

## Intent and Empirics: Race to the Subprime

Carol Necole Brown

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# MARQUETTE LAW REVIEW

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## INTENT AND EMPIRICS: RACE TO THE SUBPRIME

CAROL NECOLE BROWN\*

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\* Professor of Law, University of North Carolina at Chapel Hill School of Law. Special thanks to Mirya Holman, Associate in Research at Duke University Law School and the University of North Carolina at Chapel Hill School of Law, for preparing and analyzing the 1998, 2002, and 2006 HMDA and HUD data that is presented in Part III. Thanks to Professors Derrick Bell and Alfred Brophy, to Delvin Davis and Nikitra Bailey with the Center for Responsible Lending, and to the UNC School of Law and Dean John Charles Boger for his support of this project. Thank you to my parents, the late Allen S. Brown, Jr. and the late Valerie J. Brown.

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## I. INTRODUCTION

“[T]he sovereign and the nation must never forget that land is  
the sole source of wealth . . . .”

Francois Quesnay (1694–1774)<sup>1</sup>

The history of racially discriminatory housing policies and lending practices in the United States, including practices such as redlining<sup>2</sup> and

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1. Francois Quesnay, *General Rules for the Economic Government of an Agricultural Kingdom* (1846), translated in VOICES OF THE INDUSTRIAL REVOLUTION: SELECTED READINGS FROM THE LIBERAL ECONOMISTS AND THEIR CRITICS 3 (John Bowditch & Clement Ramsland eds., 1961) (noting that Quesnay’s essay, originally written in 1760, was subsequently published in an 1846 collection of works by leading French economists). A French economist and physician, Quesnay attempted to explain the source of economic growth in his *Tableau Économique* by understanding the relationship between the various economic classes in society. MARK BLAUG, GREAT ECONOMISTS BEFORE KEYNES: AN INTRODUCTION TO THE LIVES & WORKS OF ONE HUNDRED GREAT ECONOMISTS OF THE PAST 194–96 (1986). Quesnay identified three classes: “sterile” classes, farmers, and landowners. *See id.* Sterile classes included those involved in industry and manufacturing, and according to Quesnay, these classes consumed all that they produced, leaving no surplus for succeeding periods. *Id.* The agricultural sector was believed by Quesnay to be the only class capable of producing a surplus that could help in growing the economy. *Id.* He was an advocate of laissez-faire economics and, in fact, coined the term. *Id.* Quesnay was thought to be the intellectual leader of the first school of economic thinking, called the “Physiocrats,” and his work “paved the way for classical economics.” 1 MANFRED WEISSENBACHER, SOURCES OF POWER: HOW ENERGY FORGES HUMAN HISTORY 295 (2009).

2. MEIZHU LUI ET AL., THE COLOR OF WEALTH: THE STORY BEHIND THE U.S. RACIAL WEALTH DIVIDE 95, 103 (2006) (discussing the earliest practice of “redlining” by the Home Owners’ Loan Corporation, created in 1933 under the New Deal housing programs by the federal government to assist homeowners to avoid foreclosure). *See also* Subprime Lenders Target Minorities: Study Finds African-American, Hispanics Pay Higher Loan Rates than Whites with Similar Incomes, CNN.com (May 1, 2002), <http://money.cnn.com/2002/05/01/pf/banking/subprime> (discussing discrepancies in rates of subprime lending to minorities); Craig Torres, Regulators Kept Quiet as Subprime Lenders “Targeted” Minorities, Bloomberg.com (June 13, 2007), [http://www.nedap.org/pressroom/documents/2007-June-13\\_Bloombergv2.pdf](http://www.nedap.org/pressroom/documents/2007-June-13_Bloombergv2.pdf) (discussing investigations

steering,<sup>3</sup> created a community of historically disadvantaged borrowers among black Americans.<sup>4</sup> Over time, these borrowers grew accustomed to exploitive financial services, were targeted by subprime and predatory lenders, and became victims of our current mortgage crisis.<sup>5</sup>

My thesis is that blacks are experiencing a new iteration of intentional housing discrimination in the twentieth and twenty-first centuries in the form of a dual mortgage market. In this dual mortgage market, lenders identify vulnerable emerging and underserved markets<sup>6</sup> of blacks and knowingly target them to receive subprime or predatory loan products when similarly situated white borrowers (i.e., white borrowers with similar credit histories, economic status, and other borrower characteristics typically important to the lending decision) are given superior, prime mortgage products.<sup>7</sup>

In Part II of this Article, I discuss the history of housing and lending discrimination in the United States. I show that the disparities in subprime

into subprime lenders' targeting of minorities); *see infra* note 49 and accompanying text.

3. Traditionally, steering was the practice of directing blacks into segregated neighborhoods. Note, *Racial Steering: The Real Estate Broker and Title VIII*, 85 YALE L.J. 808, 810 nn.10–11 (1976). In the subprime context, steering has taken on new meaning and refers to the process of marketing subprime products to blacks. Gregory D. Squires, *Predatory Lending: Redlining in Reverse*, National Housing Institute: Shelterforce Online (January/February 2005), <http://www.nhi.org/online/issues/139/redlining.html>.

4. “Historically disadvantaged borrowers” refers to black borrowers as a class of minority borrowers.

5. *See, e.g.*, IRA KATZNELSON, *WHEN AFFIRMATIVE ACTION WAS WHITE: AN UNTOLD HISTORY OF RACIAL INEQUALITY IN TWENTIETH-CENTURY AMERICA* 25 (2005); MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY* 12–13 (2d ed. 2006); LUI ET AL., *supra* note 2; THOMAS M. SHAPIRO, *THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY* (2004); Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217, 1218–19 (2004) (“Black Americans experience a number of problems in their efforts to obtain and use credit. Of particular concern is their vulnerability to so-called ‘predatory lenders.’ . . . Examples of targeted consumers include women [and] minorities. . . .”) (citation omitted).

6. Richard Williams et al., *The Changing Face of Inequality in Home Mortgage Lending*, 52 SOC. PROBS. 181, 191 (2005) (discussing commonly used income and race-based definitions of underserved markets and stating that alternative definitions that are frequently used yield results that are consistent with the study’s finding of racially biased mortgage lending). The term “emerging markets” is broadly understood to include potential borrowers who may have difficulty demonstrating a conventional credit history, may be unfamiliar with the credit system, or may have credit concerns. *See, e.g.*, Complaint ¶¶ 11, 16, 31–80, 152, *Commonwealth v. H&R Block, Inc.*, No. 08-2474-BLS (Mass. Super. Ct. June 3, 2008), *available at* [http://www.mass.gov/Cago/docs/press/2008\\_06\\_03\\_option\\_one\\_suit\\_attachment1.pdf](http://www.mass.gov/Cago/docs/press/2008_06_03_option_one_suit_attachment1.pdf).

7. *See infra* Parts III–V; *see also* William Apgar & Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, in *THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA* 101, 102 (Xavier de Souza Briggs ed., 2005) (“High-cost lenders disproportionately target minority, especially African American, borrowers and communities, resulting in a noticeable lack of prime loans among even the highest-income minority borrowers.”).

lending experienced by black borrowers result from intentional reverse redlining and steering by lenders.

Next, in Part III, I analyze why black borrowers are disproportionately victims of subprime mortgages and predatory lending. I review various forms of evidence of intentional discrimination gathered from audit studies,<sup>8</sup> individual affidavits, and advertising and marketing literature, in combination with statistical evidence of disparate impact, to make the case of intentional housing discrimination.

Part IV presents my study using Home Mortgage Disclosure Act (HMDA)<sup>9</sup> data prepared and distributed by the Federal Financial Institutions Examination Council pursuant to the Federal Reserve Board's Regulation C, as well as Housing and Urban Development (HUD) data for the years 1998, 2002, and 2006 and disaggregated into the individual fifty states. The study presents an analysis of the 1998 HMDA data set containing 11,000,077 reported mortgage applications; the 2002 HMDA data set containing 14,198,111 reported mortgage applications; and the 2006 HMDA data set containing 21,735,287 reported mortgage applications.<sup>10</sup> The HMDA data from 2002 and 2006 contain additional borrower and property information as a result of the 2002 amendments to HMDA regulations.<sup>11</sup> The study also used the HUD data set of subprime lenders (HUD-Classified Subprime Lenders)<sup>12</sup> as a tool to identify those lenders that were prone to give out subprime loans.<sup>13</sup> Additionally, the study used the HMDA criteria to identify subprime lenders that define a subprime loan as any loan in which the annual percentage rate is three percentage points or more above the yield on comparable Treasury securities (Alternative Measure).<sup>14</sup> To determine the effect of race of the borrower on the

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8. An audit refers to a survey technique in which persons (auditors) are trained to visit housing agents, lenders, brokers, and others in teams of two and to record how they are treated. John Yinger, *Housing Discrimination Is Still Worth Worrying About*, 9 HOUSING POL'Y DEBATE 893, 894 (1998). One of the auditors will be a protected class member as defined by civil rights laws and the other will not be a member of a protected class. *Id.* The auditor who is not part of a protected class is considered part of the control group. *Id.* The protected class auditor will be given borrower characteristics (in the case of borrower audit studies) that make her equally if not more qualified than the non-protected class auditor to receive a particular type of loan. *Id.* "Discrimination is defined as systematically less favorable treatment of the auditors in the protected class." *Id.*

9. See *infra* notes 85–93 and accompanying text discussing HMDA, its origin, and its purposes.

10. See *infra* Part IV.

11. See *infra* notes 89–92 and accompanying text.

12. See *infra* notes 121–25 and accompanying text.

13. See United States Department of Housing and Urban Development, Data Sets: HUD Subprime and Manufactured Home Lender List, <http://www.huduser.org/portal/datasets/manu.html> (last visited Aug. 1, 2010) [hereinafter HUD User Data Sets] (listing subprime lenders).

14. Robert B. Avery et al., *Higher-Priced Home Lending and the 2005 HMDA Data*, 92 FED. RES. BULL. A123, A126 (2006) (discussed as higher priced home lending); *Home Mortgage*

lender's behavior, the study used two methods: difference of means tests<sup>15</sup> and logit analysis.<sup>16</sup> First, the study used difference of means tests to compare applicant and lending behavior on subprime loans for white and black borrowers (State Data Means Test). The study provides overwhelming evidence that black borrowers are carrying the brunt of the subprime market.<sup>17</sup> Second, the study used logit analysis to predict the probability that a borrower will receive a subprime (versus a prime) loan (State Data Control Test). Using logit analysis allowed me to control for borrower characteristics, including race, house characteristics, and neighborhood characteristics. This analysis demonstrates that, in the majority of states, being black increases the likelihood that a borrower will receive a subprime loan, even when neighborhood characteristics, the income of the borrower, and the value of the house are controlled for.<sup>18</sup> While the study could not control for all of the factors that lenders examine when making loans, this analysis shows that when neighborhood characteristics, borrower income, and the value of the houses are held constant, black borrowers are significantly more likely to receive a subprime loan product than are white borrowers in the majority of states. As explained in Part IV, this analysis allows me to remove the effects of neighborhood characteristics, borrower income, and value of the house, and examine the effect of race without these competing factors. Tables containing the data from the study are found in the appendix to this Article. As Table 6 shows, being a black borrower is continually, statistically significant, while other factors fall in and out of significance.

In Part V, I discuss direct evidence of intentional discrimination. Testimony from industry insiders, judicial opinions, and audit studies are the primary sources of evidence of intentional discrimination. Combined, the evidence presented in Parts III through V makes the case of intentional discrimination based upon race in the subprime market.

In Part VI, I focus on American society's historically race-related

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*Disclosure Act: Newly Collected Data and What It Means: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 109th Cong. 47-49 (2006) (statement of Michael E. Staten, Professor and Director, Credit Research Center at the McDonough School of Business, Georgetown University), available at <http://financialservices.house.gov/media/pdf/109-99.pdf>. The reporting thresholds differ based upon lien status. The threshold for first mortgages is an annual percentage rate that is three percentage points or more above the yield for a comparable Treasury security and the threshold for subordinate mortgages is five percentage points. The justification for the difference is the percentages reflect differences in credit risk, among other things. Avery et al., *supra*, at A126; Home Mortgage Disclosure, 67 Fed. Reg. 43,218 (June 27, 2002) (amendments effective January 1, 2004).

15. See *infra* note 113 and accompanying text.

16. See *infra* note 126 and accompanying text.

17. See *infra* Part IV.D and Tables 1-6.

18. See *infra* Part IV.D.

propensities to target black borrowers through wealth-stripping home mortgage and refinancing schemes and consider whether there is something unique about the experiences of black borrowers that predisposes them to accept loan products that are virtually designed to fail. Necessarily, this Part considers the role of “cultural affinity”<sup>19</sup> and the sociology of the poor and of the minority in exploring why black borrowers were especially vulnerable to this new form of housing inequality.

Part VII concludes by reiterating the importance of focusing on the intentional aspect of the subprime and predatory lending discrimination that has created a dual mortgage market in the United States.

## II. CURRENT PROBLEMS IN SUBPRIME PRODUCTS: THE LEGAL BACKGROUND

If progress has been made to increase access to capital for racial minorities, . . . that progress has always come with great struggle. And it appears there are few, if any, permanent victories. The emergence of predatory lending practices demonstrates that the struggle against redlining has not been won, but has simply taken some new turns.<sup>20</sup>

American housing discrimination norms and the attendant inequality in treatment experienced by the victims of housing discrimination have changed over time.<sup>21</sup> In the 1990s mortgage lenders reinvented discriminatory lending and housing policies in the form of discriminatory subprime and predatory lending.<sup>22</sup> Steering, reverse redlining,<sup>23</sup> and discriminatory mortgage lending

19. STEPHEN L. ROSS & JOHN YINGER, *THE COLOR OF CREDIT: MORTGAGE DISCRIMINATION, RESEARCH METHODOLOGY, AND FAIR-LENDING ENFORCEMENT* 213 (2002); Raphael W. Bostic, *A Test of Cultural Affinity in Home Mortgage Lending*, 23 J. FIN. SERVS. RES. 89, 89–94 (2003); Charles W. Calomiris et al., *Housing-Finance Intervention and Private Incentives: Helping Minorities and the Poor*, 26 J. MONEY, CREDIT & BANKING 634, 635 (1994); William C. Hunter & Mary Beth Walker, *The Cultural Affinity Hypothesis and Mortgage Lending Decisions*, 13 J. REAL EST. FIN. & ECON. 57, 67 (1996).

20. Squires, *supra* note 3.

21. Juliet Saltman, *Theoretical Orientation: Residential Segregation*, in *URBAN HOUSING SEGREGATION OF MINORITIES IN WESTERN EUROPE AND THE UNITED STATES* 1, 9–11 (Elizabeth D. Huttman, Wim Blauw & Juliet Saltman eds., 1991) (discussing the historical racial inequality and division attending housing segregation).

22. See *infra* notes 39–45 and accompanying text (discussing predatory lending). Previously, discriminatory lending and housing policies manifested themselves through redlining, segregation in selling and renting, and insufficiency of affordable housing.

23. Squires, *supra* note 3.

After decades of redlining practices that starved many urban communities for credit and denied loans to racial minorities, today a growing number of financial institutions are flooding these same markets with exploitative loan products that drain residents of their wealth. Such “reverse redlining” may be as problematic for minority families and older urban neighborhoods as has been the withdrawal of conventional financial services.

practices were primary implements of discrimination against blacks. Research reveals that many of the subprime mortgage loans and mortgage refinance packages offered to blacks were bad products that have done more to hamper than to help efforts to increase home ownership among blacks.<sup>24</sup> More disturbing is the evidence that lending institutions, their loan officers, and brokers (collectively, lenders) knew at the time these products were being specifically marketed to blacks that these borrowers were receiving inferior products. Estimates are that one half of all subprime borrowers actually qualified for conventional financing, a disproportionate number of which were black borrowers,<sup>25</sup> even after accounting for “legitimate risk factors”<sup>26</sup> such as

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*Id.*

24. More than 6 million borrowers accepted subprime loans between 1998 and 2006 and many already have or will lose their homes to foreclosure. ELLEN SCHLOEMER ET AL., CTR. FOR RESPONSIBLE LENDING, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 2–3 (2006).

The Center for Responsible Lending has found that subprime lending over the last nine years will result in more foreclosures than it will create new first-time homeowners. This net loss in homeownership holds especially true for African-American and Latino borrowers. For subprime originations made in 2005, among African Americans and Latinos, [estimates are] that there will be 84,000 more foreclosures than there will be first-time homeowners.

Delvin Davis, *Here Today, Gone Tomorrow: The Impact of Subprime Foreclosures on African-American and Latino Communities*, POVERTY & RACE (Poverty & Race Research Action Council, Wash., D.C.), May/June 2007, at 12. Estimates are that

2.2 million families will lose or have lost their homes to foreclosure due to reckless subprime lending, including one out of every five subprime mortgages made in 2005 and 2006. . . . [T]he losses associated with the 2.2 million completed foreclosures, if not averted, will total \$265 billion in wealth lost by American families not facing foreclosure.

*Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress?* (pt. I): *Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 21 (2007), available at <http://judiciary.house.gov/hearings/printers/110th/37978.PDF> (emphasis omitted) (statement of Eric Stein, Senior Vice President, Center for Responsible Lending). The losses from subprime lending exceeded \$300 billion by the spring of 2008. PAUL MUOLO & MATTHEW PADILLA, CHAIN OF BLAME: HOW WALL STREET CAUSED THE MORTGAGE AND CREDIT CRISIS, at x (2008). By then, approximately 1 million people had lost their homes, and it is predicted that, by the end of the decade, another 2 or 3 million will join them as subprime victims. *Id.*

25. Williams et al., *supra* note 6, at 189 (citing Franklin D. Raines, former CEO of Fannie Mae, and Edward Gramlich, a former Federal Reserve Board Governor); *see infra* Part IV.

26. DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 3 (2006), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-lending-the-effect-of-race-and-ethnicity-on-the-price-of-subprime-mortgages.html>; Manny Fernandez, *Racial Disparity Found Among New Yorkers with High-Rate Mortgages*, N.Y. TIMES, Oct. 15, 2007, at B1 (discussing New York neighborhoods where subprime mortgages were common and those in which they were rare and stating “that even when median income levels were comparable, home buyers in minority neighborhoods were more likely to get a loan from a subprime lender”).

smaller down payments and poorer credit histories.<sup>27</sup> More than three decades after the enactment of the major federal fair lending laws,<sup>28</sup> black borrowers “continue to have less-than-equal access to loans at the best price and on the best terms that their credit history, income, and other individual financial considerations merit.”<sup>29</sup> The net result was that, generally, black borrowers purchased more expensive loans than their credit profiles qualified them for, as compared to whites with similar borrower characteristics.<sup>30</sup> The number of blacks was disproportionate within the universe of consumers of subprime loans as compared with the percentage of blacks in the general population.<sup>31</sup> Because of racial discrimination in the home mortgage and refinance market, “people of color are more likely than whites with similar borrower characteristics to be victims of predatory lending, to receive higher cost loans, and to lose their homes to foreclosure.”<sup>32</sup> The foreclosure of these subprime loans will result in a net loss in home ownership in the black community and

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27. BOCIAN ET AL., *supra* note 26, at 3; ROSS & YINGER, *supra* note 19, at 25; *Minority Subprime Borrowers*, CONSUMERS UNION SWRO (Consumers Union, Austin, Tex.), Oct. 2002, at 3, available at <http://www.consumersunion.org/pdf/au-minority-rpt.pdf>. The Consumers Union study analyzed Texas refinance loans between 1997 and 2000. *Id.* at 1.

28. “Fair lending laws” frequently refers to the Fair Housing Act (FHA), the Equal Credit Opportunity Act (ECOA), the Community Reinvestment Act of 1977 (CRA), and their implementing regulations. Warren W. Traiger, *New Fair Lending Initiatives*, REV. BANKING & FIN. SERVS. (Standard & Poor’s, New York, N.Y.), Mar. 4, 1998, at 1 n.1, available at [http://www.traigerlaw.com/publications/new\\_fair\\_lending\\_initiatives\\_the\\_review\\_of\\_banking\\_&\\_financial\\_services\\_3\\_4\\_98.pdf](http://www.traigerlaw.com/publications/new_fair_lending_initiatives_the_review_of_banking_&_financial_services_3_4_98.pdf). The CRA was intended to encourage covered institutions to meet the credit needs of low- and moderate-income communities. See 12 U.S.C. § 2901 (2006). The Home Mortgage Disclosure Act of 1975 (HMDA) mandates that lenders provide the public with certain data pertaining to housing-related loans and loan applications. See 12 U.S.C. § 2801 (2006). The ECOA was enacted in 1974 to promote credit availability and prohibit creditors from discriminating based upon certain criteria, including race, color, or sex. 15 U.S.C. § 1691 (2006). Finally, the 1968 FHA prohibits discrimination in housing-related transactions and housing financing based upon, among other things, race, color, or sex. 42 U.S.C. § 3604 (2006).

29. Apgar & Calder, *supra* note 7, at 102; see also WILLIAM APGAR ET AL., HARVARD UNIV. JOINT CTR. FOR HOUS. STUDIES, CREDIT, CAPITAL AND COMMUNITIES: THE IMPLICATIONS OF THE CHANGING MORTGAGE BANKING INDUSTRY FOR COMMUNITY BASED ORGANIZATIONS 1 (2004), available at <http://www.jchs.harvard.edu/publications/communitydevelopment/ccc04-1.pdf>.

30. See ROSS & YINGER, *supra* note 19, at 61; MICHAEL B. DE LEEUW ET AL., RESIDENTIAL SEGREGATION AND HOUSING DISCRIMINATION IN THE UNITED STATES: VIOLATIONS OF THE INTERNATIONAL CONVENTION ON THE ELIMINATION OF ALL FORMS OF RACIAL DISCRIMINATION, at ii (2007), available at [http://www.ushrnetwork.org/files/ushrn/images/linkfiles/CERD/17\\_Housing%20Discrimination.pdf](http://www.ushrnetwork.org/files/ushrn/images/linkfiles/CERD/17_Housing%20Discrimination.pdf).

31. See *infra* Parts III and IV and accompanying text.

32. DE LEEUW ET AL., *supra* note 30, at ii; see also APGAR ET AL., *supra* note 29, at 68 (discussing the devastating ripple effects of foreclosure). Foreclosure may undermine the ability of borrowers to engage in commercial markets—for example, by opening businesses—because of poor credit. It may also make it more difficult for borrowers to maintain gainful employment by, for instance, making the cost of securing financing to purchase a car to drive to work too high for the borrower to afford. *Id.*

will erode the property values of non-foreclosed homes.<sup>33</sup>

The unhealthy growth in subprime lending began in the early 1990s and exploded in the late 1990s through 2006.<sup>34</sup> Subprime lending is the practice of lending to borrowers who, theoretically,<sup>35</sup> do not demonstrate eligibility under standard credit requirements. The term “subprime borrower” is not consistently defined by individual financial institutions or in the marketplace.<sup>36</sup> The credit characteristics of subprime borrowers are varied and can include delinquencies, bankruptcies, judgments, charge-offs or other negative credit indicators, as well as limited financial resources.<sup>37</sup> Lenders

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33. NAT'L CMTY. REINV. COAL., INCOME IS NO SHIELD AGAINST RACIAL DIFFERENCES IN LENDING II: A COMPARISON OF HIGH-COST LENDING IN AMERICA'S METROPOLITAN AND RURAL AREAS 8 (2008); MAJORITY STAFF OF JOINT ECON. COMM., 110TH CONG., THE SUBPRIME LENDING CRISIS: THE ECONOMIC IMPACT ON WEALTH, PROPERTY VALUES AND TAX REVENUES, AND HOW WE GOT HERE 9 (2007); Williams et al., *supra* note 6, at 188–89 (stating that, according to a 2004 study, subprime loans “contributed 28 times as much to neighborhood foreclosures as did prime loans”). *But see* Charles W. Calomiris et al., *The Foreclosure–House Price Nexus: Lessons from the 2007–2008 Housing Turmoil* 25–26, (Nat'l Bureau of Econ. Research, Working Paper No. 14294, 2008), available at <http://www.nber.org/papers/w14294.pdf>. Calomiris et al. argue that foreclosures tend to have localized effects on housing prices and that those local effects tend to be less significant than many assume. The authors control for national and statewide trends in building permit growth rates, employment growth rates, housing sale rates, single-family permits, and total house prices. After controlling for these trends, the effects of foreclosures, they conclude, are fairly minimal. *Id.*

34. Subprime refinance loans grew from 80,000 in 1993 to 790,000 by 1999. ROSS & YINGER, *supra* note 19, at 19. In 1994, subprime loans were fewer than 5% of all mortgage originations; their representation had grown to 13% by 1999. *Id.*

35. *See infra* Part III (suggesting that, even after controlling for property and borrower characteristics that are relevant to the lending decision, race is consistently a statistically significant factor in determining whether a borrower receives a subprime loan); *see infra* Part V (discussing evidence of intentional discrimination in lending based upon race).

36. Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37,569, 37,570 (July 10, 2007). Most federal agencies have incorporated the credit risk characteristics of subprime borrowers from the 2001 Expanded Guidance for Subprime Lending Programs. *Id.*

37. OFFICE OF THE COMPTROLLER OF THE CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED. DEPOSIT INS. CORP., OFFICE OF THRIFT SUPERVISION, EXPANDED GUIDANCE FOR SUBPRIME LENDING PROGRAMS 2 (2001).

Generally, subprime borrowers will display a range of credit risk characteristics that may include one or more of the following:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;
- Bankruptcy in the last 5 years;
- Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or
- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.

perceive subprime borrowers as higher credit risks than prime borrowers because of subprime borrowers' poorer credit characteristics. Consequently, subprime loans are more expensive for borrowers than are prime loans and offer lenders a greater return to compensate for the increased risk associated with them.<sup>38</sup>

There is a strong correlation between subprime lending and predatory lending, though certainly not all subprime loans are predatory and, in fact, some organizations make responsible subprime loans.<sup>39</sup> Unlike subprime lending, predatory lending is never justified; it is fraught with abuse and perhaps even fraud.<sup>40</sup> "[A] loan is predatory if the lender knowingly extracts more surplus from the borrower than the loan delivers to the borrower."<sup>41</sup> Some common characteristics of predatory loans include (1) excessive fees and interest rates; (2) abusive prepayment penalties; (3) kickbacks to mortgage brokers in the form of yield spread premiums; (4) loan flipping; (5) loose qualifying standards on high-risk loans; (6) mandatory arbitration; and (7) steering and targeting.<sup>42</sup> Generally, predatory lending practices manifest in one of two forms.<sup>43</sup> First, predatory lending occurs when lenders extend

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*Id.* at 2–3.

38. According to the risk/return tradeoff principle, high levels of risk or uncertainty are associated with high levels of return. Low levels of risk or uncertainty are associated with low potential returns. The terms risk and uncertainty are used synonymously. *See, e.g.*, Adam Borchert et al., *Understanding Risk and Return, the CAPM, and the Fama-French Three-Factor Model* (Dartmouth Tuck Sch. of Bus. Case & Teaching Paper Series, Case Note No. 03-111, 2003), available at <http://ssrn.com/abstract=481881> (discussing models for making the relationship between risk and return more precise and suggesting that investors should only be compensated for risk that cannot be "diversified away").

39. Three distinct mortgage markets exist: "the prime market, the 'legitimate' subprime market, and the predatory market." APGAR ET AL., *supra* note 29, at 64. Responsible subprime lending can expand the credit opportunities of black borrowers; however, lending institutions, their loan officers, and brokers must understand and attend to the unique risks that accompany subprime lending and refinancing. ROSS & YINGER, *supra* note 19, at 19–20.

40. Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 *FORDHAM L. REV.* 2039, 2044 (2007).

41. Philip Bond et al., *Predatory Lending in a Rational World 2* (Fed. Reserve Bank of Phila., Working Paper No. 06-2, 2006), available at <http://ssrn.com/abstract=875621>.

42. Fact Sheet, Ctr. for Responsible Lending, *Predatory Mortgage Lending Robs Homeowners & Devastates Communities*, available at [http://www.dupontfund.org/learning/pdfs/predatory\\_mortgage\\_lending.pdf](http://www.dupontfund.org/learning/pdfs/predatory_mortgage_lending.pdf); Austin, *supra* note 5, at 1218; Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 *STAN. J. L. BUS. & FIN.* 289, 296 (2007) ("[Y]ield spread premiums are not simply another form of mortgage broker compensation, but rather a unique form of compensation that allows mortgage brokers to extract excessive payments from many consumers.").

43. *See* Bond et al., *supra* note 41, at 1 ("Predatory lending is associated with highly collateralized loans, inefficient rolling over of subprime loans, lending with disregard to ability to pay, prepayment penalties, balloon payments and poorly informed borrowers."); *see also* JAMES H. CARR & LOPA KOLLURI, FANNIE MAE FOUND., *PREDATORY LENDING: AN OVERVIEW 2*, [http://www.knowledgeplex.org/kp/text\\_document\\_summary/article/relfiles/hot\\_topics/Carr-](http://www.knowledgeplex.org/kp/text_document_summary/article/relfiles/hot_topics/Carr-)

credit to borrowers on terms that are inconsistent with the amount of credit risk the lender is assuming. Excessive fees and interest rates and prepayment penalties are examples of some of these types of terms.<sup>44</sup> Second, predatory lending can be characterized by loans that are made without appropriate regard for the borrower's ability to repay.<sup>45</sup>

The federal government has intervened at various points through regulation and legislation to address housing and mortgage lending discrimination.<sup>46</sup> The intervention was often in response to pervasive discrimination by lenders and others involved in the insurance and lending sectors. For example, the Community Reinvestment Act of 1977<sup>47</sup> (CRA) was passed in response to concerns of redlining in lending. Congress passed the CRA to encourage federally insured thrifts and banks to meet the credit needs of their entire communities, including minority households, consistent with safe and sound banking practices.<sup>48</sup> Redlining,<sup>49</sup> refusing to lend to

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Kolluri.pdf (suggesting that there are as many as three categories into which predatory loans typically may be cast):

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.

*Id.*

44. Bond et al., *supra* note 41, at 2.

45. *Id.*

46. *See infra* notes 47–48, 57 & 60 and accompanying text.

47. 12 U.S.C. § 2901 (2006).

48. *Id.* § 2901(b).

49. The practice of redlining dates back at least to the 1930s when the Home Owners' Loan Corporation mapped hundreds of cities to indicate the "safe" areas for federal insurance of home loans. The practice of redlining

appears to have originated in 1935, when the Federal Home Loan Bank Board asked the Home Owners' Loan Corporation to create "residential security maps" for 239 cities that would indicate the level of security for real estate investments in each surveyed city. The resulting maps designated four categories of lending and investment risk, each with a letter and color designation. Type "D" areas, those considered to be the riskiest for lending and which included many neighborhoods with predominantly African-American populations, were color-coded red on the maps—hence the term "redlining." Private lenders reportedly constructed similar maps that were used to determine credit availability and terms. The 1961 Report on Housing by the U.S. Commission on Civil Rights reported practices that included requiring high down payments and rapid amortization schedules for African-American borrowers as well as blanket refusals to lend in particular areas.

Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Remarks at Community Affairs Research Conference, The Community Reinvestment Act: Its Evolution and New Challenges 2 (Mar. 30, 2007) (citations omitted), *available at* <http://www.federalreserve.gov/newsevents/>

borrowers in communities with high concentrations of minorities, reduced the amount of capital available in the redlined communities for home acquisition and improvement.<sup>50</sup> Redlining reduced the supply of financing in targeted neighborhoods and therefore demand for these homes, resulting in a slower rate of home appreciation compared to non-targeted neighborhoods.<sup>51</sup> Existing homeowners in redlined communities had greater difficulty selling their homes and realizing the appreciated value that those in non-redlined neighborhoods experienced. Redlining also made it more difficult for black borrowers to access credit to start or improve businesses. The predictable outcome was that those in redlined areas have not only less access to credit but also lower incomes, lower credit scores, higher debt-to-value ratios, and lower home values.<sup>52</sup>

While the CRA expanded access to credit and residential mortgages for many, it has not evolved to address changes in the financial market for subprime mortgages. Most subprime mortgages are originated by nondepository institutions<sup>53</sup> and packaged by mortgage brokers<sup>54</sup> that are not covered by the CRA.<sup>55</sup> Moreover, most subprime mortgage originators are not prime lenders, which is troubling for borrowers as “subprime lending by prime lenders is probably less prone to abuse, since prime lenders also offer lower-cost products, work less with brokers, and are often subject to greater regulatory scrutiny.”<sup>56</sup>

Additionally, the Federal Fair Housing Act<sup>57</sup> (FHA) was passed to prohibit discrimination in residential real estate-related transactions. The

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speech/bernanke20070330a.htm.

50. Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 516 (2005).

51. See generally Williams et al., *supra* note 6, at 202 (discussing the consequences of housing segregation on blacks’ access to networks of service providers and on their vulnerability to racial and economic targeting by lenders).

52. See Barr, *supra* note 50, at 516 (“Economic theories predict that low-income communities generally would have lower access to capital than they would in a fully functioning market because of market failures, in addition to discrimination.”).

53. The term “nondepository institutions” refers to financial institutions that extend credit to borrowers in the form of loans but that do not accept bank deposits. Bureau of Economic Analysis, Regional Economic Accounts, <http://www.bea.gov/regional/definitions/nextpage.cfm?key=Nondepository%20institutions> (last visited July 30, 2010).

54. Mortgage brokers are loan intermediaries, or loan originators, who bring borrowers and lenders together. Mortgage brokers do not fund the loan. 2 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 11.1, at 76 (5th ed. 2007). They have a significant role in the residential mortgage market. The mortgage broker will take relevant information from the borrower, produce the necessary loan documents, and supervise the loan closing. *Id.* “The loan will be closed in the lender’s name, and the lender will underwrite, fund, and often service the loan.” *Id.*

55. Bernanke, *supra* note 49, at 11–12; THE SUBPRIME LENDING CRISIS, *supra* note 33, at 18.

56. Williams et al., *supra* note 6, at 191.

57. 42 U.S.C. § 3601 (2006).

FHA covers many forms of housing discrimination and prohibits discrimination against individuals because of their race and other characteristics in the sale or rental of housing.<sup>58</sup> The FHA makes it unlawful to discriminate in residential real estate-related transactions because of a borrower's race. Such transactions include the provision of financial services.<sup>59</sup>

Moreover, the Equal Credit Opportunity Act<sup>60</sup> (ECOA) prohibits creditors from discriminating against applicants in regards to a credit transaction on the basis of, among other things, the applicants' race, color, national origin, or marital status. For example, under the ECOA, a creditor would be prohibited from ignoring the earnings of a female mortgage applicant when determining whether a family qualifies for a mortgage.<sup>61</sup> Lenders historically discounted or ignored the earnings of female applicants, considering only the husband's or male applicant's income, and attributed their conduct to the inherent

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58. 42 U.S.C. § 3604 (2006).

59. 42 U.S.C. § 3605 (2006):

(a) In general—

It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

(b) "Residential real estate-related transaction" defined—

As used in this section, the term "residential real estate-related transaction" means any of the following:

(1) The making or purchasing of loans or providing other financial assistance—

(A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or

(B) secured by residential real estate.

(2) The selling, brokering, or appraising of residential real property.

*Id.*

60. 15 U.S.C. § 1691 (2006):

(a) Activities constituting discrimination—

It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction—

(1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);

(2) because all or part of the applicant's income derives from any public assistance program; or

(3) because the applicant has in good faith exercised any right under this chapter.

*Id.*

61. *See id.*

uncertainty attending women's commitment to remaining in the workforce because of the competing demands of motherhood and family rearing.<sup>62</sup>

Despite these fair lending laws, discrimination by the financial services and insurance industries limited the access of black borrowers to housing and finance opportunities and segregated them into communities that were easy for lenders to target for disparate treatment with subprime loans. These fair lending laws improved black borrowers' access to credit and capital, but those resources often are provided by subprime and predatory lenders.

National leaders, in blind pursuit of the "ownership society,"<sup>63</sup> led the country into a perilous housing trap too complex to understand for many caught in that trap, perhaps until it was too late. Nationally, home ownership rates have steadily fallen since 2005, reaching a ten-year low in the first quarter of 2010.<sup>64</sup> Many assumed that more lending and greater access to credit for black communities was desirable.<sup>65</sup> But more lending is not the same as responsible lending, and these same communities that have been struggling to bridge the home ownership gap<sup>66</sup> created by historical housing

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62. Federal Citizen Information Center, Consumer Handbook to Credit Protection Laws: Applying for Credit, [http://www.pueblo.gsa.gov/cic\\_text/money/protectionlaws/apply.htm](http://www.pueblo.gsa.gov/cic_text/money/protectionlaws/apply.htm) (last visited July 30, 2010).

Both men and women are protected from discrimination based on gender or marital status. But many of the law's provisions were designed to stop particular abuses that generally made it difficult for women to get credit. For example, denying credit or offering less favorable credit terms based on the misperception that single women ignore their debts when they marry, or that a woman's income "doesn't count" because she'll stop work to have and raise children, is unlawful in credit transactions.

*Id.* Black women, in particular, have been targets of subprime and predatory lenders. This Article does not focus on the unique experiences of black women borrowers with subprime and predatory lending. The issue of gender-based intentional discrimination will be addressed in my forthcoming article.

63. In an October 2004 speech, George W. Bush said: "We're creating . . . an ownership society in this country, where more Americans than ever will be able to open up their door where they live and say, welcome to my house, welcome to my piece of property." Naomi Klein, *Disowned by the Ownership Society*, NATION, Feb. 18, 2008, at 10 (quoting President George W. Bush, Remarks to the National Association of Home Builders (Oct. 2, 2004), <http://georgewbush-whitehouse.archives.gov/news/releases/2004/10/20041002-7.html>).

64. Press Release, U.S. Census Bureau, Residential Vacancies and Homeownership in the First Quarter 2010 tbls.4 & 4SA (Apr. 26, 2010), <http://www.census.gov/hhes/www/housing/hvs/qtr110/files/q110press.pdf>.

65. *Contra* APGAR ET AL., *supra* note 29, at 67 ("Increasing default and foreclosure rates have led many analysts to question whether the recent increase in low-income homeownership—built in part on the rapid growth of subprime lending—is sustainable or even desirable.").

66. "[I]f you own something, you have a vital stake in the future of our country. The more ownership there is in America, the more vitality there is in America, and the more people have a vital stake in the future of this country." President George W. Bush, Remarks at the National Federation of Independent Businesses (June 17, 2004), <http://georgewbush-whitehouse.archives.gov/news/releases/2004/06/20040617-7.html>. *But see* A. Mechele Dickerson, *The Myth of Home*

discrimination are finding that many of the gains previously made will be lost to foreclosures.<sup>67</sup>

“[I]ndustry apologists frequently dismiss findings of disparate treatment [in mortgage lending] as simply the failure to distinguish ‘risk from race.’”<sup>68</sup> Evidence of pervasive disparate treatment of blacks across the home mortgage and refinance industry is very difficult to gather for several reasons.<sup>69</sup> First, mortgage financing is a complex, multistage endeavor. At each stage of the process, lenders can intentionally discriminate, and the discrimination can present differently in each stage.<sup>70</sup> This Article focuses on the financing stage, which is toward the end of the process when black borrowers are more likely to be offered subprime loans than similarly situated white borrowers.<sup>71</sup> Discrimination at this stage deserves more attention from researchers and analysts.

Second, evidence of disparate treatment because of race is difficult to gather because past discrimination has created disparities that exist along racial and ethnic lines within credit criteria that influence home mortgage and refinance lending. There are many borrower characteristics other than race that may explain the higher incidence of subprime and predatory loans among black borrowers as compared to white borrowers.<sup>72</sup> Discrimination that occurred elsewhere in the economy, as well as historic housing discrimination, has resulted in black borrowers generally having lower incomes, lower home values, poorer credit histories, and higher obligation-to-asset ratios than whites.<sup>73</sup> These are important borrower characteristics and a

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*Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 IND. L. REV. 189 (2009) (challenging home ownership at the root and advocating for a renewed emphasis on affordable “affordability products”).

67. See, e.g., Williams et al., *supra* note 6, at 184. Foreclosure can be devastating to individuals and to communities. Decreases in property values brought on by neighborhood foreclosures and deterioration and abandoned properties can cause homeowners to lose wealth and can negatively impact their ability to repay home loans. *Id.* But see Calomiris et al., *supra* note 33, at i (“The impact of foreclosures on prices, while negative and significant, is quite small in magnitude.”).

68. Apgar & Calder, *supra* note 7, at 112 (citation omitted).

69. See URBAN INST., MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 3–5, (Margery Austin Turner & Felicity Skidmore eds., 1999), available at [http://www.urban.org/UploadedPDF/mortgage\\_lending.pdf](http://www.urban.org/UploadedPDF/mortgage_lending.pdf); Helen F. Ladd, *Evidence on Discrimination in Mortgage Lending*, 12 J. ECON. PERSP. 41, 44 (1998) (discussing the points of potential discrimination during the loan process).

70. Ladd, *supra* note 69, at 44.

71. See *infra* Part IV.D.

72. Bernanke, *supra* note 49, at 2–3; Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data*, 86 AM. ECON. REV. 25, 25 (1996).

73. For example, on the 2000 Census, black homeowners reported a median home value of \$80,600, while white homeowners reported a median home value of \$122,800. ROBERT L. BENNEFIELD, U.S. CENSUS BUREAU, HOME VALUES: 2000, at 3 fig.4 (2003),

refusal to offer a prime loan based on the adverse nature of these characteristics would not, standing alone, evidence intentional home mortgage or refinancing discrimination. Whether housing discrimination has reinvented itself in the subprime and predatory mortgage and refinance markets is important; equally important is the need to ensure that statistically significant gaps between blacks and whites in subprime and predatory lending are not mislabeled as the results of intentionally discriminatory lending practices when, in fact, they are attributable to borrower and neighborhood characteristics that could be properly considered in the lender's decision-making process. Thus, there is much debate regarding whether differentials in the quality of loan products exist because of legitimate, credit-related factors that may vary based upon the applicant's race and ethnicity or whether the differences are more directly correlated to race.

Finally, the mortgage financing industry treats credit quality data, the information used to price loans, as proprietary and has resisted making this information available, which has effectively enabled the industry to undermine studies that find evidence of disparate treatment.<sup>74</sup> For purposes of this Article, disparate treatment occurs when black borrowers with equal or better credit indicators than "comparable" white borrowers receive less favorable loan terms or products than the white borrowers. Overwhelming proof of disparate impact can compel an inquiry into discriminatory intent. And one can imagine evidence of disparate impact so prodigious in light of the surrounding facts, such as the likeness of white and black borrowers along all relevant lending criteria, that the only plausible explanation for the differences in treatment among the groups appears to be an intent to discriminate based upon race. Against that history, both recent and ancient, regarding intentional and unintentional discrimination, we now turn to the evidence that subprime products disproportionately burden black borrowers.

### III. THE IMPACT OF RACE: DISPARATE IMPACT EVIDENCE

Numerous organizations have conducted studies of subprime lending to

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<http://www.census.gov/prod/2003pubs/c2kbr-20.pdf>. In addition, 24.9% of the black population lived under the poverty level, compared to 9.1% of the white population, while black per capita income (\$14,437) was 60% of white per capita income (\$23,918). ALEMAYEHU BISHAW & JOHN ICELAND, U.S. CENSUS BUREAU, POVERTY: 1999 (2003), at 8 tbl.6, <http://www.census.gov/prod/2003pubs/c2kbr-19.pdf>; U.S. Census Bureau, <http://factfinder.census.gov> (per capita income statistics generated on January 21, 2009 by Mirya Holman using American FactFinder).

74. See, e.g., APGAR ET AL., *supra* note 29, at 69–70 (discussing regulators' reluctance to make lenders include certain data that would be helpful in assessing the appropriateness of a loan rate given a particular borrower's characteristics and discussing Congress's failure "to adapt HMDA collection activities to reflect market trends"); Editorial, *Mortgages and Minorities*, N.Y. TIMES, Dec. 9, 2008, at A34.

determine if there is a discernable racial pattern in the marketing and acceptance of subprime loans. Many of these studies, such as those discussed below, have concluded that racial patterns exist in subprime lending. The studies are often localized, examining the impact of subprime lending on the borrowers of a particular city or state. Therefore, these studies, by themselves, do not necessarily prove intentional racial discrimination. Still, when combined with national studies that control for relevant borrower and property characteristics,<sup>75</sup> it becomes increasingly difficult to explain away stark racial disparities between white and black borrowers in subprime lending as being unrelated to race.

A 2007 study by New York University's Furman Center for Real Estate and Urban Policy considered racial differences in New York City neighborhoods when comparing the rates of subprime mortgages in those neighborhoods. The researchers found that when median income levels between minority and non-minority neighborhoods were comparable, minority neighborhoods had more subprime mortgage homebuyers than non-minority neighborhoods.<sup>76</sup> Data related to several key components of mortgage lending decisions—borrowers' assets, the amount of their debt and down payments, and their individual credit histories—were not included in the researchers' analysis.<sup>77</sup> The absence of this information makes it more difficult to draw a direct conclusion that mortgage lenders were intentionally discriminating against minorities; however, coupled with data indicating that even at higher income levels black borrowers were significantly more likely than their white peers to receive subprime loans, the New York University study highlights national concern about the role of race in mortgage lending decisions.<sup>78</sup>

Consumers Union, the nonprofit publisher of Consumer Reports, analyzed Texas refinance loans for the period of 1997 to 2000.<sup>79</sup> Consumers Union concluded that its study

reinforces (for Texas) the findings of several national studies: race matters. The race/ethnicity of borrowers is a powerful factor in the penetration of subprime lending in Texas

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75. See *infra* Part IV. Press Release, Or. Ctr. for Pub. Pol'y, OCPP Finds Racial Pattern in Oregon's Subprime Lending (Jan. 31, 2008), <http://www.ocpp.org/cgi-bin/display.cgi?page=nr080131subprime> (discussing a 2006 study). "At all income levels, Oregon's African American . . . borrowers are more likely than whites to have received subprime loans . . ." *Id.* (emphasis added). The OCPP was careful to note that its analysis, by itself, did not prove racial discrimination in lending, but that combined with other national data, the study uncovered inexplicable racial differences. *Id.*

76. Fernandez, *supra* note 26.

77. *Id.*

78. *Id.*

79. *Minority Subprime Borrowers*, *supra* note 27, at 1.

communities. [The] study shows that subprime loans are concentrated in geographical areas with a higher concentration of minority residents. Even after accounting for other factors, the likelihood of getting a subprime loan increases for minority borrowers, especially Black borrowers. Among higher income borrowers, the distinction between subprime lending to Whites and subprime lending to minorities is stark.<sup>80</sup>

Consumers Union, noting that black borrowers statistically have fewer assets and earn less than white borrowers, which negatively affects their credit scores and loan underwriting, accounted for the impact of these factors on lending decisions by analyzing all Texas home purchases and refinances in which the borrowers earned more than 1.5 times the state's median income (\$60,000 or more annually) and borrowed less than 2.5 times their reported income.<sup>81</sup> Consumers Union found that even at upper income levels, the rate of subprime financing and refinancing was highly correlated to race. Upper income whites refinanced with subprime loans at the rate of 16.7% and upper income blacks at the rate of 46.4%.<sup>82</sup>

The Federal Reserve Bank of Boston (Boston Fed) issued a report in 1996 interpreting 1990 HMDA data analyzing mortgage lending in Boston, Massachusetts.<sup>83</sup> In the report, the Boston Fed analyzed the mortgage denial rates of minorities versus non-minorities. The report did not address the quality of mortgage loans, whether prime or subprime; however, that factor is probative in its analysis of whether race is a barrier to entrance into the mortgage market.

HMDA was enacted by Congress in 1975 for the purpose of providing the public with loan data that could be used to aid (1) in discerning lending patterns that are discriminatory; (2) in verifying whether financial institutions covered by the legislation are serving their communities' housing needs; and (3) public officials as they attempt to distribute investments from the public sector in an effort to attract private investments to areas in need.<sup>84</sup> As HMDA was originally enacted, the data required to be reported was very limited and this limitation has been a point of criticism in the debate regarding whether studies relying on HMDA data to reveal housing discrimination are reliable indicators.<sup>85</sup>

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80. *Id.*

81. *Id.* at 2.

82. *Id.*

83. Munnell et al., *supra* note 72, at 25–26.

84. 12 U.S.C. § 2801 (2006); Federal Financial Institutions Examination Council, Home Mortgage Disclosure Act, Background & Purpose, <http://www.ffiec.gov/hmda/history.htm> (last visited July 31, 2010).

85. "HMDA data do not include information on credit histories, debt burdens, loan-to-value

HMDA was amended in 1989; the amendments expanded the coverage of HMDA's reporting requirements.<sup>86</sup> The amendments required reporting of data pertaining to loan applications; prior to the amendments, institutions were required only to report data regarding loans that were purchased or originated.<sup>87</sup> The 1989 amendments also required most covered institutions to report mortgage applicants' and borrowers' race, sex, and income, and to provide identifying information for the location of the property included in the application based upon 1990 Census data.<sup>88</sup>

The 2002 amendments to HMDA regulations added additional reporting fields and added significantly to the public data required to be disclosed by mortgage lenders.<sup>89</sup> For instance, the amended HMDA regulations required covered institutions to report the race, sex, and ethnicity of telephone applicants.<sup>90</sup> Covered institutions also had to begin reporting data for loan pricing. Loan originations for which the annual percentage rate exceeded the yield for comparable Treasury securities by three percentage points or more had to be reported.<sup>91</sup> Lenders began reporting the new data pursuant to the 2002 amendments in 2004, and the data was released to the public in 2005.<sup>92</sup>

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ratios, and other factors considered in making mortgage decisions . . . ." Munnell et al., *supra* note 72, at 25; APGAR ET AL., *supra* note 29, at 56. Critics argue that HMDA data fails to account for important variables—"the 'left out variable problem'"—and that the omission of these important variables "can bias the coefficients on race/ethnicity to the extent that the omitted variables are correlated with race." *Id.*

86. The 1989 HMDA amendments are contained in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, tit. XII, § 1211, 103 Stat. 183, 524-26, which became effective on January 1, 1990. *See also* Home Mortgage Disclosure, 54 Fed. Reg. 51,356 (Dec. 15, 1989) (announcing Federal Reserve Board regulations implementing amendments to HMDA).

87. Home Mortgage Disclosure, 54 Fed. Reg. at 51,356-57. Since 1990, HMDA has reported on loans that were originated and purchased as well. It includes data on applications that were approved but that were not accepted by lenders, as well as data concerning applications that were withdrawn or denied. Since 1990, HMDA also has reported data on applications that were closed because the applicant did not complete the application process. *Id.* at 51,365 (now codified at 12 C.F.R. pt. 203 app. A at 76 (2010)).

88. *Id.*; Home Mortgage Disclosure, 56 Fed. Reg. 59,853 (Nov. 26, 1991).

89. Home Mortgage Disclosure, 67 Fed. Reg. 43,218, 43,223 (June 27, 2002) (now codified at 12 C.F.R. pt. 203 app. A at 77-78); *see also* Consumer Bankers Association, Home Mortgage Disclosure Act Information Page, <http://www.cbanet.org/government/content.cfm?mnumber=&tnumber=&itemnumber=1198&unitnumber=&pf=1&snitemnumber=> (last visited Aug. 1, 2010).

90. This portion of the 2002 amendments was made applicable as of January 1, 2003. Home Mortgage Disclosure, 67 Fed. Reg. at 43,218.

91. Home Mortgage Disclosure, 67 Fed. Reg. 7222, 7241 (Feb. 15, 2002) (now codified at 12 C.F.R. pt. 203 app. A at 78-79). This requirement pertained to loans that were secured by a first lien. If the loan was secured by a second lien, the threshold was 5% or more above the comparable Treasury rate. *Id.*

92. Home Mortgage Disclosure, 67 Fed. Reg. at 43,218; Consumer Bankers Association, *supra* note 89.

Lenders indicate that many variables, in addition to those that are reported under HMDA, are important in the lending process, including the stability of the applicant's income stream, credit history reports, credit projection reports, loan-to-value ratios, total debt obligations, obligation ratios, and net wealth.<sup>93</sup> These items are not captured under the HMDA reporting requirements;<sup>94</sup> however, the Boston Fed augmented the 1990 HMDA data to account for thirty-eight additional variables, including the ones mentioned above.<sup>95</sup> These additional variables constituted virtually all of the lender's information set as captured in its loan application form, the lender's worksheet, and the credit report.<sup>96</sup> Including the additional borrower data reduced the disparity between black and white denial rates from the eighteen percentage points originally reported to slightly over eight percentage points, still statistically and economically significant.<sup>97</sup> Minority applicants with the same personal and property characteristics of white applicants had a rejection rate of 28% rather than the more favorable rate experienced by white applicants of 20%.<sup>98</sup>

The Boston Fed accounted for differences in economic factors that support higher mortgage denial rates for blacks on non-discriminatory grounds. These economic factors included disparities in net wealth, strength of credit histories, lower down payments, and fewer liquid assets.<sup>99</sup> The Boston Fed tested the pervasiveness of possible race bias by questioning whether racial disparities in rejection rates were due to isolated discriminatory conduct by one or two institutions in contrast to a market-wide phenomenon of discrimination.<sup>100</sup> Also, it assumed that lenders are driven by a desire to maximize profit and so it accounted for the possibility that the reason minority applicants were rejected at higher rates than non-minority applicants was because lenders, considering the economic characteristics of minority borrowers, simply judged their loans to be less profitable, a purely economic

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93. Munnell et al., *supra* note 72, at 28.

94. See *supra* note 85 and accompanying text. "While lenders are required to report to the federal government such things as race, gender, census tract, amount of loan and income, they omit credit score data. By guarding the single most important statistic used in making loans, the lenders have given themselves a ready shield against charges of discrimination." *Mortgages and Minorities*, *supra* note 74.

95. Munnell et al., *supra* note 72, at 28–30 (outlining the authors' survey).

96. *Id.* at 28.

97. *Id.* at 26.

98. *Id.*

99. *Id.* at 31.

100. To distinguish market-wide discrimination from the isolated behavior of a select group of lenders serving minority populations, the Boston Fed divided its test sample into two groups, lenders that had the greatest number of minority loans and the remaining lenders. *Id.* at 41. The first group accounted for only 5% of the lending institutions but 50% of the minority applications. *Id.*

decision.<sup>101</sup>

After supplementing the HMDA data to consider additional borrower characteristics gathered by lenders in the application process, abstracting for discrimination found in other areas of the economy, evaluating the study results to discern the pervasiveness of the role of race across institutions, and critically analyzing the quality of the HMDA data (correcting for errors),<sup>102</sup> the Boston Fed reported that in the Boston area, race has a statistically significant effect on mortgage lending decisions.<sup>103</sup> Moreover, the discrimination that the study revealed in the form of higher minority denial rates because of race was widespread across institution types and sizes.<sup>104</sup>

It is evident that significant differences in acceptance rates for prime loans, explainable only by race,<sup>105</sup> remain after accounting for legitimate borrower characteristics like wealth, income, credit history, and credit scores. The lending discrimination studies, audit reports, and data generated from HUD and HMDA information included in this Article pose important implications for inequality in housing and lending policy.

In the 1990s, subprime lenders, who had previously represented a much smaller share of the home mortgage lending and refinance business, accessed the emerging market of borrowers and produced gains in home ownership at a faster rate than ever before.<sup>106</sup> But, the progress these lenders apparently made in increasing home ownership among black borrowers is illusory. Many black borrowers were able to become homeowners only as a result of accepting the price of inequality—higher interest rate loans with less desirable terms and even predatory characteristics—all of which increased the likelihood of default and foreclosure for this already vulnerable group.<sup>107</sup> To the extent subprime lenders have succeeded in stealing borrowers away from prime lenders, the perceived gains in home ownership for black borrowers has come at a tremendous price.<sup>108</sup>

#### IV. THE IMPACT OF RACE ON BORROWING AND LENDING BEHAVIORS: 1998, 2002, AND 2006 HMDA DATA

This Part of the Article provides a new look at HMDA and HUD data for the years 1998, 2002, and 2006 to determine the impact of race on subprime

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101. *Id.* at 27, 41.

102. *Id.* at 45–47.

103. *Id.* at 47.

104. *Id.*

105. These differences are also explainable, in part, by gender. *See supra* note 62 and accompanying text.

106. *See supra* Part II.

107. *See id.*; *see also* Williams et al., *supra* note 6, at 201.

108. *See supra* Part II; *see also* Williams et al., *supra* note 6, at 201.

and predatory lending. The first part of the study examines the national data to discern the borrowing behaviors of blacks and whites by determining the percentage of black and white borrowers by state who (1) applied for subprime loans and (2) were accepted for subprime loans by the lender.<sup>109</sup> The study results show that blacks typically apply for subprime loans and are accepted for subprime loans at higher rates than whites.<sup>110</sup>

The second part of the study addresses the question of whether disparities in subprime rates between black and white borrowers exist *because of* or *in spite of* race. This part of the study controls for relevant borrower, house, and neighborhood characteristics.<sup>111</sup> Patterns similar to those in the first part of the study are revealed in the second part of the study. Consistently, race has a statistically significant effect on the likelihood a borrower receives a subprime loan.<sup>112</sup> Black borrowers are more likely than white borrowers to receive a subprime loan even when other measures that are relevant to the loan decision are held constant between black and white borrowers.

Section A contains a description of the data used to conduct difference of means tests, the first part of the study.<sup>113</sup> Next, section B contains a description of the data used in the logit analyses, the second part of the study. The results of the difference of means test are presented in section C, and the results of the logit analyses are presented in section D.

*A. State Data Means Test for Application and Acceptance for Subprime Loans Based upon Race—Methodology*

The primary data this study used to analyze the attributes of subprime lending broken down by race is from the 1998, 2002, and 2006 HMDA data sets. The data sets contain information on every application for a home mortgage origination or refinance loan made in the United States for those years. For each loan application, lenders were required to report borrower characteristics, including borrowers' race, gender, and income, as well as information on the house value and location. In processing the data, HMDA removed identifying features<sup>114</sup> and provided information on the neighborhood, census tract, or Metropolitan Statistical Area<sup>115</sup> (MSA) in

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109. *See infra* Tables 1–3.

110. *Id.*

111. *See infra* Tables 4–6.

112. *Id.*

113. A difference of means test (t-test) compares the means of two groups on a single variable and uses standard errors to establish whether the means have a statistically significant difference. LES SEPLAKI, ATTORNEYS' DICTIONARY AND HANDBOOK OF ECONOMICS AND STATISTICS 243 (1991).

114. Such as the house address.

115. MSA is defined as an urban area containing a minimum of 50,000 inhabitants, including surrounding counties.

which the house is located. The 1998 HMDA data set contains 11,000,077 mortgage applications, the 2002 data set contains 14,198,111 mortgage applications, and the 2006 data set contains 21,735,287 mortgage applications.<sup>116</sup> The HMDA data sets contain multiple applications for the same borrower, as each lender is required to log every application regardless of whether it is completed or leads to a lending decision. All incomplete applications were removed from the data set for cleaning and streamlining purposes. All applications where the borrower or co-borrower was black or white were identified. Submitted applications in which neither the borrower nor the co-borrower were black or white were removed.<sup>117</sup> The study begins by examining the 2006 HMDA data set, which also logs information on the lender, the borrower, the loan, and the house. Due to state level fluctuations in home prices and lending practices, and for data management reasons, each state's lending patterns are modeled individually. In addition, modeling the states separately eliminates the need to use a state fixed-effects model.<sup>118</sup>

After cleaning this data, subprime loans were identified through two processes. First, since 2004, HMDA has required lenders to report the rate of any loan where the annual percentage rate is three percentage points or more above the yield on a comparable Treasury security (Alternative Measure).<sup>119</sup> This is the first category of subprime loans, which is examined and identified in Table 4. Using this data, loans that have a subprime rate can be identified through the HMDA data set. The Treasury rate spread measure of subprime loans is not available for the 1998 and 2002 data.<sup>120</sup>

Second, using the 2005 HUD list<sup>121</sup> of subprime lenders, each lender that is listed by HUD as a subprime lender was marked (HUD-Classified Subprime Lender).<sup>122</sup> HUD identified subprime lenders based upon the percentage of their overall loans that qualified as subprime.<sup>123</sup> This is the

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116. All data on the number of applicants is from HMDA data and refers to the number of applications from white and black borrowers.

117. This Article is concerned about the impact of subprime and predatory lending practices on black borrowers. While evidence indicates that other minority groups may be experiencing negative impacts, the focus of this Article is on black borrowers as a class.

118. A fixed-effects model would require a constant dummy variable for each state, which would greatly expand the size of each model and prevent me from examining state-by-state trends.

119. See *supra* note 91 and accompanying text.

120. This measure of subprime loans results from the amendments to HMDA regulations noted in Home Mortgage Disclosure, 67 Fed. Reg. 7222, 7241 (Feb. 15, 2002) (now codified at 12 C.F.R. pt. 203 app. A at 78–79) (amendments effective January 1, 2004). Therefore, this measure of subprime loans is not available for data from the years 1998 and 2002.

121. A one-year lag between the HUD subprime lender list and the HMDA data is acceptable and recommended by HUD.

122. See HUD User Data Sets, *supra* note 13 (detailing how HUD classifies lenders as subprime).

123. *Id.*

second category of subprime loans, which is examined and identified in Table 5.

The first method of identifying subprime loans, by the Alternative Measure, will identify subprime loans given by *prime lenders*. The second method of identifying subprime loans, through the HUD-Classified Subprime Lenders, focuses on lenders who routinely engage in subprime lending practices.<sup>124</sup> These lenders include, but are not limited to, lenders whose loans are determined to be subprime because of their high interest rates. Some loans are classified as subprime because of loan characteristics other than the interest rates, such as excess fees, prepayment penalties, interest-only loans, balloon payments, and other predatory lending practices.<sup>125</sup>

The combination of these two methods of identifying subprime loans allows for a more thorough examination of the lending and borrowing behavior surrounding subprime lending. Using both methods to identify subprime loans is important, as they capture different populations. The Alternative Measure encompasses the loans that fit the standard definition of a subprime loan, regardless of whether they are given out by a prime or subprime lender. As prime lenders frequently lend money at subprime rates, it is important to look at those loans. The HUD-Classified Subprime Lender method allows the incorporation of all the loans that are given out by subprime lenders, regardless of whether the rate itself is subprime. This allows the inclusion of loans that may not have a high rate but fit other

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124. *Id.*

HUD uses a number of HMDA indicators to identify potential subprime lender specialists. First, subprime lenders typically have lower origination rates than prime lenders. Second, home refinance loans generally account for higher shares of subprime lenders' total originations than prime lenders' originations. Third, lenders who sell a significant percentage of their portfolios to the [government-sponsored enterprises] do not typically specialize in subprime lending. The rate spread variable available for the first time with the 2004 HMDA data can also be used as a screen to identify potential subprime lender specialists. As would be expected, the ranking of potential subprime lenders using the HUD indicators is very similar to the ranking of potential subprime lenders using the rate spread premium variable alone.

HUD called the lenders identified on the potential list or reviewed their web pages to determine if they specialized in subprime lending. A large number of lenders told us that they offer subprime loans but they do not constitute a large percentage of their overall conventional mortgage originations. Most lenders readily identified themselves as prime or subprime lender specialists. Some lenders identified themselves as all-purpose lenders and broke out their loan portfolios by mortgage product. In a couple of cases, we identified a lender as subprime if their subprime percentage exceeded 50 percent.

*Id.*

125. *See id.*

criteria, such as excessive fees, adjustable rate mortgages, and interest-only mortgages where the annual percentage rate is not three percentage points or more above the yield for comparable Treasury securities, but for which a closer examination might reveal that the paid rate is much higher than the initial rate. The results of this study are displayed in Tables 1, 2, and 3.

*B. State Data Control Test Using Probability of Acceptance for a Subprime Loan as the Dependent Variable with Race as the Primary Independent Variable—Methodology*

Again, using HMDA data for the years 1998, 2002, and 2006, the study applies an alternate method to investigate the relationship between race and subprime loans—logit analysis.<sup>126</sup> First, a dichotomous dependent variable was generated for the analysis, which labels a prime loan as “0” and a subprime loan as “1.” Using the variable generated, whether someone was accepted for a subprime loan,<sup>127</sup> the following information was regressed:<sup>128</sup> the applicant’s race; the applicant’s income; the house value; characteristics of the area where the house is located, including the median income, the percent of houses that are owner-occupied, the percent of the census tract that are minorities, and the median income of the MSA.<sup>129</sup> The results of this analysis are presented in Tables 4, 5, and 6.

*C. State Data Means Test for Application and Acceptance for Subprime Loans Based upon Race—Findings*

Consistently in 2006, in every state, blacks applied for loans from subprime lenders more frequently than whites. In every state except for North Dakota, there was a statistically significant difference between the rate of subprime applications for white and black borrowers. The rates of subprime

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126. Logit analysis is a statistical technique when there are dichotomous dependent variables (e.g., whether a borrower applied for a subprime or a prime loan).

127. The study used two measures of subprime loan applications; the first is the measure from HMDA, which requires that lenders report the rate of any loan that is lent at an annual percentage rate three points or more above the yield on comparable Treasury securities (Alternative Measure). See HUD User Data Sets, *supra* note 13 (explaining the methodology behind HUD’s list). The second measure uses data from HUD on subprime lenders (HUD-Classified Subprime Lenders). *Id.* HUD has routinely identified lenders that it classifies as “subprime” from their lending patterns. *Id.*

128. Through regression, this methodology attempts to estimate the relationship between each of these independent variables and the dependent variable (i.e., the probability of receiving a loan from a subprime lender).

129. The study also separated out whether someone was accepted for a subprime refinance or a subprime origination loan. These results are remarkably similar to the results presented in Tables 4, 5, and 6, given that whether the applicant is black has a substantive and significant effect on whether the applicant is accepted for a subprime loan. Generally, race has a larger effect on subprime origination loans than on subprime refinance loans (up to three times the effect size), but has a statistically significant effect in both instances in every state but Hawaii, North and South Dakota, and Montana.

applications for 2006, along with standard errors and probability values, are available in Table 1.<sup>130</sup>

Next, the study examines the percentage of borrowers accepted for loans by subprime lenders. Again, the differences between black and white borrowers are striking. For the majority of states, black borrowers qualified for subprime loans at an average of 2.325 times the rate that white borrowers qualified for subprime loans. The difference in rates ranges from 6.6% of white borrowers and 4.3% of black borrowers qualifying in South Dakota to 6% of white borrowers and 20.8% of black borrowers qualifying in Washington, D.C.<sup>131</sup>

As an alternate measure of subprime lending, the study examines the rates of approval for loans that were three percentage points or more above the yield on comparable Treasury securities (Alternative Measure). The last three columns of Table 1 indicate that black borrowers were much more likely to borrow at a rate that was considered “subprime,” in that the rate exceeded the annual percentage rate for comparable treasury securities by at least three percentage points. Again, the only places where this pattern does not hold true are North Dakota and South Dakota, both of which have very low black populations.

An analysis of two extreme states, North Dakota and Massachusetts, illustrates the disparate impact of these loans on white and black communities.<sup>132</sup> In 2006 in North Dakota, there were 144 black loan applicants, 17.4% of whom applied for loans with HUD-Classified Subprime Lenders. During the same year, there were 27,021 white applicants, 14.2% of whom applied for loans with HUD-Classified Subprime Lenders. The acceptance rates did not vary in a statistically significant way based upon race. Of the black applicants, 9.9% were accepted for loans from subprime lenders, compared to 7.7% of white applicants. Considering the Alternative Measure, 16.8% of black applicants received loans that were three percentage points or more above the yield on comparable Treasury securities, compared to 17% of white applicants. None of these differences are statistically significant, suggesting that white and black borrowers in North Dakota had an equal chance of applying for or being accepted for a subprime loan.

The findings for North Dakota sharply contrast the findings for Massachusetts. In Massachusetts in 2006, there were 38,055 black applicants

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130. Tables 2 and 3 contain information for years 2002 and 1998, respectively.

131. See *infra* Table 1; South Dakota is the only state where the rate of white borrowers qualifying for subprime loans is greater than black borrowers. This may be due to state-level differences in laws governing subprime lending or due to the fact that the black population in South Dakota is so small; the number of subprime black borrowers in South Dakota is 51.

132. See *infra* Table 1.

applying for loans, 36.5% of whom applied for loans with HUD-Classified Subprime Lenders. During the same year, there were 420,222 white applicants, 18.3% of whom applied for loans with HUD-Classified Subprime Lenders. The acceptance rates varied in a statistically significant way based upon race. Of the black applicants, 32% were accepted for loans from HUD-Classified Subprime Lenders; 11.4% of the white applicants were accepted for loans from HUD-Classified Subprime Lenders. Considering the Alternative Measure, 37.3% of black applicants received loans that were three percentage points or more above the yield on comparable Treasury securities, compared to 15.8% of white applicants. All of these differences are statistically significant to the 0.000 level. In general, the borrower and lender behavior in Massachusetts is closer than behavior in North Dakota to the 2006 national norm: black borrowers applied for subprime loans at a higher rate and were accepted for these loans at a much higher rate than were white borrowers.

The results from 2002 and 1998 are presented in Tables 2 and 3.<sup>133</sup> The number of subprime applications and of subprime loans was lower in 2002 and 1998 than in 2006.<sup>134</sup> In addition, the same pattern that was evident in 2006 was evident in the 2002 and 1998 data—black applicants applied for and received subprime loans at higher rates than white applicants, albeit at lower rates than in 2006. However, the difference between the racial groups was smaller in 2002 and 1998 than in 2006, resulting in some statistical insignificance.<sup>135</sup>

As Figures 1 and 2 show, in the years 1998, 2002, and 2006 there has been a general rise in the number of subprime loans, the share of subprime loans in the overall lending market, and the racial disparity in applying for and receiving subprime loans. This suggests that, while the effect of subprime lending has long been felt by a subset of borrowers, the last ten years have seen a significant increase in the disparate impact on black borrowers.

*D. State Data Control Tests, Using Probability of Acceptance for a Subprime Loan as the Dependent Variable with Race as the Primary Independent Variable—Findings*

Table 4 contains the results for 2006, which show that in the large

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133. For simplicity's sake, all the state-level data was collapsed into a single file to assess the nature of subprime lending in the United States. In 2006, the disparate patterns of subprime lending across states required either fixed-effects modeling or modeling each state individually. In 2002 and 1998, the number of subprime borrowers and lenders was low enough to collapse states together and estimate national effects.

134. See *infra* Tables 1–3.

135. All the differences between white and black borrowers are statistically significant *except* for the difference between the number of loans originated with subprime lenders by black and white borrowers in 1998.

majority of states, whether the applicant was black (versus white) had a positive, statistically significant effect on whether a lender approved a subprime loan, as determined by the Alternative Measure. The only states where being black did not have a positive, statistically significant effect on whether the applicant was approved for a subprime loan were states with smaller black populations, such as Hawaii, North and South Dakota, and Montana.<sup>136</sup> The effect size<sup>137</sup> of the black variable ranged from 0.014 to 0.543.<sup>138</sup> Other variables move in and out of significance. The amount of the loan, the percentage of owner-occupied housing, the income of the borrower, and the HUD median family income have very small coefficients and are routinely significant. The percentage of the census tract comprised of minorities does not have a consistent effect.<sup>139</sup>

The amount of the loan has consistently negative coefficients, meaning that as the size of the loan increased, the probability that the loan was subprime decreased.<sup>140</sup> The Alternative Measure of subprime lending contains more borrowers than are contained in the HUD-Classified Subprime Lenders measure of subprime lending.<sup>141</sup> The negative relationship between

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136. Due to the multiple log function of logit analysis, the methodology requires a fairly even distribution of data between the key variables. As such, I was unable to run the analysis for several states that either had too few observations (e.g., North and South Dakota) or had substantial outliers for some of the variables. This is largely for the effects reported in Table 5, where the dependent variable is whether a borrower received a loan from a subprime lender. More results are available in Table 4, where the dependent variable is whether a borrower received a loan that is three points or more above the comparable Treasury rate, as there are larger numbers of borrowers under this criterion of subprime lending.

137. Effect size measures the strength of the relationship between two variables, in this case the probability of being accepted for a subprime loan and the applicant's/ borrower's race. The effect size for Washington, D.C., is larger (0.775), and while the study shows the results, the District is not included with the state data because it is not a state.

138. As logit is used as the method (because of the non-linearity of the dependent variable), these results represent changes in probability and cannot be interpreted as direct effect sizes.

139. This suggests that while the amount of the loan, the percentage of owner-occupied housing, the income of the borrower, and the HUD median family income all have a statistically significant relationship, there is little substantive relationship between these variables and the dependent variable. For example, in Alaska, the percentage of the census tract that consists of minorities has a significant, negative effect on the probability that an individual will receive a loan from a subprime lender. However, when the substantive effect is examined, we see that the effect (in Alaska) is -0.001, or a percent increase in the minority population of the census tract decreases the odds of getting a subprime loan by one tenth of one percent. A 100% increase in the minority population would lead to a 10% decrease in the odds of getting a subprime loan. This may be counterintuitive, as the extant literature and this research suggest that minorities bear the brunt of the subprime mortgage market. It is important to note that the direction of this variable is inconsistent, suggesting that the relationship between percentage of minority population and probability of receiving a subprime loan may be based on other local characteristics. This variable may be picking up variations in affluence amongst minorities in various states, for example.

140. See *infra* Table 4.

141. See *infra* Table 1 (percentage of loan applicants accepted at HUD-Classified Subprime

the loan amount and the likelihood that a borrower receives a subprime loan could be capturing wealthier borrowers with positive borrower characteristics who are applying for and receiving larger loans at prime loan rates.

The median income of the MSA has a similar directionality; as the income of the borrower increases, the likelihood of receiving a subprime loan decreases.<sup>142</sup> This finding reinforces the explanation for the inverse relationship between the loan amount and the probability of receiving a subprime loan.

Table 4 analyzes the effect of the primary independent variable (race of the applicant) and the secondary independent variables<sup>143</sup> on the probability that an individual will receive a subprime loan, as defined by the Alternative Measure. Massachusetts will be used in this discussion to illustrate the data. As with the HUD-Classified Subprime Lenders, the applicant's race (being black versus being white) has a statistically and substantively significant effect on the probability that a borrower will obtain a loan from a subprime lender. This variable has a coefficient of 0.401, which can be interpreted as a log-odds ratio.<sup>144</sup> Calculated as a change in the probability of receiving a subprime loan, borrowers, if all other variables are held at their mean, see a 3.3-percentage-point increase in the probability of receiving a subprime loan. While this may appear low, it is important to remember that, as displayed in Table 1, only 11.4% of white borrowers receive subprime loans. Thus, an increase in probability of 3.3 percentage points is more than a 25% increase in the probability that an individual receives a subprime loan, simply based on that individual's race.

Table 5 reveals similar patterns: blacks are more likely than whites to be accepted for a loan from a HUD-Classified Subprime Lender. Here, again, race has a positive effect and is statistically significant, meaning that black applicants are more likely to be approved for a loan from a subprime lender than are white applicants when income, house values, median income, percentage of owner-occupied homes, percentage of the census tract that are minorities, and MSA median income are held constant. The effect size ranges from 0.232 to 1.067. As with the Alternative Measure of subprime loans, the amount of the loan, the percentage of owner-occupied housing, the income of

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Lenders compared to the percentage of loans classified by the Alternative Measure).

142. See *infra* Table 4 (median income of MSA). For example, in Alaska, the median income of the MSA has a significant, negative effect on the probability that a borrower will receive a subprime loan, as defined by the Alternative Measure. The effect is -0.003, or a \$1,000 increase in the median income of the MSA decreases the odds of getting a subprime loan by three tenths of one percent.

143. These variables are loan amount, borrower income, HUD income, median income for the MSA, percentage of owner-occupied housing, and the minority composition of the census tract.

144. See *infra* p. 937.

the borrower, and the HUD median family income have very small effect sizes and are routinely significant.

Interestingly, the effect size on the amount of the loan is positive (but small in size), suggesting that as the size of the loan goes up, borrowers are more likely to go to a HUD-Classified Subprime Lender. This is in contrast to the results for the Alternative Measure of subprime lenders.<sup>145</sup> This difference suggests that these two measures are capturing varying borrower and lender behavior, particularly among those applying for larger loans. As stated earlier, the finding that an increase in the loan amount leads to a lower probability of receiving a subprime rate (the Alternative Measure) could reflect other positive borrower characteristics such as stable credit history, low income-to-debt ratio, high credit scores, and substantial down payments.<sup>146</sup> However, the positive relationship between loan amount and borrowing from a HUD-Classified Subprime Lender suggests that those borrowing at higher loan amounts may seek out subprime lenders who are willing to make larger and potentially riskier loans. It may also be that these borrowers receive a prime rate from a subprime lender. The median income of the MSA has a negative effect, while the percentage of the population that is minority has, again, an inconsistent effect.

It is helpful to continue to use Massachusetts as an example for purposes of analyzing the data contained in Tables 4 and 5. Table 5 allows one to estimate the probability that a borrower will receive a subprime loan (versus a prime loan) through logistical regression analysis, using the HUD-Classified Subprime Lender measure. In Massachusetts, all the control variables are significant, suggesting that neighborhood characteristics, borrower characteristics, *and* borrower race are all indicators of whether an applicant receives a subprime loan. Looking across the data, the first variable is black, which is a dummy variable representing the borrower's race. A "0" indicates that the applicant is white, while a "1" indicates that the applicant is black. This variable is significant, and its impact is fairly large. Logistical regression requires that one be very careful in interpreting the substantive effects of these results. Dummy variable coefficients in logistical regression should be interpreted as *log-odds ratios*, or the ratio of the odds of receiving the subprime loan (versus receiving the prime loan) between the two groups (blacks and whites). Here, being black (versus white) means that a borrower has a ten-percentage-point greater likelihood of receiving a subprime loan. The amount of the loan is positive, suggesting that as the amount requested increases, so too does the likelihood of receiving a subprime loan. The minority population variable is positive, meaning that as the percentage of the minority population

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145. See *supra* notes 140–41.

146. See *supra* note 77.

increases, so too does the probability of receiving a subprime loan. The substantive effect of the minority population variable is that for every percentage-point increase in the minority population in the census tract, the probability of receiving a subprime loan increases by one-half of a percentage point. The median income of the MSA is negative, meaning that an inverse relationship exists—an increase in the median income of the MSA leads to a decrease in the probability of receiving a subprime loan.<sup>147</sup> The income of the individual is also negative, suggesting that as the applicant's income increases, the likelihood of receiving a subprime loan goes down.<sup>148</sup>

The control data from 1998 and 2002 is presented in Table 6. Additionally, Table 6 contains a composite of the data from Table 5 for purposes of comparing the data for these three years, particularly examining the impact of race on the same variable over time (HUD-Classified Subprime Lender).<sup>149</sup> The race of the borrower is statistically significant and positive, indicating that black borrowers are *more* likely to receive subprime loans than white borrowers. The loan amount, median income of the census tract, and percentage of housing that is owner-occupied all have negative coefficients, indicating that these variables cause the probability of receiving a loan from a subprime lender to decrease. The HUD income variable is insignificant in 2002, and is marginally negative<sup>150</sup> in 1998. Income is significant and negative, indicating that as the income of the applicant rises, the probability of receiving a subprime loan decreases. For all the variables, the relationship between neighborhood and objective borrower characteristics and the probability of receiving a loan from a HUD-Classified Subprime Lender decreased in substantive effect from 1998 to 2002, while the effect of race rose in substantive effect.

Statistics can never prove intent; intent reflects an actor's state of mind. All statistics can do, at most, is reveal overall patterns and demonstrate relationships between, in this case, borrower characteristics and lending and borrowing behavior. However, in this case, statistical analysis has shown that many of the traditional explanations for placing a borrower in a subprime loan are either (1) not statistically significant or (2) insufficient in explaining the

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147. The substantive effect of this variable is reasonably large, with an odds ratio of just over 1%.

148. The HUD income is also significant, although there is very little substantive effect, with a coefficient near zero. The percentage of housing in the census tract that is owner-occupied is significant, with a coefficient also near zero.

149. As with Tables 2 and 3, I combined the state-by-state effects into a single, national model, which allowed me to evaluate the changes in effect over time. In addition, many of the states with very low black populations did not have enough observations to permit logit analysis. By combining the states and using state fixed effects (inserting a dummy variable for each state), I was able to evaluate the effect of race on subprime lending.

150. The variable is statistically significant but the effect size is substantively insignificant.

disparate rate of subprime lending to black and white borrowers. When the reasons for placing a borrower in a subprime loan were controlled (like borrower income, cost of the loan, and neighborhood characteristics), race continued to be significant. That is, being a black borrower consistently resulted in a higher probability of receiving a loan from a subprime lender, regardless of the borrower's income or where the house was located.<sup>151</sup>

Analyzing Table 6 in depth, it is clear that, first, the baseline<sup>152</sup> has been growing in size (becoming less negative) since 1998. This indicates that the overall probability of receiving a loan from a subprime lender has grown since 1998.<sup>153</sup> Looking generally at the results, Table 6 shows that neighborhood and house characteristics (including median income of the MSA, percentage of owner-occupied housing and HUD income) all have declined in their substantive effect on the probability of receiving a loan from a subprime lender. Essentially, those who argue that subprime loans are going primarily to bad neighborhoods may have been right at some point, but their argument grows weaker over time, as we move toward 2006. Next, looking at borrower characteristics, the study shows that both the loan amount and the borrower's income have also declined in substantive effect from 1998 to 2002 to 2006; however, the substantive effect of the borrower's race grew (in each of the years 1998, 2002, and 2006), suggesting that black borrowers are bearing the true brunt of the subprime market. Taken together, this suggests that at the beginning of the subprime lending crisis, subprime lenders focused on relevant borrower and property characteristics.<sup>154</sup> Over time, lenders focused less on these legitimate characteristics and instead focused more on the race of the borrower.

#### V. THE IMPACT OF RACE: EVIDENCE OF INTENTIONAL DISCRIMINATORY TREATMENT

In fashioning a solution or response to the dilemma currently faced by many black borrowers, it is important to discern the source of the discrimination. The legal and policy response to unconscious discrimination by lenders against black borrowers might, and arguably ought to, be different from the legal and policy response to conscious and targeted discrimination.

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151. See *infra* Table 6.

152. See *id.* (column labeled "Constant").

153. In 1998, the log odds that a borrower would receive a subprime loan from a subprime lender was -234%. In 2002, the log odds increased to -189% and increased again to -65% in 2006. Essentially, this means that a borrower, starting off, regardless of borrower or property characteristics, was much more likely to receive a loan from a subprime lender in 2006 than in 1998 or 2002.

154. Such characteristics include loan amount, borrower income, median income of the MSA, and percentage of owner-occupied housing in the census tract.

A failure to accurately identify the nature of the discrimination that black borrowers face in the home mortgage and refinance markets could condemn black borrowers to re-experience this current housing predicament, or a closely analogous one, across time and across products.

As housing law advocates and scholars know, demonstrating discriminatory intent in this area of the law can be quite challenging.<sup>155</sup> Direct evidence of housing discrimination is rare and corroboration is even more difficult to establish.<sup>156</sup> The difficulty in proving intentional discrimination makes the conduct enticing and difficult to eliminate and creates a perfect breeding ground for the misconduct. The challenge with using direct examples of discriminatory intent is that without extremely large volumes of such evidence, what might appear collectively to be market-wide race discrimination could reflect only the isolated actions of a very few brokers or lenders who are active in the market of black borrowers. The challenge in proving that the overrepresentation of black borrowers in the subprime and predatory markets results from intentional discrimination does not mean that intentional discrimination is not in fact the cause. Discrimination based in prejudice has always been challenging to establish, but the importance of doing so from a remedial and accountability standpoint necessitates that one not be timid in addressing the issue.

Disparate impact evidence alone and in isolated instances is not sufficient to establish a strong correlation to discriminatory intent. The overwhelming representation of blacks in the subprime market compared to similarly situated white borrowers—after comparing borrowers with equivalent credit indicators, and in the absence of any explanation other than race—should be sufficient to establish a cognizable claim of targeting and of intentional discrimination.<sup>157</sup> Certainly, evidence of discriminatory intent is helpful in making the case and this evidence is available, though not in the same abundance as statistical evidence of disparate impact. Making the case for the impact of race across many financial institutions approaches the impossible

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155. See, e.g., *Vill. of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 270 n.21 (1977) (argued pursuant to the Equal Protection Clause of the Fourteenth Amendment):

Proof that the decision by the Village was motivated in part by a racially discriminatory purpose would not necessarily have required invalidation of the challenged decision. Such proof would, however, have shifted to the Village the burden of establishing that the same decision would have resulted even had the impermissible purpose not been considered.

*Id.*

156. Stanley D. Longhofer, *Cultural Affinity and Mortgage Discrimination*, 32 FED. RES. BANK OF CLEV. ECON. REV. 12, 16 (1996), available at <http://clevelandfed.org/research/review/1996/96-q3-longhofer.pdf>.

157. See *supra* Part IV.

unless one is willing to accept not only direct evidence in the form of affidavit statements, express market materials, and other forms of confession, but also the reasonable inferences that can be drawn from quality data, national and local, pertaining to the subject.

Gail Kubiniec, a former CitiFinancial loan officer testified about her subprime mortgage marketing practices. “If someone appeared uneducated, inarticulate, was a minority, or was particularly old or young, I would try to include all the [insurance] coverages CitiFinancial offered.”<sup>158</sup> CitiFinancial is a part of Citigroup Inc. In response to criticism about its lending practices, Citigroup agreed to send out minority and non-minority auditors posing as CitiFinancial customers to its consumer finance branches from December 2000 through January 2001 to evaluate their fair lending compliance practices. The effectiveness of the “Mystery Shopper” program was criticized under allegations that Citigroup sent a memorandum to certain CitiFinancial branches and districts providing advance notice of the tests.<sup>159</sup>

The Commonwealth Court of Pennsylvania in *McGlawn v. Pennsylvania Human Relations Commission*<sup>160</sup> affirmed a finding of reverse redlining by the Pennsylvania Human Relations Commission (the Commission) against McGlawn and McGlawn (McGlawn), a black-owned mortgage broker company. To establish a claim of reverse redlining, the plaintiffs first bore the burden of demonstrating that the loan terms and lending practices of the defendant were unfair and predatory.<sup>161</sup> Second, the plaintiffs had to demonstrate that the defendants intentionally targeted them based upon their race or that they experienced a disparate impact, again based upon their race.<sup>162</sup>

The plaintiffs, also black, alleged that McGlawn discriminated against them because of their race and because of the racial composition of their predominantly black neighborhoods. The Commission, in reaching its determination on the first element that the loan terms were unfair and predatory, relied in part upon expert testimony offered by the plaintiffs “that, even assuming a borrower is an enhanced credit risk, the difference in interest rates between a sub-prime and prime market loan is usually no greater than three percentage points. Anything higher than a three-point difference is

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158. Paul Beckett, *Citigroup's "Subprime" Reforms Questioned*, WALL ST. J., July 18, 2002, at C1 (alteration in original); see also Austin, *supra* note 5, at 1219 (delineating women, the elderly, the poor and minorities as examples of consumers targeted by predatory lenders because of their perceived vulnerabilities).

159. Citigroup Inc., 88 Fed. Res. Bull. 485, 497 n.70 (2002); Beckett, *supra* note 158.

160. 891 A.2d 757 (Pa. Commw. Ct. 2006), *appeal denied*, 906 A.2d 545 (Pa. 2006).

161. *Id.* at 767.

162. *Id.* at 772.

indicative of a predatory loan.”<sup>163</sup> The expert likely relied upon the HMDA definition of higher priced loans in reaching its conclusion. “Under HMDA, a loan is deemed to be higher-cost if the annual percentage rate exceeds the rate on the treasury security of corresponding maturity by 3% for a first lien . . . .”<sup>164</sup>

Next, the Commission found, and the court affirmed, that McGlawn intentionally discriminated against the plaintiffs.<sup>165</sup> The Commission also found substantial statistical evidence of disparate impact, which the court affirmed.<sup>166</sup> According to the Commission, McGlawn “engaged in an aggressive marketing plan targeting [blacks] and [black] neighborhoods in the Philadelphia area.”<sup>167</sup> McGlawn admitted to advertising extensively in print, radio, and television media and that many of the sources in which it chose to advertise were “oriented toward [black] audiences and readers.”<sup>168</sup> The plaintiffs testified that they contacted the defendant because of its advertisements and that their decision to contact the defendant “was influenced by the fact that it was [a black] company.”<sup>169</sup> Part of McGlawn’s advertising strategy was to market itself as one of Philadelphia’s “first [black] owned and operated Mortgage and Insurance Financial Services [companies].”<sup>170</sup> Essentially, McGlawn emphasized its cultural affinity with the black borrowers it targeted and, at least in this instance, benefited from that affinity.<sup>171</sup>

Relatedly, the court in *M & T Mortgage Corp. v. Foy*<sup>172</sup> held that a rebuttable presumption of illegal and discriminatory loan practice arises when a lender grants a mortgage to a minority borrower to purchase property in a minority area if the loan’s interest rate exceeds three percentage points above the comparable Treasury rate. The plaintiff sued to foreclose its mortgage; the court found that the defendant, a black woman, may have been a victim of reverse redlining, and after finding that the interest rate on the defendant’s mortgage was in excess of 3% above the comparable reasury rate, the court

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163. *Id.* at 770 (internal citation omitted).

164. *Subprime Mortgages and Foreclosures in New York: Hearing Before the Comm. on Banks*, N.Y. State Senate, 2007 Leg. (N.Y. 2007) (statement of Richard H. Neiman, Superintendent of Banks, N.Y. State Banking Department), available at <http://www.banking.state.ny.us/sp071213.htm>.

165. *McGlawn*, 891 A.2d at 773.

166. *Id.* at 772–73.

167. *Id.* at 764.

168. *Id.* at 772.

169. *Id.* at 773.

170. *Id.* at 772.

171. See *infra* Part VI (discussing cultural affinity).

172. 858 N.Y.S.2d 567 (N.Y. Sup. Ct. 2008) (relying on the HMDA definition of a higher priced loan).

held that the plaintiff bore the burden of proving that the loan was not “the product of discriminatory practices.”<sup>173</sup>

In 2006, HUD conciliated a case in which a black couple filed a complaint against First Franklin Financial Bank and Primary Residential Mortgage.<sup>174</sup> The complainants alleged that though they attempted to purchase a home with a fixed-rate mortgage, the lender, because of their race, switched the mortgage loan to an adjustable rate mortgage containing a prepayment penalty and that the lender also added an additional \$4,000 in closing costs. The parties entered into a voluntary conciliation agreement.<sup>175</sup> The lender paid the complainants \$4,000, waived both the closing costs and the prepayment penalty, and provided a new fixed-rate mortgage.<sup>176</sup> The lender also agreed to implement Fair Housing Act training for its employees and to prominently display the fair housing logo in its marketing and advertising materials.<sup>177</sup>

On June 3, 2008, the Massachusetts Attorney General filed a lawsuit against subprime lender Option One Mortgage Corp. (Option One) and its parent H&R Block, Inc. (H&R Block) (collectively HRB Entities). The suit alleges that HRB Entities steered prime mortgage borrowers to subprime loans, that HRB Entities engaged in predatory lending,<sup>178</sup> and that it

produced and distributed to its employees, loan officers, and brokers written marketing and educational materials explaining that the limited choices available to black and

173. *Id.* at 569.

174. *Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Lending Enforcement: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Servs.*, 110th Cong. 140 (2007) [hereinafter *Rooting Out Discrimination*] (written statement of Kim Kendrick, Assistant Sec’y for Fair Hous. & Equal Opportunity, U.S. Dep’t of Hous. & Urban Dev.), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_house\\_hearings&docid=f:38394.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:38394.pdf).

175. *Id.* Conciliation agreements may provide less probative evidence of intentional discrimination. Parties may choose to enter into these voluntary agreements for myriad reasons unassociated with the truth of the underlying complaint. As an example, lenders may find the costs associated with litigation to outweigh the benefits of private conciliation agreements.

176. *Id.*

177. *Id.*

178. Complaint ¶¶ 11, 16, 31–80, 152, *Commonwealth v. H&R Block, Inc.*, No. 08-2474-BLS (Mass. Super. Ct. June 3, 2008), available at [http://www.mass.gov/Cago/docs/press/2008\\_06\\_03\\_option\\_one\\_suit\\_attachment1.pdf](http://www.mass.gov/Cago/docs/press/2008_06_03_option_one_suit_attachment1.pdf). In a subsequent memorandum decision, the court dismissed some of the Commonwealth’s claims but allowed others to proceed to trial. *Commonwealth v. H&R Block, Inc.*, No. 08-2474-BLS-1 (Mass. Super. Ct. Nov. 10, 2008) (mem.), available at [http://www.mass.gov/Cago/docs/press/2008\\_11\\_12\\_option\\_one\\_pi\\_attachment1.pdf](http://www.mass.gov/Cago/docs/press/2008_11_12_option_one_pi_attachment1.pdf). According to the Massachusetts attorney general’s office, the case is expected to proceed to trial sometime in 2010. Press Release, Office of the Attorney Gen. of Mass., Attorney General Coakley’s Office Reaches Affordable Loan Modification and Foreclosure Prevention Agreement with Mortgage Servicer (Nov. 10, 2009), [http://www.mass.gov/?pageID=cagopressrelease&L=1&L0=Home&sid=Cago&b=pressrelease&f=2009\\_11\\_10\\_ahmsi\\_agreement&csid=Cago](http://www.mass.gov/?pageID=cagopressrelease&L=1&L0=Home&sid=Cago&b=pressrelease&f=2009_11_10_ahmsi_agreement&csid=Cago).

Latino borrowers made them good candidates for the HRB Entities' subprime loan products and that loan originators should focus on the "emerging markets" of black and Latino homebuyers.<sup>179</sup>

HRB Entities is also accused of charging black and Latinos more points and higher fees under its discretionary pricing policy even when they were similarly situated to white HRB Entities borrowers.<sup>180</sup>

On January 8, 2008, the City of Baltimore filed suit against Wells Fargo in the federal district court of Maryland alleging reverse redlining.<sup>181</sup> In addition to HMDA statistics revealing disparate impact based upon race in Wells Fargo's lending practices, the complaint also alleged that Wells Fargo's loan "pricing sheets require that equally credit worthy borrowers in predominantly [black] neighborhoods pay higher interest rates compared to their counterparts in white neighborhoods."<sup>182</sup> The City of Baltimore filed an amended complaint on June 1, 2009.<sup>183</sup> The allegations of reverse redlining and other forms of racial discrimination in lending were supported, in part, by declarations of former employees who described various practices and techniques that were designed to steer black borrowers into subprime loans.

Elizabeth M. Jacobson worked for Wells Fargo for nearly nine years, first as a loan officer and later as a sales manager.<sup>184</sup> For much of her career at Wells Fargo, she specialized in the subprime loan business.<sup>185</sup> Ms. Jacobson described a practice pursuant to which loan officers specializing in prime loans used their discretion or falsified loan applications for the purpose of

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179. Complaint ¶ 120, *H&R Block, Inc.*, No. 08-2474-BLS; see APGAR ET AL., *supra* note 29, at 64 ("Predatory practices not only include outright deception and fraud, but also efforts to manipulate the borrower through aggressive sales tactics or to exploit their lack of understanding about loan terms.").

180. Complaint ¶ 14, *H&R Block, Inc.*, No. 08-2474-BLS.

181. Complaint for Declaratory and Injunctive Relief and Damages ¶ 6, *Mayor of Baltimore v. Wells Fargo Bank, N.A.*, No. 1:08-cv-00062-BEL (D. Md. Jan. 8, 2008). On January 6, 2010, the district court granted Wells Fargo's motion to dismiss the city's complaint for lack of standing with leave to file a more limited complaint before February 3, 2010. The court found that there was an insufficient causal connection between Wells Fargo's alleged misconduct and the city's claimed damages. *Mayor of Baltimore v. Wells Fargo Bank, N.A.*, No. JFM 1:08 CV-00062 (D. Md. Jan. 6, 2010).

182. *Enforcement of the Fair Housing Act of 1968: Hearing Before the Subcomm. on the Constitution, Civil Rights and Civil Liberties of the H. Judiciary Comm.*, 110th Cong. 55 (2008) (written statement of Suzanne Sangree, Chief Solicitor, Baltimore City Law Department), available at <http://judiciary.house.gov/hearings/printers/110th/42850.PDF>; see also First Amended Complaint for Declaratory and Injunctive Relief and Damages ¶¶ 72–78, 91–94, *Mayor of Baltimore v. Wells Fargo Bank, N.A.*, No. 1:08-cv-00062-BEL (D. Md. June 1, 2009), *dismissed by* No. JFM 1:08 CV-00062 (D. Md. Jan. 6, 2010).

183. First Amended Complaint at 60, *Mayor of Baltimore*, No. 1:08-cv-00062-BEL.

184. Declaration of Elizabeth M. Jacobson ¶¶ 2–3, *id.*

185. *Id.* ¶¶ 3–7.

steering certain of their prime loan customers to her for subprime loans.<sup>186</sup> Some of these borrowers “could have qualified for a prime loan”<sup>187</sup> while others were ineligible and should not have received any type of loan.<sup>188</sup> Ms. Jacobson stated that a significant majority of her customers were black and that the company’s “Emerging Markets unit specifically targeted black churches”<sup>189</sup> while white churches were not marketed to nor were they targeted by subprime loan officers.<sup>190</sup> If what Ms. Jacobson says is to be believed and if Wells Fargo’s culture focused “solely on making as much money as possible[.]”<sup>191</sup> one might inquire why Wells Fargo’s loan officers targeted black borrowers (even those who qualified for prime loans) and black churches for subprime loans instead of focusing indiscriminately on borrowers and churches of all colors and makeups. Possible answers to this inquiry are developed in Part VI.

Tony Paschal worked as a loan officer or mortgage consultant for Wells Fargo for eight years between 1997 and 2007.<sup>192</sup> He stated that Wells Fargo targeted blacks for subprime loans by special marketing to black communities and by using black subprime loans officers to market to black communities.<sup>193</sup> “For example, if a Wells Fargo loan officer anywhere in the United States wanted to send a flyer to consumers in [a black] 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.’”<sup>194</sup> Wells Fargo maintained an “Affinity Group Marketing section”<sup>195</sup> that consisted exclusively of black employees, and the Affinity Group targeted black churches and their members for subprime loans.<sup>196</sup> According to Mr. Paschal, loan officers “regularly originated subprime loans to [blacks] . . . who could have qualified for a lower cost prime loan or FHA loan.”<sup>197</sup>

The National Community Reinvestment Coalition (NCRC) conducted a

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186. *Id.* ¶ 18. Wells Fargo’s commission system “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.” *Id.* ¶ 8.

187. *Id.* ¶ 17.

188. *Id.* ¶ 18.

189. *Id.* ¶ 27.

190. *Id.* ¶ 30.

191. *Id.* ¶ 32.

192. Declaration of Tony Paschal ¶ 2, *Mayor of Baltimore*, No. 1:08-cv-00062-BEL.

193. *Id.* ¶¶ 10–13.

194. *Id.* ¶ 11.

195. *Id.* ¶ 12; *see also infra* Part VI (discussing cultural affinity).

196. Declaration of Tony Paschal ¶ 12, *Mayor of Baltimore*, No. 1:08-cv-00062-BEL.

197. *Id.*; *see also id.* ¶¶ 13–14 (containing additional allegations of discrimination against black borrowers).

mystery shopping initiative between February 2004 and June 2006.<sup>198</sup> The NCRC visited mortgage brokers and conducted 106 “mystery shops” in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Houston, Texas; Los Angeles, California; St. Louis, Missouri; and Washington, D.C.<sup>199</sup> The NCRC sent auditors, mystery shoppers, with similar credit histories and incomes but of different ethnicities and races to contact and meet with lenders to discuss their mortgage products.<sup>200</sup> In fact, the protected class auditors “were actually given more attractive profiles in terms of their amount of equity, credit standing and employment tenure, and should have logically received better treatment.”<sup>201</sup> The control group consisted of white auditors, and the protected group was comprised of black and Hispanic auditors. The NCRC audit resulted in the following findings. Lenders discussed fees with 30% of the protected group and with 74% of the control group.<sup>202</sup> Mortgage brokers provided twice as many rate quotes to the control group as to the protected group so that the control group received the benefit of more credit products.<sup>203</sup> Control group auditors were referred to banks 16% of the time while only 8% of the time were protected group auditors referred to banks, where presumably they could get a better rate.<sup>204</sup> Seven percent of the time, the control group was “referred up” (i.e., told they could obtain a better rate elsewhere), while the protected group was never referred up for a better rate.<sup>205</sup> During the interview, brokers asked protected group auditors 40% of the time if they had prior foreclosures, debts, late payments, or poor credit; only 9% of the control group auditors were asked similar questions.<sup>206</sup> The NCRC audit shows that even though the financial profiles of the members of the protected group were superior to those of the control group, blacks posing as borrowers received significantly worse treatment and were offered less information and costlier terms than whites.

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198. *Building Sustainable Homeownership: Responsible Lending and Informed Consumer Choice: Hearing Before the Bd. of Governors of the Fed. Reserve Sys.* 88–89 (2006) (testimony of David Berenbaum, Executive Vice President, National Community Reinvestment Coalition) [hereinafter *Building Sustainable Homeownership*], available at <http://www.federalreserve.gov/events/publichearings/hoepa/2006/20060609/transcript.pdf>.

199. *Rooting Out Discrimination*, *supra* note 174, at 268 (testimony of John Taylor, President and CEO, National Community Reinvestment Coalition).

200. *Id.*

201. *Id.*

202. *Building Sustainable Homeownership*, *supra* note 198, at 89. Elsewhere, National Community Reinvestment Coalition president and CEO John Taylor asserted that lenders discussed fees with white testers 62% of the time and with blacks only 35% of the time. *Rooting Out Discrimination*, *supra* note 174, at 268.

203. *Sustainable Homeownership*, *supra* note 198, at 89.

204. *Id.* at 90.

205. *Id.*

206. *Id.* at 90–91.

Previous auditing by the NCRC of twelve major subprime lenders in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Los Angeles, California, New York, New York; and Washington, D.C., between May and September 2003 revealed similar results.<sup>207</sup> Forty-eight audits were conducted.<sup>208</sup> Auditors were given substantially similar profiles; however, black auditors were given profiles that would make them appear more qualified than white auditors. Black auditors had higher income, better ratios, longer job histories, longer duration in their homes, and higher credit scores.<sup>209</sup> All of the testing was preapplication; when questioned by the lenders about their credit scores, black auditors reported their FICO score as 690 and white auditors reported theirs as 675.<sup>210</sup> Both black and white auditors were given profiles that would qualify them for prime loans.<sup>211</sup>

The audits were analyzed to determine any differences in treatment received by the white auditors and the black auditors. The NCRC concluded that 45% of the time, black auditors received less favorable treatment than white auditors.<sup>212</sup> White auditors were more often referred up the prime lending division; they were given more detailed information and quoted lower interest rates or ranges of rates.<sup>213</sup> White auditors received more recommendations, advice, follow-up, and more time with the loan officers.<sup>214</sup> White and black auditors received different literature and materials and different information regarding interest rates, loan terms, loan programs, fees, required ratios, and qualification standards.<sup>215</sup> In some instances, loan officers gave white auditors loan quotes based upon the information provided by the white auditors, but refused to provide interest rate quotes to black auditors without a credit check or credit report.<sup>216</sup>

The NCRC audits and the other studies mentioned strongly rebut claims by lenders and others that differences in lending patterns between blacks and whites are explained solely or primarily by risk characteristics such as the borrowers' credit scores. After controlling for the borrower's credit and for legitimate, individual borrower qualification criteria, one might reasonably question whether blacks "are being discriminated against in the marketplace

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207. Memorandum from Nat'l Cmty. Reinv. Coal., Sub-Prime Fair Lending "Mystery Shopping" Update (July 21, 2008) (on file with author).

208. *Id.* at 2.

209. *Id.* at 3.

210. *Id.*

211. *Id.*

212. *Id.* at 5.

213. *Id.*

214. *Id.*

215. *Id.*

216. *Id.* at 7-8.

and being forced to pay a ‘race tax’ due to unequal access to credit.”<sup>217</sup>

#### VI. THE SEARCH FOR ANSWERS: CULTURAL AFFINITY AND THE SOCIOLOGY OF THE MINORITY

The subprime market mushroomed, partly in response to the narrow profit margins in the prime market and partly in response to demands for higher returns.<sup>218</sup> By 2000, Wall Street investment banks were demanding subprime loans, which they purchased and bundled into mortgage-backed securities and sold. Securitization of credit, also known as asset securitization, is a financial term that describes the process of packaging, underwriting, and selling mortgage loans and mortgage refinances.<sup>219</sup> Any asset that produces an income stream can be securitized—automobile loans, utility accounts, credit card balances, or mortgages, for example. Securitized mortgages are marketed as mortgage-backed securities and then sold to individuals and institutional investors. The efficiencies of securitization grew rapidly in the prime market. Fannie Mae and Freddie Mac, the largest and second-largest providers of capital for home loans in the United States, respectively, competed for prime loans from banks, resulting in a diminution in the profit margins for prime mortgage-backed securities.<sup>220</sup>

A central assumption of this Article is that mortgage lenders are highly competitive and that their primary motivation is to make money and maximize profits.<sup>221</sup> An important conceptual distinction to address is whether lenders can be labeled as engaging in intentional discrimination if their motivation is to increase profits or “whether prejudice must be put ahead

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217. *Rooting Out Discrimination*, *supra* note 174, at 269 (testimony of John Taylor, President and CEO, National Community Reinvestment Coalition).

218. Subprime borrowers are charged higher interest rates because they are perceived to be greater credit risks. Those who invested in securities based upon subprime mortgages received higher returns compared to securities based upon prime mortgages. Alec Klein & Zachary A. Goldfarb, *The Bubble: How Homeowners, Speculators and Wall Street Dealmakers Rode a Wave of Easy Money with Crippling Consequences*, WASH. POST, June 15, 2008, at A1.

219. For a general description of the effects of securitization on the housing market, see Kathleen Day, *Villains in the Mortgage Mess? Start at Wall Street. Keep Going.*, WASH. POST, June 1, 2008, at B1.

220. Jody Shenn, *U.S. Home-Loan Giants Weathering the Crisis? Subprime Exposure Is Big but High-Grade*, INT’L HERALD TRIB. (Paris, Fr.), July 30, 2007, at 12. “Fannie Mae and Freddie Mac, created by Congress to increase mortgage financing, own or guarantee about 40 percent of U.S. home loan debt. They make money by investing in mortgages and related bonds and from fees for guaranteeing repayment on securities created out of loans from primary lenders.” *Id.*; Day, *supra* note 219.

221. See GARY S. BECKER, *THE ECONOMICS OF DISCRIMINATION* 16 (2d ed. 1971) (discussing a contrary assumption); Longhofer, *supra* note 156, at 13 (“Translated to the mortgage market, this means that rather than being ‘profit maximizers,’ bigoted lenders are ‘utility maximizers’ who are willing to sacrifice profits in order to satisfy their ‘tastes for discrimination.’”).

of profits for behavior to be labeled as discriminatory.”<sup>222</sup>

Nobel Laureate Gary Becker developed the theory of taste-based discrimination.<sup>223</sup> According to Becker’s theory:

Money, commonly used as a measuring rod, will also serve as a measure of discrimination. If an individual has a “taste for discrimination,” he must act *as if* he were willing to pay something, either directly or in the form of a reduced income, to be associated with some persons instead of others. When actual discrimination occurs, he must, in fact, either pay or forfeit income for this privilege. This simple way of looking at the matter gets at the essence of prejudice and discrimination.<sup>224</sup>

Becker also distinguishes between discrimination grounded in prejudice and discrimination grounded in economic efficiency, the former being the more pernicious as prejudice reflects preference and is independent of knowledge, while perceptions of the most economically efficient choice can be changed by the dissemination of accurate information.<sup>225</sup>

A lender may target black borrowers for subprime loans because the lender is prejudiced; alternatively, the lender may underestimate the economic efficiency or value of the borrower or, the corollary, the lender may overestimate the risk of lending to black borrowers and therefore target these borrowers for subprime loans.<sup>226</sup> “Since a taste for discrimination incorporates both prejudice and ignorance, the amount of knowledge available must be included as a determinant of tastes.”<sup>227</sup> Even in the face of a lot of knowledge about black borrowers (objective signals),<sup>228</sup> prejudiced lenders may choose to discriminate by offering loans on terms that are less attractive than what the objective signals indicate the black borrowers should receive. Such a decision might indicate that ignorance about black borrowers is secondary to lenders’ prejudice and would weaken an assumption that the solution to the current dilemma this Article addresses is the “wholesale spread

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222. Ladd, *supra* note 69, at 42.

223. BECKER, *supra* note 221, at 16.

224. *Id.* at 14.

225. *Id.* at 16.

226. *See id.*; Austin, *supra* note 5, at 1250. Austin observes that blacks are generally associated with a cash economy and are stereotyped as “wasteful consumers.” Austin, *supra* note 5, at 1250 (citation omitted). As a result, they “are . . . assumed not to know the value of money or how to deal with financial matters in a knowledgeable way.” *Id.*; *see* APGAR ET AL., *supra* note 29, at 28 (“[T]oday’s dual mortgage market fails to achieve what economists term ‘allocational efficiency’ because similarly situated borrowers pay different prices to obtain a mortgage of given characteristics and terms.”).

227. BECKER, *supra* note 221, at 17.

228. *See infra* notes 245–58 and accompanying text.

of knowledge.”<sup>229</sup>

If, by definition, individuals with a taste for discrimination will behave as though they are prepared to forfeit income for the actual privilege of discriminating,<sup>230</sup> and if Becker’s theory is applied in the context of the mortgage market, then lenders with a taste for discrimination should be willing to forgo profit for the privilege of discriminating. Following Becker’s theory, one might contend that some actions by lenders that would, according to law, be interpreted as discriminatory treatment of black borrowers, actually do not result from lender prejudice because the lenders were aiming to maximize profits.<sup>231</sup> Adherents to this view of discrimination would be willing to conclude that lenders were intentionally discriminating based upon illegal prejudice if provided with knowledge in the form of “evidence that the group receiving the differentially adverse treatment imposes credit risks that on average are no higher than those imposed by other groups of borrowers.”<sup>232</sup>

In contrast to the taste-based theory of discrimination, adverse treatment of black borrowers may be the result of statistical discrimination—discrimination that lenders engage in because it is more cost-efficient (cheaper) to use borrowers’ group status, such as race or gender, to project their creditworthiness than it is to use borrowers’ individual past history.<sup>233</sup> The statistical definition of discrimination is broader than that captured by the taste-based theory and more reflective of the content of anti-discrimination laws governing lending and housing.<sup>234</sup> “The legal definition of racial discrimination does not presume that lenders are foregoing profits to exercise prejudice against the protected group. Hence, illegal discrimination need not be uneconomic in the sense that it reduces profits.”<sup>235</sup>

The definition of discrimination used here—identifying an emerging market of borrowers, black borrowers, and intentionally targeting them to receive less attractive loan products than similarly situated white borrowers—is broader than the definition of discrimination offered by Becker. This broader definition anticipates lenders attempting to capture greater gains, the contrary of forgoing profits, by trading upon their assumption about black borrowers based upon their group status. It more closely reflects the legal definition of discrimination in housing and mortgage law.

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229. BECKER, *supra* note 221, at 17.

230. *Id.* at 14.

231. *See id.*; Ladd, *supra* note 69, at 42.

232. Ladd, *supra* note 69, at 42.

233. *Id.*

234. *See supra* notes 48, 59–60 and accompanying text.

235. Ladd, *supra* note 69, at 43; *see, e.g., supra* notes 57–60 (discussing the Federal Fair Housing Act of 1968 (as amended), the Equal Credit Opportunity Act, the Community Reinvestment Act of 1977, and their anti-discrimination provisions).

If one accepts the assumption that lenders are motivated by profit, predominantly if not exclusively, what explains the persistence of intentional lending discrimination in the mortgage industry, a highly competitive market? One popular theory of the source of discrimination in mortgage lending is the cultural affinity hypothesis, first proposed by Charles W. Calomiris, Charles M. Kahn, and Stanley D. Longhofer in their article *Housing-Finance Intervention and Private Incentives: Helping Minorities and the Poor*.<sup>236</sup> According to the cultural affinity hypothesis, lenders discriminate against borrowers with whom they do not have a cultural affinity or experiential background because they find it more difficult, specifically more costly, to evaluate these borrowers' creditworthiness when compared to borrowers with whom they share the same cultural affinity.<sup>237</sup> Lenders find it less cost-effective to invest in gathering information about black borrowers either because the expected benefits of investing in this additional information are lower for these groups than for whites<sup>238</sup> or because the lender perceives that it is simply more expensive to gather information about black borrowers than white borrowers.<sup>239</sup> As a result, Calomiris et al. argue that, because it is easier and less costly to evaluate borrowers with whom lenders, who are mostly non-minority, share a cultural affinity, lenders will tend to discriminate against minority borrowers.<sup>240</sup>

The cultural affinity hypothesis has most often been used to explain mortgage market discrimination focusing on denial rates.<sup>241</sup> In this Article, I extend the hypothesis to consider how problems of cultural affinity might affect loan terms. Additionally, I argue that, consistent with the new iteration of housing discrimination that is besetting the mortgage and housing markets, "cultural affinity" has grown to take on new meaning. Traditionally, the cultural affinity hypothesis was used to explain disparities in loan denial rates between whites and blacks based upon whether the lender and the borrower shared the same race or cultural affinity.<sup>242</sup> The cultural affinity hypothesis applies in other contexts as well and helps provide insights on mortgage discrimination in additional contexts such as situations in which the borrower

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236. Calomiris et al., *supra* note 19, at 635.

237. *Id.* at 650.

238. One explanation is that, on average, they are poorer than whites. *Id.*

239. *Id.*; see also Austin, *supra* note 5, at 1218. Austin argues that "black people's money is literally a distinctive currency worth less than white people's money, both socially and materially." Austin, *supra* note 5, at 1218. Lenders adopting this position would find it comparatively more expensive to lend to blacks than whites. *Id.* at 1251.

240. Calomiris et al., *supra* note 19, at 650; see also Longhofer, *supra* note 156, at 13.

241. Calomiris et al., *supra* note 19, at 635; Hunter & Walker, *supra* note 19; Longhofer, *supra* note 156, at 12.

242. Calomiris et al., *supra* note 19, at 635.

and lender are of the same race. Thus, I extend the definition of cultural affinity to include *black* lenders and brokers whose actual or self-perceived cultural affinity and experiential backgrounds are more closely aligned with white borrowers.

The essence of the cultural affinity hypothesis is uncertainty—because the lender is uncertain about lending money to groups outside of the lender’s race, lenders will perceive the credit indicators of these groups as unreliable, even when the indicators of an individual group member exceed the lender’s requirements. As a result of this perception of unreliability, lenders will tend to discriminate against black borrowers, not only in their acceptance and denial rates, but in the quality of loans offered to these borrowers. Old forms of housing and lending discrimination facilitated this uncertainty by denying black borrowers traditional access to credit.<sup>243</sup> Cultural affinity institutionalizes the uncertainty about certain borrowers based upon race and even rationalizes discrimination against these individuals.<sup>244</sup>

Stanley Longhofer, one of the original proponents of the cultural affinity hypothesis, considers the distorting effect of the secondary market on cultural affinity in the home mortgage market. He begins with a series of propositions. First, lenders receive “objective signals” about a borrower’s creditworthiness, such as FICO scores, credit history, employment, income, and obligation ratios, that are objectively observable by outsiders.<sup>245</sup> Objective signals are derived from the information lenders collect as part of the loan evaluation process and which lenders believe allow them to infer the likelihood of a borrower’s default.<sup>246</sup> Lenders receive objective signals from minority and non-minority borrowers.

Second, lenders also receive private, “subjective signals,” but only for the group with which they have a cultural affinity; Longhofer assumes this would be the non-minority group (subjective signals).<sup>247</sup> Subjective signals include “any subjective information beyond the standard underwriting variables that lenders gather during the application process. . . . [They are] often referred to as ‘compensating factors.’”<sup>248</sup> Consequently, lenders have more information about the group with whom they share a cultural affinity; the information, if positive, can be used by the lenders to compensate for negative information

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243. See APGAR ET AL., *supra* note 29, at 70 (Unlike in the past, housing “advocates today must focus less on whether any lending takes place, and more on whether the lending that does take place is done at the best rates and terms for which borrowers would qualify.”).

244. Calomiris et al., *supra* note 19, at 650; Hunter & Walker, *supra* note 19, at 67–68; Longhofer, *supra* note 156, at 19–20.

245. Longhofer, *supra* note 156, at 15.

246. *Id.*

247. *Id.*

248. *Id.*

the lenders gathered in the evaluation process and captured as part of the objective signaling.<sup>249</sup> The new information may also be negative, suggesting that, perhaps contrary to the objective signal, the borrower is a poor credit risk.<sup>250</sup> According to Longhofer, underlying the objective and subjective signals is the basic fact that lenders trust information they receive about their own group more than they trust the information they receive about other groups, hence the cultural affinity effect. Finally, Longhofer suggests that

many lenders seem only rarely to reject applicants who have passed the initial screen, raising the question of whether negative overrides really do outnumber positive ones. Once a [white] applicant has been approved using the first (objective) signal, lenders may choose to ignore any additional “bad” information they receive about that applicant or, perhaps more likely, may never bother to observe the second signal at all.<sup>251</sup>

So, white borrowers have the benefit of objective and subjective information available to the lender. If the objective information is negative, the lender can use the subjective information to compensate, and if the objective information is positive, the lender may never consider the subjective information that might lead the lender to make a poor lending decision if the subjective information is negative and overwhelms the positive objective information. If lenders are not gathering as much subjective information from black borrowers, the potential for using this information to compensate for negative objective information is minimized. Further, I also suggest that in addition to Longhofer’s hypothesis, lenders make negative assumptions about the nature of the subjective information that would be gathered from blacks based on negative stereotypes, which further harms these borrowers.

If the first signal, the objective signal, correlates with the information that secondary market institutions will require if they are to guarantee or purchase the lender’s loans, then the lenders who sell to the secondary market have absolutely no incentive to consider negative information about borrowers who are acceptable by secondary market institutions, even when lenders have available to them negative subjective signals.<sup>252</sup> The lender will always use positive subjective signals though when the objective signals do not meet secondary market standards of acceptability. Secondary market lenders permit consideration of compensating factors when loans would not be acceptable on the secondary market based upon the initial objective signal. And, even if the lender cannot document that the loans’ quality meets the secondary market’s

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249. *Id.*

250. *Id.*

251. *Id.* at 20.

252. *Id.*

criteria, the lender could decide to hold a loan that is obviously creditworthy, after considering the subjective signal, in its own portfolio.<sup>253</sup>

Longhofer draws several conclusions regarding the distorting effects of secondary markets on discrimination in home mortgage lending. First, assuming lenders have a cultural affinity with white borrowers, minority borrowers will be denied loans more frequently than white borrowers when lenders ignore the negative information contained in the subjective signal for white borrowers.<sup>254</sup> Second, even when lenders are not discriminating they will appear to be discriminating against blacks by requiring them to meet more stringent standards. And finally, it appears to outsiders that lenders are holding blacks more stringently to traditional underwriting criteria than white applicants.<sup>255</sup>

An absolute risk is associated with lenders' misunderstanding or biased perceptions of the black economy, even when these borrowers' objective measures such as FICO and credit scores surpass the lenders' own articulated standards.

A belief in black intellectual inferiority makes investments in black people, their property, and their communities seem riskier than comparable investments in whites. A belief that black borrowers are stupid or incompetent will lead to . . . higher interest rates, demands for more information, and higher transaction costs in credit transactions involving blacks. Some blacks have internalized these notions. Others have accommodated their financial practices and preferences to them. Fear of being denied credit, for example, drives some creditworthy blacks to seek loans in the fringe or subprime sector where they receive money on less favorable terms than comparably situated whites.<sup>256</sup>

Historically, lenders simply denied many black borrowers' loans.<sup>257</sup> Today, instead of expressing their worry about risk by denying loans, lenders have absorbed this risk and managed their worry with higher rates and poorer loan terms for black borrowers.<sup>258</sup> Risk has thus become translated into less attractive products that are more likely to default.

Moreover, evidence of higher default rates among black borrowers than

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253. *Id.*

254. *Id.*

255. *Id.*

256. Austin, *supra* note 5, at 1251 (citations omitted).

257. *See supra* notes 49–50 and accompanying text.

258. Lenders are even charging rates that exceed what can be explained based upon borrower risk factors and neighborhood risk factors. *See* APGAR ET AL., *supra* note 29, at 40.

white borrowers may provide a motive for lenders to steer the former toward subprime products, even when the individual applicant meets or exceeds the lenders' loan criteria.<sup>259</sup> There is not a lot of available information on default rates by race.<sup>260</sup> The information that does exist suggests that black borrowers default at a higher rate than white borrowers, *even after controlling for the borrowers' relevant economic characteristics*.<sup>261</sup> Ironically, this practice of steering may actually have the opposite of its intended effect and may increase lenders' risk as borrowers laden with excessive monthly mortgage payments may be more likely to default than similarly situated borrowers with lower monthly payments.<sup>262</sup> Additionally, some studies have measured borrower default by looking at lender foreclosures.<sup>263</sup> Lenders exercise discretion when deciding whether to foreclose; thus, studies that measure borrower default rates based upon lender foreclosure statistics may be capturing information about lender preferences and behavior rather than information purely about borrowers' behaviors.

One can argue that higher default rates among black borrowers justify the higher representations of these borrowers in the subprime category and are consistent with "rational discrimination"<sup>264</sup> or profit maximization.<sup>265</sup> These results can also be explained as consistent with cultural affinity. "[T]he added screening costs brought about by 'cultural affinities' . . . can lead to minorities endogenously exhibiting higher default rates than do whites . . ."<sup>266</sup> Cultural affinities create higher costs that are passed on through more expensive, subprime products—loans with higher interest rates, credit enhancements such as private mortgage insurance, and higher fees. If the average likelihood of default increases as the loan becomes more expensive and if cultural affinity results in lenders pushing black borrowers into subprime loans when similar white borrowers would be offered prime loans, black borrowers may very well find themselves, more often than their white counterparts, in situations where the interest rate reaches a critically high level in the face of falling property values and it no longer makes economic sense to continue paying the loan. And, moreover, lenders may not in all cases be harmed when these defaulted loans are foreclosed. In some instances, lenders roll high

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259. *But see* Ladd, *supra* note 69, at 47 (discussing why the process of selling loans in the secondary market should make loan originators less concerned and focused on "race-specific probability of default").

260. *Id.* at 46; Calomiris et al., *supra* note 19, at 653.

261. Calomiris et al., *supra* note 19, at 635.

262. APGAR ET AL., *supra* note 29, at 29.

263. Ladd, *supra* note 69, at 54.

264. Calomiris et al., *supra* note 19, at 650 n.25.

265. *Id.* at 650.

266. *Id.* at 635.

front-end fees into the mortgage, which then may be paid out of the equity (assuming there is any) as part of the lender's foreclosure process.<sup>267</sup> These fees may be sufficient to compensate the lender for the default.<sup>268</sup>

Regina Austin makes a compelling argument that this country's history of racial discrimination in lending has resulted in creating a dual currency system in which the money of blacks is literally worth less than that of whites.<sup>269</sup> Her argument offers an alternative understanding of the perceived risk associated with black people's money. She contends that

[t]hrough blacks' historic confinement to segregated markets immune to legal attack and the operation of a culture of dealing that is permeated by economic stereotypes and practices borne of blacks' unequal material conditions, money in the hands of black Americans has come to be devalued like the currency of a "Third World" country. The devaluation has taken on a life of its own. The assumption that black people's money is worth less taints commercial transactions of all sorts and perpetuates blacks' subordinate economic status. Nowhere is the adverse impact of this interaction of race, culture, law, and economics, better reflected than in the area of personal finance and the lack of success that blacks encounter in transactions with financial institutions and other firms dealing in money as a commodity.<sup>270</sup>

Segregation forced black borrowers into an informal economy, meaning an economy that was largely unregulated and that was little understood by those operating in the formal economy.<sup>271</sup> Thus, little value and social significance was attached to their money. These borrowers are perceived as riskier and worthy of relegation to second-class credit.

Black borrowers have accepted these less attractive subprime and predatory products. The products are less attractive to the extent these loans are more expensive than what black borrowers' objective measures would indicate they are entitled to receive. Perhaps black borrowers accept these products because they do not know that better terms are available (due to historic denials to the social interactions with those who have traditionally dealt in the formal credit economy);<sup>272</sup> perhaps because though they know better loan terms are available, they have grown accustomed, over time, to

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267. APGAR ET AL., *supra* note 29, at 66.

268. *Id.*

269. Austin, *supra* note 5, at 1218.

270. *Id.*

271. *Id.* at 1257 ("Blacks are not alone in having a lower value attached to their money. Other minorities, including women and the poor, are essentially in the same boat.")

272. *See supra* Part II.

less attractive loan terms and do not believe that they can borrow on better terms;<sup>273</sup> or perhaps because in their experience, the market just will not give them better products even when they demand better products. Lenders became aware that past discrimination created a vulnerable and therefore valuable market of black borrowers. The history of the housing and financing markets stacked the cards against this group of borrowers, making it virtually inevitable that, when these subprime and predatory loan incentives came along, lenders believed they could target black borrowers without acting illegally. Past discrimination limited the ability of black borrowers to develop credit histories and to participate in the formal credit economy. So now, lenders cannot relate to these borrowers, and the lack of cultural affinity reinforces the risk lenders associate with lending to them.

The poor credit histories, FICO scores, income histories, and other objective factors lined up perfectly for many black borrowers and justified their relegation to the subprime market. Even when these objective factors indicated the contrary—that black borrowers qualified for prime products—many lenders steered them into the subprime market anyway. Driven by cynicism, lenders' approaches to lending to black borrowers resulted in this intent to discriminate.

## VII. CONCLUSION

What is happening today in the subprime market to black borrowers is a result of prior discrimination in housing and lending.<sup>274</sup> Historic discrimination has consistently, over time, secured white prosperity, undermined black acquisition of property, and facilitated the divestment of property from blacks who managed to acquire this important resource.<sup>275</sup>

[T]he old inequality helped to make the new inequality possible. The new inequality in home mortgage lending is part of a greater phenomenon in which apparent gains made by [blacks] have come at far higher costs than have gains made by other segments of society. While we might reasonably argue that the new forms of inequality are better than the old, we must not lose sight of the fact that it is inequality, nonetheless: recent gains in credit for underserved markets have come with a price.<sup>276</sup>

The proper role of government in addressing the subprime mortgage

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273. *See id.*

274. *See id.*

275. *See supra* notes 1–5 and Parts I–II.

276. Williams et al., *supra* note 6, at 182; *see also* APGAR ET AL., *supra* note 29 (stating that changes in the mortgage market pose new challenges for neighborhoods once the targets of redlining).

market failures depends upon the sources and causes of these failures. Black borrowers are being steered into subprime products because of cultural affinities and lenders' obsessions with maximizing profit by targeting emerging populations. Policies should be designed to ensure the suitability of borrowers for the loans they receive and to punish lenders who attempt to trade upon the disadvantages borne from past discrimination to further isolate historically disadvantaged borrowers.

TABLE 1: 2006 DIFFERENCE OF MEANS DATA

State	Race <sup>277</sup>	Total # of Applicants <sup>278</sup>	% Applying to HUD-Classified Subprime Lenders <sup>279</sup>	Standard Error <sup>280</sup>	Pr(T<t) <sup>281</sup>	% Accepted at HUD-Classified Subprime Lenders <sup>282</sup>	Standard Error	Pr(T<t)	% of Loans 3+ Points over Comparable Treasury Rate <sup>283</sup>	Standard Error	Pr(T<t)
AL	White	236,937	0.149	0.001	0.00	0.084	0.001	0.00	0.148	0.002	0.00
	Black	72,046	0.315	0.002		0.232	0.002		0.262	0.014	
AK	White	39,469	0.154	0.002	0.00	0.081	0.002	0.00	0.225	0.001	0.00
	Black	1,651	0.260	0.011		0.165	0.012		0.322	0.004	
AZ	White	749,919	0.187	0.000	0.00	0.140	0.001	0.00	0.201	0.001	0.00
	Black	33,455	0.222	0.002		0.201	0.003		0.331	0.005	
AR	White	127,358	0.119	0.001	0.00	0.070	0.001	0.00	0.209	0.000	0.00
	Black	16,113	0.278	0.004		0.219	0.004		0.325	0.001	
CA	White	2,614,907	0.202	0.000	0.00	0.151	0.000	0.00	0.154	0.001	0.00
	Black	280,327	0.277	0.001		0.249	0.001		0.311	0.005	
CO	White	480,405	0.147	0.001	0.00	0.088	0.001	0.00	0.158	0.001	0.00
	Black	21,305	0.267	0.003		0.217	0.004		0.364	0.004	
CT	White	234,178	0.191	0.001	0.00	0.116	0.001	0.00	0.093	0.003	0.00
	Black	33,251	0.347	0.003		0.304	0.004		0.311	0.004	
DE	White	64,484	0.160	0.001	0.00	0.096	0.001	0.00	0.258	0.000	0.00
	Black	19,308	0.289	0.003		0.234	0.004		0.413	0.001	
DC	White	17,978	0.060	0.002	0.00	0.042	0.002	0.00	0.148	0.002	0.00
	Black	26,944	0.208	0.002		0.181	0.002		0.318	0.005	
FL	White	1,755,419	0.214	0.000	0.00	0.159	0.000	0.00	0.174	0.001	0.00
	Black	322,716	0.369	0.001		0.327	0.001		0.364	0.001	

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277. Race of the borrower.

278. Total number of applicants for mortgages in that particular state of each race.

279. Percentage of applicants applying for loans from subprime lenders, as classified by appearance on the 2005 HUD subprime lender list.

280. The standard error, or the standard deviation of the sampling estimate.

281. The probability that the differences in percentages between white and black borrowers is due to chance.

282. The percentage of loans accepted by subprime lenders, as classified by appearance on the 2005 HUD subprime lender list.

283. The percentage of loans accepted by subprime lenders, as classified by a loan rate of three points or more above the comparable Treasury rate.

State	Race <sup>277</sup>	Total # of Applicants <sup>278</sup>	% Applying to HUD-Classified Subprime Lenders <sup>279</sup>	Standard Error <sup>280</sup>	Pr(T<t) <sup>281</sup>	% Accepted at HUD-Classified Subprime Lenders <sup>282</sup>	Standard Error	Pr(T<t)	% of Loans 3+ Points over Comparable Treasury Rate <sup>283</sup>	Standard Error	Pr(T<t)
GA	White	516,012	0.141	0.000	0.00	0.078	0.000	0.00	0.141	0.002	0.00
	Black	288,685	0.304	0.001		0.235	0.001		0.240	0.012	
HI	White	43,083	0.134	0.002	0.00	0.101	0.002	0.00	0.092	0.001	0.00
	Black	1,985	0.210	0.009		0.176	0.011		0.165	0.019	
ID	White	150,911	0.143	0.001	0.00	0.092	0.001	0.00	0.187	0.001	0.00
	Black	732	0.217	0.015		0.165	0.019		0.277	0.023	
IL	White	824,327	0.194	0.000	0.00	0.132	0.000	0.00	0.206	0.001	0.00
	Black	180,788	0.382	0.001		0.329	0.002		0.433	0.003	
IN	White	413,193	0.192	0.001	0.00	0.105	0.001	0.00	0.219	0.001	0.00
	Black	43,735	0.337	0.002		0.260	0.003		0.420	0.003	
IA	White	178,577	0.183	0.001	0.00	0.105	0.001	0.00	0.129	0.001	0.00
	Black	3,736	0.297	0.297		0.213	0.009		0.177	0.006	
KS	White	229,589	0.161	0.001	0.00	0.100	0.001	0.00	0.200	0.001	0.00
	Black	17,496	0.275	0.003		0.215	0.004		0.334	0.005	
KY	White	229,589	0.161	0.001	0.00	0.100	0.001	0.00	0.128	0.001	0.00
	Black	17,496	0.275	0.003		0.215	0.004		0.309	0.002	
LA	White	182,534	0.128	0.001	0.00	0.086	0.001	0.00	0.206	0.001	0.00
	Black	62,383	0.309	0.002		0.257	0.003		0.387	0.003	
ME	White	93,649	0.203	0.001	0.00	0.127	0.001	0.00	0.127	0.001	0.00
	Black	521	0.365	0.021		0.272	0.027		0.272	0.027	
MD	White	357,272	0.184	0.001	0.00	0.119	0.001	0.00	0.189	0.001	0.00
	Black	233,611	0.322	0.001		0.259	0.001		0.367	0.001	
MA	White	420,222	0.183	0.001	0.00	0.114	0.001	0.00	0.158	0.001	0.00
	Black	38,055	0.365	0.002		0.320	0.003		0.373	0.004	
MI	White	685,344	0.185	0.000	0.00	0.109	0.000	0.00	0.204	0.001	0.00
	Black	143,851	0.365	0.001		0.311	0.002		0.431	0.002	
MN	White	362,778	0.175	0.001	0.00	0.096	0.001	0.00	0.182	0.001	0.00
	Black	22,817	0.333	0.003		0.289	0.004		0.397	0.005	
MS	White	102,539	0.134	0.001	0.00	0.078	0.001	0.00	0.243	0.002	0.00
	Black	44,083	0.337	0.002		0.248	0.003		0.409	0.003	

State	Race <sup>277</sup>	Total # of Applicants <sup>278</sup>	% Applying to HUD-Classified Subprime Lenders <sup>279</sup>	Standard Error <sup>280</sup>	Pr(T<t) <sup>281</sup>	% Accepted at HUD-Classified Subprime Lenders <sup>282</sup>	Standard Error	Pr(T<t)	% of Loans 3+ Points over Comparable Treasury Rate <sup>283</sup>	Standard Error	Pr(T<t)
MO	White	408,997	0.181	0.001	0.00	0.108	0.001	0.00	0.206	0.001	0.00
	Black	67,230	0.381	0.002		0.316	0.003		0.438	0.003	
MT	White	60,629	0.113	0.001	0.00	0.066	0.001	0.01	0.168	0.002	0.03
	Black	155	0.181	0.031		0.134	0.038		0.244	0.048	
NE	White	93,306	0.173	0.001	0.00	0.104	0.001	0.00	0.193	0.002	0
	Black	4,362	0.336	0.007		0.261	0.009		0.407	0.010	
NV	White	305,752	0.193	0.001	0.00	0.144	0.001	0.00	0.144	0.001	0.00
	Black	26,978	0.245	0.003		0.229	0.004		0.229	0.004	
NH	White	105,835	0.169	0.001	0.00	0.108	0.001	0.00	0.166	0.001	0.00
	Black	1,221	0.291	0.013		0.215	0.018		0.285	0.019	
NJ	White	555,662	0.161	0.000	0.00	0.105	0.001	0.00	0.170	0.001	0.00
	Black	101,062	0.289	0.001		0.239	0.002		0.351	0.002	
NM	White	141,678	0.187	0.001	0.00	0.102	0.001	0.00	0.187	0.001	0.00
	Black	3,455	0.253	0.007		0.172	0.009		0.285	0.010	
NY	White	711,388	0.191	0.000	0.00	0.121	0.001	0.00	0.184	0.001	0.00
	Black	152,771	0.370	0.001		0.330	0.002		0.379	0.002	
NC	White	513,173	0.125	0.0004	0.00	0.074	0.0004	0.00	0.151	0.0006	0.00
	Black	126,564	0.270	0.001		0.210	0.002		0.344	0.002	
ND	White	27,021	0.142	0.002	0.14	0.077	0.002	0.20	0.170	0.003	0.51
	Black	144	0.174	0.032		0.099	0.030		0.168	0.037	
OH	White	681,629	0.195	0.000	0.00	0.119	0.001	0.00	0.203	0.001	0.00
	Black	99,464	0.337	0.001		0.282	0.002		0.402	0.002	
OK	White	200,364	0.181	0.001	0.00	0.108	0.001	0.00	0.225	0.001	0.00
	Black	17,361	0.336	0.004		0.265	0.005		0.384	0.005	
OR	White	325,626	0.137	0.001	0.00	0.085	0.001	0.00	0.085	0.001	0.00
	Black	6,240	0.172	0.005		0.152	0.007		0.152	0.007	
PA	White	783,866	0.172	0.000	0.00	0.093	0.000	0.00	0.160	0.001	0.00
	Black	88,115	0.273	0.002		0.222	0.002		0.357	0.002	
RI	White	80,377	0.235	0.001	0.00	0.148	0.002	0.00	0.190	0.002	0.00
	Black	5,367	0.389	0.007		0.329	0.009		0.395	0.009	

State	Race <sup>277</sup>	Total # of Applicants <sup>278</sup>	% Applying to HUD-Classified Subprime Lenders <sup>279</sup>	Standard Error <sup>280</sup>	Pr(T<t) <sup>281</sup>	% Accepted at HUD-Classified Subprime Lenders <sup>282</sup>	Standard Error	Pr(T<t)	% of Loans 3+ Points over Comparable Treasury Rate <sup>283</sup>	Standard Error	Pr(T<t)
SC	White	259,548	0.142	0.001	0.00	0.083	0.001	0.00	0.173	0.001	0.00
	Black	69,599	0.344	0.002		0.269	0.002		0.374	0.003	
SD	White	42,893	0.133	0.002	0.00	0.066	0.001	0.86	0.170	0.002	0.86
	Black	297	0.185	0.023		0.043	0.017		0.209	0.035	
TN	White	374,627	0.176	0.001	0.00	0.107	0.001	0.00	0.193	0.001	0.00
	Black	80,196	0.378	0.002		0.303	0.002		0.373	0.002	
TX	White	1,255,524	0.195	0.000	0.00	0.126	0.000	0.00	0.204	0.000	0.00
	Black	200,971	0.383	0.001		0.330	0.001		0.368	0.002	
UT	White	280,542	0.147	0.001	0.00	0.099	0.001	0.00	0.185	0.001	0.00
	Black	1,881	0.204	0.009		0.165	0.011		0.296	0.014	
VT	White	34,618	0.174	0.002	0.0096	0.110	0.002	0.05	0.141	0.002	0.00
	Black	228	0.232	0.028		0.154	0.031		0.235	0.037	
VA	White	512,606	0.147	0.000	0.000	0.090	0.000	0.00	0.166	0.001	0.00
	Black	153,315	0.296	0.001		0.230	0.001		0.342	0.002	
WA	White	561,746	0.157	0.000	0.000	0.101	0.000	0.00	0.178	0.001	0.00
	Black	25,395	0.241	0.003		0.212	0.004		0.314	0.004	
WV	White	96,347	0.122	0.001	0.000	0.075	0.001	0.00	0.221	0.002	0.00
	Black	3,052	0.199	0.007		0.153	0.009		0.303	0.012	
WI	White	392,062	0.160	0.001	0.000	0.088	0.001	0.00	0.173	0.001	0.00
	Black	30,514	0.365	0.003		0.295	0.004		0.443	0.004	
WY	White	38,405	0.157	0.002	0.000	0.088	0.002	0.00	0.194	0.002	0.00
	Black	299	0.271	0.026		0.190	0.030		0.293	0.035	

TABLE 2: 2002 DIFFERENCE OF MEANS DATA

2002 SUBPRIME LENDING					
	Number of Loan Applicants	% Applying to Subprime Lenders	Pr(T < t)	% Accepted at HUD-Classified Subprime Lenders	Pr(T < t)
WHITE	13,867,631	0.0912	0	0.0725	0.05
BLACK	1,211,921	0.163		0.1233	

TABLE 3: 1998 DIFFERENCE OF MEANS DATA

1998 SUBPRIME LENDING					
	Number of Loan Applicants	% Applying to Subprime Lenders	Pr(T < t)	% Accepted at HUD-Classified Subprime Lenders	Pr(T < t)
WHITE	10,503,741	0.0753	0	0.0651	0.12
BLACK	1,294,019	0.1323		0.0752	

FIGURE 1: PERCENTAGE OF APPLICATIONS NATIONALLY TO HUD-CLASSIFIED SUBPRIME LENDERS BY RACE

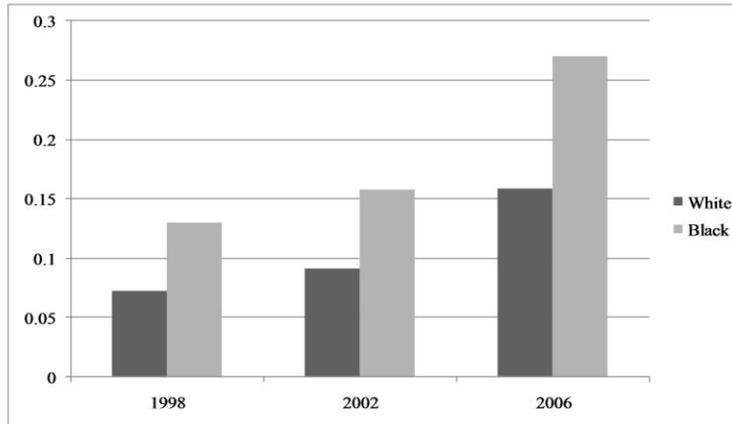


FIGURE 2: PERCENTAGE OF LOANS ORIGINATED FROM SUBPRIME LENDERS

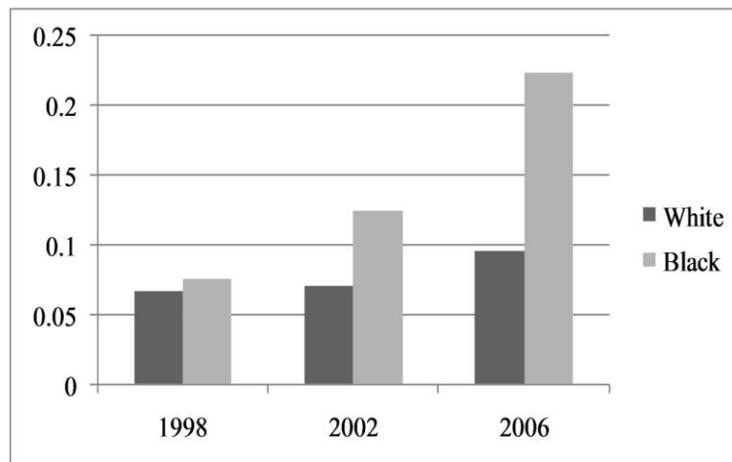


TABLE 4: 2006 CONTROL DATA—ALTERNATIVE MEASURE  
(LOAN IS 3+ POINTS ABOVE COMPARABLE TREASURY RATE)<sup>284</sup>

State	Black Applicant <sup>285</sup>	Loan Amount <sup>286</sup>	HUD Income <sup>287</sup>	Minority Population <sup>288</sup>	Median Income of MSA <sup>289</sup>	Owner-Occupied Housing <sup>290</sup>	Income <sup>291</sup>	Constant <sup>292</sup>	Increase of Probability for Black Applicant <sup>293</sup>
AL	0.014	-0.004	0.000	-0.002	-0.005	0.000	0.000	0.010	4.7%
AK	0.459	-0.002*	0.000*	-0.001	-0.003	0.000	0.001	-1.921	5.2%
AZ	0.151	-0.001	0.000	0.007	-0.002	0.000*	0.000*	-2.497	5.2%
AR	0.298	-0.004	0.000	-0.004	-0.007	0.000	0.000*	0.685	3.9%
CA	0.299	0.000*	0.000	0.002	-0.011	0.000*	0.000*	-0.417	3.4%
CO	0.327	-0.002	0.000	0.005	-0.003	0.000	0.001	-2.037	2.3%
CT	0.417	0.001	0.000	0.005	-0.011	0.000	-0.002	0.556	3.2%
DE	0.470	-0.001	0.000	0.003	-0.007	0.000	0.000	-1.698	5.2%
DC	0.775	0.000*	—	0.016	-0.001*	0.000	0.000	-3.652	7.8%
FL	0.170	-0.001	0.000	0.007	-0.002	0.000	0.000	-1.184	5%
GA	0.513	-0.003	0.000	-0.001	-0.003	0.000	0.000	-1.055	6.5%
HI	0.066*	-0.001	0.000	0.005	-0.007	0.000*	0.000	-0.060	—
ID	0.224	-0.002	0.000	0.004	-0.005	0.000	0.001	-1.831	5.3%
IL	0.317	-0.001	0.000*	0.003	-0.005	0.000*	0.000*	-1.437	3.7%
IN	0.212	-0.003	0.000	0.002*	-0.006	0.000*	0.000	-0.849	4.2%
IA	0.105	-0.002	0.000	0.004	-0.005	0.000	0.001	-1.814	2.7%
KS	0.274	-0.003	0.000*	-0.001	-0.005	0.000	0.000*	-1.029	2.3%
KY	0.326	-0.003	0.000	-0.001*	-0.004	0.000*	0.000*	-0.712	6.1%

284. Estimating the effect of race, borrower characteristics, and neighborhood characteristics on the likelihood that a borrower receives a loan that is three points or more above the comparable Treasury rate.

285. Dummy variable representing whether or not the borrower was black (versus white).

286. Amount of the loan (in thousands of dollars).

287. The maximum income for qualification for HUD services in the census tract.

288. The percentage of the census tract that is not white.

289. The median income (in thousands) in the MSA.

290. The percentage of housing in the census tract that is owner-occupied.

291. The income of the borrower (in thousands).

292. The constant, or the baseline level of subprime lending, represents the base probability of receiving a subprime loan (i.e., the log odds that a white person receives subprime loan).

293. The change in probability if all other variables are kept at their means, but the race of the borrower changes from white to black. This is calculated using Clarify software, developed by Gary King.

State	Black Applicant <sup>285</sup>	Loan Amount <sup>286</sup>	HUD Income <sup>287</sup>	Minority Population <sup>288</sup>	Median Income of MSA <sup>289</sup>	Owner-Occupied Housing <sup>290</sup>	Income <sup>291</sup>	Constant <sup>292</sup>	Increase of Probability for Black Applicant <sup>293</sup>
LA	0.324	-0.003	0.000	-0.002	-0.004	0.000	0.000	-0.599	6.2%
ME	0.427	0.000*	0.000	0.002	-0.010	0.000	0.000*	-0.336	3.8%
MD	0.541	0.000	0.000	0.004	-0.005	0.000	0.001	-0.552	10%
MA	0.401	-0.001	0.000	0.000*	-0.007	0.000*	0.000	0.234	3.3%
MI	0.270	-0.002	0.000	0.002	-0.004	0.000	0.000	-0.892	5.8%
MN	0.543	-0.002	0.000	0.001	-0.007	0.000	0.000	-0.885	4.2%
MS	0.206	-0.004	0.000	-0.002	-0.005	0.000	0.000	-0.194	7.1%
MO	0.343	-0.002	0.000	0.001	-0.005	0.000	0.000	-1.081	4.1%
MT	0.278*	-0.003	0.000	-0.005	-0.005	0.000	0.000	0.105	3.1%
NE	0.359	-0.003	0.000	0.003	-0.007	0.000*	0.000*	0.230	6.1%
NV	0.235	-0.002	0.000	0.012	0.000*	0.000	0.000	0.870	2.8%
NH	0.241	-0.001	0.000	-0.001*	-0.010	0.000*	0.000*	-0.174	3.6%
NJ	0.299	0.000	0.000	0.006	-0.007	0.000	0.000*	-0.984	3.1%
NM	0.306	-0.002	0.000*	0.002	-0.002	0.000*	0.000	-1.555	3.8%
NY	0.295	0.000	0.000	0.005	-0.005	0.000	0.000	-1.970	2.1%
NC	0.235	-0.002	0.000	0.012	0.000	0.000	0.000	0.870	5.5%
ND	0.090*	-0.004*	0.000*	-0.006*	-0.009*	0.000*	-0.002*	0.279*	—
OH	0.331	-0.002	0.000	0.000	-0.006	—	0.000	-0.986	6.1%
OK	0.253	-0.004	0.000	-0.002	-0.005	0.000	0.000	-0.549	4.1%
OR	0.211	-0.002	0.000	0.002	-0.005	0.000	0.000	-1.530	2.2%
PA	0.364	0.000*	0.000	0.001	-0.009	0.000	0.000	-0.425	3.1%
RI	0.298	0.000	—	0.002	-0.012	0.000	0.000*	-0.908	2.6%
SC	0.356	-0.003	0.000	-0.001*	-0.004	0.000	0.000	-0.987	3.9%
SD	-0.162*	-0.007*	0.000*	-0.001*	-0.007*	0.000*	0.000*	0.093*	—
TN	0.457	-0.001	0.000	-0.001	-0.006	0.000	0.000	-0.379	6.2%
TX	0.363	-0.001	0.000	0.003	-0.003	0.000	0.000*	-1.271	4.1%
UT	0.298	-0.002	0.000	0.008	-0.002	0.000	0.001	-2.017	1.2%
VT	0.429	-0.001	0.000	0.003	-0.007	0.000	0.000	-1.372	2.5%
VA	0.526	0.000	0.000	-0.020*	-0.013	0.000	-0.002	0.933	5.4%
WA	0.344	-0.002	0.000	0.000*	-0.006	0.000*	0.001	-1.199	4.3%
WV	0.242	-0.002	0.000	-0.003	-0.007	0.000*	-0.001	-0.782	5.1%

State	Black Applicant <sup>285</sup>	Loan Amount <sup>286</sup>	HUD Income <sup>287</sup>	Minority Population <sup>288</sup>	Median Income of MSA <sup>289</sup>	Owner-Occupied Housing <sup>290</sup>	Income <sup>291</sup>	Constant <sup>292</sup>	Increase of Probability for Black Applicant <sup>293</sup>
WI	0.373	-0.001	0.000	0.003	-0.008	0.000*	-0.001	-0.482	3.4%
WY	0.338	-0.004	0.000	0.006	0.000*	0.000*	0.000*	9.456	0.5%

\* = Statistically insignificant; Pr < 0.05 = Variable had too little variation to be included in the model

TABLE 5: 2006 CONTROL DATA—HUD-CLASSIFIED SUBPRIME LENDER<sup>294</sup>

State	Black Applicant <sup>295</sup>	Loan Amount <sup>296</sup>	HUD Income <sup>297</sup>	Minority Population <sup>298</sup>	Median Income of MSA <sup>299</sup>	Owner-Occupied Housing <sup>300</sup>	Income <sup>301</sup>	Constant <sup>302</sup>	Increase of Probability for Black Applicant <sup>303</sup>
AL	0.848	0.000	0.000	0.000*	-0.004	0.000*	-0.002	-0.535	11.3%
AK	0.671	-0.001	0.000	0.003	-0.002	0.000	-0.001	1.850	14%
AZ	0.293	0.000	0.000	0.001	-0.006	0.000*	0.000	-0.670	9.3%
AR	0.918	0.000*	0.000	0.002	-0.001	0.000	-0.001	-2.455	13.6%
CA	0.417	0.001	0.000	0.005	-0.011	0.000*	-0.002	0.556	5.3%
CO	0.546	0.000	0.000	0.006	-0.007	0.000*	-0.001	-2.371	8%
CT	0.299	0.000	0.000	0.002	-0.011	0.000	0.000	-0.417	7.2%
DE	0.551	0.001	0.000	0.004	-0.006	0.000	-0.005	-1.500	8.9%
DC	1.031	0.001	—	0.020	0.001*	0.000*	0.000*	-4.479	13.1%
FL	0.552	0.000	0.000	0.008	-0.002	0.000	-0.002	-0.643	9.3%
GA	0.861	0.000	0.000	0.002	-0.004	0.000	-0.002	-0.990	14.3%
HI	0.470	0.000*	0.000	0.011	-0.006	0.000*	-0.001	-0.873	—

294. Estimating the effect of race, borrower characteristics, and neighborhood characteristics on the likelihood that a borrower receives a loan from a HUD-Classified Subprime Lender versus receiving a loan from a prime lender.

295. Dummy variable representing whether the borrower was black (versus white).

296. Amount of the loan (in thousands of dollars).

297. The maximum income for qualification for HUD services in the census tract.

298. The percentage of the census tract that is not white.

299. The median income (in thousands) in the MSA.

300. The percentage of housing in the census tract that is owner-occupied.

301. The income of the borrower (in thousands).

302. The constant, or the baseline level of subprime lending, represents the base probability of receiving a subprime loan (i.e., the log odds that a white person receives a subprime loan).

303. The change in probability if all other variables are kept at their means, but the race of the borrower changes from white to black. This is calculated using Clarify software, developed by Gary King.

State	Black Applicant <sup>295</sup>	Loan Amount <sup>296</sup>	HUD Income <sup>297</sup>	Minority Population <sup>298</sup>	Median Income of MSA <sup>299</sup>	Owner-Occupied Housing <sup>300</sup>	Income <sup>301</sup>	Constant <sup>302</sup>	Increase of Probability for Black Applicant <sup>303</sup>
ID	0.584	0.000	0.000	0.002*	-0.008	0.000	-0.002	-0.011*	12.3%
IL	0.513	0.001	0.000	0.006	-0.006	0.000*	-0.001	-1.441	11.2%
IN	0.513	0.002	0.000	0.004	-0.008	0.000	-0.002	0.129	7.5%
IA	0.584	0.000	0.000	0.002*	-0.008	0.000	-0.002	-0.011	8.7%
KS	0.597	0.002	0.000	0.002	-0.006	0.000	-0.003	-0.880	12.1%
KY	0.603	0.001	0.000	0.002	-0.006	0.000	-0.004	-0.191	9%
LA	1.029	0.001	0.000	0.000*	-0.004	0.000	-0.001	-1.801	12.8%
ME	0.844	0.002	0.000	-0.009	-0.010	0.000*	-0.003	1.421	14.6%
MD	0.408	-0.0007	0.000	0.003	-0.005	0.000	0.001	-1.459	5.8%
MA	0.582	0.001	0.000	0.005	-0.011	0.000	-0.002	0.574	10.1%
MI	0.517	0.002	0.000	0.005	-0.007	0.000	-0.002	0.296	6.1%
MN	0.821	0.001	0.000	0.004	-0.008	0.000	-0.001	-0.159	13.2%
MS	1.067	0.001	0.000	0.003	-0.001	0.000	-0.002	-1.972	14.2%
MO	0.708	0.001	0.000	0.004	-0.007	0.000	-0.003	-0.711	12.1%
MT	0.638	0.000	0.000	0.006	-0.006	0.000	-0.002	0.979	9.9%
NE	0.664	0.002	0.000	0.005	-0.008	0.000	-0.001	0.549	10.4%
NV	0.259	0.000	0.000	0.014	-0.001	0.000	-0.001	-0.429	11.6%
NH	0.775	0.002	0.000	-0.016	-0.011	0.000	-0.004	1.244	11%
NJ	0.412	0.001	0.000	0.006	-0.006	0.000*	-0.002	-0.810	7.1%
NM	0.375	0.000	0.000	0.004	-0.003	0.000*	-0.002	-0.436	9.2%
NY	0.407	0.001	0.000	0.009	-0.004	0.000	-0.001	-1.699	12.3%
NC	0.259	0.000	0.000	0.014	-0.001	0.000	-0.001	-0.429	9.3%
ND	0.265*	0.002*	0.000*	-0.005*	-0.003*	0.000*	-0.003*	-0.050*	—
OH	0.549	0.002	0.000	0.001	-0.008	—	-0.003	0.224	11.9%
OK	0.702	0.002	0.000	0.001	-0.004	0.000	-0.001	-1.310	9.1%
OR	0.329	0.000	0.000	0.004	-0.006	0.000	-0.002	-0.695	8.7%
PA	0.460	0.003	0.000	0.001	-0.008	0.000	-0.004	0.544	11.2%
RI	0.232	0.002	—	0.006	-0.013	0.000	-0.003	-0.423	7.6%
SC	0.943	0.000	0.000	0.002	-0.005	0.000*	-0.003	-0.790	15.5%
SD	0.293*	0.000*	0.000*	0.001*	-0.006*	0.000*	0.000*	-0.670*	—
TN	0.935	0.000	0.000	0.002	-0.004	0.000*	-0.003	-0.246	13.3%

State	Black Applicant <sup>295</sup>	Loan Amount <sup>296</sup>	HUD Income <sup>297</sup>	Minority Population <sup>298</sup>	Median Income of MSA <sup>299</sup>	Owner-Occupied Housing <sup>300</sup>	Income <sup>301</sup>	Constant <sup>302</sup>	Increase of Probability for Black Applicant <sup>303</sup>
TX	0.828	0.001	0.000	0.007	-0.002	0.000	-0.002	-1.137	15.2%
UT	0.373	0.000	0.000	0.017	-0.003	0.000	-0.001	-0.708	10%
VT	0.464	0.001	0.000	-0.048	-0.016	0.000	-0.002	1.948	9.6%
VA	0.704	0.000	0.000	0.002	-0.007	0.000	-0.003	-0.624	9.2%
WA	0.536	0.000	0.000	0.003	-0.007	0.000	-0.002	-0.351	13.3%
WV	0.491	0.002	0.000*	0.006	-0.001	0.000	-0.006	-1.655	12.2%
WI	0.559	0.001	0.000	0.004	-0.010	0.000	-0.002	0.119	6.9%
WY	0.643	0.000*	0.000	-0.002*	-0.004	0.000	-0.001	-7.122	9.1%

TABLE 6: 2006, 2002, AND 1998 CONTROL DATA—HUD-CLASSIFIED SUBPRIME LENDER

Year	Black Applicant	Loan Amount	HUD Income	Minority Population	Median Income of MSA	Owner-Occupied Housing	Income	Constant
2006	0.324	0.001	0.000	0.003	-0.004	0	0	-0.653
2002	0.19825	-0.001	0.000*	0.002*	-0.005	-0.01	-0.01	-1.892
1998	0.12362	-0.002	-0.001	0.002	-0.008	-0.015	-0.012	-2.348