Mortgage lending in Middle America: Subprime and predatory lending

by

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CHAPTER 1. GENERAL INTRODUCTION

Background

Over the past decade there has been significant progress in expanding borrowers' access to capital for homeownership and other activities. "However, gains have been offset by an increase in predatory lending practices, particularly in the home mortgage market" (Knowledgeplex). Predatory lending has become a serious problem for many homeowners and potential homeowners in the United States. As the name suggests predatory lending preys on those considered to be weak. According to Davis (2000), predatory lending is a combination of unfair or abusive loan terms, unscrupulous and misleading marketing, and high pressure lending tactics that limit information or choices available to a consumer.

Predatory lenders promise lower monthly payments as a way out of debt. These lenders seem to maximize the advantages and minimize the disadvantages. "Worse yet, the homeowners will be entering a system that promotes a cycle of debt that has been compared to sharecropping, an economic system that is unequal and unfair" (Bradley & Skillern, 2000, p. 3). The positives are accentuated because it is a win-win situation for the lenders. When the borrower makes the monthly mortgage payment a profit is made. Also, if the borrower cannot make the monthly payments then the lender can foreclose, sell the house, and make an even larger profit. The borrower loses money, equity in the home, and ultimately he/she can lose the home.

Predatory lending is known as reverse redlining (Reverse redlining, 1993). Redlining refers to a practice in which the extension of credit is limited in targeted areas usually minority or low-income neighborhoods. Reverse redlining refers to specifically targeting those neighborhoods to extend loans with predatory characteristics.

Predatory lending is sometimes used synonymously with subprime lending. However, all subprime lending is not predatory lending. In the past several years mortgage lenders have been originating what has become known as subprime loans. Subprime lending extends credit to borrowers who exhibit characteristics indicating a significant higher risk of default than conventional borrowers. As such subprime lending is linked to the credit status of the borrowers. These borrowers have had some credit problems such as late payments on bills, charge-offs, and bankruptcies (Rizer, 2001).

Subprime customers typically are referred to as "B/C" credit customers as distinguished from "A," or "prime," customers who have excellent credit histories. However, subprime loans are often given to borrowers with good credit. Citizens for Community Improvement (CCI) of Des Moines found that 63% of the subprime loans are made to people eligible for prime loans. This is unethical and is considered to be a predatory practice (CRA-NC).

Subprime lending is a very vital part of the economy. Subprime lenders provide loans to borrowers who do not meet the standards, which would make them "prime" borrowers. "Fair subprime lenders make loans that are appropriately priced to compensate for the risk of lending to a credit-blemished borrower" (Citibank). Although these borrowers are charged more than prime borrowers they are not victims of the abusive practices that define predatory lending.

The subprime market has grown dramatically. The market growth occurred between 1993 and 1998 (Housing Ohio). There was an explosion of loans combined with the nearly hyper-segmentation of mortgage lending markets by race and neighborhood, which created opportunities for abuse. This two-tier system has increased the opportunity for abuses within the market, especially targeting the less sophisticated homeowners.

According to the Woodstock Institute (1999) there are several reasons for growth of subprime and predatory lending:

- Increase in homeownership among less experienced, less sophisticated homeowners,
- Increase in medical and credit card debt, growth of securitization and increase in supply of capital,
- Use of information technology to target vulnerable homeowners, including those with equity in homes and unsecured debt,
- Minimal regulation of mortgage and finance companies, and
- Weak community reinvestment activities and less attention to fair lending in refinance and home equity lending.

Targeted populations consist primarily of elderly, minority, women and/or low-to-moderate income homeowners. These households are targeted because the access to conventional loans and other financial services is severely disproportionate. It has been suggested that elderly populations are usually equity rich and cash poor (Quercia & Rohe, 1992). Also, their homes may be in need of expensive repairs (often roofing work) or they may have fallen behind on their property taxes, incurred substantial medical bills, or suffered a loss of income after the death of a spouse (Jesuit Social and International Ministries, 2000).

In minority and low-income neighborhoods home equity comprises over 60% of the net worth (The case against predatory lending, URL). Low and moderate-income homeowners are targeted because they appear to have a higher risk of default. This wealth-stripping impact of predatory lending is harmful given the already existing wealth gap between whites and non-whites. According to the US Census Bureau, the median black

(African-American) or Hispanic household has one-seventh of the net worth of non-Hispanic white household (Knowledgeplex, URL). "A 1998 Federal Reserve survey of consumer finance found that white renters had a median income of $22,000, while African-American renters earned $13,000 and Hispanic renters earned $19,000. White renters had net-wealth of $5,800 three and a half times the net wealth of the amount of African-American renters ($1,661) and three times the amount for Hispanic renters ($2,000)" (National Housing Conference, 2001).

Predatory lending needs to be explored, explained, and understood for many reasons. These practices raise serious issues about community reinvestment, fair housing, and fair lending concerns, largely because banks and their mortgage and /or finance company subsidiaries appear to be representing the market and targeting minority communities for higher priced, lower quality products (Housing Ohio, URL).

Predatory lending violates the Fair Housing Act of 1968 and the Equal Credit Opportunity Act of 1972. The Fair Housing Act of 1968 " requires equal treatment in terms and conditions of housing opportunities and credit regardless of race, religion, color, national origin, family status, or disability" (Bradley & Skillern, 2000, p. 5). The Act has been amended to include sex. The Equal Credit Opportunity Act of 1972 requires equal treatment in loan terms and availability of credit for all the previously listed categories as well as age, sex, and marital status (Bradley & Skillern, 2000). Specifically targeting minority and elderly communities is a violation of their protected class status.

"Predatory and abusive practices by mortgage lenders and brokers, which impose excessive and unreasonable charges on homeowners, are pervasive and cause serious harm. The American dream of homeownership is jeopardized or denied by these pernicious practices" (Sturdevant & Brennan, 2000, p. 1). The practices undermine the stability of the neighborhoods where the loans are made. A major effect of predatory lending is rapid turnover of property and ultimately an increase in vacant housing structures. This affects property values, which strips wealth from communities that can least afford to lose it (Davis, 2000). Vacant places become public nuisances as they become places where children play, squatters inhibit, and particularly places where criminal activity takes place. Predatory lenders abuse families until they can no longer meet their housing expenses. Predatory lending also leads to a high volume of foreclosures, which are costly to the holder of the mortgage. Each time a foreclosure takes place a family is displaced.

Nationally the practice of subprime lending has grown exponentially over the past several years. The Woodstock Institute (1999) reported that from 1993 to 1998, in the United States, home purchase loans by subprime lenders grew 760%. Prime lending grew only 38%. This same study also reported that refinance loans by subprime lenders grew by 890% and prime lending by only 2.5%. From 1993-1998, 80% of subprime lending was comprised of refinance and equity loan. Families and /or individuals become homeowners as an expression of independence and to build wealth. In 1993, only 100,000 home purchase or refinance loans were brokered in the subprime market; by 1999 that number jumped to nearly 1 million loans (US HUD, 2000).

Subprime lending, locally, is just as popular as the nationally expressed statistics. According to CCI, subprime lending is a growing problem in Des Moines, Iowa. From 1993 to 1998, the number of subprime loans grew from 67 to 1,678. The increase in subprime lending in Des Moines from .9% to 20.8% of all loans is astronomical. The state also saw an increase, from 1994 to 1999, in the percentage of Iowa loans that are subprime from 5.8% to 17.73%.

Recent changes in the Fair Credit Reporting Act (FCRA) have been linked to the explosion in direct mail advertising and telemarketing by home equity lenders. The FCRA (public law 91-508) was enacted to ensure that credit-reporting agencies provide creditors with accurate, up-to-date information regarding one's credit history, and to ensure that this information is used only for permissible purposes. Credit covered by the FCRA includes personal, family, credit, household credit, and insurance. Identity, employment, credit history, and public record information are included as well.

The FCRA sets forth legal standards governing the collection, use, and communication of credit data and certain other information about consumers (Federal Trade Commission, 2000). According to Manhattan legal resources, the FCRA allows a consumer to challenge the information on his/her credit report on the basis of "completeness and accuracy" (Manhattan Legal Resources, URL).

In 1996, changes made under the act allowed lenders to offer pre-approved loans to lists of prospective customers obtained from credit bureaus (The case against predatory lending, URL). Many organizations researching predatory lending make statements about aggressive marketing and advertisement techniques, but no formal research has been found.

The general purpose of this dissertation is to determine the prevalence and impact of subprime and predatory lending in the Midwestern city of Des Moines, Iowa. Lending patterns and marketing strategies, will also be examined. This area has been unexplored or underreported in literature on predatory lending. In this research, the strategies that encouraged households to become victims of predatory lenders will be studied. One of the objectives of this study is to determine the marketing techniques employed by predatory lenders. Another objective is to examine the characteristics of victims of predatory loans and of borrowers with subprime loans.

Dissertation Organization

The organization of this dissertation will proceed as follows: literature review, the first article, the second article, and a general conclusion. Because many journals do not encourage in-depth literature review sections within journal papers, a literature review is being included as a separate chapter. The literature review also will include an overview of the general systems theory and conflict theory.

This dissertation is composed of two manuscripts, prepared for submission to scholarly journals. The two manuscripts relate broadly to discrimination in mortgage lending and more specifically to subprime and predatory lending. The first article is quantitative in nature and is centered around the Home Mortgage Disclosure Act (HMDA) data for the city of Des Moines, Iowa. The second article is a qualitative study using data from Citizens for Community Improvement of Des Moines, Iowa (CCI) and the Iowa Attorney General's office.

The first article discusses subprime lending in the city of Des Moines using HMDA data. The data identify areas of subprime lending and the probability of reverse redlining based on census tracts of the city. Demographic characteristics of the tracts that would indicate reverse redlining, such as the median household income and minority population percentage, are studied in relation to the lending patterns.

The second article discusses predatory lending and discriminatory marketing techniques utilized in the city of Des Moines, Iowa. Data are generated using interviews conducted by CCI for the *CCI/ Fannie Mae Anti-Predatory Lending Initiative.* Also included in this article is the impact of contract sales, with information from the Attorney General's office. Each article contributes to the body of research concerning mortgage-lending discrimination.

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CHAPTER 2. LITERATURE REVIEW

"In the United States today, one-half of all homeowners hold at least 50% of their net worth in home equity" (The case against predatory lending, URL). This equity is used in many ways, such as to start a business or to help with the cost of a child's education. The home equity market has doubled in size since 1990 and currently has an annual growth rate of 18.8% compared with 4.3% for total consumer debt and 7.5% for total residential mortgage debt.

Predatory lending is a hot topic locally and nationally. With little or no information and understanding, or the ability or desire to compare prices, borrowers often rely on the information supplied by a mortgage broker. Subprime borrowers pay higher rates and fees, and they are much more likely to be victims of predatory lending practices, which, as stated previously, strip them of the equity in their homes and can lead to foreclosure (Business Wire, 2000).

Minority and elderly households have experienced most of the increase in subprime and predatory lending. Subprime lenders now account for half, 51%, of all refinance loans made in predominately black neighborhoods, compared to just 9% of the refinance loans made in predominately white neighborhoods (US HUD, 2000). "Studies across the country show that Blacks proportionately apply for fewer loans than Whites, yet are rejected more often" (Williams & Nesiba, 1997).

The Rural Housing Institute of Iowa (RHI, 2002) conducted a study on fair lending in Iowa, using one metropolitan county and six rural counties. The study used several secondary data sources: grantee/grantor index reports, which included a list of all mortgage records file in a particular county; Home Mortgage Disclosure Act/ Loan Application Registers

(HMDA/LAR) which listed the type and purpose of each application, amount of loan applied for, race of applicant and co-applicant, income of applicant, and final disposition of application separated by state, county, and census tract; the FDIC deposit summaries by county; community reinvestment act performance evaluation; department of transportation lien records; local newspaper legal listings of foreclosure; declarations of value report (DOV); land contracts, and the US Census. RHI's findings are consistent with those of other studies.

The study showed that the amount of subprime lending that has taken place in Iowa has increased in urban and rural Iowa since 1993. It also found that low-to moderate-income and minority borrowers were more likely to enter into subprime loans than other borrowers. Also, subprime lenders were more likely to make refinance loans than home purchase loans. The study did, however, find that subprime lending has not infiltrated the most rural counties as deeply as expected (RHI, 2002). This statement is based on their belief that current data often exaggerate the presence of subprime lenders in nonmetropolitan counties.

Discrimination

Discrimination seems to manifest itself in many ways and in numerous markets. According to Holmes and Horvitz (1997), racial discrimination in mortgage lending can take and has taken many different forms. Courchane, Nebhut, and Nickerson (2002) stated that some of these forms include uneven treatment by brokers, pre-application screening, unfair application and credit standards in the loan approval process, differing levels of assistance provided during the application process, discriminatory pricing practices, and overt bigotry.

It has been argued that one cause of unequal and segregated housing is mortgage lending practices. In the 1960's the Kerner Commission reported that the nation was moving in two directions: one direction was African-American and poor and the other was White and affluent. Housing discrimination is known to influence many housing outcomes and life chances (Yinger, 1998). Yinger (1998) reported that discrimination constrains the opportunity to go to good schools, to find jobs, and to accumulate home equity, thus providing a rationale for the title of his article: Housing discrimination is still worth worrying about.

In 1989 large disparities in mortgage lending between minority and nonminority neighborhoods refocused attention on possible racial discrimination in the home loan market (Schill & Wachter, 1993). It has been noted (through housing audits) that sellers and real estate agents discriminate against minority home buyers (Turner, 1992). Racial disparity in homeownership can be attributed directly to discriminatory practices. Three cities in 1988 and 1989 (Baltimore, Boston, and Chicago) revealed geographic racial and ethnic disparities congruent with home loan discrimination.

A study by Munnell, Browne, McEneaney, and Tootell (1992) found that Blacks and Hispanics were 60% more likely than Whites of identical characteristics to be refused a mortgage loan after controlling for all variables that underwriters take into account in approving or denying loan applications. A study by the Urban Institute in conjunction with Syracuse University researched 3,800 realty offices located in 25 cities to explore housing discrimination (Urban Institute, 1989). It was found that Blacks experience a 56% rate of discrimination in rental units and a 59% rate in home purchases, and that 60-90% of the housing units shown to Whites were not available to Blacks.

The Urban Institute performed another study of discriminatory housing practices in 25 metropolitan areas in 1990. The study found that African-Americans and Latinos experienced discriminatory practices 55-56% of the time, respectively in the area of housing sales market (Nyden, Maly, & Lukehart, 1997). Another finding of the study revealed "minorities were frequently steered to different neighborhoods, told units they wanted to see were not available, or given less information than White's sources of financing" (Galster, 1990; Nyden, Maly, & Lukehart, 1997, p. 495).

The Federal Reserve Bank of Boston stated that for the same flaws, Whites seem to enjoy a presumption of credit worthiness that other minority applicants do not and that lenders seem to be more willing to overlook those imperfections for White applicants than for minority applicants (Walters, 1996). Ironically, a survey of 1,521 households by the National Mortgage Association reported that 87% of the Whites (opposed to 33% of the minorities) believe that minority purchasers have the same chance they have of getting a home that they can afford (Walters, 1996).

Ondrich, Ross, and Yinger (2001) used audit data to examine how discriminatory behavior varied with location across Atlanta, Chicago, Los Angeles, and New York. The purpose was to gain a better understanding of how housing discrimination occurred. They hypothesized that real estate agencies may discriminate to protect their business with prejudice White customers. The authors found that discrimination tends to decrease as one moves farther away from the real estate agent's office, thus supporting their hypothesis.

Massey and Lundy (2001) supervised students in an undergraduate research methods class to examine if speech patterns are used in housing discrimination. They hypothesized that speech patterns offer real estate agencies the opportunity to discriminate over the phone. The speech patterns were categorized into three parts: Black English Vernacular, Black Accented English, and White Middle Class English. Students in the class collaborated with the authors to design an instrument for use in the telephone audit study. The study was conducted, over a four-week period, in the metro area of Philadelphia in the Spring of 1999. They developed a script to be followed and created a common set of profiles that were assigned to each auditor (male/female). To carry out a more rigorous test of the hypothesis, logistic regression was used to predict whether the auditor spoke to an agent, whether a unit was reported as available, whether the auditor ultimately granted access to information about the unit, and, if so, whether the application fees were required and credit worthiness was mentioned as an issue (Massey & Lundy, 2001). It was found that female speakers of Black English Vernacular fared the worst. They experienced the lowest possibility of making contact and of being told of a unit's availability. On average they were assessed $32 more per application than White middle-class males.

Disparate Treatment and Impact

There are two types of mortgage discrimination: disparate treatment and disparate impact. Disparate treatment occurs when a housing provider treats a member of a protected class different from other persons. This type of discrimination is detected easily because it typically involves intentional acts of discrimination. Evidence of the motive may be direct, such as open hostility, or circumstantial.

Courchane, Nebhut, and Nickerson (2000) addressed disparate treatment of loan applications by analyzing data collected in fair lending examinations between 1994 and mid-1999. Statistical modeling has been emphasized and utilized in the analysis of fair lending issues. The fair lending examination conducted most frequently with statistical methods was meant to determine whether there was a reasonable cause to believe disparate treatment resulted from the acceptance or rejection for home mortgage loans (Courchane, Nebhut, &

Nickerson, 2000). In this study, statistical analysis was used to determine if underwriting guidelines were applied consistently for all applicants. "The Department of Justice has recognized statistical modeling as a valid tool for discovery of disparate treatment in the credit-granting process" (Courchane, Nebhut, & Nickerson, 2000 p. 278). It was found that statistical analysis could be useful when identifying patterns of discrimination and that custom modeling is most effective when used to identify discrimination.

Disparate impact as a rule or regulation may be neutral on its face, but nonetheless have a discriminatory impact on a protected class. Disparate impact is the disproportionate effect of higher denial rates (or pricing effects) that any underwriting system likely has and is a consequence of statistical group disparities in wealth, income, and other factors affecting the group distributions of mortgage applicant's collateral, capacity, and credit (Straka, 2000). Disparate impact is not intentional and generally involves policies or laws that cause harm to members of a protected class. It can be subtle and even unconscious, but when a significant statistical effect is found to be disfavorable to those protected by law, the result is discriminatory. A business necessity must be presented as justification.

The potential misuse of credit scores is an example of disparate impact. It has not been shown that the scores or process is discriminatory, but rather how the information is used. "Prevention of misuse in scoring requires strong industry communication, education, and system design" (Straka, 2000). Straka (2000) also argued that giving too much latitude to subjective judgments could bring improper interpretations.

Holloway & Wyly (2001) contend that both forms of discrimination are geographically contingent, that is, that the treatment of minority applicants depends on where the property is located, and that the impacts of lending institutions' actions are variable geographically in many ways that differently affect applicants of various racial and ethnic groups.

Racial Segregation and Disparity

"Residential segregation is a key contemporary institution for creating and maintaining inequality, not only for individuals and racial groups, but also for neighborhoods and entire municipalities" (Orfield, 1985, p. 161). It is a major influence in abetting residential segregation by race (Galster, 1991). Farley and Frey (1994) suggested four practices that exacerbate segregation: (1) discriminatory mortgage lending policies, (2) violence and intimidation in the face of African-Americans who seek housing in White areas, (3) the development of strategies for keeping African-Americans out, and (4) the encouragement of segregation in many cities by federally sponsored public housing. These practices create racial segregation (as well as class segregation). "Overall, residential racial segregation declined very little in most established metropolitan statistical areas (MSA) over the 1960's, but did decline in most MSA's (90 percent) over the 1970's, a decade of rapid black suburbanisation" (MacDonald, 1998). MacDonald (1998) continued, stating that the decline in segregation continued in the 1980's but at a slower rate than that of the 1970's.

One of the most influential analyses of racial disparities in mortgage lending was the *Color of Money* (Holloway and Wyly, 2001). In 1988 the Atlanta Journal-Constitution published a four-part series of articles reporting problems in mortgage credit in African-American neighborhoods in Atlanta. Following the articles, steps were taken to restrict discriminatory lending practices. Some of the steps included "substantial restructuring of the mortgage lending industry and regulatory changes that resulted in increased lending to minorities and some optimism for declining discrimination" (Holloway & Wyly, 2001, p. 85).

In another study, the National Training and Information Center (NTIC) analyzed lending disparities (race/income) between borrowers receiving *Citigroup* mortgage loans. Redlining has been renewed through the abundance of subprime lending affiliates and the limited number of prime affiliates. "While communities throughout the 48 states only have access to subprime loans originated at *Citifinancial* branches, only nine metropolitan areas have access to prime loans through *Citibank* branches" (National Training and Information Center, 2001, p. 56).

Using HMDA, NTIC analyzed *Citigroup* on a national and citywide level including eleven cities, two New York boroughs, and five metropolitan statistical areas in Central Illinois. The study reported three major trends: (1) nationally 74.1% of *Citigroup's* home loans were originated by financial institutions that originate subprime loans exclusively; (2) nationally, as a borrower's income increases so does the likelihood of receiving a *prime Citigroup* home loan; and (3) nationally, African-Americans are more likely to receive a subprime loan from *Citigroup* than are White applicants (African-American: 7.4, Latino: 2.5, and White: 2.0) (National Training and Information Center, 2001).

Redlining and Reverse Redlining

During the 1970's, lending institutions were commonly accused of redlining – intentionally withholding funds from areas on the basis of racial and ethnic makeup (Perle, Lynch, & Horner, 1993). Lending institutions refused to lend money in the area (presumably) by drawing a red pencil line around the area on a map (Morris & Winter, 1978). In the 1960's and 1970's, when redlining first surfaced it was not exclusively a racial issue. It was known in mostly older, primarily White neighborhoods of Chicago, Baltimore, and other larger cities (Holmes & Horvitz, 1997, p. 51).

Redlining affects all members of a community regardless of race. It can lead to deterioration of living conditions, which is a direct result of disinvestments in neighborhoods. "Yet the preponderance of African-American residents in many such areas usually means that the policy in effect becomes one of racial discrimination" (Forman, 1971, p. 68).

The two most widely publicized responses to redlining in mortgage lending were the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA). "The CRA and HMDA are both the result and the vehicle of community-based efforts to combat redlining and other discriminatory bank lending practices" (Schwartz, 1998, p. 270). HMDA was enacted in 1975 and required lenders provide information about location (by census tract) of loan origination (Yinger, 1995). In 1989 revisions were made to HMDA requiring lenders to provide additional information for each individual application (Ladd, 1998). The new variables include loan guarantee (conventional, FHA, or VA), purpose of loan (purchase, improvement, refinancing), loan amount, date of application, loan disposition (approved, approved but withdrawn, no lender action taken, or denied), race, census tract, gender, if property is owner-occupied, and applicant income.

The conclusion of many studies using HMDA data indicate that redlining has been practiced in numerous places (Holmes & Horvitz, 1997). HMDA has "consistently revealed disparities in mortgage credit flaws by neighborhood racial, ethnic, and income characteristic… and data have pointed to glaring disparities in mortgage application rejection rates by the applicant's race, income, and neighborhood choice" (Carr & Megbolugbe, 1993, p. 1).

"In January 2002 the Federal Reserve Board announced changes in Regulation C, which implements HMDA" (Center for Community Change, URL). The two changes receiving the most attention are (1) lenders must designate which of the loans they originate are high cost loans and (2) lenders will be required to supply information regarding information about the pricing of some loans. Other changes include: indication of which applications are for manufactured homes, requirement of reporting denials under "covered" pre-approval programs for home purchase loans and the new rule allows an applicant to report more than one race.

Munnell, Tootell, Browne, and McEneaney (1996) used HMDA (for Boston) to determine whether race played an independent role in the mortgage lending decision. This study found that minority applicants have less wealth, weak credit histories and high loan to value ratios than White applicants do, and that these disadvantages account for a large portion of the differences in denial rates. White applicants with the same property and personal characteristics as minorities have a rejection rate of 20% compared to the minority rate of 28%.

The Community Reinvestment Act (Title VIII of the Housing and Community Development Act) was enacted in 1977. "Passage of CRA made it clear that banks had a positive obligation to serve all parts of their market area, and could not distinguish on the basis of the racial composition of the neighborhood" (Holmes & Horvitz, 1997, p. 52). Assessment factors for determining CRA compliance fall under five categories: ascertainment of community credit needs, marketing and types of credit offered and extended, geographic distribution of applications and loans and opening and closing of offices, discrimination and other illegal activities, and community development (Yinger, 1995). If CRA obligations are not met the financial institution will be denied federal approval of their applications. Community activists use the CRA challenge process to organize and educate members of the community around credit and reinvestment issues (Bohner, 1995).

A study by Shlay (1999) suggested that local organizing provides the impetus for the establishment of a national political climate favorable to serious CRA enforcement. Shlay (1999) use a longitudinal and comparative research design to examine the impact of CRA organizing on local lending by comparing lending activities among cities that varied in levels of CRA organizing activities. Six cities between 1990 and 1995 were used to compare residential lending patterns. Of the six cities, three had high levels and three had low levels of community organizing around CRA. It was found that all of the cities and lenders revealed lending patterns in the direction of more responsible lending to minority and lower-income communities (Shlay, 1999).

Reverse redlining takes place most often in communities where predatory lenders face no competition. They purposely take advantage of residents by pushing high cost loans, soliciting aggressively over the phone, through the mail, or face-to-face interaction. Many reverse redlining loans are so bad that the recipients would be better off not receiving a loan at all (Reverse redlining, 1993).

Reverse redlining was recognized legally as a form of predatory lending in The Associates Home Equity v. Troupe, A-3410-00 case (Gallagher, 2001). The Troupes, a 75-year-old African–American woman and her son, showed that Home Equity Associates violated their civil rights. It was proven that the terms of their loan were not justified by their credit history and debt-to-income ratio.

Government Sponsored Enterprises (GSEs)

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are congressionally chartered, private, shareholder-owned corporations that have been regulated by HUD since 1968 and 1989, respectively. These Government-Sponsored Enterprises (GSE) fund residential mortgages by purchasing loans directly from primary market mortgage originators, such as mortgage bankers and depository institutions, and holding these loans in portfolio or by issuing mortgage-backed securities which are sold to a wide variety of investors in the capital markets. The Congressional charter requires the corporations to achieve public purposes that include providing stability and liquidity in the secondary mortgage market, providing secondary market assistance relating to mortgages for low-and moderate-income families, and promoting access to mortgage credit throughout the Nation, including underserved areas (US HUD, 2002).

"Subprime lending grew in the 1990's largely without the assistance of Fannie Mae and Freddie Mac (US HUD, 2002, p. 1). These agencies purchased only about 14% of subprime loans, but plans have been made to increase their purchases in the very near future. This idea has been met with some scrutiny. The GSEs believe they can aid in making subprime loans more efficient and creating standardized underwriting and pricing guidelines in the subprime market (US HUD, 2002). Opponents believe that allowing GSEs to purchase more loans is unfair. They anticipate that this will cause a detrimental effect on several subprime mortgage market participants and ultimately drive them out of business.

US HUD (2002) spoke with seven leading company representatives and interviewed eleven representatives of organizations "to provide the United States Department of Housing and Urban Development with a preliminary picture of the potential effects of a larger GSE role in the subprime markets and suggest an oversight and monitoring strategy that is appropriate given HUD's regulatory responsibility and its encouragement of a larger GSE role in the subprime market" (p. 2).

By participating more in the subprime market the GSE could increase the financial obligations and meet the expectations of their investors. It was also reported that borrowers of subprime loans originated by Fannie Mae are charged lower interest rates (and points and fees) than those subprime loans originated elsewhere.

Most respondents agreed to an increase in the role of GSEs. They did request that there be guidelines to prevent the purchasing of loans with predatory features. Five areas of concern outlined from the interviews were as follows: interest rates offered, standardization of mortgage products, available liquidity, incidence of predatory lending, and risk to the GSEs.

Advantages of Subprime Lending

Subprime lenders originate loans to individuals who require personalized manual underwriting. Based on this process borrowers who are more creditworthy than those with lower credit scores are identified and given appropriate prices for loans (US HUD, 2002). "Good subprime lenders are able to judge and price risks accurately according to standards different from those used in the prime market, and serve customers who would not be eligible for "A" credit" (US HUD, 2002, p. viii). Subprime lending has provided lending opportunities to a multitude of low-and moderate-income and minority borrowers who a decade earlier, might not have qualified (Gale, 2001).

"The growth of subprime lending has benefited credit-impaired borrowers, those who may have blemished in their credit records, insufficient credit history, or nontraditional credit scores" (Bradford, 2002 p.1). Legitimate subprime lending serves a very useful and necessary function (National Housing Conference, 2001). "Clearly the increased availability of credit for riskier borrowers has played an important role in increasing access to homeownership opportunities" (National Housing Conference, 2001, p.5).

Minority and Low-Income Homeowners

ACORN (2000) released a study analyzing 1999 home mortgage lending data, which found that minority and lower income borrowers are much more likely to receive a higher-cost subprime mortgage when refinancing or buying a house. ACORN (2000) reported that two out of every three conventional refinance loans (61.3%) received by low-income African-Americans in 1999 were from subprime lenders and more than half (52.6%) of the conventional refinance loans received by moderate-income African-Americans were from subprime lenders. Other findings were that the number of subprime loans to African-American home buyers has risen 631% from 1995 to 1999, while the number of prime conventional purchase loans received by African-American home buyers in 1999 was lower than in 1995. White homebuyers also saw an increase in the percentage of subprime loans by 285%.

Also in 2001, ACORN analyzed data released by the Federal Financial Institutions Examinations Council (FFIEC) about the lending activity of more than 7,800 institutions covered by HMDA. The report examined figures for the nation as a whole, as well as for 60 metropolitan statistical areas (MSA). To analyze the subprime market, ACORN used the list of subprime lenders developed by HUD (ACORN, 2001). This study included findings regarding subprime refinance loans and subprime purchase loans. ACORN found that racial disparity remained when minority homeowners were compared with white homeowners of the same income and it persisted among higher income homeowners. The study also reported that subprime lenders also targeted lower income white homeowners and the rate of growth of subprime lending had been much faster than the rate of growth of prime lending, especially to African-American borrowers (ACORN, 2001).

Williams and Nesiba (1997) examined racial and economic disparities in the home mortgage market of St. Joseph County, Indiana. The study focused primarily on three areas of importance: (1) an individual look at the community reinvestment performance (including types of institutions, local or non-local ownership, the size of the bank, and location of the bank), (2) differences in lending activities with low-income and minority neighborhoods and individuals, (3) replicating earlier studies in a moderate-sized urban area as opposed to a large area.

Data was collected using HMDA/LAR, census tracts, and lending institution data. A three-part analysis was utilized to generate the most accurate results. This included a descriptive analysis of the community reinvestment performance, similarities shared by lenders (in regards to low-income and minority neighborhoods, and individuals) and the use of multivariate logistic regression to examine the probability of a loan being denied.

The finding suggested that in St. Joseph County, Indiana credit unions and consumer finance corporations did more business with low-income and minority neighborhoods and individuals than their counterparts, lender characteristics were related to denial rates, out of state lenders seem less affected by race and more affected by income, and small locally owned banks tend to have lower denial rates than others (William & Nesiba, 1997).

In 2001 Black, Robinson, and Schweitzer reported results from a study investigating if banks with different racial ownership make-ups were more likely to accept mortgages from applicants that are of a similar race. Researchers used HMDA and a zip code cluster technique developed by R. Clair in 1988 to study this type of phenomenon. The *Reports of Condition and Income Database* was used to identify zip codes from a sample of Black-owned banks. Once this was achieved adjacent zip codes were located. Only Black-owned banks with at least one White-owned bank located in the same zip code were used in the sample (Black, Robinson, & Schweitzer, 2001).

Findings revealed that Black-owned banks accepted 70.24% of low-income African-American applicants compared to 59.47% by White-owned banks. Low-income White applicants were four times as likely to be accepted at a Black-owned bank as a White-owned bank when compared to Black applicants with similar income. The study concluded that African-Americans were more likely to receive a loan at an African-American bank while White applicants were equally likely to receive a loan regardless of the bank's racial background.

Older Homeowners

Although minorities and low-income borrowers have been victims of predatory lending so have elderly borrowers. As previously stated elderly homeowners are equity rich and cash poor which makes them prime targets for predatory lending practices. The American Association of Retired Persons has an array of reports on predatory lending. One study (Walters & Hermanson, 2001) analyzed 4,342 mortgage borrowers who had acquired first lien mortgage between January 1996 and June 1997. The respondents were asked questions about their home mortgages and their survey responses were matched with lending firms and credit scores. "Regression analysis identified financial risk, demographic variables, and a variety of other factors as significant indicators of the likelihood of a borrower having a subprime mortgage" (Walters & Hermanson, 2001 p. 3).

The two significant financial risk factors were credit history and loan to value ratio. It was found that older borrowers with lower-risk FICO scores (that is 680 and above) were less likely to hold a subprime mortgage. "While most older borrowers with low loan-to-values and high FICO scores held prime mortgages (43%), five percent held subprime mortgages" (Walters & Hermanson, 2001, p.4). Gender and ethnicity were the two significant demographic factors. It was reported that older females held 45% of the subprime and older African-American borrowers held 18% of the subprime mortgages (Walters & Hermanson, 2001). Additional significant factors consisted of application hurdles (asked to pay off debts, turned down for a mortgage, and asked to provide additional documents), life disruptions (decrease in income and medical expenses/ illness), search behavior (interest rate searching and responding to advertisements), and financial perceptions and mortgage preparedness (in control of finances and mortgage preparedness). "Other factors revealed distinctions between older subprime and prime borrowers: subprime borrowers were more likely to have been turned down for a mortgage, and to have responded to an advertisement offering guaranteed approvals or mortgage loans for people who may have had credit problems" (Walters & Hermanson, 2001 p. 7).

Brown (2000) with the assistance of International Communications Research (ICR) questioned U.S. adults age 50 and over about home equity and home improvement loans. ICR called 2,114 individuals 50 years and over between October 23 and 31, 2000. Eighty-five percent of the persons called owned their own primary place of residence. It was found that 86% of the homeowners had seen or heard advertisements for borrowing money against their home and 73% have received information offering them the opportunity to borrow money against their homes. Brown (2000) also reported that those most likely to get equity loan information are younger (under age 65- 80%), more affluent (income $30K and over), and better educated (college graduates- 80%). Brown found that the most frequent marketing techniques used by equity lenders were mail (92%), phone (38%), and email (12%). When asked how they selected their lender; 62% of the respondents said they applied to a personal bank or credit union, 16% said they applied to a broker, and 28% said that they selected their lender based on their solicitations (advertisement- 15% and mail, phone, or door-to-door- 13%).

In a report by the National Association of Attorneys General (NAAG) it was stated that older homeowners are especially vulnerable to predatory loans because they are likely to be home during the day, available for telephone and door-to-door solicitations. "Consumers may first fall victim to predatory lending when a door-to-door solicitation from someone offering to perform home repair work and, conveniently, offering to finance the cost of the work through a loan" (NAAG, 2001 p.1). Door-to-door sellers often offer to let borrowers sign paperwork at the kitchen table.

Information Technology

Gale (2001) researched subprime lending and the Internet. He suggested that while the mortgage lending industry was slow to adopt some of the opportunities of the information age, it is quickly changing. One innovation discussed was that of the geodemographic-marketing tool. This electronic search tool permitted lenders to identify clusters of households by demographic characteristics such as age, income, home value, and other variables (Gale, 2001). MicroVision, another information age invention, identifies four demographically and behaviorally distinct types of segments of households. They range from the "Upper Crust" to "Trying Rural Times". PRIZM, another innovation, provides 62 clusters across 15 social groups, including "Blue Blood Estates" to the remote rural families of "Blue Highway" (Gale, 2001 p.9). There are many other geodemographic search tools. These services allow organizations and businesses to target areas based on their criteria. "In the case of mortgage lenders, once geographic units such as zip codes and census tracts are classified according to their inhabitants' primary characteristics, mass mailings and telemarketing solicitations can contact nearly all addresses in the geographic unit" (Gale, 2001 p.9). While no one has studied the extent to which subprime lenders use this information it displays how feasible it is to target specific neighborhoods.

Foreclosures

A major indicator that predatory lending may be prevalent in a neighborhood is the incidence of a high number of foreclosures. "The most compelling evidence that subprime lending has become a fertile ground for predatory practices is the current disproportionate percentage of subprime loan foreclosures in low-income and minority neighborhoods" (Fishbein & Bunce, 2001). A recent study by Stock (2001) utilized records of mortgage foreclosures in Montgomery County, Ohio. The data were based on county recorder data on mortgages, auditor data on property appraisals and bases, and loan application register data from HMDA to access the extent of predatory lending in Montgomery County.

There were also 27 interviews with a sample of homeowners whose mortgage foreclosures exhibited evidence of predatory practice and 200 interviews with a sample of people who had mortgage loans (not foreclosed) with lenders who have been identified as using predatory practices (Stock, 2001). Stock (2001) found that from 1994 to 2000, mortgage foreclosure filings in Montgomery County increased from 1,022 to 2,451. From 1994 to 1999 the percent of foreclosures rose continuously (19% to 48%) and then dropped sharply in 2000 (41%). The subprime lenders that exhibited predatory characteristics account for 65% of the subprime associated foreclosures in 2000 (Stock, 2001). Through the telephone-conducted interviews, Stock (2001) found that 45% of the mortgage foreclosure respondents and 24% of current mortgage respondents' terms at closing were different than the terms that had been discussed during the process. Charges in the terms were often associated with high fees, interest rates, balloon payment, and hidden insurance fees.

Another foreclosure study was conducted by Abt Associates, Inc. (Gruenstein & Hubert, 2000). Abt Associates, Inc., who obtained data from the Atlanta foreclosure records between 1996 and 1999, compared foreclosures of loans by subprime and non-subprime lenders and identified subprime lenders that primarily originated subprime loans.

They found that foreclosures in Atlanta declined by 7% (1996-1999), but the volume of foreclosures started by subprime lenders grew by 232%. The Abt study (US HUD, 2000) mentioned that the foreclosures in Atlanta, in the subprime market, occurred amidst a trend of rapidly increasing subprime lending. Abt Associates, Inc. also found that the subprime share of foreclosures was highest in lower-income and predominately minority neighborhoods.

A study by ACORN (2002) in Bernadillo County, New Mexico, found a three-fold increase in foreclosure filings between 1996-2001. In 1996, Bernadillo County in Albuquerque, New Mexico, logged 673 mortgage foreclosures. In 2001 the number increased to 2,160. This area showed a substantial increase in the subprime lender share of mortgage foreclosures, but only a slight decline in the prime lender share of mortgage foreclosures.

In 1999, NTIC and NietoGomez et al. studied the subprime market in Chicago. This study was composed of three parts: Quantitative research, case study, and individual stories. Quantitative data were used from two major sources: the foreclosure report of Chicago (FRC) and Home Mortgage Disclosure Act (HMDA). Results in part one indicated that subprime lenders were responsible for 30 foreclosures in 1993 and 1,417 in 1998, a 4,623 % increase (NietoGomez et al., 1999). Foreclosures on high-rate loans increased more than 400% and foreclosures on home loans less than four years old tripled.

The second part used the "Neighborhood Foreclosure and Abandonment Survey" as a case study to investigate the relationship between subprime lending and housing abandonment. The case study focused on a southside neighborhood in Chicago. Results indicated that on average two properties per block, in a 36-block area, was foreclosed in 1998 (NietoGomez et al., 1999). Sixty-four percent of these abandoned properties were originated by subprime lenders or were high interest rate loans. Based on the case study researchers speculated that abandonment ultimately would have a negative effect on the property values within that neighborhood. The neighborhood, physically, becomes unattractive. Abandoned places become public nuisances. Communities will be destroyed, which upsets the cohesion between community members, and ultimately lives will be changed. In a time when self-sufficiency is on everyone's mind it is depressing to encounter practices that may cost people their homes and their independence.

Studies of foreclosure have been conducted in cities such as Chicago, Boston, Atlanta, and Baltimore. Based on these previous studies on foreclosure and 16 large subprime lenders, Fishbein & Bunce (2001) suggest that special attention be shown to the following areas: foreclosures of subprime loans have increased substantially with the growth of subprime loan originations; subprime loans account for a larger share of overall foreclosures than of total loan originations; subprime lenders are quick to foreclose: subprime foreclosures are disproportionately concentrated in low-income and predominately African-American neighborhoods; and the estimated volume of subprime foreclosures is substantial.

Predatory Lending Practices

There are a number of abusive lending practices associated with predatory lending. The following list describes several common practices that occur.

Marketing

- Solicitations to targeted neighborhoods: Victims of predatory lending frequently describe being subjected to a flood of phone calls and letters from brokers and lenders, encouraging them to take out a home equity loan (The case against predatory lending, URL). They also advertise through television commercials, highly visible signs in neighborhoods, door-to-door solicitations, and flyers stuffed in mailboxes. Many companies deceptively tailor their solicitations to resemble social security or other government checks to prompt homeowners to open the envelopes and otherwise deceive them about the transaction (Sturdevant & Brennan, Jr., 2000).
- Home Improvement Scams: Local home improvement companies are used to arrange loan business. The company may originate a mortgage loan to finance the improvements and sell the mortgage to a predatory lender for financing of the improvements (Sturdevant & Brennan, Jr., 2000).
- Steering: Steering occurs when predatory lenders deliberately turn or steer borrowers into loans with high interest rates.

Sales

- Shifting Unsecured Debt Into Mortgages: The benefits of consolidating bills into mortgage loan are embellished without note of the disadvantages. This practice increases the monthly payments and exacerbates the risk that the homeowner will lose the home (Sturdevant & Brennan, 2000).
- Bait and Switch: A lender offers one set of loan terms when the borrower applies but pressures the borrower to accept worse terms at closing (National People's Action, URL).

The Loan

- High Annual Interest Rate: Predatory lenders charge interest rates well above prime rate and not justified by risk. Predatory lenders are able to charge these interest rates (frequently 14%-18%) because subprime borrowers with limited financial resources or knowledge may be relegated to finding credit at any price (The case against predatory lending, URL).
- Balloon Payments: This practice involves setting up a loan so that at the end of the loan period the borrower still owes most of the principal amount borrowed. The balloon payment is often hidden and is structured to force foreclosure or refinance.
- Asset-Based Lending: This simply means to lend without regard to ability to repay. Individuals who are equity rich and cash poor are prime targets for this tactic. This type of lending is designed to fail.
- Padded Closing Costs: A method of getting additional money by which, certain costs and fees are increased above the typical costs.

After Closing

- Flipping: This is also a very common practice. Loan flipping involves the successive repeated refinancing of the loan by rolling the balance of an existing loan into an unnecessary new loan. There is usually no benefit to the borrower.

- Prepayment Penalties: This tactic is used to lock borrowers into high interest rates. Borrowers are charged huge fees when or if there is a decision to pay off a loan early (or possibly refinance into another one).
- Abusive Collection Practices: To make sure that the payments are received continuously lenders call homeowners at all hours. Some borrowers are contacted prior to the grace period. These tactics often involve threats to evict the homeowner immediately, even though the lenders know they first must foreclose and follow eviction procedures (Sturdevant & Brennan, 2000).

While many of he loan terms previously mentioned may not be predatory on their own, the failure of the lender to disclose fully to the borrower the risk or cost associated with each individual term can make the loan package more problematic, especially if the borrower is unaware that better terms may be available (Housing Ohio, URL).

Theoretical Framework

Two theoretical perspectives provide the basis for this dissertation: General Systems Theory (GST) and Social Conflict Theory. The two theories guide an understanding of housing finance, especially subprime and predatory lending. GST is a theory embedded in harmony. The theory suggests that parts of a society must work in a smooth and orderly manner for the system to survive. GST fits well with the institutional approach using Home Mortgage Disclosure data to study subprime lending and potential problems for homeowners. Social conflict theory states that conflict is a natural occurring process that can be used to provide solutions to problems. Conflict theory fits well with the qualitative, grassroots approach using files of homeowners who voice their concerns about predatory lending experiences. Both theories provide insight into relevant aspects of how mortgage lending and contract sales can be problematic for homeowners and communities.

General Systems Theory

Theory guides research by determining why an event has occurred. General Systems Theory (GST) is based on the belief that society is a system of highly interrelated parts that operate together harmoniously. This idea reflects a system of legitimate, effective subprime lending. Subprime lending was created to ensure those individuals with less than an "A" credit rating would have access to financial means. According to GST each part serves a very useful function and contributes to the overall performance of the system. Discriminatory acts occur because parts of society are not functioning in a harmonious manner, thus providing the initiation of abusive subprime lending.

Abusive subprime lending can be addressed in relation to the major concepts of the GST. The major concepts are interdependence/mutual influence, boundaries, equifinality, and feedback. Boss, Doherty, LaRossa, Schumm, and Steinmetz (1993) stated that the components in a system are interdependent, or held together in a system, and that behaviors of the components exhibit mutual influence, meaning that what happens with one component generally affects every other component. If one house is affected by abusive subprime lending then there is potential for the whole block to be affected. When one block is affected the tract is affected. When one tract is affected then the city is affected, and so on. Deteriorating structures or abandoned houses make neighborhoods unattractive visually, and in extreme cases causes property values to become stagnant or decrease.

Boundaries are the point of contact where one system ends and another begins or the point of contact between the system (neighborhood) and other systems (lending institutions). Boundaries define membership in a system. The environment itself may be viewed as a supra-system because human systems are embedded in and transact strongly with the environment. It is difficult to gain a full understanding of human systems because political, economic, and social matrices must be taken into account (Boss, et al. 1993).

The concept of boundary in families usually is expressed in one of two ways: assessment of permeability or of the inverse, the internal cohesion of the family (Constantine, 1986) or by the emotional connectedness among family members (Olson, Sprenkle, & Russell, 1979). This explanation can be transferred to neighborhoods, to include cohesion or lack thereof in areas affected by discriminatory lending practices. It is not uncommon for individuals to become attached to their home, community, and in many cases their neighbors. Communities provide a basis for stability and neighbors are important when forming social bonds.

Equifinality is the ability to achieve the same goals through different routes. The ultimate goal is to eliminate discriminatory lending and all forms of abusive lending tactics. There may be several ways to achieve this, such as passing legislation, educating individuals (homeowners and prospective homeowners) about the problem, or forming a community awareness group made up of members of the community, advocates of neighborhood cohesion, realtors, and bankers.

Feedback is a response or reaction. It involves a path of communication known as the feedback loop. Feedback loops come in two forms: positive or negative. A positive feedback loop amplifies deviation while a negative feedback loop seeks to restore or maintain equilibrium, thus operating to reduce deviation. The decision as to whether a behavior is positive or negative is contingent upon not the content but the effect on the system. In discriminatory lending, the pattern of discrimination is problematic for all members of a community and therefore, the appropriate feedback loop is negative.

GST also has three key assumptions: 1) GST has the potential for unifying science, 2) a system must be understood as a whole, and 3) human systems are self-reflexive (Boss, et al. 1993). The third assumption is most important in combating predatory lending. Self-reflexivity refers to the ability to make oneself and one's behavior the object of the examination and the target of the explanation (Boss, et al. 1993). Communities, as a whole, can use this action to their advantage. Self-Reflexivity assists when organizing and determining ways to combat a common threat (such as in the case of unfair lending tactics). Through the analysis of Home Mortgage Disclosure data patterns of unfair lending practices can be uncovered. Once unfair lending tactics are documented, communities and neighborhoods can organize efforts to counteract the marketing of abusive lenders. Because local units are part of the system, GST supports the concept of neighborhoods educating themselves about homeownership and abusive lending practices.

Another major component of GST is effective communication. Perceptions of what abusive subprime lending means individually could and probably does differ from person to person. Individual differences in realities exist, of course, but within a given society there exists a consensus on tolerable differences in realities (Berger & Kellner, 1964). In simpler terms, although subprime lending is understood differently, there is an agreement that it can be a form of abuse and that ultimately abusive subprime lending can deteriorate neighborhoods.

Social Conflict Theory

Based on the review of literature of predatory lending, it seems that borrowers lack vital information they need to make sound financial decisions. Therefore, the lenders, with more knowledge, have power over the less knowledgeable. Most research reviewed on this topic has occurred at the grassroots local level without consideration for theory. To better understand predatory lending, it is important to consider theoretical contexts. Social conflict theory provides a basic understanding of the concept of predatory lending. The basic premise of social conflict theory is that society is in a constant state of disagreement with only temporary periods of stability. Social conflict theory emphasizes that in any social group, organization, or society, positions of unequal power probably exist (Kammeyer, Ritzer, & Yetman, 1994). The incumbents of these positions, those with greater power and resources (the lenders, financial institutions, etc.) and those with fewer resources (borrowers, possibly those considered to be less sophisticated) according to this theory are engaged in a continuous struggle.

Conflict theory encompasses several aspects of predatory lending. According to Farrington & Chertok (1993), conflict exists because individuals are motivated to act in accordance with their own interests. "Conflict theorists are interested in how society's institutions- including the family, government, religion, education, and the media- may help to maintain the privileges of some groups and keep others in subservient positions" (Schaefer, 2002, p. 15). As the name implies predatory lenders prey on homeowners' equity and attempt to take control of resources. Homeowners are also interested in building equity and maintaining control of their neighborhoods. They share a common interest, which is where the conflict occurs.

The major constructs of social conflict theory are power, coercion, authority, and stratification. Power refers to the ability to get others to do what you want even against their will. Power is legitimate because it is sanctioned by social norms (Farrington & Chertok, 1993). Power structures are many times obscured so that the dominant group doesn't seem as "dominant" or in other words power structures minimize the advantage of the dominant group. The dominant group, in predatory lending, is the lender and the weaker group is the unaware homeowner.

Conflict has strengths. If limited in amount and manner, conflict could create individual growth. Conflict theory provides a basis for not only why predatory lending exists but can lead the way to solutions. Conflict also increases internal cohesion. Conflict has the ability to bring people together (community, advocates, etc.) to fight against a common enemy (predatory lenders). This is the blueprint for what communities and advocates for healthy communities are doing. Based on conflict theory, communities can become educated about predatory lending and take action to prevent it.

Integration of Theories

Each theory plays an important role in understanding abusive lending. The theories provide guidance for exploring and explaining the intricacies of subprime lending and potential discriminatory mortgage lending and contract sales. General systems theory explains how the parts of society can break down and how the system can regain stability. Conflict theory provides an understanding of the struggle and what communities must do to deter discrimination in mortgage lending and contract sales. By integrating the theories, it is possible to produce communities grounded in knowledge and equipped with skills useful for fighting abusive subprime lending and to alter the system beyond a local community through legislation and legal action to help regain stability and fairness in housing finance.

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CHAPTER 3. Subprime Lending and Reverse Redlining: An Analysis Using HMDA

A paper to be submitted to the Journal of Housing Research

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Abstract

In this research endeavor, subprime lending and reverse redlining were examined. Using data from the Home Mortgage Disclosure Act and Census tracts, over 8,000 loan applicant registers in the city of Des Moines, Iowa were studied regarding the probability of applicants being victims of reverse redlining, an abusive tactic in mortgage lending. Logistic regression was used to analyze the data. The results suggest that race, income, loan amount, and loan purpose are significant factors in reverse redlining.

Introduction

The purpose of this article is to determine the prevalence of subprime lending by geographic location, specifically in relation to the census tracts in the city of Des Moines, Iowa. Also, this study explores the likelihood of reverse redlining in relation to the demographic characteristics of the tract and lending patterns within the tract.

Subprime Lending

Subprime lending is a very vital part of the economy. Subprime lenders provide loans to borrowers who do not meet standards, which would make them "prime" borrowers. "Fair subprime lenders make loans that are appropriately priced to compensate for the risk of lending to a credit-blemished borrower" (Citibank, URL). Although these borrowers are

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charged more than prime borrowers, the higher cost associated with higher interest rates do not make the victims of abusive practices that define predatory lending.

However, subprime loans are often given to borrowers with good credit. Citizens for Community Improvement (CCI) of Des Moines found that 63% of the subprime loans in Des Moines are made to people eligible for prime loans. This is unethical and considered to be a predatory practice (CRA-NC, URL).

The subprime market has grown dramatically. The growth occurred between 1993 and 1998 (Housing Ohio, URL). There was an explosion of loans combined with the nearly hyper-segmentation of mortgage lending markets by race and neighborhood, which created opportunities for abuse. This two-tier system has increased the opportunity for abuses within the market, especially targeting less sophisticated homeowners.

According to the Woodstock Institute (1999), there are several reasons that explain the growth of subprime and abusive subprime lending:

- Increase in homeownership among the less experienced,
- Increase in medical and credit card debt,
- Use of information technology to target vulnerable homeowners,
- Minimal regulation of mortgage and finance companies, and
- Weak Community Reinvestment Activities and less attention to fair lending in refinance and home equity lending

Targeted populations consist primarily of elderly, minority, women, and/or low-to-Moderate-income homeowners. These households are targeted because the access to conventional loans and other financial services is severely limited. It has been suggested that elderly populations are usually equity rich and cash poor (Quercia & Rohe, 1992). Also, their homes may be in need of expensive repairs (often roofing work) or they may have fallen behind on their property taxes, incurred substantial medical bills, or suffered a loss of income after the death of a spouse (Jesuit & International Ministries, 2000).

Nationally the practice of subprime lending has grown exponentially over the past several years. The Woodstock Institute (1999) reported that from 1993 to 1998, in the United States, home purchase loans by subprime lenders grew 760% and prime lending grew only 38%. This same study also reported that refinance loans by subprime lenders grew by 890%, and by only 2.5%. From 1993-1998, 80% of subprime lending was comprised of refinance and equity loans. In 1993, only 100,000 home purchase or refinance loans were brokered in the subprime market; by 1999 that number jumped to nearly 1 million loans (US HUD, 2000).

According to a flyer distributed by CCI (2001), the National Training and Information Center (NTIC, 2001) of Chicago found that 2,991 subprime loans were originated in Iowa in 1994. Five years later, in 1999 15,291 subprime loans were originated. In 1994 in Des Moines (NTIC, 2001), 198 subprime loans were originated and by 1999 that amount increased to 1,903 (Figure 1).

Discrimination

Discrimination seems to manifest itself in many ways and in numerous markets. According to Holmes and Horvitz (1997), racial discrimination in mortgage lending can take and has taken many different forms. Courchane, Nebhut, and Nickerson (2002) stated that some of these forms include uneven treatment by brokers, pre-application screening, unfair application and credit standards in the loan approval process, differing levels of assistance provided during the application process, discriminatory pricing practices, and overt bigotry.

It has been argued that one cause of unequal and segregated housing is mortgage lending practices. In the 1960's the Kerner Commission reported that the nation was moving in two directions: one direction was African-American and poor, and the other was White and affluent. Housing discrimination is known to influence many housing outcomes and life chances (Yinger, 1998). Yinger (1998) reported that discrimination constrains the opportunity to go to good schools, to find jobs, and to accumulate home equity, thus providing a rationale for the title of his article: "Housing discrimination is still worth worrying about."

In 1989 large disparities in mortgage lending between minority and non minority neighborhoods refocused attention on possible racial discrimination in the home loan market (Schill & Wachter, 1993). It has been noted (through housing audits) that sellers and real estate agents discriminate against minority home buyers (Turner, 1992). Racial disparity in homeownership can be attributed directly to discriminatory practices. Three cities in 1988 and in 1989 (Baltimore, Boston, and Chicago) revealed geographic racial and ethnic disparities congruent with home loan discrimination (Freeman, 2000).

A study by Munnell, Browne, McEneaney, and Tootell (1992) found that Blacks and Hispanics were 60% more likely than Whites of identical characteristics to be refused a mortgage loan after controlling for all variables that underwriters take into account in approving or denying loan applications. A study by the Urban Institute in conjunction with Syracuse University researched 3,800 realty offices located in 25 cities to explore housing discrimination (Urban Institute, 1989). It was found that Blacks experience a 56% rate of discrimination in rental units and a 59% rate in home purchases, and that 60-90% of the housing units shown to Whites were not available to Blacks.

The Urban Institute performed a study of discriminatory housing practices in 25 metropolitan areas in 1990. The study found that African-Americans and Latinos experienced discriminatory practices approximately 55% of the time, in the area of housing sales market (Nyden, Maly, & Lukehart, 1997). Another finding of the study revealed minorities were frequently steered to different neighborhoods, told units they wanted to see were not available, or given less information than White's sources of financing (Galster, 1990; Nyden, Maly, & Lukehart, 1997, p. 495).

The Federal Reserve Bank of Boston stated that for the same flaws, Whites seem to enjoy a presumption of credit worthiness that minority applicants do not and that lenders seem to be more willing to overlook credit imperfections for White applicants than for minority applicants (Walters, 1996). Ironically, a survey of 1,521 households by the National Mortgage Association reported that 87% of the Whites (opposed to 33% of the minorities) believe that minority purchasers have the same chance they have of getting a home that they can afford (Walters, 1996).

Ondrich, Ross, and Yinger (2001) used audit data to examine how discriminatory behavior varied with location across Atlanta, Chicago, Los Angeles, and New York. The purpose was to gain a better understanding of how housing discrimination occurred. They hypothesized that real estate agencies may discriminate to protect their business with prejudice White customers. The authors found that discrimination tends to decrease as one moves farther away from the real estate agent's office, thus supporting their hypothesis.

Massey and Lundy (2001) supervised students in an undergraduate research methods class to examine if speech patterns are used in housing discrimination. They hypothesized that speech patterns offer real estate agencies the opportunity to discriminate over the phone.

The speech patterns were categorized into three types: Black English Vernacular, Black Accented English, and White Middle Class English. Students in the class collaborated with the authors to design an instrument for use in the telephone audit study. The study was conducted, over a four-week period, in the metro are of Philadelphia in the Spring of 1999. They developed a script to be followed and then they created a common set of profiles that were assigned to each auditor (male/female).

Logistic regression was used to predict whether the auditor spoke to an agent, whether a unit was reported as available, whether the auditor ultimately granted access to information about the unit, and if so, whether the application fees were required and credit worthiness was mentioned as an issue (Massey & Lundy, 2001). It was found that female speakers of Black English Vernacular fared the worst. They experienced the lowest possibility of making contact and of being told of a unit's availability. On average they were assessed $32 more per application than White middle-class males.

Disparate Treatment and Impact

There are two types of mortgage discrimination: disparate treatment and disparate impact. Disparate treatment occurs when a housing provider treats a member of a protected class different, than other persons. This type of discrimination is easily detected because it typically involves intentional acts of discrimination. Evidence of the motive may be direct, such as open hostility, or circumstantial. The following scenario is an example of disparate treatment. A customer, of a protected class, enters a bank and inquires about mortgage options. He is told to fill out an application and return it. An identically qualified White applicant enters the establishment, inquires about mortgage options, and is given an interview immediately.

Courchane, Nebhut, and Nickerson (2000) addressed disparate treatment of loan applications by analyzing data collected in fair lending examinations between 1994 and mid-1999. Statistical modeling has been emphasized and utilized in the analysis of fair lending issues. The fair lending examination conducted most frequently with statistical methods was meant to determine whether there was a reasonable cause to believe disparate treatment resulted from the acceptance or rejection for home mortgage loans (Courchane, Nebhut, & Nickerson, 2000). In this study, statistical analysis was used to determine if underwriting guidelines were applied consistently for all applicants. "The Department of Justice has recognized statistical modeling as a valid tool for discovery of disparate treatment in the credit-granting process" (Courchane, Nebhut, & Nickerson, 2000, p. 278). It was found that statistical analysis could be useful when identifying patterns of discrimination and that custom modeling is most effective when used to identify discrimination. The authors found that three out of the eleven banks in their sample treated minorities differently.

Disparate impact as a rule or regulation may be neutral on its face but nonetheless have a discriminatory impact on a protected class. Disparate impact is the disproportionate effect of higher denial rates (or pricing effects) that any underwriting system likely has and is consequence of statistical group disparities in wealth, income, and other factors affecting the group distributions of mortgage applicant's collateral, capacity, and credit (Straka, 2000). Disparate impact is not intentional and generally involves policies or laws that cause harm to members of a protected class. It can be subtle and even unconscious, but when a significant statistical effect is found to be disfavorable to those protected by law, the result is discriminatory. A business necessity must be presented as justification.

The potential misuse of credit scores is an example of disparate impact. It has not been shown that the scores or process is discriminatory but disparate impact is possible in how the scores are used. "Prevention of misuse in scoring requires strong industry communication, education, and system design" (Straka, 2000). Straka (2000) also argued that giving too much latitude to subjective judgments could bring improper interpretations.

Holloway and Wyly (2001) contend that both forms of discrimination are geographically contingent. The treatment of minority applicants depends on where the properties are located, and that the impacts of lending institutions' actions are geographically variable in ways that affect differently applicants based on their racial and ethnic groups.

Redlining

During the 1970's, lending institutions were commonly accused of redlining – intentionally withholding funds from areas on the basis of racial and ethnic makeup (Perle, Lynch, & Horner, 1993). Lending institutions refused to lend money in the area (presumably) by drawing a red pencil line around the area on a map (Morris & Winter, 1978). In the 1960's and 1970's, when redlining first surfaced it was not exclusively a racial issue. It was known in mostly older, primarily White neighborhoods of Chicago, Baltimore, and other larger cities (Holmes & Horvitz, 1997, p. 51). "Yet the preponderance of African-American residents in many such areas usually means that the policy in effect becomes one of racial discrimination" (Forman, 1971, p. 68).

The two most widely publicized responses to redlining in mortgage lending were the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA). "The CRA and HMDA are both the result and the vehicle of community-based efforts to combat redlining and other discriminatory bank lending practices" (Schwartz, 1998, p. 270).

Just as neighborhoods where once identified as African-American or White they are now being identified as subprime or prime.

> "Increasingly, sub-prime lending is becoming the only option of all too many low-income and minority borrowers. This reality sadly documents the continued existence of the race line in America and the continued existence of the dual lending market in the United States. Whereas before, African Americans were openly denied access to credit, today the "race tax" is more sophisticated, more costly – and equally exploitative. Where once redlining undermined communities, today "reverse redlining" has become the norm and threatens to undermine our communities' economies, social services, and tax base. Sadly, an analogy to racial profiling is appropriate here. We have all become familiar with the term "Driving While Black." Sub-prime predatory lending has become the equivalent of "Borrowing While Black" *United States Senate Committee on Banking, Housing, and Urban Affairs* (2001).

Reverse redlining takes place most often in areas where predatory lenders face no competition. Some subprime lenders purposely take advantage of residents by pushing high cost loans, soliciting aggressively over the phone, through the mail, or by face-to-face interaction. Many loans that characteristically are called "reverse redlining loans" are so bad that the recipients would be better off not receiving a loan at all (United States Senate Committee on Banking, Housing, and Urban Affairs, 2001).

Home Mortgage Disclosure Act

The Home Mortgage Disclosure Act (HMDA), enacted in 1975, required lenders to provide information about location (by census tract) of loan originations (Yinger, 1995). In 1989 revisions were made to HMDA requiring lenders to provide additional information for each individual application (Ladd, 1998). The new variables include loan guarantee (conventional, FHA, or VA), purpose of loan (purchase, improvement, refinancing), loan amount, date of application, loan disposition (approved, approved but withdrawn, no lender action taken, or denied), race, census tract, gender, owner-occupied status, and applicant income.

HMDA does have some discrepancies that need to be addressed. Missing data in HMDA is a serious problem. Although race is required when reporting data, it is not always reported. Applications taken entirely by mail or telephone may lack this vital piece of information. The rising incidence of missing data on race in recent years and emerging technological trends in the mortgage industry, which facilitate lending without face-to-face contact, make it reasonable to predict that this problem will become more serious in the not-to-distant future (Huck, 2001). Fair housing was established to ensure that minorities were being treated fairly in housing. It is paradoxical when questions regarding race are not required for applicants applying through the mail or by phone. This makes it very difficult to use HMDA to determine how much, if any, discrimination is occurring; thus providing an environment for abusive mortgage lending to prosper.

"In January 2002 the Federal Reserve Board announced changes in Regulation C, which implements HMDA" (Center for Community Change, URL). The two changes receiving the most attention are: (1) lenders must designate which of the loans they originate are high-cost loans; and (2) lenders will be required to provide information regarding information about the pricing of some loans. Other changes include: (1) indication of which applications are for manufactured homes, (2) requirement of reporting denials under "covered" pre-approval programs for home purchase loans, and (3) the new rule allows an applicant to report more than one race. A very important amendment, effective January 1, 2003, requires lenders to ask applicants their race or national origin and sex in applications taken by telephone, conforming the telephone application rule to the rule applicable to mail and Internet applications (Federal Financial Institutions Examination Council, URL).

The conclusion of many studies using HMDA data indicate that redlining has been practiced in numerous places (Holmes & Horvitz, 1997). HMDA has "consistently revealed disparities in mortgage credit flaws by neighborhood racial, ethnic, and income characteristics ... and data have pointed to glaring disparities in mortgage application rejection rates by the applicant's race, income, and neighborhood choice" (Munnell, Tootell, Browne, & McEneaney, 1996).

Munnell, et al. (1996) used HMDA (for Boston) to determine whether race played an independent role in the mortgage lending decision. This study found that minority applicants have less wealth, weaker credit histories and higher loan to value ratios than White applicants do, and that these disadvantages account for a large portion of the differences in denial rates. White applicants with the similar property and personal characteristics as minorities have a rejection rate of 20% compared to the minority rate of 28%.

Minority and Low Income Homeowners

Association of Community Organization for Reform Now (ACORN, 2000) released a study analyzing 1999 home mortgage lending data, which found that minority and lower income borrowers are much more likely to receive a higher- cost subprime mortgage when refinancing or buying a house. ACORN (2000) reported that two out of every three conventional refinance loans (61.3%) received by low-income African-Americans in 1999 were from subprime lenders and more than half (52.6%) of the conventional refinance loans received by moderate-income African-Americans were from subprime lenders. Other findings were that the number of subprime loans to African-American home buyers has risen 631% from 1995 to 1999, while the number of prime conventional purchase loans received by African-American home buyers in 1999 was lower than in 1995. White homebuyers also saw an increase in the percentage of subprime loans by 285%.

Also in 2001, ACORN analyzed data released by the Federal Financial Institutions Examinations Council (FFIEC) about the lending activity of more than 7,800 institutions covered by HMDA, including figures for the nation as a whole, as well as for 60 metropolitan statistical areas (MSA). In order to analyze the subprime market, ACORN used the list of subprime lenders developed by HUD (ACORN, 2001). This study included findings regarding subprime refinance loans and subprime purchase loans. ACORN found that racial disparity remained when minority homeowners were compared with white homeowners of the same income and it persisted among higher income homeowners. The study also reported that subprime lenders also targeted lower income white homeowners and the rate of growth of subprime lending had been much faster than the rate of growth of prime lending, especially to African-American borrowers (ACORN, 2001).

Williams and Nesiba (1997) examined racial and economic disparities in the home mortgage market of St. Joseph County, Indiana. The study focused primarily on three areas of importance: (1) an individual look at the community reinvestment performance (including types of institutions, local or non-local ownership, the size of the bank, and location of the bank), (2) differences in lending activities with low-income and minority neighborhoods and individuals, (3) replicating earlier studies in a moderate-sized urban area as opposed to a large area. Data used included HMDA/LAR, census tracts, and lending institution data. A three-part analysis was utilized to generate the most accurate results. This included a descriptive analysis of the community reinvestment performance, similarities shared by lenders (in regards to low-income and minority neighborhoods and individuals) and the use of multivariate logistic regression to examine the probability of a loan being denied. The findings suggested that in St. Joseph County, Indiana credit unions and consumer finance corporations did more business with low-income and minority neighborhoods and individuals than their counterparts, lender characteristics were related to denial rates, out of state lenders seemed to be less affected by race and more affected by income, and small locally owned banks tend to have lower denial rates than others (Williams & Nesiba, 1997).

In 2001 Black, Robinson, and Schweitzer reported results from a study investigating whether banks with different racial ownership make-ups were more likely to accept mortgages from applicants that are of a similar race. Researchers used HMDA and a zip code cluster technique developed by R. Clair in 1988 to study this type of phenomenon. Findings revealed that Black-owned banks accepted 70.24% of low-income African-American applicants compared to 59.47% by White-owned banks. Low-income White applicants were four times as likely to be accepted at a Black-owned bank as a White-owned bank when compared to Black applicants with similar income. The study concluded that African-Americans were more likely to receive a loan at an African-American bank while White applicants were equally likely to receive a loan regardless of the racial background of the bank's owner.

Based on the literature review the following hypotheses will be examined to meet the objectives of this research:

Hypothesis 1: Minority homeowners are more likely to be victims of subprime lending and reverse redlining than non-minority homeowners.

Hypothesis 2: Homeowners below the area median income are more likely to be victims of subprime lending and reverse redlining.

Hypothesis 3: Homeowners with refinance loans are more likely to be victims of a subprime lending and reverse redlining than homeowners with home purchase loans.

Methodology

Home Mortgage Disclosure Act

HMDA, as previously stated, was enacted by Congress in 1975 and is implemented by the Federal Reserve Board's Regulation C. According to the Federal Financial Institutions Examination Council, (FFIEC, URL) this regulation provides public loan data that can be used in three ways: 1) in determining whether financial institutions are serving the housing needs of their communities; 2) for public officials to use in distributing public-sector investments to attract private investment to areas where it is needed; 3) and in identifying possible discriminatory lending patterns. This study is concerned primarily with the last area of use.

Included under Regulation C are several types of financial institutions: banks, savings associations, credit unions, and other mortgage lending institutions. In 2001, 7,713 financial institutions reported approximately 19 million loan records for 2000. Using the loan data submitted by these financial institutions, the Federal Financial Institutions Examination Council (FFIEC) creates aggregate and disclosure reports for each metropolitan area (MA). Loan application registers (LAR) for the Des Moines SMA in Polk County, Iowa were used in this study. Over 41,000 loan applications were reported for 2001.

Variables from the HMDA file used in this study are lenders, type of lending, loan type, loan amount, loan purpose, applicant's sex, applicant's race, and applicant's income. Proportions of minority population and median household income were added to the data file from the 2000 census. A new variable was created identifying each lender as subprime (1) or not subprime (0). A list generated by the National Training and Information Center (NTIC) identified lenders for Des Moines, Iowa. Citizens for Community Improvement of Des Moines (CCI) supplied the list. For a detailed description of variables and the values of each variable, refer to Table 1.

This study looks only at loan activity in the census tracts for the city of Des Moines. A census tract identifies a small, relatively permanent statistical subdivision of an area. Partial tracts were eliminated from the data file because HMDA does not specify information for partial tracts. There are 47 complete tracts for the city of Des Moines. For the purpose of this study only loans originated were studied. This decreased the sample size to 8,297 households. This number was reduced further to 7,877 due to missing cases for the applicant's income.

Two new variables were created to address tract minority population percentage and median income. Based on 2000 census information, the minority population for the city of Des Moines was 17.4% and the median income was $38,408. The new variables were constructed to determine tracts above or below a designated minority population of 17.4% and the median income for the city. Each variable was coded 1 if above minority population percent of 17.4% or below median income of $38,408 and if 0 not below minority population percentage or above median income. The two census tract variables and the subprime variable were combined to create the reverse redlining variable. If a household had a subprime loan and was located in a high-minority and low-income tract, it was considered a probable source of reverse redlining (Figure 2 and Table 2). Of the loan applicants, 2,522 were holders of subprime loans, 798 resided in high-minority tracts and 3,641 were located in low-income tracts. When the three variables were combined for the reverse redlined variable 258 were classified as potentially reverse redlined loan applicants.

Results

Descriptive analyses were performed with type of lending crosstabulated by the loan amount, loan purpose, race, sex, and household income. Crosstabulations are used primarily to show the relationship between two or more categorical variables. The results of these analyses can be found in Table 3.

Higher percentages of subprime loans were used for home purchase and refinancing than for home improvement. Since the loan amount is a continuous variable, the amounts were collapsed into four categories. The lowest one-fourth loan amounts had the smallest percentage of subprime loans, 18%. The other three loan size categories all had about 34-35% subprime loans.

Applicants within the highest income bracket had the lowest percentage of subprime loans (23%), while those in the lowest income category had the highest percentage of subprime loans (34%).

Gender did not yield a difference between subprime and not subprime lending, except for the category that included "no information." Race, on the other hand, was a very interesting variable when comparing type of lending. Although the percentage of subprime loans ranged between 24 and 38%, African-Americans and American Indians had the highest subprime percent (38.6 and 38.5%, respectively) and Asians had the lowest percent (24.4). Finally, 28% of the applicants with conventional loans had subprime loans, while 51% with Federal Housing Administration (FHA) loans and 45% with VA loans had subprime loans.

Logistic Regression

Binomial logit techniques were used to estimate the effects of the selected variables on the probability of securing a subprime loan or of being reverse redlined. Logistic regression estimates the probability of a certain event occurring. The models work by fitting the probability of response to the proportions of the responses observed.

In the first logistic regression, the dependent variable measures whether one has a subprime loan or not. In the second logistic regression the dependent variable measures whether one has been reverse redlined or not. The logistic regression output in SPSS produces a number of tables. This study reports the Hosmer and Lemeshow test, the omnibus tests of model coefficients, the model summary, the classification table, and the statistics of individual variables in the equation.

The first logistic regression used type of lending (subprime/not subprime) as the dependent variable. The omnibus test of the first model coefficients includes the model chi-square. The results of this test on the data used displays a chi-square of 520.604, df=14, and $p < .001$ (Table 4). Therefore, the first model is statistically significant. The results of Hosmer and Lemeshow test implies that the first model results lead to rejection of the null hypothesis; therefore, the model's estimates do not fit the data at an acceptable level. (Table 4).

The model summary includes three important pieces of information: -2 log likelihood (LL), the Cox and Snell R^2, and the Nagelkerke R^2. According to the -2LL test the model does not fit the data very well. It yields a –2LL value of 9051.395. The Cox and Snell R^2 and the Nagelkerke R^2 attempt to imitate the interpretation of the multiple R^2. The Nagelkerke's R^2 is a modification of the Cox and Snell R^2 and normally is larger. This study yielded a low Cox and Snell R^2 value of .064 and a low Nagelkerke R^2 value of .091 (Table 4).

Based on results in the classification table, the first model correctly predicts that the value of the dependent variable is observed in the data 61% of the time (Table 4), with 60.9% of prime loans and 61.3% of subprime loans predicted successfully.

Although the first model for subprime loans does not fit the test well there are six applicant variables and specifically seven applicant variable values that yield significant results (Table 4). Male and female applicants' probability of receiving a subprime loan both decrease when compared to the same probability for those whose gender is unknown. African-Americans are more likely to receive a subprime loan when compared to applicants whose race is unknown. The probability of receiving a subprime loan for conventional loans was lower when compared to VA-guaranteed loans. The result for income indicates that applicants with higher incomes have a lower probability of receiving a subprime loan than those with lower incomes. Applicants with refinancing loans and those with home improvement loans increases the likelihood of receiving subprime loans compared to home purchase loans.

The second logistic regression analysis was performed using reverse redlining as the dependent variable (Table 5). The results of the Omnibus tests display a chi-square value of 250.282, df=14, and $p < .001$. Therefore the overall model for reverse redlining is statistically significant.

The Hosmer and Lemeshow test shows a goodness result that is greater than .05 ($p =$ .343). This implies that the model's estimates fit the data at an acceptable level. This does not necessarily mean that the model explains much of the variance of the dependent variable, but however much it does explain is significant statistically.

The second model summary yields a –2LL value of 1980.475. This suggests that the model does not fit the data very well. The second model yielded a Cox and Snell R^2 value of .031 and a Nagelkerke R^2 value of .127 (Table 5), which are not very high.

Based on the classification table the second model correctly classifies 69.6% of the applicants overall classifying 72.2% of those who are reverse redlined, and 69.6% of the borrowers who are not.

Table 5 also displays variables that have been included in the equation. There are six variable values that yield significant results. Loan amount indicates that as the loan amount increases the probability of being reverse redlined decreases. African-Americans are more likely to be victims of reverse redlining when compared to those whose race is unknown. The probability of being reverse redlined using a conventional loan decreases when compared to the use of VA-guaranteed loans. Income indicates that applicants with high income have a high probability of not being reverse redlined. Refinancing loans results in increased likelihood of being reversed redlined compared to home purchase loans. The probability of being reverse redlined decreases when using the loan for home improvement compared to home purchase loans.

Conclusion

The subprime market has grown dramatically. This explosion of loans combined with the nearly hyper-segmentation of mortgage lending markets has created opportunities for lending abuse. The opportunity for the use of subprime loans within the market, especially targeting the less sophisticated homeowners has increased. In this study the probability of receiving a subprime loan lies in applicant's sex, race, loan type, income, and loan purpose.

All three hypotheses about subprime loans were supported; minorities, low-income, and refinancing were significant and related to subprime loans.

This study also shows the probability of being reverse redlined lies in race, loan amount, income, and purpose for the loan. The results of the analysis support the first and second hypothesis that income and race are factors in determining the likelihood of being reverse redlined. African-Americans and households with low-income compared to applicants of unknown race and those with high incomes were among the variables that yielded significant results. The third hypothesis was supported in that refinancing had a higher likelihood of being reverse redlined than home purchase.

This study provides an overall understanding of the lending patterns of lenders in the city of Des Moines. It provides additional information to contribute to the quality of life for individuals and communities by addressing the housing finance of under-served populations, which can challenge the current housing policy. Also as a contribution, the research method provides a creditable method for measuring reverse redlining that can be shared with policy makers and researchers understanding lending practices. The systematic investigation illustrated in this research could help federal policy makers, local program administrators, and the general population decide how to invest in efforts aimed in addressing problems with subprime lending and their potential targeting of neighborhoods identified as low-income and/or minority. In addition, HUD could assist local program administrators by producing a series of best practice reports to disseminate information about effective strategies for preventing or addressing problems with lending institutions. Educating the public about what goes on in their community is a good defense to end abusive lending tactics.

A major limitation in this study is the missing data. The race of many applicants was not included in the HMDA file because they applied by mail or over the telephone. This makes it very difficult when making comparisons based on race. Beginning January 2003 race of all applicants will be required, whether the application is in person, by mail, or over the telephone. Another limitation is that the HMDA file does not include enough information to detect predatory lending. HMDA should be revised to include the type of loan (fixed, ARM, etc.), interest rate, the term, loan fees, applicants' age, and the number of dependents. Inclusion of these factors would show the conditions of the loan and allow evaluation of the borrower's ability to repay.

The final limitation in this study is the analysis of only one city. Hopefully, by establishing and presenting the methodology to investigate reverse redlining, additional studies will follow to further test the concept of reverse redlining.

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Table 1. Definition of Variables Used in Analysis

Variable Name	Variable Definition
Reverse Redlining	1= Reverse Redlining; 0= Not Reverse Redlining
Subprime Lending	1= Subprime Lending; 0= Not Subprime Lending
Tract	Census Tract Number
Applicant's Sex	1= Male; 0= Female; 2=Information not provided by applicant in mail or telephone application; 3= Not Applicable; (2 & 3= Comparison Group)
Applicant's Race	1= American Indian or Alaskan Native; 2= Asian or Pacific Islander; 3= African-American; 4= Hispanic; 5= White; 6= Other; 7= Information not provided by applicant in mail or telephone application; (6 & 7= Comparison Group)
Applicant's Income *	1= $1,000- 31,000; 2= $32,000- 46,000; 3= $47,000-64,000; 4= $65,000- 1,250,000
Loan Type	1= Conventional (any loan other than FHA, VA, FSA, or RHS loans); 2= FHA-insured (Federal Housing Administration); 3= VA-guaranteed (Veterans Administration); 4= FSA/RHS (Farm Service Agency or Rural Housing Service)
Loan Purpose	1= Refinancing; 2= Home Improvement; 3= Home purchase; 4= Multifamily Dwelling
Loan Amount *	1= $1,000- 44,000; 2= 45,000-69,000; 3= 70,000-92,000; 4= 93,000- 8,775,000
High Minority Tract	1= Tracts identified as high minority (greater than 17.4%); 0= Tracts identified as low minority (less than 17/4%)
Low-Income Tract	1= Tracts identified as low-income (less than $38,408); 0= Tracts identified as high income (greater than $38,408)

** Continuous variable in regression. Collapsed into quartiles for cross tabulations.*

Table 2. Distribution of Variables (Per Tract)

Census Tract	Percent of Subprime Loans	Minority Population Percentage	Median Income
1.01	29.3%	3.2%	$32,188
1.02	37.3%	3.4%	$47,025
1.03	28.8%	3.9%	$35,000
2.01	33.3%	5.3%	$39,125
2.02	27.5%	4.0%	$35,093
3.00	28.6%	9.7%	$32,439
4.00	30.6%	6.0%	$33,665
5.00	43.2%	14.8%	$36,613
6.00	32.7%	5.6%	$36,153
7.01*	29.3%	22.5%	$32,951
7.03	27.1%	2.6%	$47,009
8.02	26.7%	2.2%	$49,512
8.03	29.2%	3.9%	$40,546
9.01	30.4%	3.3%	$45,280
9.02	29.8%	2.5%	$48,875
10.00	26.9%	6.0%	$38,629
11.00*	42.1%	35.8%	$29,375
12.00*	37.4%	62.0%	$26,436
15.00	28.5%	10.25	$42,353
17.00*	28.9%	75.8%	$26,490
18.00	49.0%	7.9%	$30,573
19.00	36.3%	4.0%	$38,397
21.00	37.0%	7.2%	$35,186
26.00*	26.2%	52.1%	$23,472
27.00*	29.3%	39.1%	$23,256
28.00	20.9%	5.7%	$40,362
29.00	27.8%	7.5%	$33,620
30.01	17.5%	2.2%	$48,750
31.00	27.3%	1.3%	$67,917
32.00	29.5%	2.1%	$61,809
39.00	30.8%	12.6%	$42,088
40.01	31.5%	4.7%	$46,368
40.02	27.9%	4.8%	$76,467
41.00	31.2%	3.0%	$46,563
42.00	23.0%	8.7%	$27,414
43.00	28.8%	4.8%	$40,716
44.00	25.3%	9.4%	$37,448
45.01	28.0%	8.0%	$45,969
45.02	22.0%	4.9%	$35,145
46.01	30.7%	3.6%	$42,391
46.02	30.4%	6.4%	$33,591
48.00*	31.0%	28.0%	$28,333
49.00*	16.7%	35.7%	$26,849
50.00*	36.0%	67.1%	$22,711
51.00	27.8%	6.8%	$16,875
52.00*	37.8%	19.8%	$22,173
53.00	30.4%	7.7%	$38,438

* Those identified as having a higher probability of being reverse redlined.

Table 3. Crosstabulations of Variables

Purpose	Not Subprime	Subprime
Refinancing	67.4%	32.6%
Home Improvement	92.5%	7.5%
Home Purchase	65.2%	34.8%

Loan Amount	Not Subprime	Subprime
$1,000-44,000	82.4%	17.6%
$45,000-69,000	64.5%	35.5%
$70,000-92,000	65.8%	34.2%
$93,000-8,775,000	65.9%	34.1%

Income	Not Subprime	Subprime
$1,000-31,000	66.1%	33.9%
$32,000-46,000	67.8%	32.2%
$47,000-64,000	70.3%	29.7%
$65,000-1,250,000	77.0%	23.0%

Applicant's Sex	Not Subprime	Subprime
Male	69.9%	30.1%7
Female	68.8%	31.2%
Information not provided by applicant in mail or telephone	70.4%	29.6%

Applicant's Race	Not Subprime	Subprime
American Indian or Alaskan Native	61.5%	38.5%
Asian or Pacific Islander	75.6%	24.4%
African-American	61.4%	38.6%
Hispanic	67.3%	32.7%
White	69.3%	30.75
Other	73.8%	26.3%
Information not provided by applicant in mail or telephone	71.6%	28.4%

Loan Type	Not Subprime	Subprime
Conventional	72.4%	27.6%
FHA-Insured	49.4%	50.6%
VA-Guaranteed	54.6%	45.4%

Note: Column totals=100%

Table 4. Logistic Regression (Classification of Loan as Subprime/Not Subprime)

Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	520.604	14	<.001
	Block	520.604	14	<.001
	Model	520.604	14	<.001

Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	32.671	8	<.001

Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	9051.395	.064	.091

Classification Table

Type of Lending	Not Subprime	Subprime	Percentage Correct
Not Subprime	3377	2167	60.9
Subprime	902	1431	61.3
Overall Percentage			61.0

Table 4 (Continued).

Variables in the Equation

Variable	**B**	**S.E.**	**Wald**	**df**	**Sig.**
Applicant's Sex			11.940	2	.003*
Male	-.496	.148	11.292	1	.001*
Female	-.515	.151	11.643	1	.001*
Loan Amount	.001	.000	1.870	1	.171
Applicant's Race			13.558	6	.035*
American Indian or Alaskan Native	.253	.596	.180	1	.671
Asian or Pacific Islander	-.014	.221	.004	1	.950
African-American	.627	.194	10.474	1	.001*
Hispanic	.263	.201	1.7000	1	.192
White	.253	.132	3.699	1	.054
Other	-.006	.284	.000	1	.984
Type of Loan			125.030	2	<.001*
Conventional	-.694	.215	10.420	1	.001*
FHA-insured	.234	.222	1.107	1	.293
Applicant's Income	-.005	.001	33.119	1	<.001*
Purpose of the Loan			168.743	2	<.001*
Refinancing	.163	.061	7.152	1	.007*
Home Improvement	-1.546	.139	123.638	1	<.001*
Constant	.160	.227	.495	1	.482

* Significant at the $p < .05$ level

Table 5. Logistic Regression (Classification of Loan as Reverse Redline/Not Reverse Redline)

Omnibus Tests of Model Coefficients

		Chi-square	Df	Sig.
Step 1	Step	250.282	14	<.001
	Block	250.282	14	<.001
	Model	250.282	14	<.001

Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	8.988	8	.343

Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	1980.475	.031	.127

Classification Table

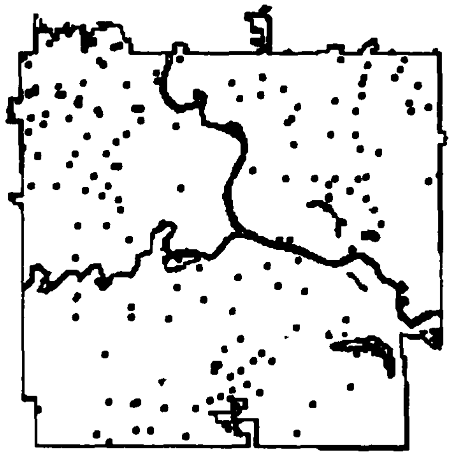
Redornot	Not Reverse Redlined	Reverse Redlined	Percentage Correct
Not Reverse Redlined	5304	2321	69.6
Reverse Redlined	70	182	72.2
Overall Percentage			69.6

Table 5 (Continued).

Variables in the Equation

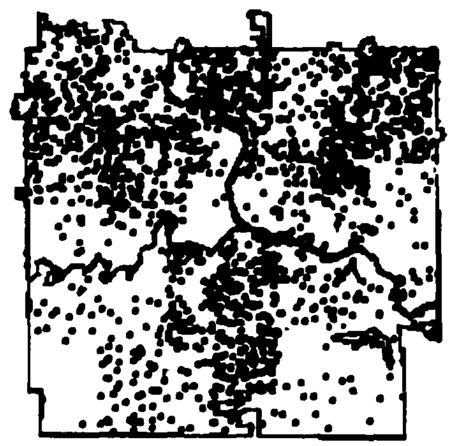
Variable	B	S.E.	Wald	df	Sig.
Applicant's Sex			.906	2	.636
Male	-.308	.329	.879	1	.349
Female	-.255	.335	.577	1	.447
Loan Amount	-.017	.003	41.059	1	<.001*
Applicant's Race			115.513	6	<.001*
American Indian or Alaskan Native	-4.259	10.016	.181	1	.671
Asian or Pacific Islander	.130	.468	.077	1	.781
African-American	1.629	.344	22.401	1	<.001*
Hispanic	.314	.420	.557	1	.455
White	-.560	.304	3.396	1	.065
Other	-.541	.765	.501	1	.476
Type of Loan			5.535	2	.063
Conventional	-1.079	.504	4.580	1	.032*
FHA-insured	-.761	.530	2.064	1	.151
Applicant's Income	-.014	.003	16.167	1	<.001*
Purpose of the Loan			45.163	2	<.001*
Refinancing	.452	.173	6.806	1	.009*
Home Improvement	-1.685	.368	20.915	1	<.001*
Constant	-.374	.554	.456	1	.500

* Significant at the $p < .05$ level



198 Subprime Loan Originations made in Des Moines in 1994

• = 1 subprime loan



1,903 Subprime Loan Originations made in Des Moines in 1999

• = 1 subprime loan

Figure 1. Subprime Loan Originations made in Des Moines in 1994 and 1999

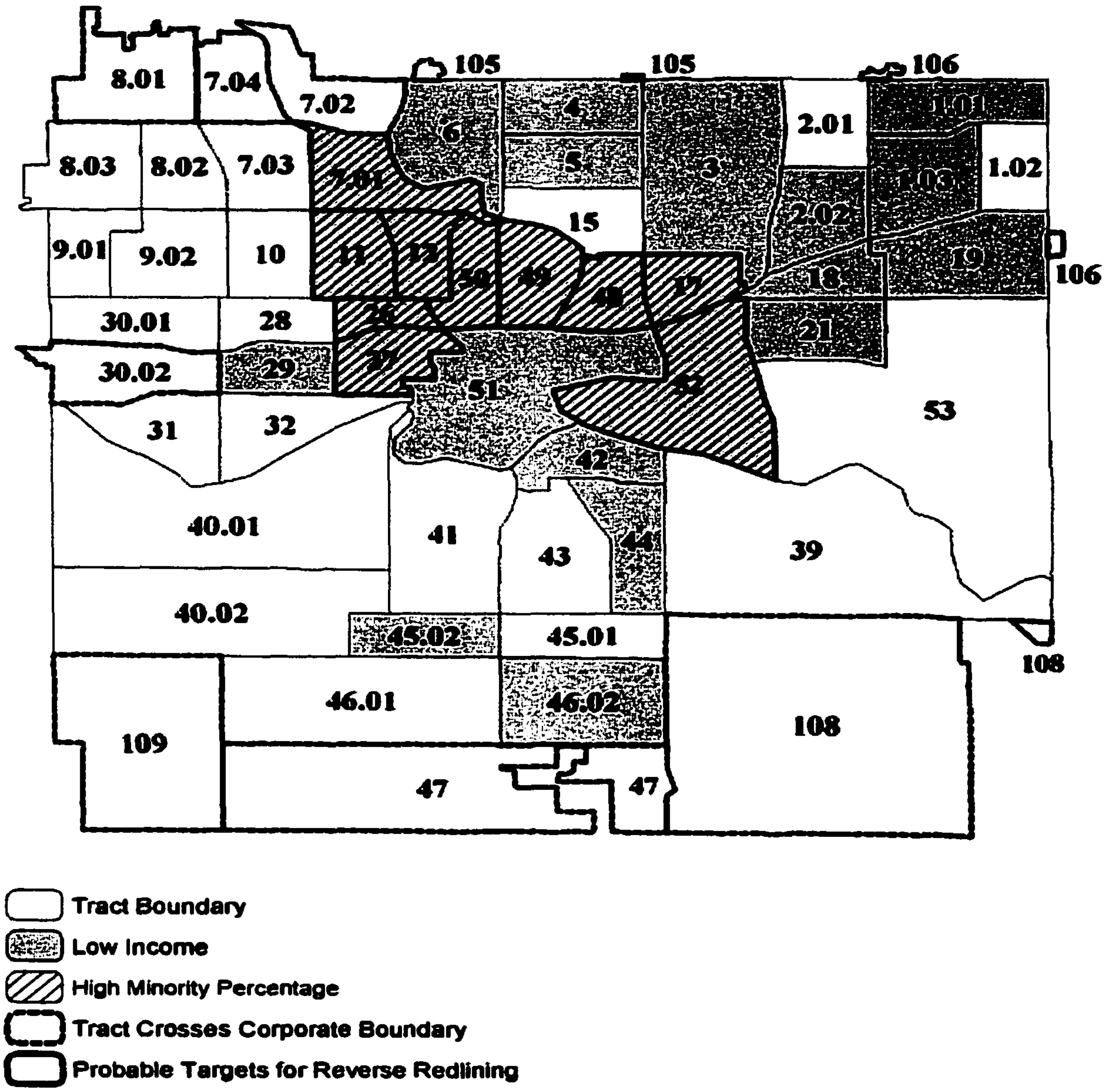


Figure 2. Census Tracts for the City of Des Moines

CHAPTER 4. Exploring Predatory Lending in Middle America

A paper to be submitted to the

Journal of the American Association of Family and Consumer Sciences

Thessalenuere Hinnant-Bernard and Sue R. Crull[1]

Abstract

In this research endeavor, the impact of predatory lending and discriminatory marketing techniques are examined through a qualitative review of data files. Citizens for Community Improvement (CCI) assembled the data files from interviews with homeowners regarding their concerns about their mortgages in response to an announcement of Fannie Mae's Anti-Predatory Lending Initiative. Qualitative data from the files of the 27 homeowners at the CCI office in Des Moines, Iowa were examined. Six complaint files from the Iowa Attorney General's office supplied data to highlight the activities of abusive contract sales. Repeated phone calls were the primary marketing strategy used by predatory lenders and contract sellers. The data suggest that educating the public about predatory lending tactics is a key component to combat negative aspects associated with home loans or contracts.

Introduction

The purpose of this research is to explore the impact of predatory lending and discriminatory lending practices in Middle America, Des Moines, Iowa. The objective is to determine the marketing techniques employed by predatory lenders and examine the characteristics and concerns of households who believe that they may be victims of predatory

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loans or contracts. This qualitative approach using homeowner files, which include their experiences written in their words, allows the practices of predatory lending to emerge through the voices of the victims.

Predatory lending has become a serious problem for many homeowners and potential homeowners in the United States. Predatory lending is a combination of unfair or abusive loan terms, unscrupulous and misleading marketing, and high pressure lending tactics that limit information or choices available to a consumer (Davis, 2000). It is of great concern locally and nationally. For example, locally Citizens for Community Improvement (CCI) and Conseco Finance Corporation agreed to a new lending program that should help staunch predatory home mortgage loans in the state of Iowa (Dinnen, February 2, 2002). The new program seeks to set standards for legitimate subprime loans. Conseco had been previously charged with crafting many of its loans in ways that were detrimental to borrowers. In 1999 Conseco made 2,700 subprime mortgage loans in Iowa. Nationally, the Bush administration also launched the *credit watch* program to provide additional protection for homebuyers to help curb predatory lending (US HUD, August 2002). With this program HUD has the authority to bar lenders from issuing FHA-insured mortgages if their default and claim rates on average exceed the national default and claim rate (US HUD, August 2002).

Predatory Lending

The expansion in lending initiatives has created unprecedented opportunities for ownership among low- to moderate-income (LMI) families, racial and ethnic minorities, and other populations once excluded from the nation's mainstream housing finance system (Wyly, Cooke, Hammel, & Hudson, 2001). This increased activity also provides predatory lenders with opportunities to take advantage of those considered less sophisticated. Predatory lending is a collection of abusive practices that are made with malicious intent of gaining resources from others. Common predatory lending practices include, but are not limited to, solicitations of targeted neighborhoods (repeated phone calls, mail solicitations, etc.), high interest rates (rates not justified by risk), balloon payments (most of principal is stilled owed at end of loan), flipping (repeated refinancing), and asset based lending (lending with disregard to borrower's ability to repay).

"Predatory and abusive practices by mortgage lenders and brokers, which impose excessive and unreasonable charges on homeowners, are pervasive and cause serious harm. The American dream of homeownership is jeopardized or denied by these pernicious practices" (Sturdevant & Brennan, Jr., 2000, p. 1). The practices undermine the stability of the neighborhoods where the loans are made. A major effect of predatory lending is rapid turnover of property and ultimately an increase in vacant housing structures. This affects property values and strips wealth from communities that can least afford to lose it (Davis, 2000). Vacant places become public nuisances as they become places where children play, squatters inhibit, and particularly places where criminal activity takes place. Predatory lenders abuse families until they can no longer meet their housing expenses. Predatory lending also leads to a high volume of foreclosures, which are costly to the holder of the mortgage. Each time a foreclosure takes place a family is displaced.

Predatory lending practices raise serious issues about fair housing and fair lending concerns, largely because banks and their mortgage and /or finance company subsidiaries appear to be representing the market and targeting minority communities for higher priced, lower quality products (Housing Ohio). There remains strong concern that lending discrimination persists, even after years of scrutiny (Courchane, Nebhut, & Nickerson, 2000).

Predatory lending violates the fair housing act of 1968 and the Equal Credit Opportunity Act of 1972. Specifically, predatory lending targets minority households which is a violation of their protected class (Housing Ohio).The Fair housing Act of 1968 "requires equal treatment in terms and conditions of housing opportunities and credit regardless of race, religion, color, national origin, family status, or disability" (Bradley & Skillern, 2000, p. 5). The act has been amended now to include sex. The Equal Credit Opportunity Act of 1972 requires equal treatment in loan terms and availability of credit for all the previously listed categories as well as age, sex and marital status (Bradley & Skillern, 2000).

Fair Credit Reporting

Recent changes in the Fair Credit Reporting Act (FCRA) have been linked to the explosion in direct mail advertising and telemarketing by home equity lenders. The FCRA (public law 91-508) was enacted in 1971 to ensure that credit reporting agencies provide creditors with accurate, up to date information regarding one's credit history, and to ensure that this information is used only for permissible purposes. Credit covered by the FCRA includes personal, family, credit, household credit, and insurance. Identity, employment, credit history, and public record information are included as well. The FCRA sets forth legal standards governing the collection, use, and communication of credit data and certain other information about consumers (Federal Trade Commission, 2000).

In 1996, changes made under the act allowed lenders to offer pre-approved loans to lists of prospective customers obtained from credit bureaus (The case against predatory lending, URL). Many organizations discussing predatory lending make statements about aggressive marketing and advertisement techniques offering pre-approved loans and other products, but no formal research was found. According to CCI, (URL) predatory lenders aggressively market their loan products through mailings, telephone sales, door-to-door and partnering with home improvement contractors. Predatory lenders are lurking in areas where borrowers have traditionally found it difficult to obtain financing, now these households are routinely exposed to expensive and dangerous loans.

Fair Housing

The most frequently used concept related to predatory lending and fair housing is redlining. Predatory lending is known as reverse redlining (Reverse redlining, 1993). Redlining refers to a practice in which the extension of credit is limited in targeted areas usually minority or low-income neighborhoods. Racial redlining encompasses the direct refusal to lend in minority neighborhoods that also includes procedures that discourage mortgage loan applicants from minority areas. Mortgage lenders figuratively draw a red line around minority neighborhoods and refuse to make mortgage loans available inside the red lined area (Brown and Bennington, 1993).

"In direct economic terms, racial redlining reduces housing finance options for borrowers in minority neighborhoods and weakens competition in the mortgage market. This often results in higher mortgage costs and less favorable mortgage loan terms. More subtly, racial redlining discourages minorities from pursuing home ownership opportunities and in the broadest sense further entrenches the debilitating sociological effects of racial discrimination" (Brown & Bennington, 1993).

> Reverse redlining specifically targets the minority or low-income neighborhoods to extend loans with predatory characteristics. Neighborhoods that had previously been ignored (redlined) are now experiencing active recruitment for home loans, equity loans, and contracts. "Increasingly, sub-prime lending is becoming the only option of all too many low-income and minority borrowers. This reality sadly documents the continued existence of the race line in America and the continued existence of the dual lending

> market in the United States. Whereas before, African Americans were openly denied access to credit, today the "race tax" is more sophisticated, more costly – and equally exploitative. Where once redlining undermined communities, today "reverse redlining" has become the norm and threatens to undermine our communities' economies, social services, and tax base. Sadly, an analogy to racial profiling is appropriate here. We have all become familiar with the term "Driving While Black." Sub-prime predatory lending has become the equivalent of "Borrowing While Black" *United States Senate Committee on Banking, Housing, and Urban Affairs (2001).*

Contract Real Estate Sales

Contract real estate sales can also include predatory lending practices. A contract real estate sale is a purchasing method that does not use third party financing through a bank or other financial lending institution. The seller and the buyer are the only two parties involved. The seller has a legal title that means the seller legitimately holds the title to the home until the buyer completes the purchase. The buyer holds an equitable title that recognizes that the buyer has the authority to have the title transferred to him/herself upon completion of the contract.

According to literature from Citizens for Community Improvement (CCI) of Des Moines redlining has been attributed to the origination of predatory contract real estate sales (CCI). Knowing that banks would not lend to particular areas opened up the market of selling houses on contract, thus reverse redlining. Abusive contract sales are detrimental to homeowners and their stability in the same way as predatory mortgages and equity loans.

Social Conflict Theory

Most research on the topic of predatory lending has occurred at the grassroots local level without much consideration its theoretical underpinnings or its examination in a broader societal context. It is possible however, to explain predatory lending in terms of social conflict theory. Taking a more theoretical approach than previous research on this topic, contributes to a better understanding of both the process-tactics-used in predatory lending as well as revealing solutions-strategies-for its eradication.

The basic premise of social conflict theory is that society is in a constant state of disagreement with only temporary periods of stability. The major constructs of social conflict theory are power, coercion, authority, and stratification. Power refers to the ability to get others to do what you want even against their will. Power is legitimate because it is sanctioned by social norms (Farrington & Chertok, 1993). "... theorists are interested in how society's institutions- including the family, government, religion, education, and the media- may help to maintain the privileges of some groups and keep others in subservient positions" (Schaefer, 2002, p. 15). The theoretical emphasis is on the distribution of power in any social group, organization, or society (Kammeyer, Ritzer, & Yetman, 1994).

Conflict is natural (Spencer, 1989). In this theoretical framework, incumbents, those with greater power and resources are engaged in a continuous struggle with those with fewer resources. Thus conflict exists because individuals are motivated to act in accordance with their own interests (Farrington & Chertok, 1993). Those victimized, however, may form alliances. In social conflict theory, conflict can increase internal cohesion among community members and community advocates.

As the name implies predatory lenders prey on homeowners' equity and attempt to take control of resources. Homeowners are also interested in building equity and maintaining control of their neighborhoods. They share a common interest in controlling resources, which is where the conflict occurs. The dominant group, in predatory lending, is the lenders and the weaker group is the unaware homeowners. The homeowners are approached by persons to whom they can relate; persons who are friendly, well educated, and appear to instilled with nothing but good intentions. In this scenario, the predatory lender seeks only to make a profit as the expense of the homeowner. Made aware of the activity of unscrupulous predatory lenders, however, victimized homeowners can coalesce and organize to minimize or eliminate these practices. Since conflict has the ability to bring people together, community advocates are likely to arise that are willing to fight the common enemy. This can be a blueprint for what communities and advocates for healthy communities.

Methodology

Two recent activities in the state of Iowa, the second specifically in Des Moines, have contributed to the availability of qualitative data for this study. The first is legislation passed in the state in 2002 which was proposed by the Attorney General's office to regulate contract sales. This proposal was the result of numerous complaints received by the Iowa Attorney General. Personnel from the Attorney General's office estimated that they received about 40 complaints annually on contract sales (L. Ludwig, personal communication, November 15, 2002). Per the request of Freedom of Information Act (FOIA), the Iowa Attorney General's office supplied six recent complaint files regarding abusive contract real estate sales.

The second activity is a partnership formed between CCI in Des Moines and the Federal National Mortgage Association (Fannie Mae). The National Training and Information Center (NTIC) from six states partnered with the Federal National Mortgage Association (Fannie Mae) in July 2000 to support local organizing on predatory lending. Fannie Mae piloted the program in Chicago where it announced plans to buy $5 million of refinancing loans to help predatory lending victims in Chicago. The loans are available to people who make less than 80% of the area's median income for single-family homes and two-flats (Fannie Mae). A similar initiative is available through CCI in Des Moines (Des

Moines, Iowa). On February 22, 2002 Fannie Mae, CCI of Des Moines, local banks, and attorneys announced an innovative anti-predatory lending refinance initiative to help Des Moines homeowners obtain responsible mortgage loans (Dinnen, February 23, 2002). Shortly after the refinance initiative was announced in the local paper (Dinnen, February 23, 2002), homeowners began calling and coming to CCI. CCI supplied the files of 27 homeowners seeking assistance through the refinance initiative.

The files provided by the Attorney General's office and by CCI serve as the data for this qualitative study. By using the files of homeowners who describe their lending experiences in their own words, the voices of the victims express the impact of predatory practices. Through the voices, illustrations and patterns of the many faces of predatory lending emerge.

Contracts Sales Complaints and Related Legal Reform

Prior to the recent legislation passed in Iowa (House File 2565, West's No. 136) contract sales did not require appraisals, credit checks of purchaser, inspections, escrow, or title searches. According to an article in the Des Moines Register, characteristics of contract real estate sales include: overpriced houses, poor quality of houses, liens, unpaid taxes, balloon payments, high interest rates, high down payment, and in some cases condemned houses are sold ("Review finds", 2001).

A complaint filed with the Attorney General's office illustrates the quality of the house and how the seller handled roof repair:

> *"The original contract states that _____ will supply the materials to replace the roof on the said property. In March '99 we received a letter from ___stating that we had 30 days to replace the roof on the said property or he would proceed with foreclosure. He continued to verbally threaten to foreclose on the house if the work was not completed by his immediate deadline. We were summoned to the home of ___*

> *for a meeting stating that he wanted us to get a mortgage on the house because he didn't want to be out hanging for the next 15 years." (Homeowners- AG's File)*

As of April 1, 2002 there were 166 houses on the active public nuisance list for the city of Des Moines. Of those houses, 49% were involved in contract sales (Citizens for Community Improvement, Des Moines). Since 1998, Des Moines has had over 2,629 unregulated contract real estate sales according to literature distributed by CCI. A typical story was printed in a CCI flyer:

> *"I always figured my credit was too bad to own a home, so I jumped at the chance to buy a house on contract. What a mistake. The house they sold me was $48,000 turned out to be $55,000 at 14% interest when I went to sign the final papers. When I got my first water bill for $400, I found out there was a water leak under the house. Then the furnace they said was nearly new stopped working and I had to put my kids in a shelter temporarily. With all the extra costs, I eventually fell behind on my payment. That's when the contract holder served me a 30-day notice to vacate. All my savings went into the house. What is my family supposed to do now?" (CCI, 2001)*

In 2002, the state of Iowa passed a law that required sellers to disclosure more information for buyers of contract real estate sales. The law only applies to those who sell four or more houses on contract a year and excludes bankers and others already subject to disclosure laws (Rodd, February, 2002). The law consists primarily of three sections: disclosure statement, penalty, and civil liberties. The law requires that contract sellers disclose information regarding liens, unpaid real estate taxes and the assessed value of the house. A homeowner's complaint regarding taxes was given to the Attorney General's office:

> *"When I purchased this house, there were back taxes owed. ______ said I had to pay after March 2000. They still have not paid the prior taxes." (Homeowner- AG's File)*

Another requirement is that a contract seller, who intentionally provides false information or does not use reasonable care to determine accuracy, will be charged with fraudulent practice in the 5th degree (simple misdemeanor). The following homeowners were refused copies of the documents used for their transaction with the contract seller:

> *"We went to ________ office to attempt to get signed copies of our contract with them. But they refused to give us the rest of the signed copies under the grounds that is was a legal matter, even to the point where we were kicked out of their office, informed that we were trespassing, and the police would be called if we didn't leave and never come back." (Homeowner- AG's File)*

The law also states that a contract buyer found to have been discriminated against may within a year bring an equitable action to rescind the contract and award restitution. The law requires that real estate contract sales must be recorded in 45 days as opposed to the prior law of 180 days.

The CCI Fannie Mae Initiative and Interested Homeowners

The $3 million initiative is designed to provide relief to borrowers who have been victims of predatory lending. Fannie Mae plans to assist lenders in refinancing homeowners out of predatory loans or land contracts made under recognized predatory lending practices. This initiative is part of the Predatory Lending Intervention and Prevention Project (PLIPP) sponsored by NTIC and Fannie Mae. Included in the following sections are excerpts allowing the homeowners to speak candidly about their experiences with predatory loans and contract sales.

Des Moines CCI is responsible for identifying borrowers in need of assistance and also provides one-on-one counseling, and post-closing counseling including six months client follow-up required for all mortgages. CCI is interviewing homeowners who come to the agency for assistance. The procedure used by CCI is outlined below:

1. Homeowner contacts CCI for interview
2. CCI conducts interview with homeowner regarding their mortgage situation

3. CCI reviews homeowner situation- makes a decision regarding loan; pre-purchase counseling/ education
4. Legal advocate partner may negotiate down the terms of original loan
5. Loan committee reviews loan files monthly
6. Lender underwrites/ originates loan
7. Fannie Mae purchases the loan
8. CCI provides post-purchase/ early delinquency counseling

The data for this study are comprised of information gathered during step 2 listed in the CCI procedure above. This purposive sample is used to study the details of predatory lending practices. The respondents self-selected themselves as homeowners in trouble and possibly victims of predatory loans. It should be noted that not all interested persons seeking interviews with CCI of Des Moines were eligible for the lending refinance initiative.

Following the news release in February of 2002 about the refinance initiative, over 100 interested homeowners contacted CCI of Des Moines. These homeowners brought documentation of their loans with them to the interview so a complete assessment could be made. At the time of this study, 27 homeowners had made appointments and had been interviewed by Tyler Uetz of CCI. Some homeowners submitted written accounts of their interaction with lenders. These accounts are used to depict the experiences homeowners have had with financial institutions.

Homeowners were interviewed using the "Foreclosure Intake Questionnaire and the Document Review Checklist" provided by Fannie Mae to identify predatory loans. Some of the pertinent questions for this study are as follows:

- Background Information/ Household Demographics
  - Home Purchase Price?

- Original mortgage amount? Monthly payments?
- Current mortgage amounts and monthly payments?
- Property census tract?
- Second mortgage?

- Credit History
  - Before you refinanced your loan, did you stay current on your monthly mortgage payments?
- Mortgage History (how many times refinanced, loan amount, lender)
  - Reason for refinancing (i.e. home repairs, pay taxes, pay other bills, lower monthly payment)?
  - How did you come to contact the repair company (i.e. response to mail solicitations, door-to-door solicitation, phone call)?
  - How did you come to contact the specific lender/broker (i.e. contractor referral, referral from a friend/relative, mail solicitation, phone solicitation, door-to-door solicitation)?
  - Interaction with lender?
  - As a result of the refinancing, did your payments increase or decrease from your previous mortgage payments? By how much?

Information from Homeowners Interviewed by CCI

Although the interviews were conducted by CCI of Des Moines, the files void of names and street addresses were available for this study under the human subject guidelines of Iowa State University. Among the 27 homeowners, 20 were White and 7 were African American (Table 1). Seventeen of the households consisted of married couples. The homeowners ranged in age from the early 30's to the late 70's.Ten of the homeowners interviewed were female. The household size ranged from 1-10 persons (Table 2) with household incomes from $6,408 to $76,308 per year. As noted, predatory lending has stretched far beyond the confines of the city of Des Moines. Of the 27 homeowners, 19 reside in Des Moines, while 8 resided in surrounding areas including Altoona, Urbandale, and Greenfield.

The initial purchase price of the 27 houses ranged from $10,000 to $170,000. Estimates of current house worth ranged from $31,000 to $152,000. The current loans range from $21,700 to $157,000 with interest rates of 6.5%-15.43%. Three of the homes had loans higher than the current worth value.

The homeowners were asked questions regarding additional debt. Of those who answered this question 18 reported having additional debt. Examples of this additional debt include car loan, credit cards, medical bills, and personal loans. This led to a series of questions about bankruptcy. Twelve homeowners reported having filed bankruptcy previously and another 12 reported that their mortgages were not current (Table 2).

Twenty-five respondents refinanced their original mortgage at least once (Table 3). The loan amounts were between $12,662-114,900 and 16 received money from the transaction. There were several types of loan terms but three were most frequently cited: ARM 30 years, fixed 30 years, and a 15 year balloon (Table 3). Over one half of the respondents experienced an increase in monthly payments. Several homeowners reported that their house was in the process of foreclosure while only three received financial services from the same original and current lender.

Marketing Techniques Used in Predatory Lending

A major interest of this paper is the marketing techniques employed by the lenders. A breakdown of the marketing techniques reveal that eleven homeowners were contacted by phone, nine were contacted by mail, six were referred to the lenders, two saw advertisements on television, one found the lender in the phone book, and one homeowner's initial contact was arranged by a contractor. There were some homeowners with overlapping marketing techniques. Based on information in table 3, the most frequently utilized techniques were repeated phone calls, mail solicitations and referrals from friends, brokers, and financial institutions (Table 3).

Victims of predatory lending frequently describe being subjected to a flood of phone calls and letters from brokers and lenders, encouraging them to take out a home equity loan (The case against predatory lending, URL). They also advertise through television commercials, highly visible signs in neighborhoods, door to door solicitations, and flyers stuffed in mailboxes. Many companies deceptively tailor their solicitations to resemble social security or other government checks to prompt homeowners to open the envelopes and otherwise deceive them about the transaction (Sturdevant & Brennan, Jr., 2000). In the files from the Attorney General, one homeowner speaks about a referral received from their student loan collector:

> *"In 2000 (my husband) was dealing with a dispute over a guaranteed student loans that was being collected upon by the government through ______. We told them we could borrow no money from anywhere to pay off this. _______referred us to _______. They routinely referred people to _______mortgage. They would hold off on proceedings until they heard if we were approved for a loan with _____or not." (Homeownwer- AG's Office)*

Common predatory lending marketing techniques involve solicitations to targeted neighborhoods. Targeted populations consist primarily of elderly, minority, women and/or low-to-moderate income homeowners. These households are targeted because the access to conventional loans and other financial services is severely disproportionate. It has been suggested that elderly populations are usually equity rich and cash poor (Quercia & Rohe, 1992). One elderly homeowner in the CCI sample is a 65-year old widow with a fixed income of less than $18,000 year. She purchased her house five years ago for $130,000. It has been refinanced twice and currently she is behind in her mortgage payments. She describes her fear of not having enough money:

"I'm 65 years old and this is my one and only house I have ever owned at age 61. Please, please, please make them eat this loan; otherwise I am going to lose my house. My mortgage payment to ______was $519.13 it had all my taxes, flood insurance, and house insurance all in one taken out automatically from checking so its never late. The payment to _______was $597.95 so, 597.95+519.13= 1117.08 a month from 1476.24 = 359.16 left. That does not leave enough for car insurance, life insurance, gas, electric, food, clothing, phone, cable, newspapers and so on. I'm now in a financial bind." (Homeowner- CCI File)

Sales Techniques Used in Predatory Lending

Shifting unsecured debt into mortgages is a tactic used in the sale of the loan. The benefits of consolidating bills into mortgage loan are embellished without note of the disadvantages. This practice increases the monthly payments and exacerbates the risk that the homeowner will lose the home (Sturdevant & Brennan, Jr., 2000). Another sales tactic used is commonly referred to as bait and switch. Bait and switch simply means that a lender offers one set of loan terms when the borrower applies but pressures the borrower to accept worse terms at closing (National People's Action, URL).

Inaccurate appraisals are of concern also. Borrowing more than the worth of the house can cause problems when/if the borrower decides to move and sell the house. A couple of the homeowners in this sample have loans that are higher than the current worth value of the home. This can be attributed to inaccurate appraisals. One homeowner referred to the appraisal as a *"drive by appraisal" (Homeowner- CCI File).* Predatory lenders are lending more money and being paid more money in return. One homeowner makes over $76,000 year and currently is in the process of foreclosure. He and his wife tried to refinance their loan in an attempt to save their home but found out they would not be able to do so based on the appraised value of the house:

"There were no problems until July/August of 1999 when we found out they had no intention of refinancing us because we owed more than the house was worth. Evidently it was appraised for more than it was worth when we bought it." (Homeowner- CCI File)

Loan Conditions Used in Predatory Lending

Predatory lenders charge interest rates well above prime rate and not justified by risk. Predatory lenders are able to charge these interest rates (frequently 14%-18%) because subprime borrowers with limited financial resources or knowledge may be relegated to finding credit at any price (The case against predatory lending, URL). Padded closing costs also are a method of getting additional money. Certain costs and fees are increased above the typical costs. One couple shares what they were told about their interest rate and consequently what took place:

> *"The broker said he had tried every bank in town and could not get us financing. After a day or so he called back to tell us that he was unable to come up with something but the interest rate would be high for a year. After we had made all of our payments for a year on time we would be refinanced at a lower and more reasonable rate. Our credit was being destroyed, so we decided to sell our home in August 2000 when the interest rate went from 11.3% to 13.1%." (Homeowner- CCI File)*

Another common practice associated with the actual loan in a predatory lending transaction is the balloon payment. This practice involves setting up a loan so that at the end of the loan period the borrower still owes most of the principal amount borrowed. The balloon payment is often hidden and is structured to force foreclosure or refinance.

Many loans are made without regard to the ability to repay. This type of lending is known as asset-based lending. Individuals who are equity rich and cash poor are prime targets for this tactic. This type of lending is designed to fail. Here is a description of one homeowners experience with asset-based lending:

> *"...we also did not have enough money for a down payment or closing costs, but we were again assured that we could get financed. After visiting with the mortgage broker, which turned out to be Mr. X's son, he also assured us that financing would not be a problem." (Homeowner- CCI File)*

Another homeowner questioned whether her income was even factored when she applied for the loan:

> *"No where does any of these papers show my income. What papers did he turn in to them to show income, or did he falsify a paper as to income to the loan company?"(Homeowner- CCI File)*

Still some predatory lenders will not take no for an answer. They will tell borrowers that there are ways to make the transaction of the loan possible. This homeowner states that she and her spouse could not afford the house:

> *"After showing it (the house) to us and then telling us the selling price, I told him it was just outside of our budget. He said he would show me a way to adjust my withholding exemptions to make better use of our finances." (Homeowner- CCI File)*

Predatory Techniques Used After the Closing

Loan flipping is a very common practice that occurs after the loan has been closed. Loan flipping involves the successive repeated refinancing of the loan by rolling the balance of an existing loan into an unnecessary new loan. There is usually no benefit to the borrower.

Prepayment Penalties are used to lock borrowers into high interest rates. Borrowers are charged huge fees when or if there is a decision to pay off a loan early (or possibly refinance into another one). Prepayment penalties are often times unknown to the borrower. One homeowner gives a description of how he and his wife discovered they had a prepayment penalty:

> *"By December Realtor X had sold our home. We knew we could sell it for what we owed so we were willing to take out an unsecured loan for $15,000. Everything concerning the sale seemed to be going fine until the lender called and told us we would have to pay a penalty of $18,000 for paying off our loan early." (Homeowner- CCI File)*

Abusive collection practices are utilized to make sure that the payments are received. Lenders continuously call homeowners at all hours. Some borrowers are contacted prior to the grace period. These tactics often involve threats to evict the homeowner immediately, even though the lenders know they must first foreclose and follow eviction procedures (Sturdevant & Brennan, Jr., 2000). This homeowner illustrates an episode that takes place as they attempt to make their mortgage payment:

> *"...we made our house payment by mailing them a check each month for $1247.30 and $330.31 to _____. Several times during August 1999-September 2000 ___ would accuse us of not sending in our payment when we had. Once they called and said if we did not overnight them the check it would be counted as bad credit, so we overnighted it to them only to have them cash both checks the next day." (Homeowner- CCI File)*

Foreclosure is a very realistic possibility for homeowners with predatory loans. Foreclosures affect everyone involved. They are costly to the holder of the mortgage, financially and emotionally. Each time a foreclosure takes place a family is displaced. This couple describes foreclosure as their only alternative:

> *"This was their final solution to our problem. We were told that we had to sell the home or face foreclosure. When it became clear that we had no other choice we sought legal counsel and were advised to file for bankruptcy and let the lender foreclosure on the home." (Homeowner- CCI File)*

While many of the loan terms previously mentioned may not be predatory on their own, the failure of the lender to fully disclose to the borrower the risk or cost associated with each individual term can make the loan package problematic, especially if the borrower is unaware that better terms may be available (Housing Ohio, URL).

Conclusions About Predatory Loans and Contract Sales

The Fair Credit Reporting Act and Fair Housing have been set in place to ward off discrimination, but as the rules are enforced the act of discrimination reinvents itself and returns with the same intent in mind. Homeowners in Des Moines were seeking lower interest rates, lower monthly payments, and the opportunity to get ahead. Instead they received loans with higher interest rates and monthly payments, in some cases payments that doubled in amount causing them to fall further into debt. Complaints from the Attorney General's office seem to echo these sentiments. Homeowners are not only paying excessive fees and back taxes, but they are paying for houses that are dilapidated and sometimes hazardous.

A purpose of this research is to describe discriminatory lending practices in Des Moines, Iowa and determine the primary marketing strategy. A recurring theme from the data suggests that loans are made with disregard to the households' ability to repay. Based on the interviews, repeated phone calls were identified as the primary marketing tool followed by mail solicitations, and referrals.

Predatory Lending is readily practiced in Middle America. "Subprime loans now constitute about 20% of home loans in Des Moines, said Tyler Uetz, an organizer with Des Moines based Citizens for Community Improvement, who estimated that about 10% of these mortgages could be classified as predatory" (Dinnen, February 23, 2002). At the time of this study no homeowners had received any funding from the Fannie Mae initiative. Uetz said that he is currently working with two borrowers and is optimistic that they will be refinanced. Borrowers from several lenders have joined CCI to take on the problems they have experienced. CCI will be holding meetings with borrowers from these selected lenders in the near future. Families and individuals are encouraged to speak out about the abuses they have suffered at the hands of their lender or contract seller.

Limitations for this research study include the sample size and the type of sampling technique used. Generalizations can not be made due to the size of the sample and the use of purposive sampling. Another limitation is the specifics of the data files. The data files need to be more thoroughly and consistently organized. Some files were very specific, including demographic, household, and mortgage history while others were not. This, by no means, could imply that the study is unimportant. One improvement should include increasing the sample size by waiting until the initiative has been "in service" for at least one year. Another alternative is to perform a longitudinal analysis of the households entering and exiting the program and possibly a six to eight month follow-up to measure the impact of the initiative. As for the Attorney General's office it may help to perform a thorough search of more of the files and possibly look for overlapping and new themes. As the consumers become wiser the abusive lenders become more creative.

Legal restrictions to prevent predatory lending have been approved in Chicago, Massachusetts, New York State, and North Carolina. Thus far, two predatory lending companies have been held accountable for their actions. Citigroup, Inc. agreed to repay customers $215 million to settle federal charges that a company it acquired manipulated people into buying overpriced mortgages and credit insurance (Ho, 2002). About 2 million victims will receive cash refunds or reduced loan balances to compensate for their losses. Another settlement of $484 million was reached with one of the nation's largest predatory mortgage lenders, Household International, Inc. Of the $484 million, Iowa stands to gain $1.3 million in direct restitution (Rodd, October, 2002). "While the record restitution in the household case seems huge, the amount pales next to the financial losses of the company's victims nationwide" (Rodd, October, 2002, p. 2B).

This qualitative study illustrates the kind of treatment that homeowners experience when seeking assistance from predatory financial institutions or contract sellers in the Des Moines area. It also pushes for legislation, education, and outreach to deal with the problem. Sorenson (2002) suggested that the best way to fight against abusive lending practices is through consumer education. "This is clearly an area where the lending community and community based organizations can partner to help Iowans make better financial decisions" (p.40P). He continued by stating that having some knowledge of our lender and how he/she conducts business are the best defense against those who might prey on unsuspecting (Sorensen, 2002, p.40P).Although this study provides limited information, it does give a voice to victims of predatory lending and permits the reader to become aware of predatory lenders and how they operate.

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Table 1. Sociodemographic Profile of Homeowners

	Race	Age	Sex	Marital Status	Census Tract	Tract Characteristics
1	White	79	Male	Married	21	Low-income, low minority
2	White	41	Male	Married	107.01*	
3	African American	49	Female	Married	8.01	Partial
4	White	58	Male	Married	28	High-income, low minority
5	African American	54	Male	Married	104.04*	
6	White	Mid 30s	Male	Married	9601*	
7	White	Upper 40s	Female	Divorced	48**	Low-income, high minority
8	White	48	Male	Married	112.01*	
9	White	Mid 30s	Male	Married	105	Partial
10	African American	Mid 30s	Male	Married	27**	Low-income, high minority
11	White	Mid 50s	Male	Married	19	Low-income, low minority
12	African American	71	Female	Married	18	Low-income, low minority
13	White	Mid 40s	Female	Divorced	53	High-income, low minority
14	African American	50	Male	Single	105	Partial
15	White	Mid 50s	Female	Single	105	Partial
16	White	Mid 50s	Female	Divorced	43	High-income, low minority
17	White	Mid 40s	Male	Married	46.01	High-income, low minority
18	White	60	Female	Widow	19	Low-income, low minority
19	White	Early 40s	Male	Married	9804*	
20	African American	50	Female	Divorced	2.01	High-income, low minority
21	White	56	Male	Married	50**	Low-income, high minority
22	White	Early 50s	Male	Single	107.01*	
23	White	Early 30s	Male	Married	3	Low-income, low minority
24	White	40	Male	Married	106	Partial
25	White	Early 40s	Female	Married	9703*	
26	White	64	Female	Widow	301*	
27	African American	Early 60s	Male	Single	27**	Low-income, high minority

* Reside outside of Des Moines, Iowa

**Tracts identified as Low-income (< $38,408 median household income for the city),
High minority (> 17.4% minority population for the city)

Partial= Tracts that cross the corporate limits of a city

Table 2. Household Demographics/ Credit History

	HH Size	HH Income	Year purchased	Purchase Price	Current mortgage/ Monthly	Current Interest	Include escrow original/ current	File Bankruptcy	House Worth	Other debt
1	3	21,600	1966	10,000	76,000/ 783.95	10.99	Y/ N	Y	56,960	Y
2	10	76,308	1998	159,900	157,000/ 1,896.59	11.30	Y/ Y	Y	152,000	N
3	4	33,480	1989	50,900	79,5000/ 1,209.57	14.806	Y/ N	Y	90,190	Y
4	9	38,000	1999	77,600	66,228/ 915.91	*13.39/ 14.25	Y/ N	Y		
5	4	31,176	1990	78,000	114,700/ 1,015.06	10.10	Y/ Y	Y	126,000	Y
6	6		1997	67,000	74,000/ 774.12	11.80	Y/ N	N	93,500	Y
7	1		1988	15,000	48,000/ 451.83	10.38	Y/	Y	54,000	Y
8	2	36,372	1978	39,900	83,300/ 787.00	10.90	N/ N	N	97,000	Y
9	3		2000	98,000	98,000/ 1,064.96	12.75	N/N	N	115,000	N
10			1994	28,500	51,500/ 695.00	15.40	N/N	N	64,500	Y
11			1987	36,000	42,000/ 432.02	12.0	Y/N		44,440	N
12	3	12,012	1972	30,000	/ 591.00	15.43		N		Y
13	3	30,000	1988	39,000	59,500/ 649.25	10.75	Y/Y	Y	69,525	Y
14	1	55,744	1996	66,400	85,000/ 800.00	10.50	Y/N	N	115,000	Y
15	1	6,408	1998	40,000	42,250/ 384.90	10.45	/N		60,000	
16	3	17,160	1985		79,200/ 668.53	11.25	/N	Y	68,110	Y
17	2		1990	57,500	45,000/ 392.00	6.50				Y
18	1	14,400	2000	61,646	74,250/ 756.14	10.13	/Y	Y		Y
19	4	46,000			27,757/ 308.21	10.50	/Y	N		Y
20	3		1987	53,720	67,000/	9.50	Y/N	Y		
21	5	32,172	1984	28,000	63,000/ 661.29	9.59	Y/N	Y	70,000	
22	4	45,180	2001	86,500	69,500/ 649.20	8.75	Y/Y	N	86,500	Y
23	4		1999	61,000	112,250/ 1,306.88	*7.5/ 16.0	Y/N	Y	90,000	Y
24	4	40,000	1996	38,400	76,500/ 699.78	10.50	/Y	Y	90,000	Y
25	2	22,572	1985	15,000	21,700/ 248.55	13.50	Y/Y	N	31,000	
26	1	17,712	1997	130,000	143,504/ 597.95	11.80	/N	N	135,000	
27	1	16,536	1965	170,000	38,138/ 512.00	14.90	Y/N		48,000-58,000	Y

* Two loans

Table 3. Mortgage History

	Current Lender	Original Lender	Refinance Original	Times Refinanced	Loan Terms	Receive Cash
1	Greentree	Plaza State Bank	Yes	3	20 yr.	Yes
2		Associates*	No	N/A	Fixed 18 yr.	N/A
3	Greentree	Union Planters	Yes	2	15 yr.	No
4	Citifinancial*	Commercial Credit	Yes	1	15 yr.	Yes
5	Money Store	Money Store	Yes	5	ARM 30 yr.	Yes
6	Traveler's Bank*	Union Planters	Yes	1	Fixed 30 yr.	Yes
7	Wisconsin Funding Corp.	Midwest Family Lending	Yes	1	ARM 30 yr.	Yes
8	NationsCredit*	Principal Residential Mortgage	Yes	1	15 yr. Balloon	Yes
9	Accred. Home Lenders*	Accred. Home Lenders*	Yes	1	15 yr. Balloon	No
10	Greentree	Contract Sale	Yes	2	15 yr. Balloon	No
11	Ameriquest*	First National	Yes	1	ARM 30 yr.	Yes
12	Conseco Financial Services*		Yes	1	Fixed 20 yr.	No
13	Mortgage One	Bank of America	Yes	2	ARM 30 yr.	No
14	North America Mortgage	Mercantile	Yes	1	ARM 30 yr.	Yes
15	NationsCredit*	SRS	Yes	1	15 yr. Balloon	Yes
16	First Union Home Equity	NationsCredit*	Yes	1	Fixed 30 yr.	Yes
17	ABN AMRO Mortgage	Principal	Yes		Fixed 15 yr.	Yes
18	Indymac	Mortgage Express	Yes	1	Fixed 30 yr.	
19	US Bank National Association	United Bank & Trust	Yes	1		
20	Vanguard Corporation	GMAC	Yes	1	40 yr.	
21	Greentree	Norwest	Yes	1	Fixed 15 yr.	Yes
22	Saxon Mortgage	Saxon Mortgage	No	N/A	ARM 30 yr.	N/A
23	Citifinancial*	Centex*	Yes	2	Fixed 30 yr.	Yes
24	Equicredit Corporation	Mercantile	Yes	1		
25	Rescue Mortgage	American General	Yes	1	15 yr. Balloon	Yes
26	Full Compass Lending	Firstar	Yes	2	Fixed 20 yr.	Yes
27	Citifinancial*	Associates*	Yes	2	Fixed 17 yr.	Yes

* Identified as subprime lender in Des Moines, Iowa (Based on 2000 HMDA data)

Table 3 (Continued).

	Mortgage Current?	Mortgage Current Before Refinancing?	Payment Change	Foreclosure	How Contacted By Lender
1	No	Yes	Increase	Yes	Phone
2	No	N/A	Increase	Yes	Referral
3	Yes	Yes	Increase	No	Phone
4	No	Yes	Increase	Yes	Mail/phone
5	No	Yes	Increase	Yes	Phone/TV
6	Yes	Yes	Increase	No	Mail/phone
7	Yes	Yes	Increase	No	Referral
8	Yes	Yes	Increase	No	Mail
9	Yes	N/A	Increase	No	Referral
10	Yes	Yes	Increase	Yes	Phone
11	No				Mail
12		Yes	Increase		Arr. By contractor
13		No	Increase	No	Phone Book
14	No	No	Increase	Yes	Phone
15	No	Yes	Decrease		Mail
16	Yes		Increase	Yes	Mail
17	Yes				TV
18		Yes	Increase		Mail (check)
19	No				Mail
20		No	Increase		Mail
21	No	Yes			Phone
22	Yes	N/A	No change	No	Referral by Mortgage Company
23	Yes	Yes	Increase	No	Phone
24	No	No	Increase		Referral by Firstar Bank
25	Yes		Decrease	No	Referral
26	No				Phone
27	No		Increase	No	Phone

CHAPTER 5. GENERAL CONCLUSIONS

In Middle America, Des Moines, Iowa, and other areas as well, subprime and predatory lending are real problems for homeowners, especially minorities and those residing in low-income neighborhoods. Through a number of abusive practices, such as high interest rates, excessive fees, and misleading terms, predatory lenders lock borrowers into contracts designed to cost more and/or lead to financial failure.

Predatory lending is always abusive. However, subprime lending is not. There are legitimate subprime lenders who assist homeowners who would not be eligible to receive a loan elsewhere. Subprime loans become predatory when they cross the line between "helping and hindering" and exhibit the previously mentioned practices. Predatory lending has been and should continue to be the subject of renewed debate and policy attention and especially in terms of discriminatory actions.

Fair housing laws were established to ensure that minorities were being treated fairly. Specific to this topic, race is not to be a factor in home lending practices. However, it is paradoxical when questions regarding race are not required for applicants applying through the mail or by phone. This makes it very difficult to use data from the Home Mortgage Disclosure Act (HMDA) to determine how much, if any, discrimination is occurring; thus providing an environment for abusive mortgage lending to prosper. The Fair Credit Reporting Act and Fair Housing have been set in place to ward off discrimination, but as the rules are enforced the act of discrimination reinvents itself and returns with the same intent in mind. In January 2003, race will be required in HMDA for all forms of mortgage applications.

The general purpose of this dissertation was to determine the prevalence and impact of subprime and predatory lending in a Middle American city. Lending patterns and marketing strategies, were also examined. An objective of this study was to determine the marketing techniques employed by predatory lenders. Another objective was to examine the characteristics of borrowers with subprime loans and victims of predatory loans or contract sales.

The two studies in this dissertation contribute to the understanding of housing mortgage lending and discrimination. Each study uses households as the unit of analysis and Des Moines, Iowa as the area of study. As shown through the interviews collected by Citizens for Community Improvement (CCI), predatory lending stretches beyond the Des Moines area. This is a very important topic because housing is a basic need of every family and an investment for many families.

One limitation in this study is the use of relatively small samples in only one city. Another is the unexplored or unreported area of marketing strategies used in predatory lending in the literature. Sources that do mention marketing have no systematic count of the frequency of marketing techniques that are used. A third limitation in this study is the lack of theoretical oriented research in the literature. Most research of predatory and subprime lending has been performed without theoretical orientation.

Two theoretical perspectives were used to guide the understanding of subprime and predatory lending in this dissertation: General Systems Theory (GST) and Social Conflict Theory. Systems theory was used to explain subprime lending, while conflict theory was used to explain predatory lending. According to GST each part serves a very useful function and contributes to the overall performance of the system. Discriminatory acts occur because parts of society are not functioning in a harmonious manner, thus providing the initiation of abusive subprime lending. Social conflict theory emphasizes positions of unequal power that may exist in social groups, organizations, or society. The incumbents of these positions, those with greater power and resources (the lenders, financial institutions, etc.) and those with fewer resources (borrowers, possibly those considered to be less sophisticated) according to this theory are engaged in a continuous struggle. Both theories provided insight into relevant aspects of how mortgage lending and contract sales can be problematic for homeowners and communities.

By integrating the two theories it is possible to understand the process of producing communities grounded in knowledge and equipped with skills useful for fighting abusive subprime lending and to alter the system beyond a local community through legislation and legal action to help regain stability and fairness in housing finance.

The first article, a qualitative study, explored subprime lending in the city of Des Moines using 2001 HMDA data. These data and 2000 census data were used to identify areas of reverse redlining. Reverse redlining refers to specifically targeting those neighborhoods to extend loans with predatory characteristics. Demographic characteristics of the tracts were studied in relation to the lending patterns of households to explore the concept of reverse redlining. The data revealed that African-Americans, low-income applicants, and applicants receiving loans for home refinance had a greater probability of becoming victims of reverse redlining than others. Also, this article established a logistic regression technique for testing the concept of reverse redlining using characteristics of the census tracts to designate areas where reverse redlining would occur. Based on the results of the logistic regression, households that were reverse redlined were predicted 72.2% of the time.

The second article, a qualitative study, discussed predatory lending and discriminatory marketing techniques in Des Moines, Iowa. Data generated from interviews conducted by CCI for the Fannie Mae/CCI Anti-predatory lending initiative revealed that abusive practices are occurring and that many of these predatory loans are designed with the intention of failing. The marketing tool used most often was repeated telephone calls followed by mail solicitations, and referrals. This article also explored the impact of contract real estate sales by reviewing homeowners' complaints filed with the Iowa Attorney General's Office. Numerous complaints regarding contract real estate sales suggest that abusive contract lending is also thriving in this area. A proposal submitted to the state legislature by the Attorney General's office to tighten guidelines for contract sales was recently passed into law in Iowa.

As a contribution, the research in the first article provides a creditable method for measuring reverse redlining that can be shared with policy makers and researchers to aid in understanding lending practices. The second article provides insight to the kind of treatment that homeowners experience when involved with predatory lenders and contract sellers in Des Moines, Iowa.

There are a number of policy implications for this study. The systematic investigation illustrated in this research could be replicated to scientifically document concepts and tactics used in predatory lending. More rigorous systematic study would help federal policy makers, local program administrators, and the general population better understand the predatory tactics and help them decide how to invest in efforts aimed in addressing problems with predatory lending and their potential targeting of neighborhoods identified as low-income and/or minority. In addition, the United States Department of Housing and Urban

Development (HUD) could assist local program administrators by producing a series of best practice reports to disseminate information about effective strategies for preventing or addressing problems with abusive lending tactics.

Often a push for legislation is the first approach suggested to curtail predatory lending. Also alerting the public about what is going on in their community is a good defense against abusive lending tactics. However, based on the experiences of the homeowners in Des Moines, it appears that education and outreach to help consumers to become knowledgeable and to be able to identify and deal with predatory lending practices may be the best approach of all to counteract predatory lending.

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