The Changing Face of Inequality in Home Mortgage Lending

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Revised January 2005
A slightly revised version of this paper will appear in the May 2005 *Social Problems*

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We thank Theresa DiVenti, Randy Scheessele, Sarah MacMillen, Robert Bossarte, Jessica Ziembroski, Maureen Hallinan, Mark Chaves, Greg Squires, Stephen L. Ross, John Yinger and several anonymous reviewers for their many valuable suggestions and assistance with this work.

The work that provided the basis for this publication was supported, in part, by funding under grants with the U.S. Department of Housing and Urban Development (Grant # HUD-H-21104RG) and the National Science Foundation (Grant #s SES01-12699 and SES02-22355). The substance and findings of the work are dedicated to the public. The authors and publisher are solely responsible for the accuracy of the statements and interpretations contained in this publication. Such interpretations do not necessarily reflect the views of the Government.

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Abstract

American homeownership has long been characterized by racial, ethnic and geographic inequality. Inequality in homeownership, in turn, has contributed to racial and class segregation and inequality in other aspects of American life. Recently, however, there have been signs of dramatic change, as minorities and low-income groups have achieved all time record high rates of homeownership. To explain these developments, we compare and contrast neoclassical economic theory, which suggests that banking deregulation, increased competition, better information and improved risk assessment reduce or eliminate mortgage market discrimination, with a sociological theory of networks that argues industry restructuring can disrupt markets and social relationships and create new opportunities for exploitation. We argue that, as the old inequality in home mortgage lending has slowly diminished, a new inequality has emerged, characterized by less favorable loan terms, sometimes-problematic forms of housing, and a lack of adequate consumer protection from predatory and abusive practices.

Specifically, we describe trends in subprime and manufactured housing lending in United States MSAs. Our study finds that such loans accounted for as much as half or more of the gains made by underserved markets between 1993 and 2000. Subprime lenders made particularly strong inroads among minority markets at all income levels. We discuss how the old inequality helped make the new inequality possible, and how the new inequality in home mortgage lending is part of a much larger phenomenon in which apparent gains made by minorities and low income groups have come at a far higher cost than gains made by other segments of society.

The Changing Face of Inequality in Home Mortgage Lending

American homeownership has long been characterized by racial, ethnic and geographic inequality. Inequality in homeownership, in turn, has contributed to inequality in other aspects of American life (Feagin 1999; Massey and Denton 1993). Recently, however, minorities and low-income groups have achieved all time record high rates of homeownership (U.S. HUD 2000c). This paper asks, why has there been such dramatic change – and what costs, if any, have been associated with it?

To answer these questions, we compare, contrast, and integrate two alternative theoretical explanations for these developments. Neoclassical economic theory (e.g. Becker 1957; Stiglitz and Weiss 1981) implies that banking deregulation, better information, improved risk assessment, and increased competition have reduced mortgage market discrimination. Sociological network theory (e.g. Tillman and Indergaard 1999) argues that industry restructuring can disrupt markets and social relationships, creating new opportunities for the exploitation of borrowers.

We argue that, in order to assess the relative merits and contributions of these two perspectives, it is necessary to examine exactly how home mortgage lending actually did change during the 1990s. Did low income and minority groups suddenly gain increased access to traditional, but now less discriminatory forms of lending? Or were their gains produced by new and possibly less desirable sources of credit?

To address these issues we do three things. First, we describe the general characteristics of finance industry change during the 1990s. We show that deregulation and industry restructuring led to increased competition, but also led to the rise of new lenders who were quite unlike the old. Second, we conduct empirical analyses that quantify the magnitude and nature of these changes. Specifically, we describe recent trends in subprime and manufactured housing lending. Via an analysis of home finance lending in United States MSAs during the years 1993-2000, we illustrate the increasing importance of each of these. We further examine how the activities of these lenders are related to race and income, noting there are key similarities between them but also important differences. Third, we discuss the theoretical and substantive significance, not only of our own findings, but also of related research. This other work, much of it descriptive, has offered important empirical findings but can now yield new insights by being re-interpreted in light of our theoretical framework.

We conclude that both theoretical perspectives offer insight into recent developments. Many of the recent homeownership gains represent real progress and, should they continue, inequalities will further diminish. But, as the old inequality has declined, a new inequality has also emerged, characterized by less favorable loan terms, sometimes-problematic forms of housing, and a lack of adequate consumer protection from predatory and abusive practices. We further conclude that the old inequality helped to make the new inequality possible, and that the new inequality in home mortgage lending is part of a much larger phenomenon in which apparent gains made by minorities and low income groups have come at a far higher cost than gains made by other segments of society. While we might reasonably argue that the new forms of inequality are better than the old, we must not lose sight of the fact that it is inequality nonetheless: recent gains in credit for underserved markets have come with a price.

The Old Inequality

As Reynolds Farley and William Frey (1994) point out, a good portion of the 20th century was characterized by legal and official discrimination and inequality. Federal agencies strongly endorsed redlining, and the ethical standards of the National Association of Real Estate Boards actually prohibited its members from introducing minorities into white neighborhoods. It was not until the passage of the 1968 Federal Fair Housing Act and the 1974 Equal Credit Opportunity Act that mortgage discrimination based on race became illegal (Walter 1995).[1]

Nevertheless, various authors have made it abundantly clear that whites and blacks continue to experience different results when it comes to obtaining a home mortgage (see Ross and Yinger 2002, and Nesiba 1996, for detailed reviews). For example, numerous studies have shown that blacks have much higher denial rates than seemingly comparable whites (e.g. Schaefer and Ladd 1981). The famous Boston Fed Study (Munnell et al. 1996) collected actual loan application data from Boston-area financial institutions in 1990, analyzing the variables that lenders themselves identified as important for making their decisions. The authors conclude that even if two mortgage applicants are identical financially, a minority applicant is 60 percent more likely to be rejected than a comparable white applicant is. Geographic differences also exist, as studies of several cities have shown large racial differences in home mortgage lending across neighborhoods. Based on such research, Douglas Massey and Nancy Denton (1993) conclude that

> Despite the diverse array of characteristics that have been controlled in different studies, one result consistently emerges: black and racially mixed neighborhoods receive less credit, fewer federally insured loans, fewer home improvement loans, and less total mortgage money than socioeconomically comparable white neighborhoods. (P. 106)

[1] The 1968 Federal Fair Housing Act is primarily aimed at eliminating discrimination by Realtors, rental agencies, and owners as well as those assisting with housing finance. The 1974 Equal Credit Opportunity Act is

The consequences of the old inequality have been well documented. Even though studies show a widespread desire across demographic groups for achieving homeownership (Fannie Mae Foundation 1998), both higher income and lower income minorities are less likely to own their own homes than white households with comparable incomes (U.S. HUD 1995). Similarly, homeownership rates are much lower in cities than in suburbs (50 percent versus 73.2 percent) and central city residents of all income levels are less likely to own a home than suburban residents with similar incomes (U.S. HUD 1999).

These disparities are unfortunate, because the benefits of homeownership to both individuals and society are well known. Homeownership is one of the primary means for accumulating wealth in the United States. Homeowners enjoy better living conditions than renters and have a higher sense of overall well being (Turner and Skidmore 1999). Additionally, homeowners tend to be more involved in their communities, helping to promote strong neighborhoods and good schools (Turner and Skidmore 1999; U.S. HUD 1999).

Joe Feagin (1999) discusses how blacks in particular have been hurt by their lack of homeownership. Because discriminatory practices limit the ability of all African Americans, including the middle-class, to build up housing equity, "Black parents often have been unable to provide the kind of education or other cultural advantages necessary for their children to compete equally and fairly with whites" (p. 86).

As Massey and Denton (1993) note, another related consequence of housing inequality has been racial segregation and the problems associated with it. Pervasive discrimination systematically channels money away from integrated areas, causing blacks to be the most spatially isolated population in U.S. History. Residential segregation, in turn, has led to class

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focused on all forms of personal and commercial credit transactions. Enforcement of both of these acts has been used to reduce discrimination in housing finance.

segregation for blacks. While poor whites are seldom highly concentrated, poor African American families are likely to live in census tracts where approximately 30 percent of the families are poor. This racial and class segregation builds "mutually reinforcing and self-feeding spirals of decline into black neighborhoods" (Massey and Denton 1993:2). Massey and Denton therefore conclude that "racial residential segregation is the principal structural feature of American society responsible for the perpetuation of urban poverty and represents a primary cause of racial inequality in the United States" (p. viii).

Recent Changes

The old inequality has been around for many decades. However, there seems to have been dramatic change in recent years. The proportion of total mortgage lending going to lower income families and minorities increased substantially during the 1990s (Day 2000; Federal Financial Institutions Examination Council 2000). Thanks to these gains, in September 2000 homeownership rates were at an all time high for central cities (51.9 percent), minorities (48.2 percent), Hispanics (46.7 percent), and households with less than the median income (52.2 percent). While it did not break the record (which was set earlier in the year), the Black non-Hispanic homeownership rate of 47.3 percent was substantially higher than the 42.9 percent rate of four years earlier (U.S. HUD 2000c).

While striking, this progress must be kept in perspective. While minorities, central cities, and lower-income individuals made advances, they continued to lag well behind the nation as a whole, where the overall homeownership rate was 67.2 percent. If current trends continue it will still take several years for past inequalities to be eliminated.

Even more critically, it must be kept in mind that, despite its many desirable aspects, homeownership is not universally beneficial. Low-income homebuyers can lose money if the value of their property decreases. Homeownership can be particularly problematic when borrowers lack the resources to repay their loans, resulting in foreclosures, abandoned properties and neighborhood deterioration. Before we can praise the seeming progress of recent years, we need to understand exactly how it was accomplished.

Why, after racial, economic, and geographic inequality in home mortgage lending has persisted for so long, has there been such dramatic change in such a relatively short period? In order to answer that question, it is important to first understand that the American finance industry has undergone major transformations over the last few decades.

As James Campen (1998) notes, prior to 1975, the finance industry was highly compartmentalized, with different types of institutions providing specific services and only limited competition with each other. Thrift institutions provided three-fifths of all home mortgage loans. By the 1990s, however, lending institutions were far less specialized, and thrifts were only the third largest provider of home mortgages, behind mortgage companies and commercial banks.

These changes were largely a result of banking deregulation, which increased the range of products and services that banks and other financial institutions could offer, eliminated interest rate ceilings, and greatly expanded the geographical areas in which individual companies could operate. As a result, the banking industry became far more competitive.

A more recent and also very important change in the home mortgage industry has been the development of new means for gathering information and doing risk assessment. The use of automated underwriting (AU) systems has grown dramatically since the mid-1990s. Developed by Fannie Mae, Freddie Mac and others, automated underwriting uses statistically based models to predict mortgage default based on the performance of millions of mortgages, offering "the potential for AU to be far more accurate than manual underwriting" (Gates, Perry and Zorn 2002:373). Susan Gates, Vanessa Perry and Peter Zorn (2002) estimate that 60 to 70 percent of residential mortgages now originate under automated underwriting systems.

What are the implications of this restructuring and other changes for low income and minority borrowers? Neoclassical economic theory and contemporary sociological network theory offer two very different answers.

Neoclassical Economic Theory

Reynold Nesiba (1996) asserts, and we concur, that neoclassical economists tend to begin with the assumption that prejudice-based discrimination in lending does not exist, or that if it does, a perfectly competitive market—which presumes perfect information and market entry—will lead to its eventual demise. As Nobel Prize winning economist Kenneth Arrow (1998) puts it, "market-based explanations will tend to predict that racial discrimination will be eliminated" (p. 93). To explain the economic grounds for optimism, we briefly discuss three neoclassical economic theories of discrimination and their collective implications regarding recent changes in banking competition and credit assessment (see Nesiba 1996 for a fuller discussion).

Chicago**.** Gary Becker (1957) argues that discrimination is a taste for which an individual must either pay (or forfeit) income in order to have the privilege of not associating with certain persons. One would expect prejudiced bankers to charge higher rates to minority group members. However, under competitive conditions, non-prejudiced competitors will eventually drive prejudiced lenders out of the market. Thus, when confronted with vigorous competition, racial discrimination in lending will not persist in the long run[2]. Hence, any seemingly biased lending patterns that do exist and persist across time must be caused not simply by racial preferences, but instead by imperfect competition or by differences in economic fundamentals such as a borrower's credit history, income, or wealth.

Credit Rationing. In contrast to the Chicago School perspective, the credit rationing perspective (Stiglitz and Weiss 1981) does not assume that lenders engage in preference-based bias or that they pay a cost for indulging their tastes. To understand credit-rationing models one must first understand the three key assumptions underpinning them. First, they assume asymmetric information—borrowers have private information about the likelihood of repayment that is unknown to the lender. Second, if lenders were to freely provide credit at the market-clearing rate of interest, perverse incentives would be created for borrowers. At the higher market-clearing rate the only borrowers who would attempt to obtain credit would be the riskiest borrowers willing to pay the highest rate of interest. The lender's expected return would not be maximized at that rate. Third, at the lower equilibrium (non-market-clearing) rate, some borrowers must be denied credit since the demand for funds is greater than the supply of funds. For Joseph Stiglitz and Andrew Weiss (1981), this means that banks may "deny loans to borrowers who are observationally indistinguishable from those who receive loans" (p. 394). The conclusion, then, is that under these circumstances, blacks could be denied credit relative to

[2] Not all economists agree on this interpretation of the Becker model. In an often-cited article in the *Journal of Economic Perspectives* (1998) James J. Heckman implies that discrimination may persist, "as long as income is received from entrepreneurial activity" (p. 112) (i.e., mortgage lending in the context of this paper) and as long as there are a sufficient number of nonprejudiced lenders. Heckman's insightful point is that as long as lenders have disposable income, they can continue to indulge their "taste for discrimination" indefinitely. Nesiba (1996) also points out that in conditions of imperfect competition, inequality can persist over time. However, like the Nobel Prize winning Kenneth Arrow (1998), we take the traditional long run interpretation of Becker's model. This presumes that after all adjustments have been made in a competitive market, including entry, non-bigoted bankers will take business away from bigoted bankers and eliminate disparate treatment discrimination. Although the law recognizes disparate impact discrimination—where a uniform practice has a discriminatory effect on a prohibited basis—this form of discrimination is not directly addressed in these three models.

equivalent whites without any costs to the lender and that this inequality could persist over time because of the need to ration credit.

Statistical Discrimination. A related theoretical case is “statistical discrimination” (see Lundberg and Startz 2000 for a survey of this literature). This occurs when a lender treats an individual based on the average performance of that person’s group membership. For example, if a lender finds that a particular group of borrowers have higher average default rates and then denies a loan application or charges a higher rate to a member of that group—independent of the individual’s other characteristics—then statistical discrimination has occurred. Such actions are considered “non-discriminatory” or “rational” in an economic sense because they are based on a factually accurate perception of the underlying actual risk and return of a borrower’s group affiliation. The borrower is adversely affected not because of bigotry, but because of an underlying true “statistical” basis. The result is of course the same; biased lending patterns persist despite an absence of overt racial prejudice. Unlike the Chicago school perspective where lenders engage in preference-based bias, with statistical discrimination lenders are presumed to engage in belief-based bias regarding differences among groups. This is done without malice toward any individual potential borrowers and also without cost to the lender (Longhofer and Peters 2004).

Neoclassical Implications. According to these three main microeconomic perspectives, biased lending patterns are not always a result of racial prejudice alone. Rather, biased lending patterns are the result of rational actions taken by lenders as they try to minimize their risks and maximize their profits. Should the underlying economic basis for these actions change, the biased lending patterns would presumably change as well. If, by some chance, a lender does engage in discriminatory actions for non-rational reasons, that lender will be economically punished and eventually driven out of a competitive market.

Nesiba (1996) challenges these microeconomic arguments and offers several critiques. He cites the extensive empirical literature that suggests that discrimination and unequal treatment of underserved markets does exist and also argues that there are several flaws behind the reasoning of these theories. With empirical trends having recently changed, however, the possibility arises that, thanks to deregulation, technological change, new forms of competition, and advancements in assessing risk, markets are finally starting to operate the way Becker and other economists said they always should. According to this view, legal limits on the range of services lenders can offer and on the geographic areas in which they can operate have artificially constrained competition. Now, freed from excessive government regulation, new lenders are finally starting to reach out to the markets that have been ignored in the past. Supporters of these changes say that freeing up the market geographically leads to increased competition, increased services, improved credit availability and a more efficient allocation of financial resources (Evanoff and Fortier 1986; Mengle 1990). Similarly, as Gates, Perry, and Zorn (2002) imply, improvements in risk assessment created through automated underwriting (AU) systems eliminate many of the information problems feared by credit rationing and statistical discrimination theorists. As a recent study from the Joint Center for Housing Studies at Harvard University (Apgar et al. 2004) puts it:

> Today's mortgage market bears little resemblance to the one that existed just a decade ago. Key changes include the increasing use of automated underwriting, credit scoring, and risk based pricing, as well as the development of a mortgage delivery system dominated by mortgage brokers, secondary market activities and national mortgage banking and mortgage servicing operations. With new low down payment products

> and a highly automated mortgage delivery system, the mortgage industry -- often operating through a network of mortgage brokers -- has dramatically expanded lending in the same low-income, low-wealth and minority neighborhoods that were once victimized by mortgage "redlining." (P. 1)

Hence, neoclassical economic theory offers possible and positive explanations for recent increases in lending to underserved markets. Sociologists Robert Tillman and Michael Indergaard (1999), however, present a theoretical perspective that offers a radically different interpretation of the possible effects of finance industry changes.

Sociological Theory of Networks

Tillman and Indergaard (1999) use sociological theories of networks to explain how economic restructuring in an industry can lead to crime and exploitation. They argue that, with economic restructuring, corporations "have abandoned markets or segments where they once supplied products or services" and that "such changes and related regulatory shifts are creating opportunities for crimes that cannot be explained by theories grounded in an earlier period" (p. 573). More specifically, they argue that market shifts disrupt networks. Social ties and understandings that guide transactions are eroded. Further, deregulation in an industry can create the opportunity for widespread misdeeds. New market actors can step in and exploit the situation. While they may be "untrustworthy agents" (p. 573), they can gain trust because they are being evaluated by individuals who are at a structural disadvantage. These untrustworthy agents, or "bogus brokers" (p.573) as Tillman and Indergaard call them, benefit from having information denied to other parties. The disrupted economic context in which they operate, caused by regulatory shifts, and ambiguous laws, make it difficult for regulators and prosecutors to control their activities.

Tillman and Indergaard focus on fraud in the health insurance industry, but, as we will show, the potential implications of their perspective go far beyond that. While generally not illegal, changes in the finance industry and growth in the manufactured housing industry have also made it possible for new forms of inequality to develop. As neighborhood bank branches close, new lenders and new kinds of lenders have entered the market. The connections or networks that used to exist—albeit underdeveloped in many cases—among local borrowers and local lenders are transformed. Economic restructuring and the disrupting of old networks have created additional opportunities for loans to underserved markets, but the nature of these loans is often very different from those made to other borrowers.

In summary, neoclassical economic theory and sociological network theory differ greatly in how they see the possible effects of changes in the lending industry. Neoclassical theory sees deregulation as increasing competition that benefits borrowers; network theory sees deregulation as potentially disrupting institutional relationships and creating new opportunities for exploitation. Neoclassical economic theory sees borrowers benefiting from lenders' improved information and risk assessment; network theory stresses that informational disparities can put borrowers at a structural disadvantage when dealing with creditors. In order to assess the relative merits and contributions of these two perspectives, we now consider more carefully the ways in which home mortgage lending actually did change during the 1990s.

The New Inequality: Subprime Lending and Manufactured Housing

In the Boston Fed Study (Munnell et al. 1996) the authors early on state one of their critical assumptions.

> It is assumed that both the mortgage rate and the rate at which lenders borrow are set by competition in the industry. Since the choice variable for the lender is not the interest rate but whether to grant the mortgage at all, mortgage applications are accepted or rejected at the mortgage market rate. (P. 27)

That assumption may have been largely true in 1990, when the authors collected their data. But, it is certainly not true today. Rather than be rejected, as they have been in the past, many borrowers can get a loan, if they are willing to go to lenders who offer higher interest rates and/or buy cheaper forms of housing. Subprime and manufactured housing lending (collectively referred to as "specialized lending") have made this possible.

Subprime Lending

Subprime (also called B and C) lending has historically referred to loans where a borrower has a blemished (or non-existent) credit record and a lender makes a higher fee, higher interest rate loan to compensate for the greater risk of delinquency and higher costs of loan servicing and collection. There is widespread consensus that subprime lending increased dramatically during the 1990s. The United States Department of Housing and Urban Development (U.S. HUD 2000d) estimates that home mortgage subprime lending went from $20 billion in 1993 to $150 billion in 1998. Perhaps because of differing definitions or methods, Steven Davidson (1995) and Bill Merrick (1999) provide even higher estimates.

While some have praised subprime lenders for providing homeownership opportunities to low income and minority borrowers (Levin, 1999), others have expressed concern. In particular, there is fear that some subprime lenders engage in "predatory" practices (Apgar 2000; Bradley and Skillern 2000; Consumer Reports 1998b; Goldstein 1999; Immergluck and Wiles 1999; Medine 2000). These practices include reverse redlining, where lenders target minority, elderly and low-income homeowners, charging them high interest rates and fees that are unrelated to the credit risk posed by the borrower; negative amortization, where payments are structured so they do not even cover interest, causing the principal balance to increase; prepayment penalties that keep borrowers from refinancing at lower rates; excessive fees, sometimes exceeding 10 percent of the loan amount; loan flipping, where creditors pressure borrowers to repeatedly refinance their loans (often because they cannot afford the payments on their previous loans), providing the creditor with additional income from points and fees charged; and asset based lending, where the loan is based not on the ability to repay but on the equity in one's home. According to the Woodstock Institute (Immergluck and Wiles 1999), these abusive lending practices lead to strains in household finances, worsened credit problems, foreclosures, abandoned homes and blighted neighborhoods.

When assessing the above, it is important to keep in mind that subprime lending need not be predatory. For those who do not meet the credit standards of the prime market, subprime lending can make it possible to buy a new home, improve an existing home, or refinance their mortgage to increase cash on hand (U.S. HUD 2000d). Further, there has been debate about how common predatory lending is. Hugh Miller (1999), the President and Chief Executive of Delta Financial Corporation, attacks the "myth" of predatory lending. He claims that lenders lose thousands of dollars every time they foreclose or make loans that people cannot afford. Others, however, strongly disagree. Maryland Senator Barbara Mikulski calls the rise in predatory lending "a virus and it's spreading nationwide" (Shepard 2000). In hearings before the New York State legislature, Assemblyman Scott Springer stated "Examples of people scammed by mortgage brokers abound" while Pamela Sah of South Brooklyn Legal Services claimed "the problem is enormous" (Timmons 1999). Deborah Goldstein (1999), Consumer Reports (1998b), and William Apgar (2000) cite several instances where borrowers have been abused or lenders sued over their practices.

Inspired by the numerous anecdotal reports of abuses in predatory lending, recent empirical studies have tried to quantify the actual costs. The Coalition for Responsible Lending (Stein 2001) conservatively estimates that predatory lending costs American borrowers at least $9.1 billion a year. In testimony before Congress, William Apgar (2000), HUD's then-Assistant Secretary for Housing, said there could be little doubt that predatory lending practices are on the rise. The most dramatic evidence of this, he argued, is a recent doubling of foreclosure rates, with subprime lenders accounting for a large share of the increase. Apgar further claimed that

> Predatory lenders target untold numbers of the most vulnerable homeowners… loading them down with debt, and stripping them of equity. In a growing number of cases, these predatory loan terms are too much to bear and, as a result, the family loses its home to foreclosure… These foreclosures not only ruin the financial future of individual families, they threaten to destabilize entire communities. In short, for millions of low- and moderate-income families, minorities, seniors, and others not well served by the primary market place, predatory lending threatens to turn the American dream of homeownership into an American nightmare.

A March 2004 study of Chicago by the Woodstock Institute (Immergluck and Smith 2004) further underscores Apgar's concerns about foreclosure rates. The researchers found that subprime home purchase loans contributed 28 times as much to neighborhood foreclosures as did prime home purchase loans: a tract with 100 additional subprime home purchase loans is expected to have almost 9 additional foreclosures, compared to only 0.3 additional foreclosures for a tract with 100 additional prime purchase loans. Similarly, a HUD-funded study of St. Clair, Illinois (Fitzgerald 2003) found that just over half the county's foreclosure complaints stemmed from predatory loans and that suspected predatory loans comprised almost 10 percent of owner occupied housing in some neighborhoods of East St. Louis, Alorton and Centreville.

The less desirable aspects of subprime lending might be worth it to many borrowers if that was the only way they could get a home. But, what makes things even worse is that many borrowers have no need to be in the subprime market in the first place. David Medine (2000), the Associate Director for Financial Practices of the Federal Trade Commission's Bureau of Consumer Protection, says that many of those living in areas where traditional banking services are in short supply (e.g. lower-income and minority neighborhoods) tend to turn to subprime lenders regardless of whether they would qualify for less expensive loans. Franklin Raines (2000), CEO of Fannie Mae, estimates that about half the borrowers in the high-cost subprime market could qualify for lower-cost conventional financing. Federal Reserve Board Governor Edward Gramlich (2004) similarly notes that half the borrowers in the subprime market have credit scores that qualify them for prime market loans. Gramlich also points out that subprime loans typically carry interest rates that are 350 basis points higher (3.5 percent) than prime loans. To place this in perspective, a 30-year prime market loan for $100,000 at 6 percent interest will have a monthly payment of $599.55. The same loan at 9.5 percent in the subprime market will cost an additional $241.30 a month. Over the life of the loan, the subprime borrower will pay $86,877 in additional and, in many cases, unnecessary interest[3].

Manufactured Housing

Restructuring and changes in the home mortgage finance industry did not simply result in alternative sources and types of funding for traditional homes. New lenders also offered credit

[3] In July 2004 a typical fixed-rate mortgage had an interest rate of about 6 percent. Those paying 9.5 percent will pay $202,715.48 in total interest over the life of the loan while those borrowing at 6 percent will pay $115,838.45. Calculations were done by the authors.

for non-traditional homes – specifically, manufactured housing (MH). Manufactured homes, also often called (although not always correctly) mobile homes, are built in factories according to national standards, transported to a location on its own wheels, and installed semi-permanently to the location with steel straps (Bradley 1997; Consumer Reports 1998a). Early manufactured homes were of poor quality, with most homes built before 1980 lasting only a decade (Bradley 1997). However, the construction and materials used in manufactured homes have improved in recent years (Consumer Reports 1998a).

For those who purchased their manufactured homes in 2000, the average cost (not including land) was $46,400. The average cost of site-built homes in 2000 (again excluding land) was $159,524 (Manufactured Housing Institute 2004). Not surprisingly, the demographic characteristics of those living in MH differ sharply from other homeowners. In 1995 the median household income of manufactured-home owners was $22,000, just slightly more than half the $42,000 median for all other homeowners. Differences in wealth were even greater, with MH owners having a median net worth of nearly $27,000 compared to $117,000 for others (Canner, Passmore and Laderman 1999).

After years of declining sales, manufactured housing enjoyed a rebirth in the 1990s, accounting for nearly a quarter of all new single-family housing starts during the decade (Manufactured Housing Institute 2004). Today, approximately 22.5 million people live full-time in ten million manufactured homes across the nation (Manufactured Housing Institute 2004). The industry entered a slump late in the decade with sales declining by about a third, but still, over 250,000 units were sold in 2000 (U.S. Census Bureau 2004).

Many have applauded the recent growth in the manufactured housing market. Professional Builder Magazine (Matesi, Jan 2000), for example, commended the Manufactured

Housing Institute for showing that manufactured housing was a practical means of providing desirable, much needed single-family housing at a reasonable price for inner-city residents. Nevertheless, concerns persist. Based on its two-year study of the industry, Consumer Reports (1998a) warned that it is still "buyer beware" in the market for mobile homes. Similarly, Joe Perkins (AARP, 1999), President of the AARP (formerly the American Association of Retired Persons) cautioned that

> Manufactured housing is affordable housing, but there is more to affordability than a low price. Mobile home buyers are not protected sufficiently now and will not be in the future without tougher standards.

Based on their investigations, Consumer Reports (1998a) and the AARP (1999; Brice, 1999) identify a number of concerns with manufactured housing. First, there are often problems with the construction, installation and safety of manufactured homes. The AARP found that three quarters of the manufactured home owners it surveyed reported significant problems with their homes. Commenting on the AARP findings, George Corey, a technology consultant who helped write the 1974 law on manufactured housing, claimed that "People would be outraged" if three quarters of those who bought $35,000-$40,000 cars reported problems with them (Fleishman 1999:G01). Consumer Reports (1998a) also found that a majority of manufactured home owners reported at least one major problem. According to the state and federal regulators that Consumer Reports talked to, manufactured homes are often installed incorrectly, resulting in more than half the problems that consumers report. Poor installation can lead to major safety problems and make manufactured homes, which tend to be less sturdy than conventional homes to begin with, even more vulnerable to natural disasters. As an example of such problems, Consumer Reports notes that when Hurricane Andrew hit Florida in 1992 half the mobile homes in the southern part of Dade County were destroyed compared to only 28 percent of the contractor-built homes. Based on such problems, Rutherford Brice (1999) of the AARP concluded that at that time there was a "critical deficiency" in the quality assurance regulations administered by HUD and that consumers were being hurt by a lack of construction and safety standards enforcement.

Second, Consumer Reports (1998a) found that half the homeowners in their survey leased the land on which their homes were located. This left them vulnerable to sudden and sometimes dramatic rent increases. Owners who cannot afford such increases must either pay to move their homes or else sell them, often to their landlords at distress prices. Also, because they must approve new tenants, abusive landlords can set up roadblocks to sales and force owners to sell their homes to park operators at a discount (Hill-Holtzman 1999). In Florida, 40,000 people signed petitions to Governor Jeb Bush complaining about chronic, unfair rent increases (Smith 1999). Consumer Reports (1998a) and Mike Patty (1999) offer several anecdotal examples of abusive landlords.

Third, the low purchase costs of manufactured housing are partially offset by higher costs elsewhere. The Housing Assistance Council (2004) reports that manufactured housing mortgages have interest rates that are 300 to 500 basis points (i.e. 3 to 5 percentage points) higher than conventional mortgages. Insurance premiums are substantially higher than for a traditional home (Consumer Reports 1998a). Also, the resale value for used factory-built homes has historically been low; Consumer Reports found that two-thirds of its survey respondents said their homes would sell for less than they had paid for them.

In short, the rise of manufactured housing has been both beneficial and problematic. For many, it has made homeownership affordable. At the same time, a lack of consumer protection has exposed many homeowners to problems that could have been avoided.

Study Design /Methods and Data

As shown above, several recent studies have documented the rise of subprime and manufactured housing lenders during the 1990s. Through one of the broadest nationwide empirical and longitudinal analyses to date, we now add to that discussion by examining more carefully the magnitude of these changes and how they were related to the racial and economic characteristics of borrowers. Our empirical methodology for doing so consists of three parts: (1) definition of types of underserved markets, (2) description of data sources, and (3) outline of analytical methods.

Types of Underserved Markets

Different authors define underserved markets in various ways. For our purposes, we employ some of the most commonly used race- and income-based definitions of individuals and/or neighborhoods[4]. Other commonly used alternative definitions of underserved markets were also examined and yielded results consistent with those reported below. In "Very Low Income Families," income is not in excess of 60 percent of area median income. Following practices used in published government Home Mortgage Disclosure Act reports, we define a loan application as "Black" if the applicant is black and the co-applicant (if any) is not white. "Minority Neighborhoods" are defined as census tracts that are more than 30 percent non-white.

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[4] In particular, the Department of Housing and Urban Development has often used these definitions in its own research and in its definitions of underserved markets.

We use the term "underserved markets" to refer to loans made to any of these three lending categories.

Data

Data were collected for each of the years 1993-2000[5] and came from several sources.

HMDA Loan Application Registers and Transmittal Sheets. Starting in 1990, the Home Mortgage Disclosure Act required most lenders in metropolitan areas to provide information on every home mortgage application they received. The information includes the name of the lender, the final disposition of the application (e.g., approved or denied), the census tract in which the desired property was located, and the income, race and gender of the applicant(s). The HMDA data includes key information on census tracts, making it possible to determine whether a neighborhood is low-income or minority. Our analyses suggest that it makes little difference whether one uses a 1 percent, 10 percent, or 100 percent sample, which is not surprising given the millions of records contained in HMDA. We use a 10 percent national sample in our study.

Manufactured Housing and Subprime Loans. HUD (2000a) has developed a list of lenders who specialize in subprime and manufactured housing loans. This list can be linked with the HMDA data to identify loans that are especially likely to be either subprime or MH. A few cautions concerning this list are in order. Unfortunately, the HUD list cannot identify subprime and manufactured housing loans made by traditional lenders, nor can it separate out any prime loans that are made by specialized lenders. In addition, manufacturing housing is disproportionately likely to be placed in non-metropolitan rather than urban areas (Housing Assistance Council 2004), which means that many of the manufactured home loans will not appear in our MSA data. Hence, not all specialized loans will be correctly identified in our analysis. However, as the Woodstock Institute (Immergluck and Wiles 1999) points out, subprime lending done by prime lenders is probably less prone to abuse, since prime lenders also offer lower-cost products, work less with brokers, and are often subject to greater regulatory scrutiny. Further, the trends we find are consistent with both the industry statistics we cited earlier and with HUD's estimates on the nationwide rise in subprime lending. Hence, we are confident that the primary trends and conclusions discussed here are not materially influenced by shortcomings in the data.

Sample Selection

The following criteria were used for selecting loans in our analysis, all of which are common in home mortgage lending research. First, all loans are for owner-occupied home purchases or for home refinance. Second, loan records with high loan-to-income ratios (six or above) or missing income data are excluded because they are likely caused by data errors. Third, the case must be from an MSA, as HMDA data provide little coverage of non-MSA areas. Additionally, the case must include census tract information, as it is necessary to determine whether a loan is to an underserved market. Fourth, only applications that resulted in either originations or denials are included. Withdrawals, loans not accepted, and files closed for incompleteness are excluded, since the disposition of these types of applications may be due to factors not under the control of the lender (e.g. the applicant changes his or her mind about wanting the home[6]). Fifth, we exclude Jumbo loans (mortgages over $252,000 in 2000). These

[5] We choose 1993 as the starting point for several reasons. The HUD subprime and manufactured housing lenders list begins with 1993. Also, the quality of the HMDA data was not as good in the early part of the decade, with several lenders not providing required reports.

[6] Alternatively, poor service by the lender, high interest rates and disadvantageous loan terms could also contribute to applications being withdrawn and loans not being accepted. While the exclusions we are making are common, it would be worthwhile for future studies to examine these types of applications more carefully.

loans constitute a very small percentage of home mortgage loans and an even smaller percentage of the loans going to underserved markets. Finally, we look only at conventional loans and exclude government-backed FHA and VA loans[7].

Methods

Our empirical analysis is three-fold. First, we present trends in number of loans made and in market share in United States MSAs for the years 1993-2000. We show how specialized lenders have gained an increasing share of the conventional home mortgage purchase and refinance markets, and that these gains have been particularly great among members of underserved populations. Second, we examine how race and income variables are jointly related to underserved market lending. In particular, we show that income alone cannot account for differences in the types of lending used by blacks versus others. Finally, we show that the growth of specialized lenders has had a major impact on loan denial rates. Hence, studies that focus on denial rates but which fail to consider the role of specialized lenders can produce misleading conclusions.

Results

Trends in the Number of Loans and Market Share

Table 1 presents the number of home purchase loans made nationwide by each type of lender to each type of market for the years 1993-2000. The next to last column shows the

[7] FHA lending has itself been a source of considerable controversy. Even though many FHA loans go to members of underserved markets, the beneficial impact of these loans has been hotly disputed. Based on studies done by the Chicago Area Fair Housing Alliance of housing market patterns in Cook and Dupage County, Bradford (1998) contends that FHA lending "is inordinately concentrated in minority and racially changing communities"; [has resulted in] "undue levels of blight and disinvestment"; "limits housing opportunities, contributes to segregation, [and] perpetuates the myth of race as a contributor to community disinvestment"; and "ultimately leads to community decline itself" (p. 7). However, government officials claim that problems with FHA have now been corrected. A discussion of FHA is beyond the scope of this paper, but future studies should look at how FHA lending today either alleviates or contributes to the new inequality.

change in the number of home purchase loans made between 1993 and 2000. The final column shows how much of the change in the total number of loans to a market came from each type of lender. Results are presented for all markets combined and for the three types of underserved markets we previously identified: (1) very low-income borrowers, (2) blacks, and (3) minority neighborhoods. For home purchase loans, three major findings are immediately apparent.

Table 1 about here

First, the number of home purchase loans increased during the 1990s, but the greatest gains occurred in underserved markets. In our 10 percent sample, there were 155,059 home purchase loans made in 1993, compared to 250,863 loans in 2000 – an increase of 61.8 percent. But, during this same period, the number of loans to very low-income borrowers, blacks, and minority neighborhoods all more than doubled. Total loans to very low-income borrowers increased from 16,630 to 36,875; loans to black applicants increased from 5,482 to 12,889; and loans to minority tracts increased from 19,656 to 39,586. Hence, members of underserved markets made disproportionate gains in homeownership during the 1990s.

A second finding is also apparent from the table: 40 percent or more of the gains made in underserved markets came as a direct result of increased activity by specialized lenders. Specialized lenders accounted for 32.4 percent (23.3 percent subprime, 9.1 percent MH) of all the additional loans made in 2000 as compared to 1993. However, they accounted for 42.2 percent of the additional loans that went to very low income borrowers (23.2 percent subprime, 19 percent MH) and minority neighborhoods (33 percent subprime, 9.2 percent MH), and more than half (51.5 percent; 43.5 percent subprime, 8.5 percent MH) of the additional loans to blacks.

Third, while subprime and manufactured housing lenders contributed about equally to the total number of additional loans made to very low income borrowers, subprime lenders played a far larger role in the increased lending to blacks and minority neighborhoods. Subprime lenders made 33 percent of the additional loans to minority neighborhoods and 43 percent of the additional loans to blacks. The corresponding figures for MH lenders were only 9.2 percent and 8.5 percent respectively, about the same as their contribution to all additional loans (9.1 percent).

Table 2 about here

Table 2 presents the corresponding results for refinance loans. Unlike home purchase loans, the number of refinance loans does not increase steadily from one year to the next. This is because, for many, interest rates heavily influence the decision to refinance. Another difference from home purchase loans is that hardly any refinance loans involve manufactured housing lenders[8].

The importance of interest rates makes across time comparisons of the volume of refinance lending more difficult. Nevertheless, it is apparent from Table 2 that subprime lenders played an increasingly important role across time in refinance lending to underserved markets and to blacks and minority neighborhoods in particular. In 2000, they were making anywhere from six to twelve times as many loans to underserved markets as they had been in 1993, while the number of refinance loans made by traditional lenders actually declined, especially in minority neighborhoods. Because the number of refinance loans varies so much from year to year, the final two columns compare the totals for 1997-2000 with 1993-1996. These columns show that, while subprime lenders accounted for about half of the total increase and very low-

[8] As Mortgage Marketplace Magazine (1998) points out, few lenders refinance manufactured housing homes. As a result, many manufactured home owners are stuck with loans at high interest rates, even though their credit is good and they have been in their homes for years.

income increase in refinancing between the first four years and the second four years, their gains in minority markets were much greater. They accounted for 78 percent of the increase in minority neighborhoods and 72 percent of the increased refinance lending to blacks.

Figure 1 recasts the information from Table 1 to provide another means of assessing the influence of specialized lenders. The figure presents trends in market share for the home purchase loans of subprime and manufactured housing lenders, i.e. the annual percentage of all loans in each type of market that were made by specialized lenders. The results are clear and striking.

Figure 1 about here

In 1993, subprime and manufactured housing lenders together held less than 4 percent of the overall home purchase market. These numbers gradually increased, however, and by 2000 specialized lenders held 14.4 percent of the market (9.6 percent subprime, 4.8 percent MH). For much of the decade, the greatest growth occurred among manufactured housing lenders. But, in 1998, subprime lenders continued to surge while manufactured housing began to decline, and by 2000 subprime lenders had twice as much market share as MH lenders.

As the figures show, growth was particularly great in underserved markets. In 1993, specialized lenders made just 8.6 percent of the loans to very low-income borrowers (1.2 percent subprime, 7.4 percent MH). By 2000, they controlled more than a fourth of that market (13.3 percent subprime, 13.8 percent MH). Subprime lenders were far more dominant than MH lenders in the minority markets, making about a fourth of the loans to blacks and a sixth of the loans in minority neighborhoods. Conversely, MH lenders held only about 6 percent of each minority market at decade's end, a substantial decline from their peak year of 1998.

Figure 2 about here

As Table 2 showed, there are very few refinance loans involving manufactured housing lenders, so Figure 2 presents comparable information for subprime refinance loans. Shifts were even more dramatic in this segment of the housing market, with subprime lenders clearly dominating the changes. After making only 2 percent of all refinance loans in 1993, subprime lenders controlled 27 percent of the market in 2000. Again, the gains were greatest among underserved markets. By 2000 subprime lenders were making more than half of all the refinance loans that went to blacks and about 40 percent of the loans to very low-income borrowers and minority neighborhoods. Hence, in less than a decade, subprime lending was transformed from playing a minor role in overall mortgage refinancings to playing the leading role in refinancings for black applicants.

Pervasiveness of Racial Disparities Across Income Levels

As the preceding makes clear, while subprime lenders made major advances in underserved markets between 1993 and 2000, their gains were particularly pronounced in minority markets. One possible explanation is that income differences across races and neighborhoods accounted for differences in the types of lenders utilized. Table 3 therefore presents 2000 specialized lenders' market share broken down by the race and income of applicants. At every income level, and for both home purchase and refinance loans, blacks are far more likely than others to receive their loans from a subprime lender. At the lowest income level, almost 30 percent of all blacks get their home purchase loans from a subprime lender, compared to less than 10 percent of members from other racial groups. Even at the highest income level, blacks are almost three times as likely to get their loans from a subprime lender as are others. For refinance loans, blacks are always at least twice as likely as others of comparable incomes to borrow from a subprime lender. Indeed, subprime lenders have captured more than a third of the refinance business of the highest-income blacks.

Tables 3 about here

Table 4 provides similar information for minority neighborhoods and applicant income. Again, borrowers from minority neighborhoods at every income level are far more likely to turn to a subprime lender than are borrowers from non-minority neighborhoods.

Table 4 about here

Tables 3 and 4 also illustrate the role of manufactured housing lenders in minority markets. Here, there are relatively few and inconsistent differences between minority and non-minority markets. Unlike subprime lending, those who receive loans for manufactured housing differ greatly by income but little by race. Whatever its other benefits and disadvantages, racial inequality did not seem to be a major characteristic of manufactured housing lending in the year 2000.

Hence, the great success of subprime lenders in minority markets reflects, in part, their ability to disproportionately attract members of those markets regardless of income. At every income level, blacks and residents of minority neighborhoods are more likely to turn to subprime lenders than are others.

Of course, it could be argued that these findings are due to racial differences in other variables that are not available in the HMDA data, such as credit histories and wealth. Certainly, these variables account for some of the disparities, and it is unfortunate that HMDA does not include measures of them. There is compelling evidence from other studies, however, which lead us to believe that significant differences would remain even if such variables were taken into account.

First, the Boston Fed Study (Munnell et al. 1996) showed that significant racial disparities in denial rates persisted even after controlling for the variables that lenders themselves said determined their decisions. Second, and more directly, preliminary tests of lending discrimination done by the National Fair Housing Alliance indicate that creditworthy whites who approach subprime lenders are referred more often to prime lenders, who offer better terms. Creditworthy blacks are not given this advice (Dedman 1999). Likewise, the National Community Reinvestment Coalition (2003) conducted 48 matched pair, race-based tests of 12 major subprime lenders in selected metropolitan areas. Similarly qualified white and black applicants contacted subprime lenders about a home mortgage loan. The study, which was funded by HUD, found that there were often significant differences in treatment that favored white borrowers. Whites were quoted lower interest rates and were more often referred up to the lender’s prime borrowing division. Whites were more often assumed to be qualified, and received more advice, recommendations and follow-up contacts from the loan officers. The NCRC study also found that the subprime lenders quoted very high rates, fees and closing costs that were not correlated with risk. In short, it does not appear that credit histories and other omitted variables provide an explanation for the findings we have presented here; but even if they did, this would not justify the unfair treatment that low income and minority borrowers often receive in the home mortgage market.

Denial Rates

There is one other aspect of lending trends that demands attention. So far, we have focused on market share and numbers of loans made. This is an analysis of approved loan applications. However, as noted earlier, many studies have focused on denial rates, and, in particular, the differences between black and white denial rates. Specialized lenders had a major impact on denial rates. Changes in denial rates were not due to a worsening of the old inequality; rather, they were due to the rise of the new inequality, which made it possible for high denial rates to be combined with large numbers of loans being made to underserved markets. Failing to understand the role of specialized lenders on denial rates will result in a failure to understand the changes in home mortgage lending during the 1990s.

Because racial differences in denial rates have been of greatest interest to researchers and policy makers, we will focus on the trends for blacks, which are graphically illustrated in Figure 3. Patterns are similar for other markets, both served and underserved.

Figure 3 about here

As Figure 3 shows, the denial rates for all lenders rose from 29.9 percent in 1993 to 42.5 percent in 2000[9]. Given the increase in lending to blacks that occurred during this time, the increase in denial rates that also occurred might seem to be a major paradox. However, as the chart also shows, the home purchase black denial rate for traditional lenders was fairly steady over the decade. Indeed, perhaps because of automated underwriting, their denial rate was

[9] For all borrowers regardless of race, the corresponding figures are 14.5 percent and 25.4 percent.

actually lower in 2000 than it was in 1993 (26.8 percent in 1993 versus 24.4 percent in 2000) [10]. Hence, specialized lenders accounted for the overall increase in denial rates. Partly, their own denial rates went up, but even more critically, they were getting more and more applications. As a result, their market shares rose, and the overall denial rate went up too. Also, as Scheessele (1999) notes, manufactured home retailers typically send the same application to many lenders simultaneously. Hence, the increase in denial rates is deceptive because it is produced, in part, by individuals who were denied repeatedly by different lenders but who may have eventually received a loan from some institution.

Discussion

In this section, we discuss the theoretical and substantive significance, not only of our own findings, but of related research. This other work, much of it descriptive, has offered important empirical findings but now yields new insights by being re-interpreted in light of our theoretical framework.

Summary of Key Findings

Empirically, three major findings stand out from our study. First, subprime and manufactured housing lenders dramatically increased their share of the home mortgage market between 1993 and 2000, with their gains being particularly great among underserved markets. As a result, they accounted for much of the gains in home credit made by those groups. Together, specialized lenders accounted for as much as half of the increase in home purchase loans made to underserved markets between 1993 and 2000.

[10] Similarly, for all borrowers regardless of race, the corresponding figures are 12.4 percent and 11.5 percent.

Second, gains made by subprime lenders with minority markets cannot be attributed simply to racial differences in income. At every income level, and for both home purchase and refinance loans, blacks and residents of minority neighborhoods were far more likely than others to receive their loans from a subprime lender. Findings from other studies further suggest that other variables, such as credit histories or wealth, cannot account for the racial disparities noted here. Conversely, race had little to do with the gains made by manufactured housing lenders.

Third, specialized lenders had a dramatic impact on home purchase denial rates. The significant increase in denial rates that occurred during this period was almost entirely due to the increased activity of subprime and manufactured housing lenders.

Sociological and Social Implications

What are the implications of these findings? One key insight that arises from this study is that the rise of specialized lending fundamentally changes the way in which lending discrimination studies should be conducted. Mortgage lending has historically been characterized by a failure of underserved markets to obtain home loans. But, during the 1990s, this link was broken: denial rates rose at the same time that lending to underserved markets increased. This is not to say that racial differences in denial rates, particularly among traditional lenders, are no longer worth studying; but with the rise of specialized lending, it is important to examine not only whether a loan was made, but also the characteristics of the loan, such as the interest rate and terms associated with it.

Even more critical, however, are the implications of these findings for inequality. During the 1990s, the old inequality started to weaken as specialized lenders helped to produce homeownership gains for underserved markets that outstripped the gains made by others. However, these advances were not quite what they seemed. While homeownership in general is desirable, it is not clear how much of its benefits go to those borrowing from specialized lenders, even when predatory or abusive practices are not present. We earlier noted the many benefits of homeownership, such as the accumulation of wealth. However, the higher interest rates charged by specialized lenders, combined with the potential loss of equity from subprime home refinance, can work against the accumulation of wealth. Further, while manufactured homes may be cheaper to acquire, their true costs are unclear because of the uncertainty concerning unit durability and appreciation (Vermeer and Louie 1997). We also noted that barriers to homeownership have produced racial segregation and the many problems associated with it. But, by targeting minority neighborhoods, subprime lenders may increase rates of homeownership in those areas, but do little to increase racial integration.

In the specific case of manufactured housing, thousands of individuals achieved homeownership via the purchase of lower cost homes, homes that are generally of far better quality than their counterparts of 25 years ago. In exchange, however, some may have risked or experienced installation, construction and safety problems, higher interest rates and insurance premiums, low resale values, problems with landlords, and other consumer protection problems.

The low cost of manufactured housing may be enough to offset many of its problems. But, for subprime lending, there is no such compensating factor. The alleged "predatory practices" of some lenders have raised great concern. Critics point out or allege that subprime borrowers may face unreasonably high interest rates, exorbitant fees, the loss of their property, and other abusive practices. Even in the absence of such practices, the fact that half or more of subprime borrowers could probably qualify for better deals elsewhere (Gramlich 2004; Medine 2000; Raines 2000), and that subprime lenders may actually be stealing away borrowers from traditional lenders (Williams, McConnell and Nesiba 2001) are reasons for concern.

In short, the apparent progress of the past decade is not all that it seems. The old inequality, which denied many access to homeownership, has slowly diminished. The result has been record growth in the rates of homeownership for minorities and other members of underserved markets. But, for many of these homeowners, a new inequality has replaced the old. This new inequality is characterized by less desirable loan terms, exposure to predatory practices, and a lack of consumer protection. While we might reasonably argue that the new inequality is better than the old, we must not lose sight of the fact that it is inequality nonetheless: recent gains in homeownership for underserved markets have come with a price.

Explanations for Inequality Revisited

In light of the evidence we have presented, we again ask, why has the new inequality emerged? As neoclassical economic theory suggests, industry deregulation did lead to increased competition in home mortgage lending. In the past, riskier borrowers were simply denied loans; but in the newly competitive market place, markets that had long been ignored suddenly found a multitude of lenders willing to serve them. Automated underwriting may also have made it possible for traditional lenders to better identify and serve more of the qualified borrowers from underserved markets.

But, just as Tillman and Indergaard found in the health insurance field, there was also a dark side to these changes. Deregulation in the 1980s led many banks to close branches located in inner cities and to relocate them in higher-income areas regarded as more likely to generate profitable business (Campen 1998). Subprime lenders took their place. Because many of these are mortgage and finance companies, they are not regulated as closely as are banks and other depository institutions; nor do they have the same obligations to serve underserved markets that the Community Reinvestment Act requires of others. Indeed, it may be that depository institutions set up subprime affiliates for these very reasons. Further, despite the recent explosion in subprime lending, the Federal Trade Commission has fewer than forty people on staff to address predatory lending (Immergluck and Wiles 1999).

Similar to what Tillman and Indergaard found in the health insurance industry, borrowers from these lenders were often at a structural disadvantage in their dealings with them. Lenders had information denied to others, and a lack of effective regulation made it possible for them to exploit it. A recent report from the Joint Center for Housing Studies at Harvard University (Apgar et al. 2004) summarizes the handicaps that low income and minority borrowers found themselves confronted with:

> The bewildering array of mortgage products combined with the various available combinations of points and fees and aggressive marketing tactics with "too good to be true" offers can make shopping for a mortgage an overwhelming process for even the most sophisticated borrower. Indeed, the lack of readily available data on the price of alternative mortgage products puts the consumer at a distinct disadvantage in negotiating with a mortgage broker who has ready access to this information… The growing use of mortgage brokers, the lack of effective regulatory oversight, [and] the lack of readily available mortgage pricing data have combined to reinforce a dual market where some borrowers pay more for mortgage credit and/or receive less favorable treatment (or even abusive treatment) than other similarly situated and equally creditworthy borrowers. (P. 5)

Increases in manufactured housing were probably more beneficial to underserved markets. But even here, a lack of government regulation and consumer protection sometimes resulted in unsafe installations, frequent defects, and exposure to abusive landlords. Further, as

Kevin Jewel (2003) of the Consumers Union points out, unequal access to information also put purchasers of manufactured homes at a disadvantage when dealing with their lenders and dealers.

> Consumers find it difficult to obtain information on home quality and available options for themselves. The dealership sales process discourages shopping through high pressure sales techniques and deposit requirements… Consumers may lack the technical expertise to ascertain the quality of the construction process and materials used to construct the home… Thus, consumers lack information needed to be informed shoppers in this market place. They have to trust the dealer and manufacturers, whom are often their only source for information. But… this trust rests on faith, not on the solid foundations of enforceable law. This leaves consumers vulnerable.

Hence, economic theory, such as Becker's, help to explain why lending to underserved markets increased during the 1990s. Sociological network theories such as Tillman and Indergaard's help to explain why these changes were not universally beneficial.

Neither perspective, however, clearly explains why there were strong racial differences in subprime market lending, or why few racial differences were found for manufactured housing. We therefore argue that a new sociological/demographic explanation helps to provide part of the answer: The old inequality helped to make the new inequality possible.

As Massey and Denton point out (1993), African Americans are heavily segregated in America. Because blacks are disproportionately located in low-income areas, they have been more likely to have their networks of service providers disrupted as traditional lenders have withdrawn from their neighborhoods. Further, residential segregation makes it easier for lenders to target borrowers by race and income. As Matthew Lee (1999) of the Inner City Press notes,

> Mailboxes in moderate-income neighborhoods are full of pitches from subprime lenders. As the subprime industry has gotten more sophisticated, direct marketing has become focused on communities whose residents have already shown a taste or need for high interest rate loans.

As Lee (1999) further argues, race appears to be a key factor in this targeting of areas, as subprime marketing is disproportionately concentrated in minority census tracts. Such strategic placement of offices and direct marketing efforts to minority areas would be far more difficult, of course, if the old inequality had not helped create these neighborhoods in the first place. Manufactured housing, on the other hand, is disproportionately likely to be placed in non-metropolitan rather than urban areas (Housing Assistance Council 2004) and hence does not typically involve existing residential inner city and minority neighborhoods. It is therefore not surprising that manufactured housing does not show the strong racial differences that subprime lending does.

The Future of the New Inequality

Is the new inequality destined to continue? Luckily, there seems to be a growing awareness that something can and should be done. A joint taskforce of the Departments of HUD and Treasury has announced recommendations for curbing predatory lending (U.S. HUD and U.S. Treasury 2000), and various states and communities have either adopted or are considering their own laws on predatory lending[11]. In December 2000 Congress passed the Manufactured Housing Improvement Act (Manufactured Housing Institute 2000). The act calls on HUD to

[11] As ACORN (2004) notes, states that have passed or have considered legislation against abusive mortgage practices include Arkansas, California, Massachusetts, New York, New Mexico and New Jersey. Cities that have passed or considered laws include Chicago, Philadelphia, Oakland, Los Angeles, New York and Washington D.C. As of this writing, detailed information on anti-predatory lending efforts can be found on the web pages of ACORN (www.acorn.org), the Mortgage Bankers Association (http://www.mortgagebankers.org/resources/predlend/index.html) and the law firm of Butera and Andrews (http://www.butera-andrews.com/state-local/b-index.htm).

update construction and safety standards in a timely fashion and for states to establish resolution programs for handling customer complaints. HUD has also suggested that the Government Sponsored Enterprises Fannie Mae and Freddie Mac be more active in the subprime and manufactured housing markets (U.S. HUD 2000b). Lind (2000) argues that the entry of the GSEs into subprime markets should be beneficial because the GSEs attach conditions to their purchases that curb predatory lending. Congressman Barney Frank (Mortgage Marketplace 1998) argues that manufactured housing owners are generally not wealthy, and they deserve the same sorts of benefits that the GSEs provide to other segments of the American Housing Finance system. If successful, these initiatives offer hope that the new inequality in home mortgage lending will not last as long as the old inequality has. But for now, the ultimate fate of these efforts remains to be seen.

The Broader Picture

So far, we have focused on a description of the trends in specialized mortgage lending and the implications those have for housing inequality. It is important to realize, however, that these are only part of a much larger phenomenon. Deregulation has also helped cause traditional banking services to decline in the nation's central cities (Branch 1998; Squires and O'Connor 1998). In their place has arisen a new system of "fringe banking" composed of check-cashing/payday loan businesses. As Donna Tanoue (2000) of the FDIC notes, such businesses have gone from a few hundred outlets in the mid-1990s to approximately 10,000 branches in 2000. Among their most controversial services are payday loans, where "service fees" and a need to repeatedly roll over loans can cause the annual percentage rate to exceed 1,000 percent (Consumer Reports 2000).

In still other areas of lending, Black plaintiffs have recently sued automobile finance companies, claiming that blacks were charged higher interest rates than were comparable white borrowers (Henriques 2000). Subprime lenders are also starting to make a significant number of automobile loans (Consumer Reports 1998b). The rent-to-own industry, which attracts 3 million people and $4 billion in business a year, has been criticized for prices that are two to five times greater than those charged at other retail outlets (Consumer Reports 1998b). Pawnshops and high-rate credit cards are still other examples of how the poor can obtain loans, but at a far higher cost than is paid by others.

Such developments all have their supporters, who claim that abuses do not exist or that valuable services are being provided. Still, many may join with Iowa assistant attorney general Kathleen Keest (Consumer Reports 1998b) in asking, "Why, for the poor, does every commercial transaction have to be an exercise in self-defense" (p. 29). As Jean Ann Fox (Branch 1998) of the Consumer Federation of America notes, we may be moving towards a polarized system where "middle class people will be served by one federally insured system, and moderate-income people will have to rely on costly fringe bankers." Squires and O'Connor (1998) add that

> A two-tiered banking system--just like the dual housing market, segregated school systems, and segmented labor markets--constitute critical institutionalized barriers confronting cities in their efforts to bring hope to their most depressed areas and revitalize metropolitan economies… Residents of distressed communities deserve better. The health of the nation's cities depends on it. (P. 146)

Conclusion

Both the privileged and less-privileged segments of society have seen major changes in the financial and lending options available to them. The last 30 years have seen the rise of IRAs, 401K plans, and numerous other financial instruments, products, and services that have increased access, increased savings returns, and lowered borrowing costs for middle and upper income groups. Lower income and minority groups have also seen changes in the financial options available to them, but their choices are of a very different nature. As conventional financial institutions grow more distant and/or less responsive, these potential savers and borrowers are increasingly forced to meet their financial services needs with institutions that target their neighborhoods with higher-fee, unfavorable-term borrowing opportunities.

One of the key contributions of this work is showing how both neoclassical economic theory and contemporary sociological network theory offer insights as to why these changes in inequality have occurred. As neoclassical economic theory would predict, a deregulated marketplace has made it possible for low income and minority groups to gain access to credit like never before. This has helped them to achieve record rates of homeownership and to also get loans for any number of other purposes. But, as sociological network theory suggests, the new lenders are quite unlike the old ones. As a result, the gains made by underserved markets have come in very different ways than those made by the rest of American society. For better or for worse, as the old inequalities have slowly diminished, new inequalities have risen in their place.

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Table 1: Number of Conventional Home Purchase Loans
Subprime, Manufactured Housing, and Traditional Lenders
United States MSAs, 10% Sample, 1993-2000

All Markets

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*Change, 2000-1993*	*% of total change*
Subprime	1,883	3,152	3,141	4,164	7,218	12,842	18,197	24,191	22,308	23.3%
MH	3,400	5,604	8,574	13,109	13,839	16,560	16,432	12,094	8,694	9.1%
Traditional	149,776	169,013	160,513	174,939	171,663	208,883	218,758	214,578	64,802	67.6%
Total	155,059	177,769	172,228	192,212	192,720	238,285	253,387	250,863	95,804	

Very Low Income

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*Change, 2000-1993*	*% of total change*
Subprime	200	421	414	504	1,027	2,122	3,718	4,896	4,696	23.2%
MH	1,225	1,816	2,626	4,365	4,847	5,914	6,884	5,075	3,850	19.0%
Traditional	15,205	18,821	17,539	19,909	19,404	23,785	27,453	26,904	11,699	57.8%
Total	16,630	21,058	20,579	24,778	25,278	31,821	38,055	36,875	20,245	

Blacks

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*Change, 2000-1993*	*% of total change*
Subprime	163	226	326	401	851	1,845	2,656	3,351	3,188	43.0%
MH	136	377	609	983	1,069	1,326	1,331	764	628	8.5%
Traditional	5,183	8,095	7,999	7,738	7,065	7,403	8,296	8,774	3,591	48.5%
Total	5,482	8,698	8,934	9,122	8,985	10,574	12,283	12,889	7,407	

Minority Neighborhoods

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*Change, 2000-1993*	*% of total change*
Subprime	432	749	811	1,023	1,865	3,660	5,357	7,007	6,575	33.0%
MH	533	1,036	1,614	2,588	2,735	3,380	2,997	2,357	1,824	9.2%
Traditional	18,691	23,426	21,832	22,075	21,693	25,102	28,567	30,222	11,531	57.9%
Total	19,656	25,211	24,257	25,686	26,293	32,142	36,921	39,586	19,930	

Table 2: Number of Refinance Loans
Subprime, Manufactured Housing, and Traditional Lenders
United States MSAs, 10% Sample, 1993-2000

All Markets

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*1997/2000 - 1993/1996*	*% of total change*
Subprime	7,740	9,424	10,564	19,598	33,939	52,169	53,777	42,854	135,413	53%
MH	629	3,047	3,039	3,463	4,291	6,762	3,838	2,405	7,118	3%
Traditional	369,375	130,667	84,049	139,413	131,372	367,897	222,401	113,526	111,692	44%
Total	377,744	143,138	97,652	162,474	169,602	426,828	280,016	158,785	254,223	

Very Low Income

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*1997/2000 - 1993/1996*	*% of total change*
Subprime	906	1,915	2,456	4,948	8,326	13,231	15,646	12,031	39,009	50%
MH	73	613	632	755	918	1,227	897	582	1,551	2%
Traditional	21,374	13,082	9,038	15,522	15,184	34,321	29,218	17,638	37,345	48%
Total	22,353	15,610	12,126	21,225	24,428	48,779	45,761	30,251	77,905	

Blacks

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*1997/2000 - 1993/1996*	*% of total change*
Subprime	733	1,402	1,794	3,222	5,176	7,685	8,090	6,298	20,098	72%
MH	8	652	582	385	408	322	51	6	-840	-3%
Traditional	7,864	5,141	3,838	5,885	5,574	10,649	9,175	6,064	8,734	31%
Total	8,605	7,195	6,214	9,492	11,158	18,656	17,316	12,368	27,992	

Minority Neighborhoods

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*1997/2000 - 1993/1996*	*% of total change*
Subprime	2,282	3,288	3,637	6,455	10,473	16,456	17,449	13,656	42,372	78%
MH	44	1,038	1,086	1,092	1,150	1,627	922	617	1,056	2%
Traditional	49,005	21,109	12,847	18,348	17,684	43,109	32,158	18,955	10,597	20%
Total	51,331	25,435	17,570	25,895	29,307	61,192	50,529	33,228	54,025	

Table 3: Specialized Lenders Market Share
Race of Applicant by Income of Applicant
United States MSAs, 10% Sample, 2000 Only

		Type of Lender					
		Subprime			Manufactured Housing		
Type of Loan	Applicant's Income	Not Black	Black	All	Not Black	Black	All
Home Purchase	<= 60% of MSA Median	9.5%	29.8%	11.9%	11.9%	11.2%	11.8%
	60%-80% of MSA Median	8.1%	26.9%	9.5%	6.1%	5.9%	6.1%
	80%-100% of MSA Median	8.2%	26.1%	9.2%	4.0%	5.2%	4.1%
	100%-120% of MSA Median	7.7%	25.4%	8.6%	2.6%	3.6%	2.7%
	> 120% of MSA Median	7.1%	21.1%	7.6%	1.1%	1.4%	1.1%
Refinance	<= 60% of MSA Median	28.0%	59.4%	34.3%	0.6%	0.1%	0.5%
	60%-80% of MSA Median	24.4%	52.9%	27.8%	0.2%	0.0%	0.2%
	80%-100% of MSA Median	21.1%	47.8%	23.6%	0.1%	0.0%	0.1%
	100%-120% of MSA Median	18.7%	44.9%	20.7%	0.1%	0.0%	0.1%
	> 120% of MSA Median	14.0%	37.8%	15.2%	0.1%	0.0%	0.1%

Table 4: Specialized Lenders Market Share
Racial Composition of Neighborhood by Income of Applicant
United States MSAs, 10% Sample, 2000 Only

		Type of Lender					
		Subprime			Manufactured Housing		
Type of Loan	Applicant's Income	Not Min	Min	All	Not Min	Min	All
Home Purchase	<= 60% of MSA Median	10.5%	23.4%	13.3%	14.3%	11.9%	13.8%
	60%-80% of MSA Median	8.8%	18.4%	10.5%	7.1%	8.1%	7.3%
	80%-100% of MSA Median	8.8%	17.1%	10.1%	4.6%	6.0%	4.9%
	100%-120% of MSA Median	8.0%	16.9%	9.3%	2.9%	4.4%	3.1%
	> 120% of MSA Median	7.0%	14.7%	8.0%	1.2%	2.0%	1.3%
Refinance	<= 60% of MSA Median	33.2%	53.7%	39.8%	1.9%	2.0%	1.9%
	60%-80% of MSA Median	28.6%	44.5%	32.3%	1.6%	1.7%	1.6%
	80%-100% of MSA Median	24.8%	39.5%	27.8%	1.6%	1.6%	1.6%
	100%-120% of MSA Median	21.4%	36.0%	24.0%	1.5%	2.2%	1.7%
	> 120% of MSA Median	16.6%	27.3%	18.2%	1.0%	1.8%	1.1%

Figure 1: Specialized Lenders Market Share
Conventional Home Purchase Loans
United States MSAs, 10% Sample, 1993-2000

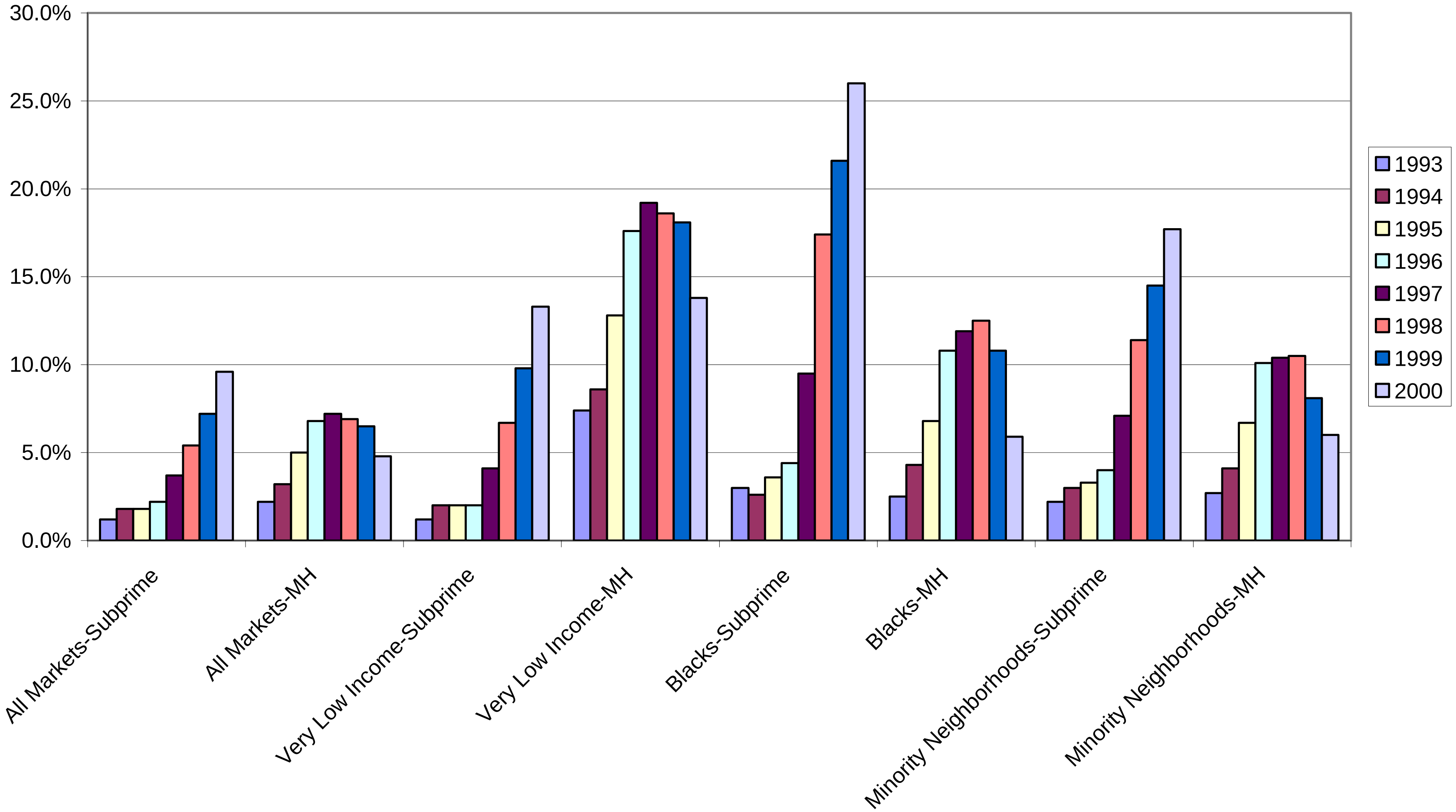

Figure 2: Subprime Lenders Market Share
Conventional Refinance Loans
United States MSAs, 10% Sample, 1993-2000

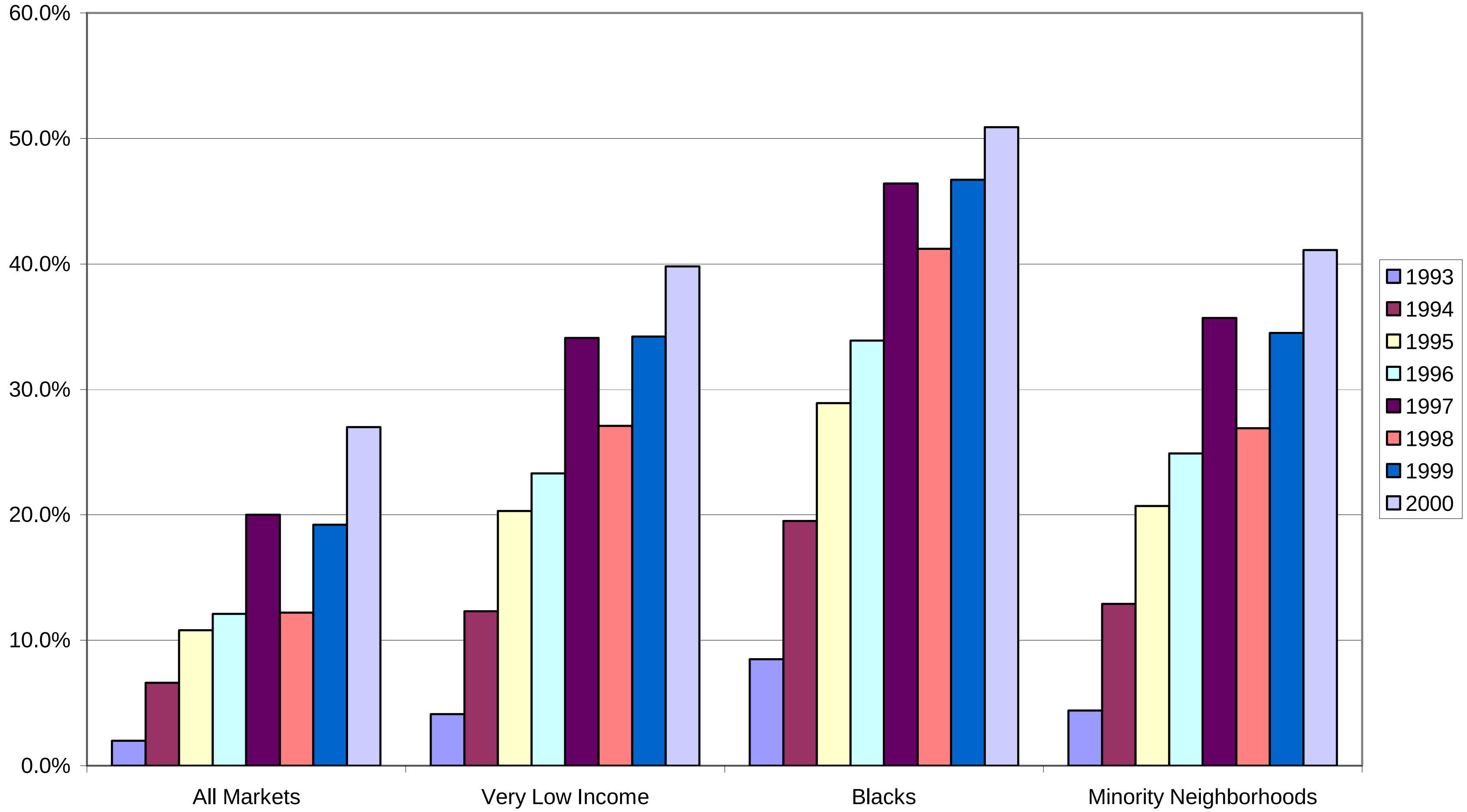

Figure 3: Black Denial Rates
Conventional Home Purchase Loans
United States MSAs, 10% Sample, 1993-2000