

The Untold Costs Of Subprime Lending

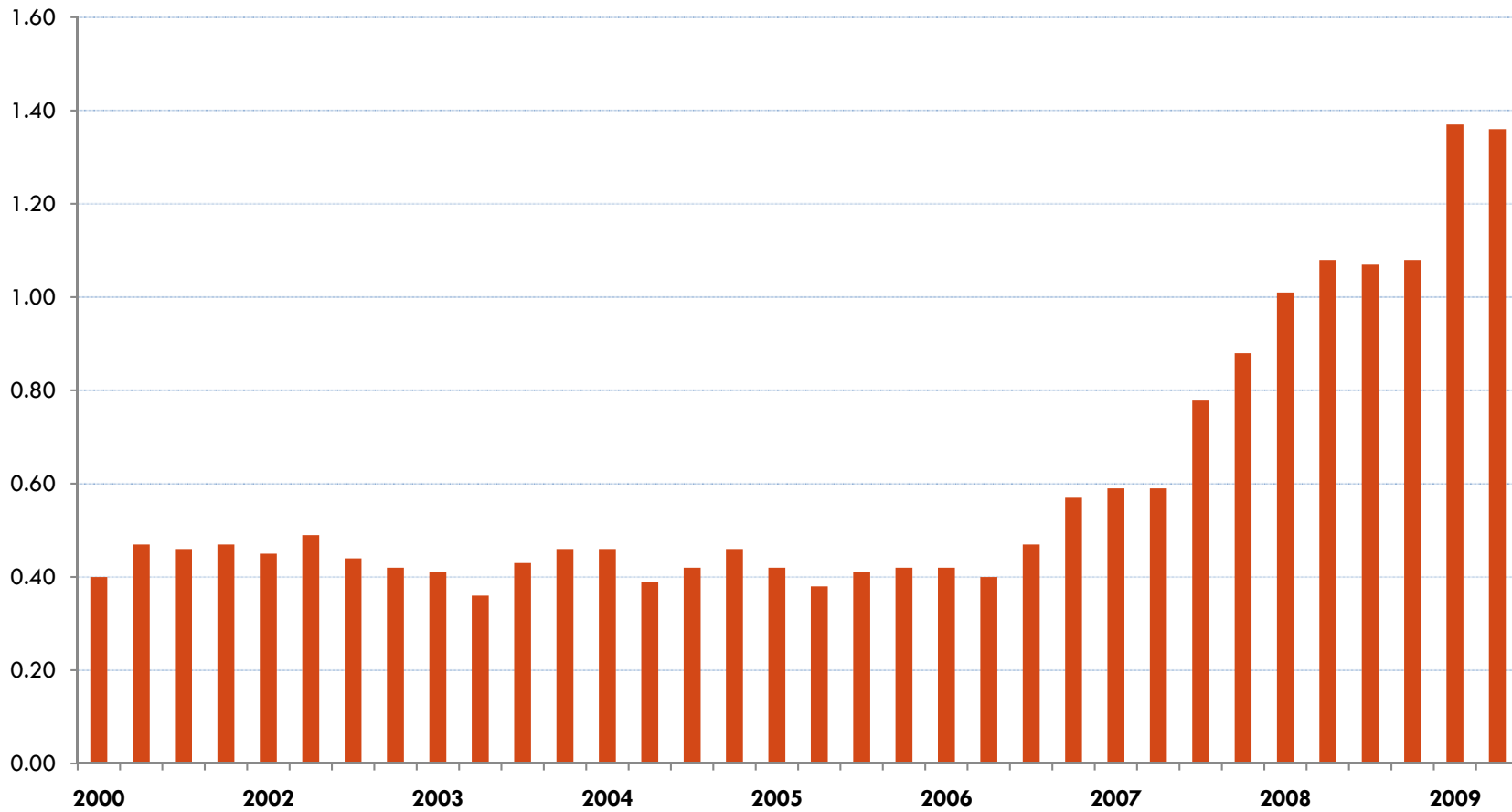
Examining The Links Among Higher-Priced Lending, Foreclosures And Race In California

Presentation at NALCAB, *“Creando Bienes, Construyendo Un Nuevo Futuro: Lead the Economic Recovery in Your Community,”* September 24, 2009

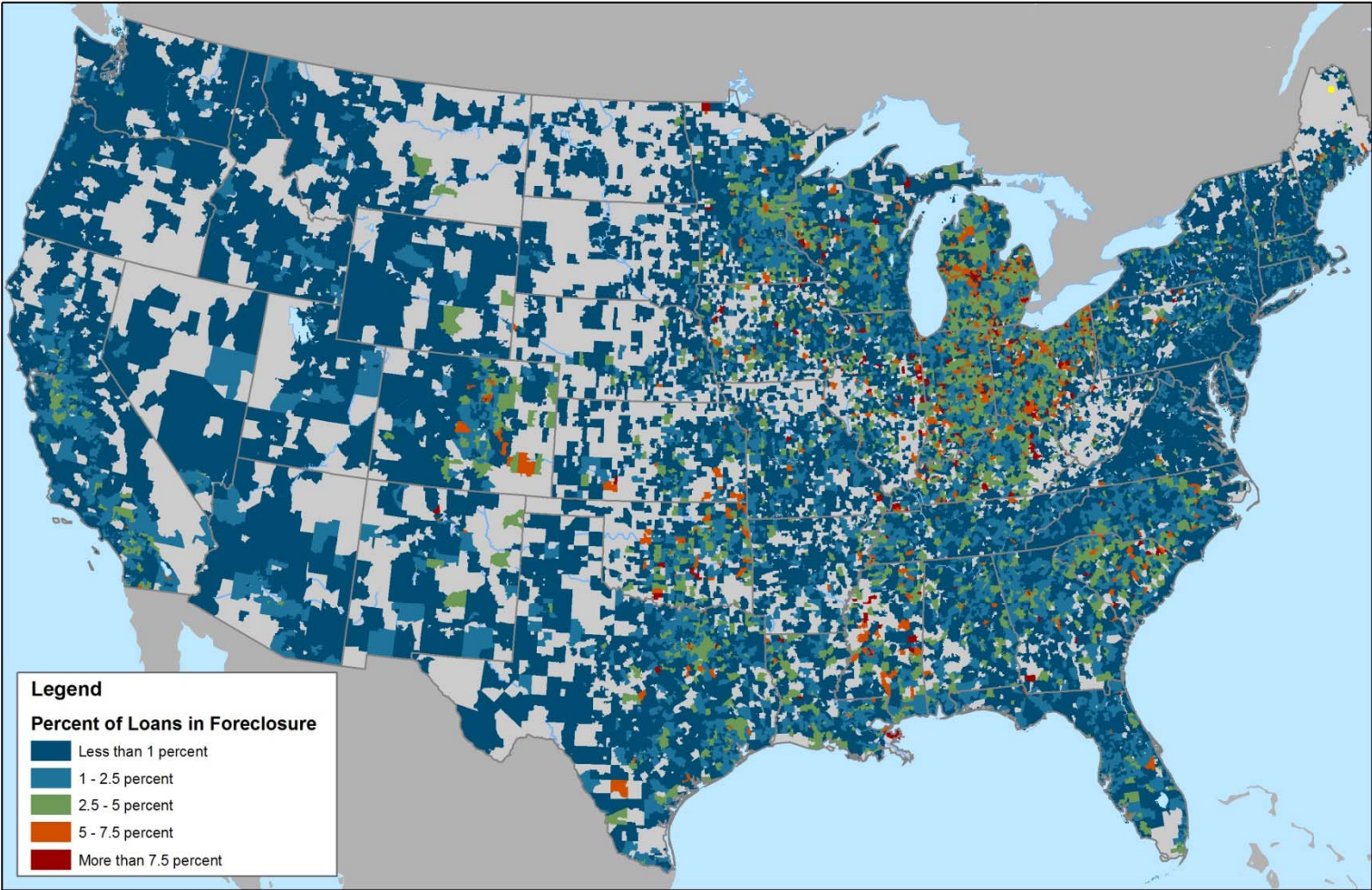
Carolina Reid, Federal Reserve Bank of San Francisco

National Foreclosure Trends

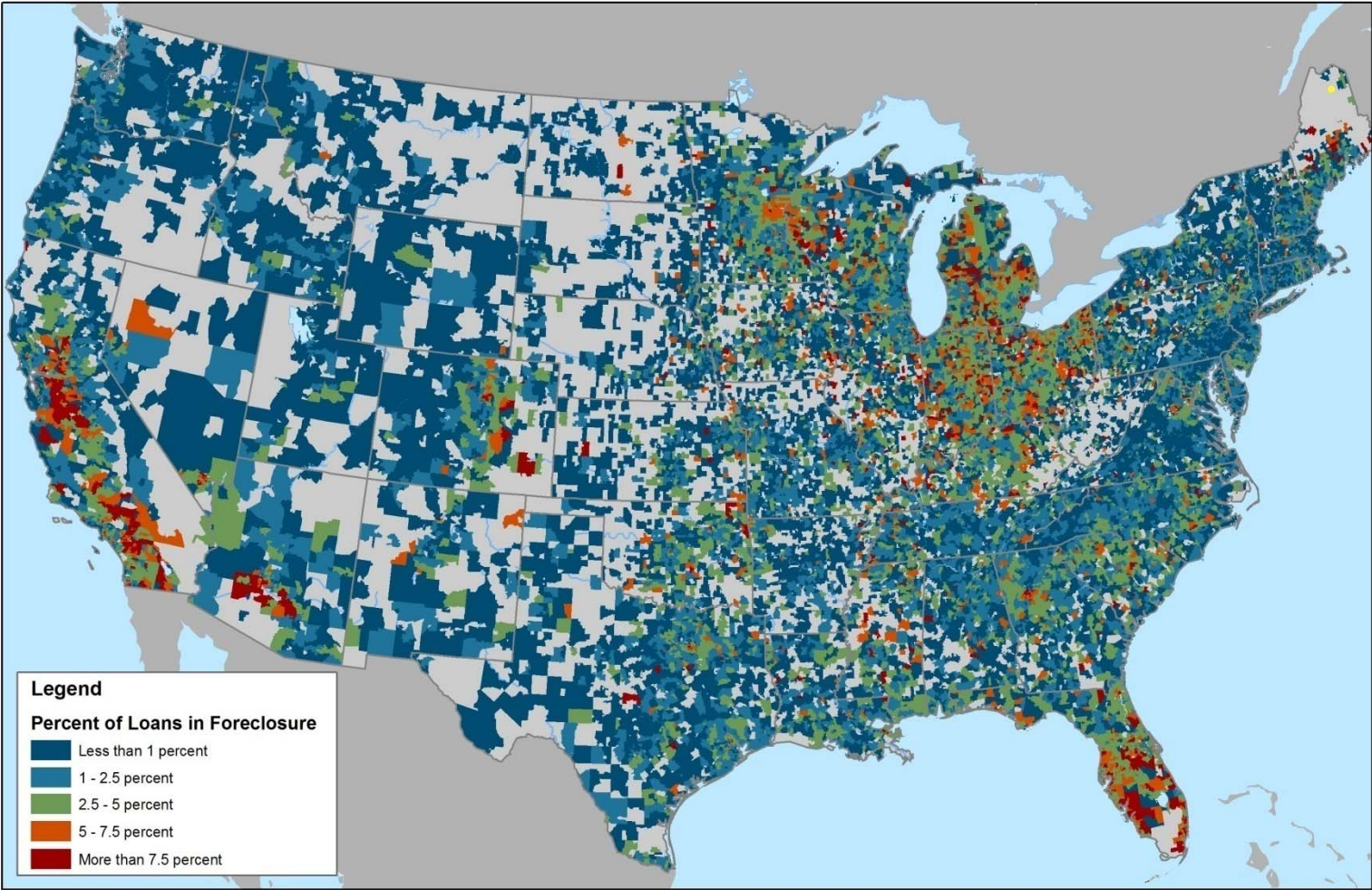
National Foreclosures Starts
Percent of All Loans



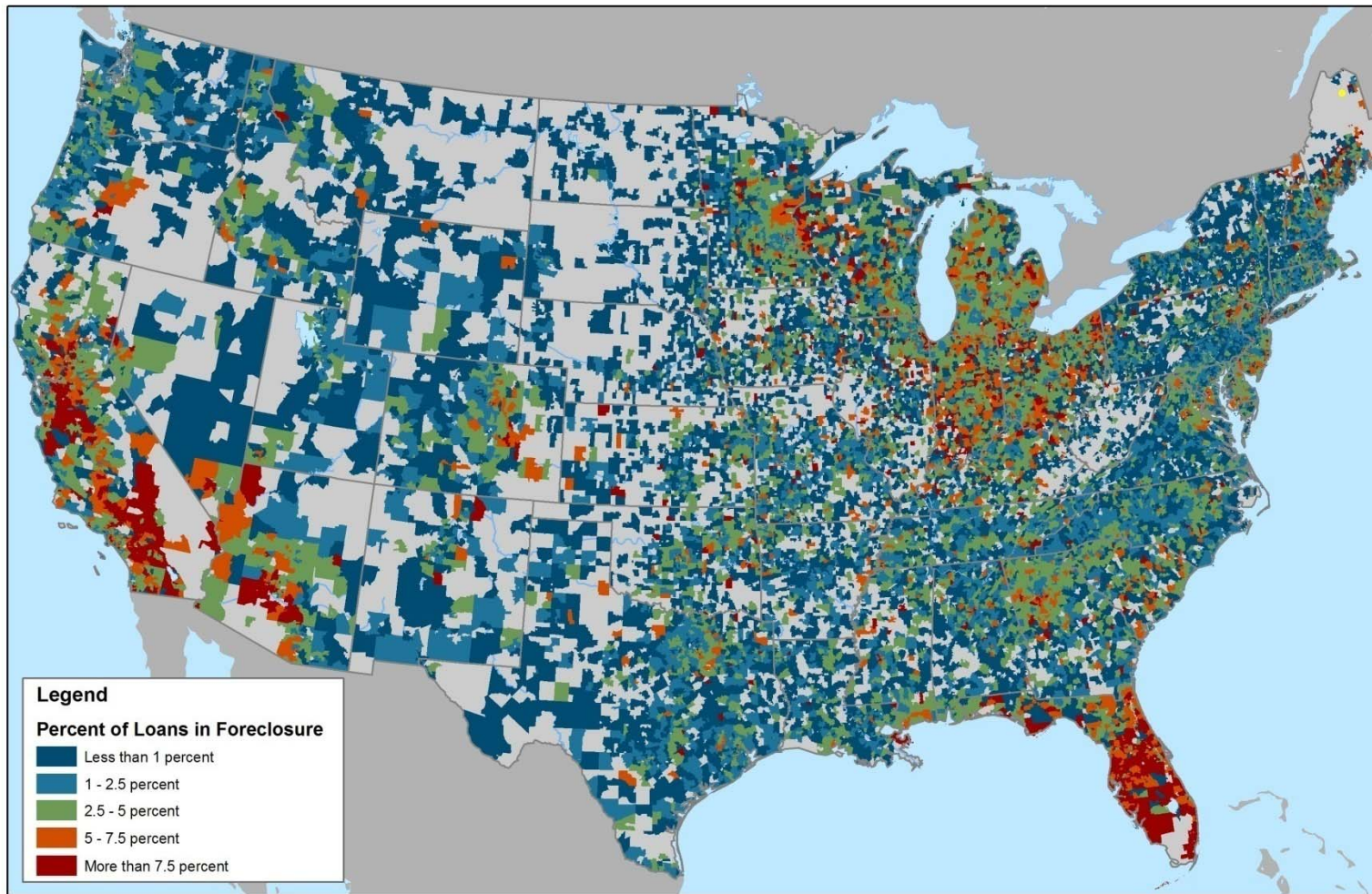
Foreclosure Rate – June 2007



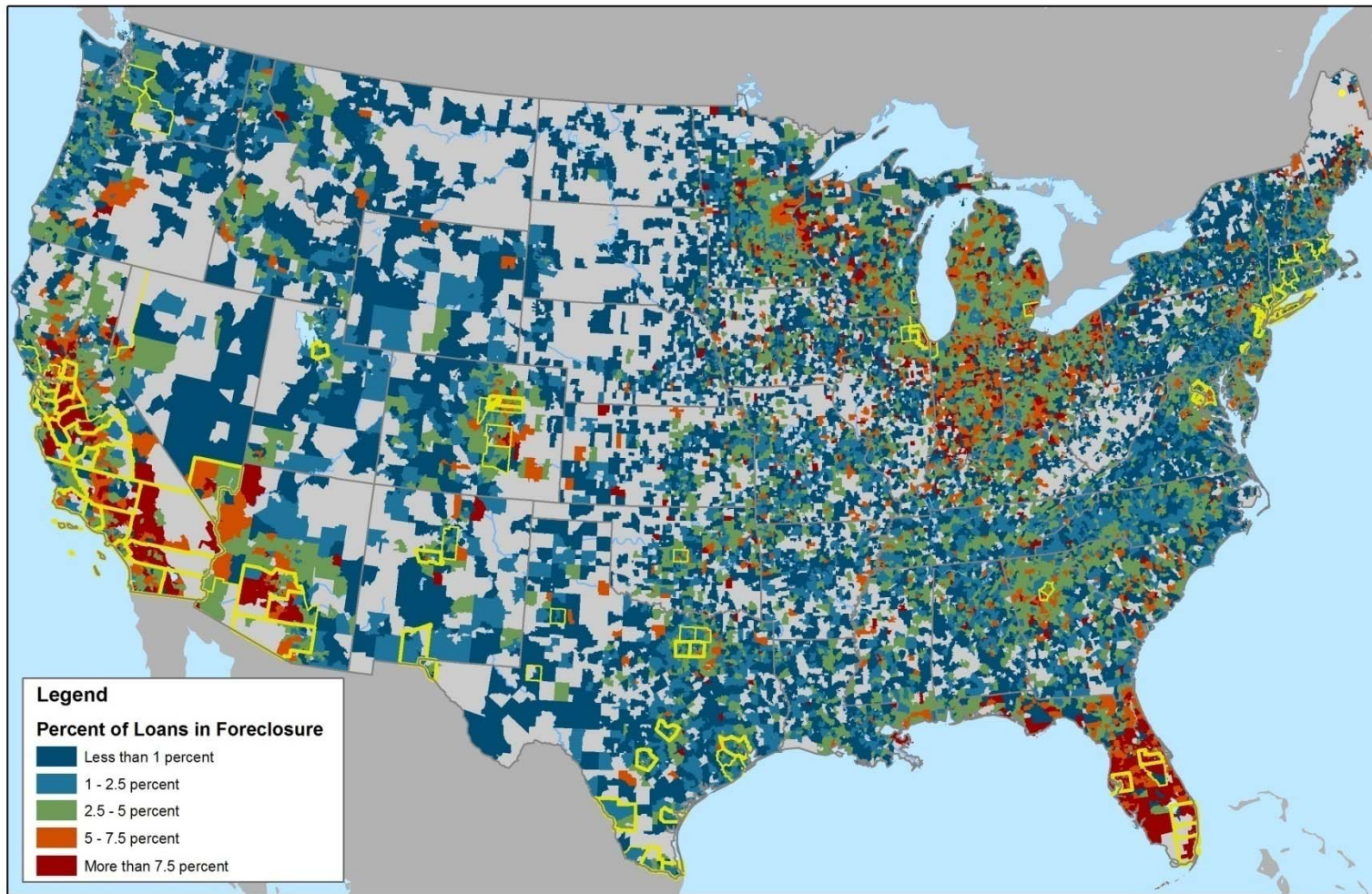
Foreclosure Rate – June 2008



Foreclosure Rate – June 2009

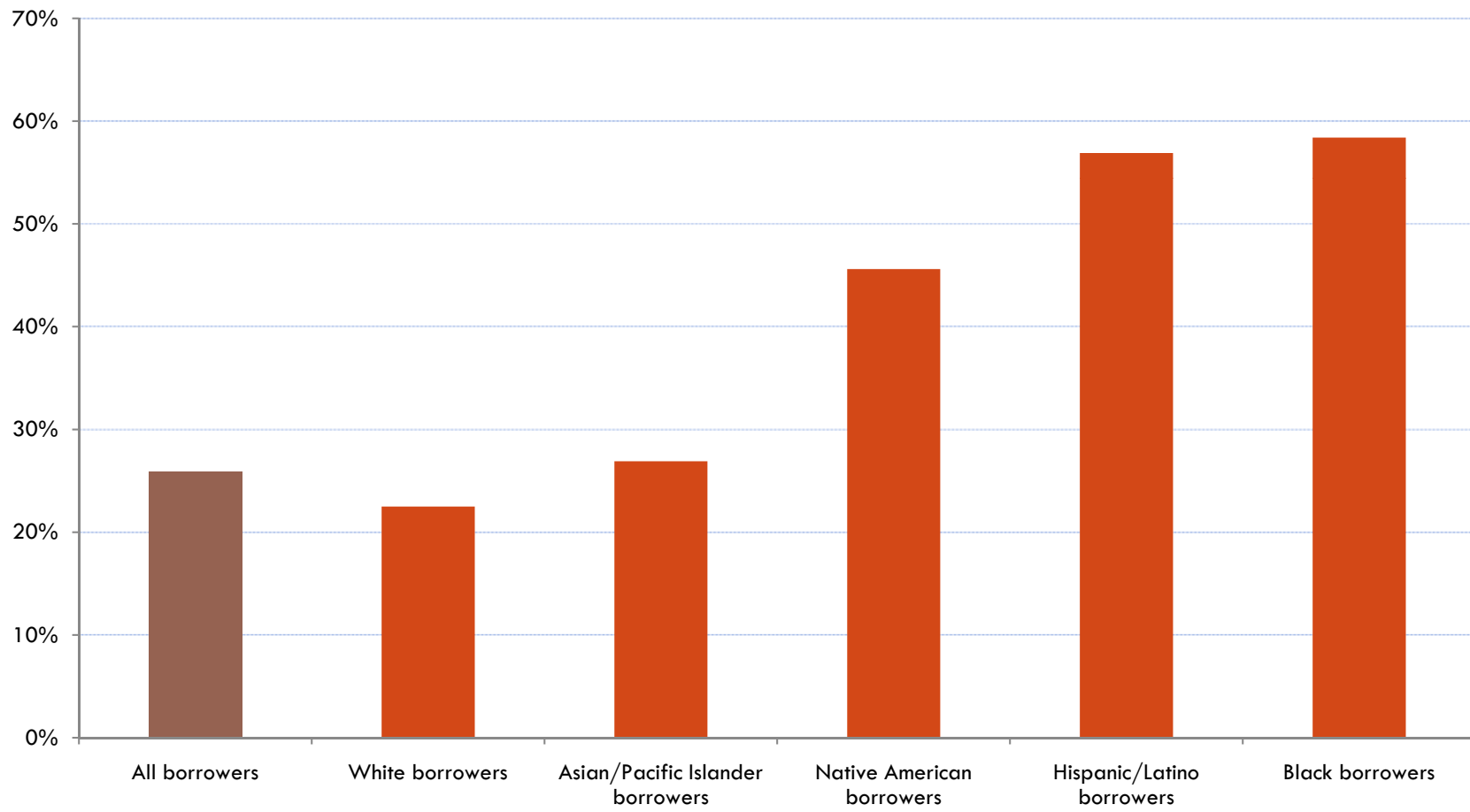


Foreclosure Rate – June 2009



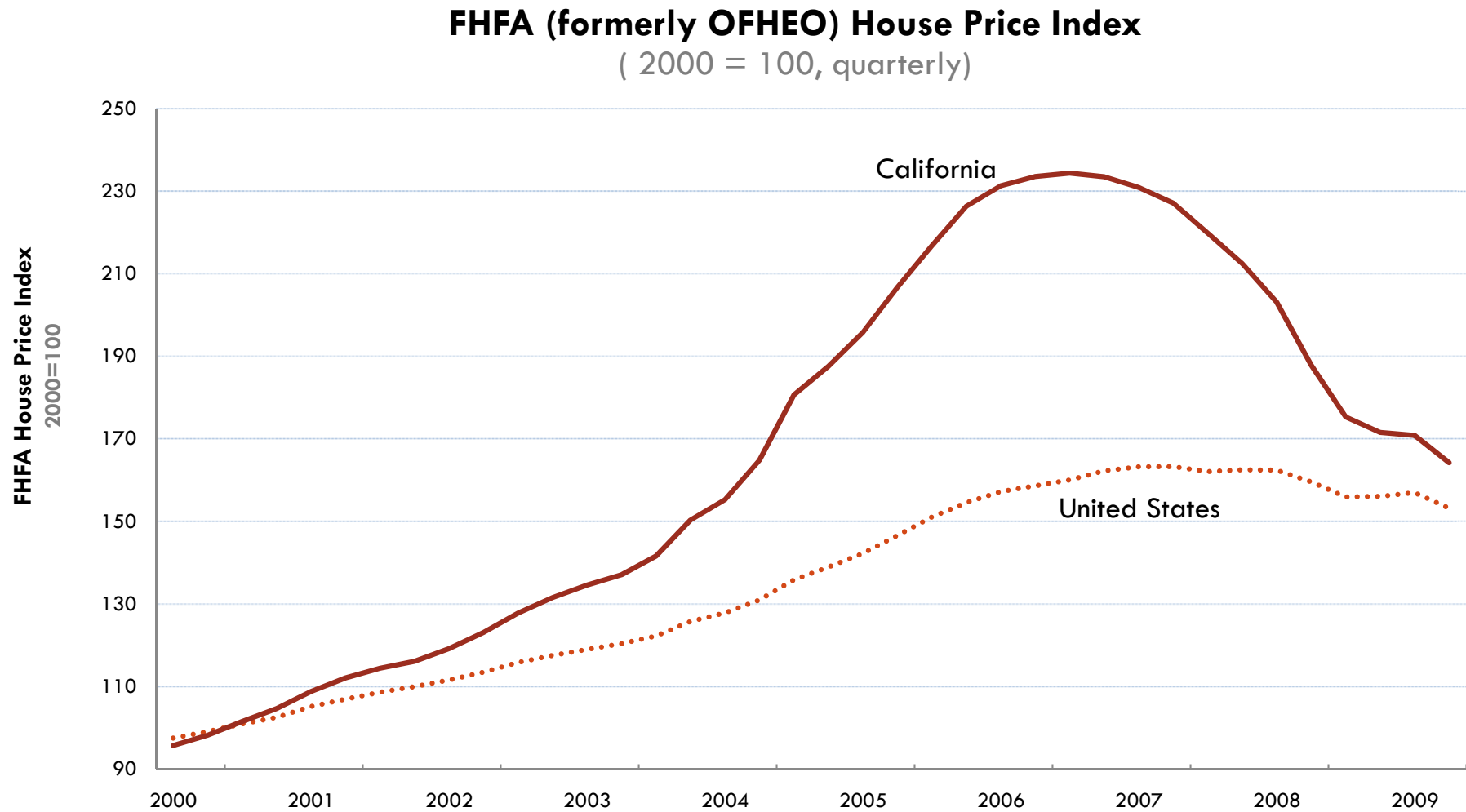
Incidence of High Cost Lending Among Minority Borrowers

California: High Cost Conventional Loans by Race, 2005



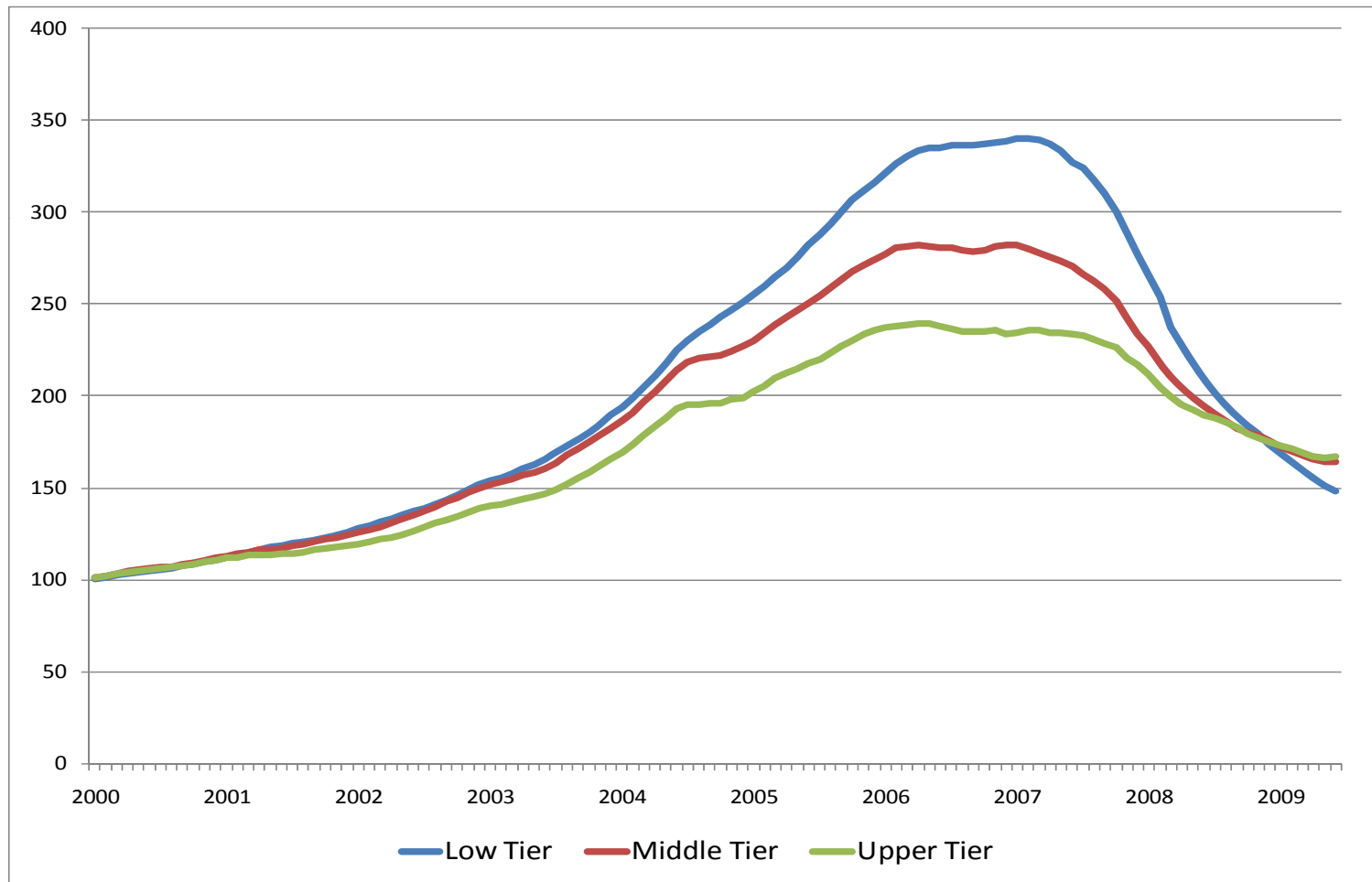
Source: Home Mortgage Disclosure Act Data, 2005

Steep Declines in House Values



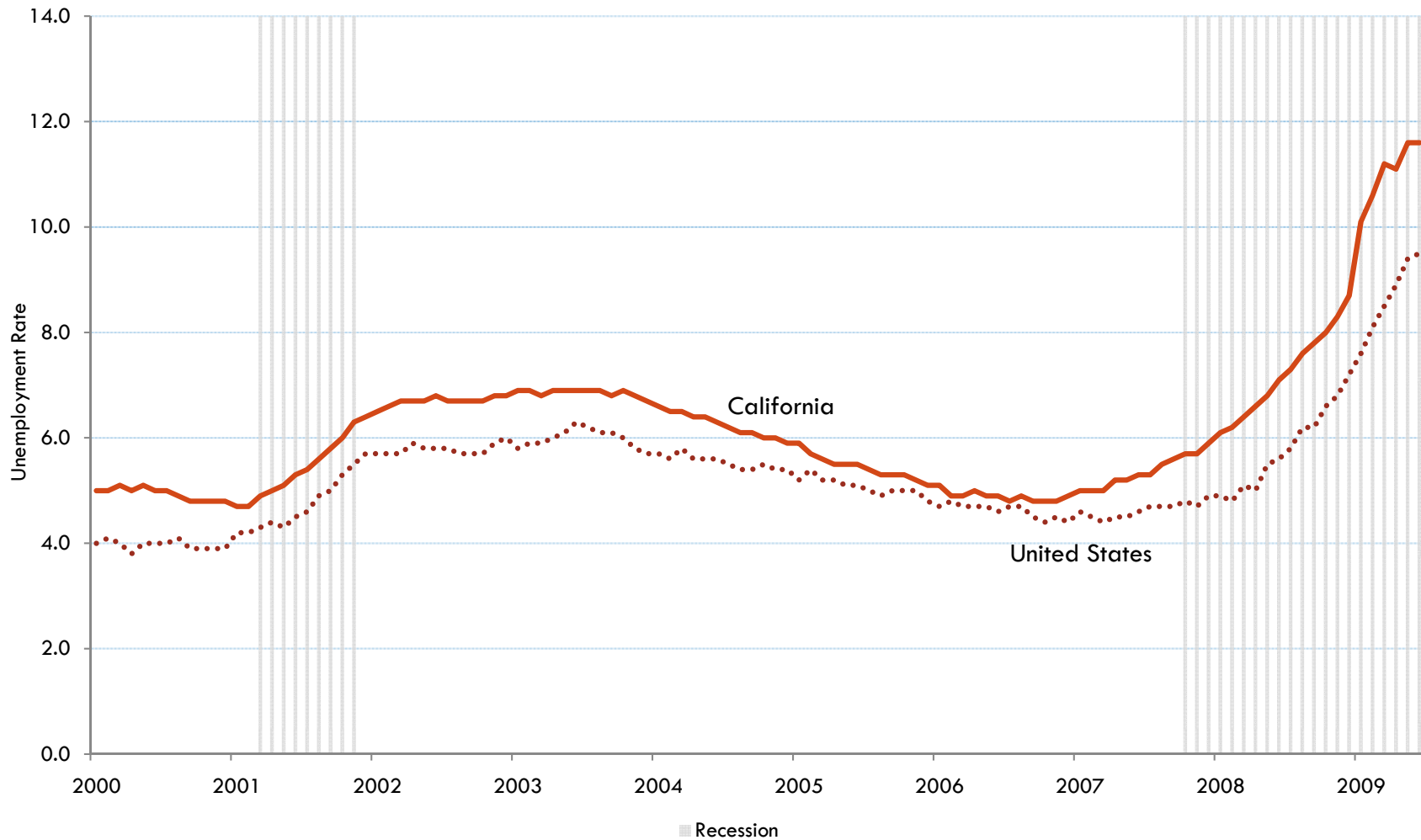
Source: Federal Housing Finance Agency (formerly OFHEO)

Price Swings Have Been Most Dramatic for Lower-Priced Properties



Source: Case - Shiller Home Price Index

Unemployment Rate has Risen Steeply, Affecting Service, Construction and Manufacturing Sectors



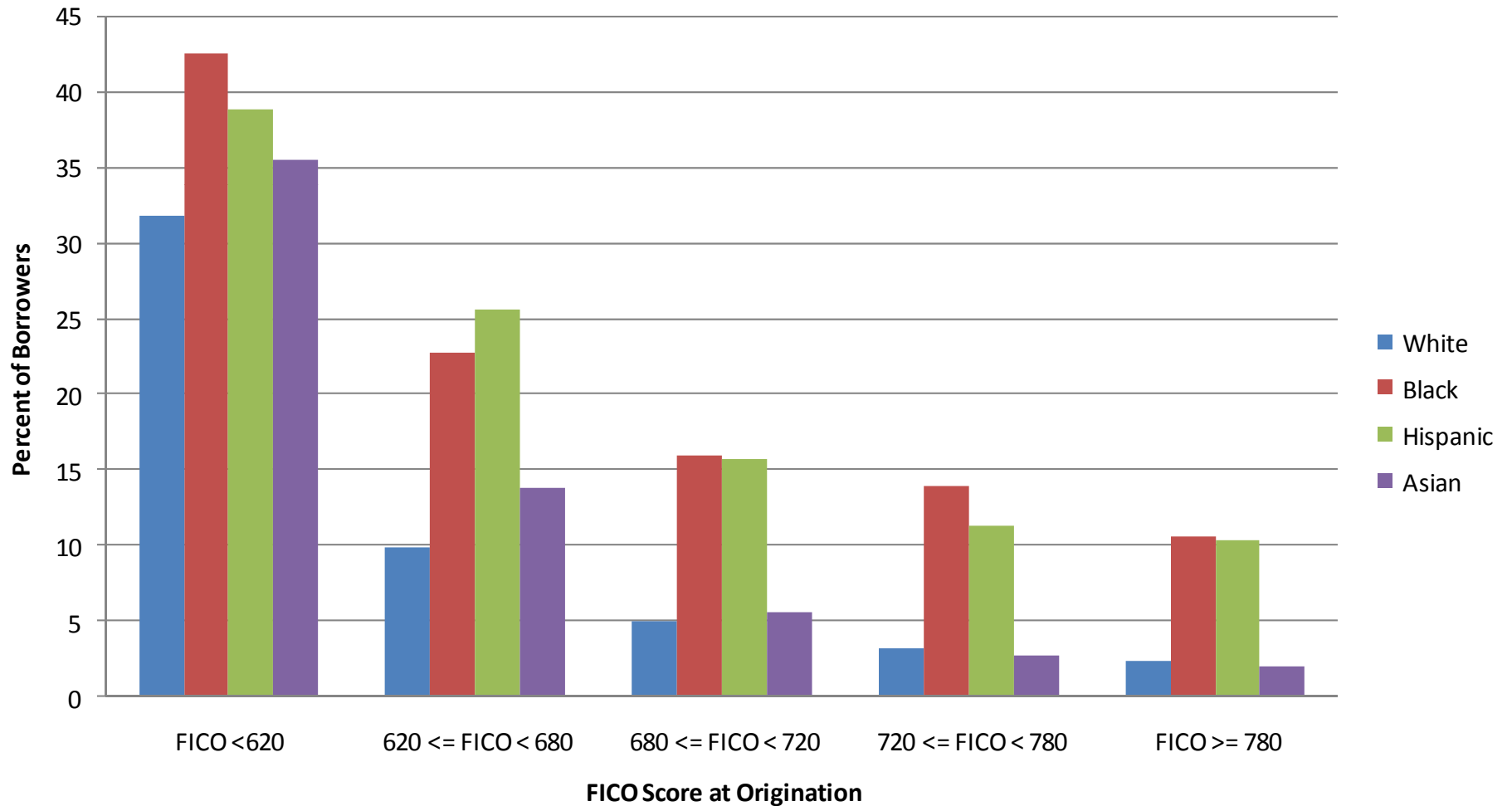
Source: Bureau of Labor Statistics

What Has Been the Impact of Foreclosures on Lower-Income and Minority Communities?

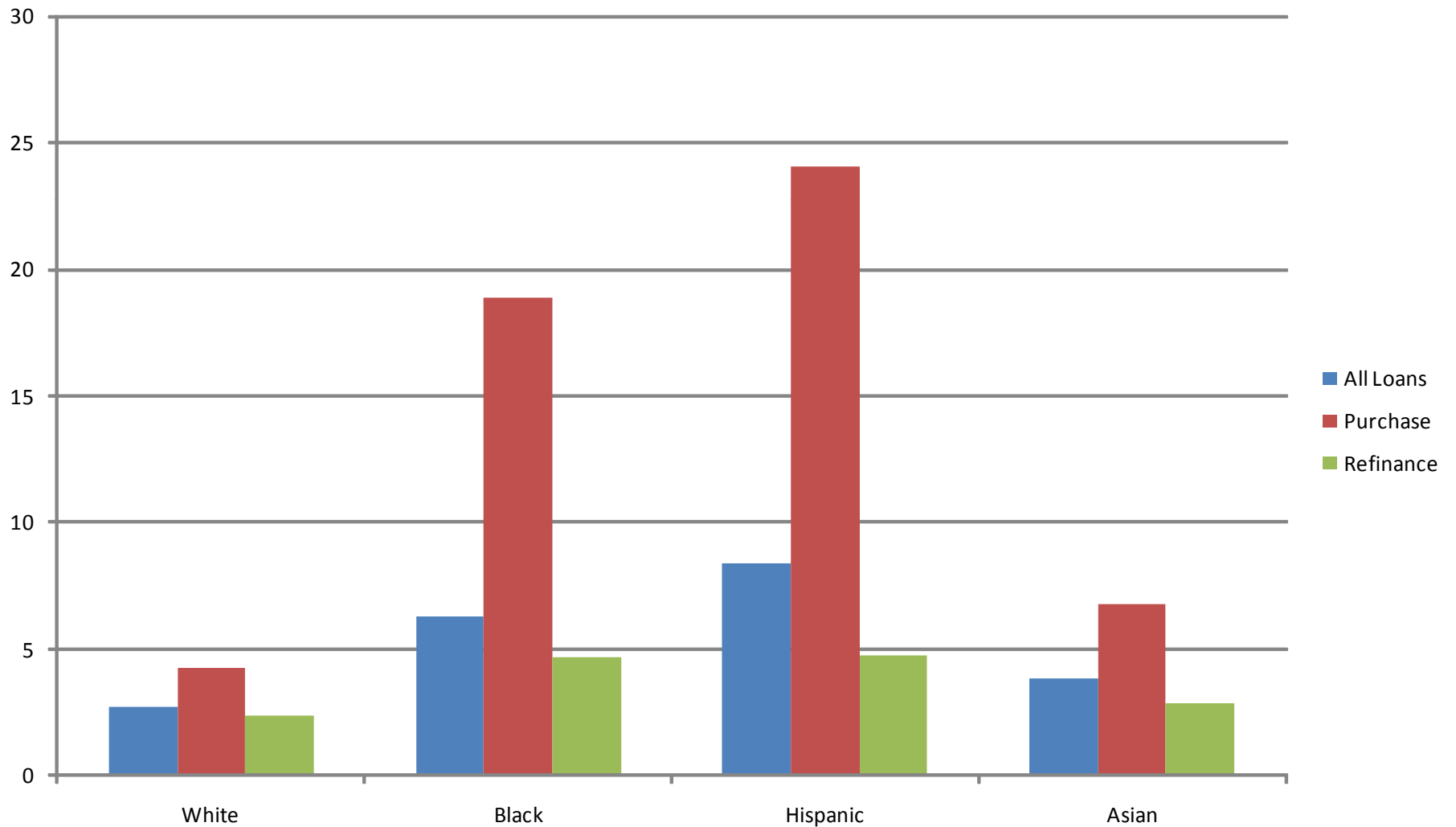


- Not an easy question to answer, since loan performance data do not include information on race
- Critical question for public policy and consumer protection
 - Did minority households receive a disproportionate share of higher-priced loans, or were they appropriately priced given higher default risks?
 - Is lending to lower-income households inherently unsustainable?
 - Institution specific or mortgage market system?
 - Long-term implications for financial stability and wealth

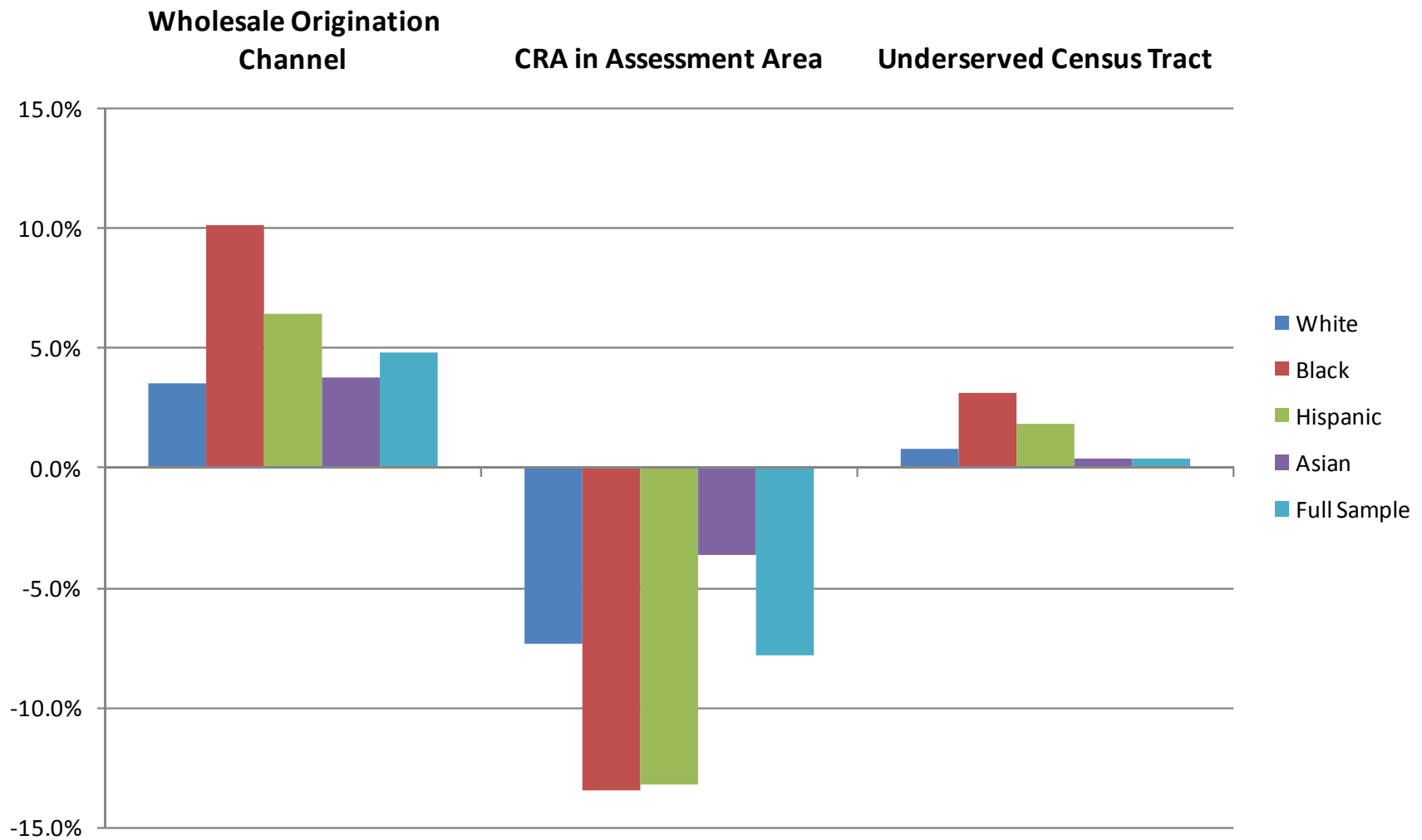
Minorities More Likely to get a High Cost Loan, Even After Controlling for Borrower Risk Characteristics



Foreclosure Rates in California by Race/Ethnicity



The Important of Mortgage Market Channel and Relationship to Financial Institutions



Key Findings

- African Americans and Latinos in California had access to very different mortgage markets
 - Geographic distance doesn't seem to be defining feature: even in relatively small area like Oakland, minorities were more likely to get high-cost loan from independent mortgage company
- This differential access led to very different mortgage product choices, even after controlling for borrower credit risk profiles
- Foreclosure crisis has hit minority households much harder, with significant implications for minority wealth
 - Majority of households earned between \$60,000 and \$120,000 – “middle” class
- Much of this differential foreclosure rate can be explained by mortgage product choice
 - Once we control for likelihood of receiving high-cost loan, differences in foreclosure rate largely disappears

Policy Implications

- Findings support the need to reevaluate the regulatory landscape to ensure access to “responsible” credit
 - Consider extending supervisory regime to non-regulated financial institutions
 - Examine “systems”, not just institutions
- “Product” matters
- Prudent underwriting clearly matters
 - Close the gap in credit risk between minorities and whites
 - Expand supply of affordable homeownership opportunities, particularly for historically disadvantaged groups
- “Local” matters
 - Link disconnected actors, fill information gaps, provide reputational controls, shape preferences
 - Mediating institutions (e.g. nonprofits) may be an important way of ensuring that both borrowers and lenders make the right credit decisions