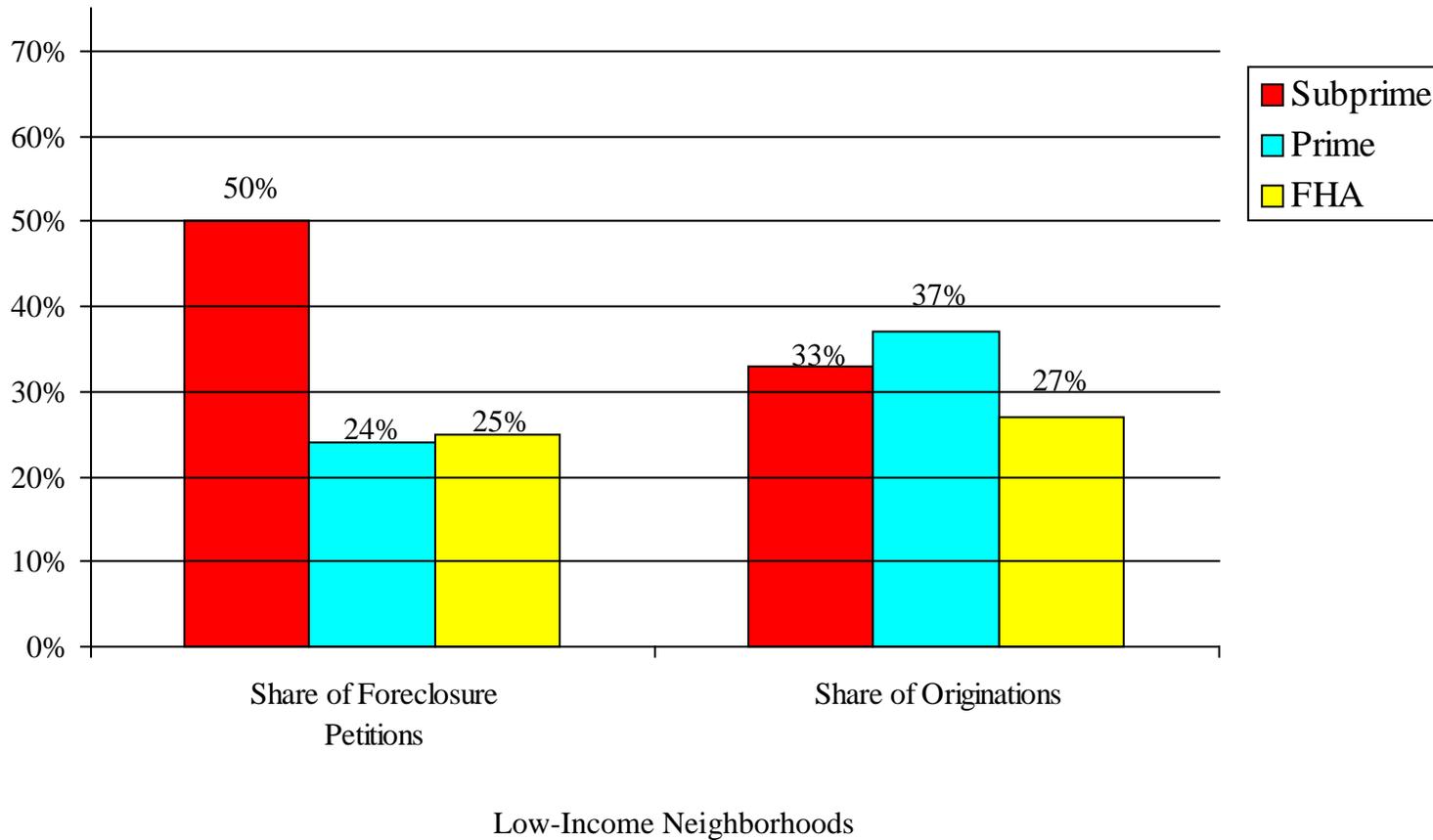


Figure 11

Subprime Share of Foreclosures and Originations in Predominantly Black Neighborhoods

