African-American Disparities in Lending: A Complex Problem for FHFA Enterprises, and Lenders

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Fannie Mae and Freddie Mac (Enterprises) are the largest secondary mortgage market investors in the United States. Their regulator, the Federal Housing Finance Agency (FHFA), in its Annual Housing Report of 2014, reported that "excluding second liens and reverse mortgages, Fannie Mae and Freddie Mac acquired $1.13 trillion of single-family loans in 2013, a decrease of 8.6 percent from the $1.24 trillion the Enterprises acquired in 2012."

Homeownership, often referred to as the "American Dream," has been a driving force behind personal wealth creation. Through the equity built from home appreciation, many American families have paid for home improvement, college tuition, debt restructuring, and inter-generational transfers of wealth. Homeownership is placed on a high pedestal in this country. This is evidenced by the high levels of government support directed to homeownership in the form of favorable tax treatment to homeowners, depreciation write-offs for real estate investors, and government support of institutions like Fannie Mae, Freddie Mac, the Federal Housing Administration (FHA), Veterans Administration (VA), and Ginnie Mae. All of us who work in the mortgage industry have benefited from the largess bestowed upon the housing industry. To be sure, our industry has received most favored industry status.

The black loan origination problem is beginning to take center stage in the discussions among policy makers in the nation's capitol.

Unfortunately, we have a dirty little secret. The home mortgage finance system in America has benefited some groups more than others. In particular, primary market lenders have had a difficult time originating loans to blacks. In addition, successful originations to blacks have been overly concentrated in the higher cost FHA loan type or, at one time, subprime.

The black loan origination problem is beginning to take center stage in the discussions among policy makers in the nation's capitol. Fannie Mae and Freddie Mac have been cited by FHFA's Office of Inspector General (OIG) for failing to monitor primary lenders' loan origination activities by race. The OIG purports that the FHFA and the Enterprises have a statutory responsibility under the Housing and Economic Recovery Act (HERA) to protect the public

interest, which is partially defined by federal and state consumer protection laws. Thus, the OIG recommended that the "FHFA develop and implement a risk-based plan to assess the Enterprises' oversight of their counterparties' compliance with their contractual obligations including consumer protection laws." This could be a warning shot signaling greater fair lending scrutiny of the Enterprises and their lender-partners regarding the paucity of black originations. Moreover, it would not be surprising to see the Consumer Financial Protection Bureau (CFPB) and other bank regulators begin to give this subject some attention. Lenders would be well-served to conduct their own self-examination of black loan originations and potential steering issues to be ahead of the game.

IS IT REASONABLE FOR THE FHFA TO ASK THE ENTERPRISES TO MONITOR THE RACIAL LENDING PRACTICES OF THEIR COUNTERPARTIES?

Prior to 2008, the Enterprises were government sponsored, but privately owned. In exchange for government support, the Enterprises agreed to lead the market and support affordable housing by creating loan programs for low- and moderate-income homebuyers. Although the Enterprises are still privately owned, once they went into conservatorship the amount of government support and involvement changed radically. According to the FHFA, "A key component of the conservatorships is the commitment of the U.S. Department of the Treasury to provide financial support to Fannie Mae and Freddie Mac to enable them to continue to provide liquidity and stability to the mortgage market. The Treasury Department has provided $189.5 billion in support which includes an initial placement of $1 billion in both Fannie Mae and Freddie Mac at the time of the conservatorships and an additional cumulative $187.5 billion investment from the Treasury Department."

The issue of compliance monitoring of counterparties was raised by the Office of Inspector General (OIG) of the FHFA in its Audit Report: AUD-2013-008 (Audit Report) issued March 26, 2013. The OIG Audit Report found that FHFA "does not thoroughly oversee how the Enterprises monitor compliance with consumer protection laws, and that the Enterprises do not ensure that their counterparties' business practices follow all federal and state laws and regulations designed to protect consumers from unlawful activities such as discrimination."

The Audit Report states that "FHFA officials rely on other federal regulatory agencies to enforce laws that protect mortgage borrowers." The other agencies include the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the recently-formed Consumer Financial Protection Bureau (CFBP). The report found that the Enterprises focus on counterparty compliance primarily in situations where they might face legal liability for a counterparty's noncompliance, such as predatory lending. Otherwise, the report found that the Enterprises rely on their counterparties' self-certified compliance and informally monitor federal agencies' enforcement activity.

When you think about it, if lenders had to choose between the CFPB and the Enterprises to regulate compliance, the latter does not seem like an unreasonable concept. The Enterprises are in the best position to monitor the performance of the lenders from whom they buy loans, and it ▷

Table 1: Number of Loans* by Race and Ethnicity 2004-2013

Year	White	Black	Hispanic	Asian	Native Am.	Hawaiian	Total
2004	8,757,288	946,951	1,207,769	518,692	46,561	54,760	11,532,021
2005	9,654,434	1,204,465	1,678,653	589,045	46,083	67,171	13,239,851
2006	8,523,996	1,200,041	1,660,659	510,259	41,373	61,488	11,997,816
2007	6,803,331	773,810	994,744	375,498	31,152	38,238	9,016,773
2008	5,033,820	416,340	510,943	261,659	20,977	20,425	6,264,164
2009	6,591,339	366,578	490,391	387,282	23,048	22,973	7,881,611
2010	5,758,563	302,228	429,413	404,107	19,102	19,876	6,933,289
2011	5,155,082	275,235	415,316	371,808	18,330	17,615	6,253,386
2012	7,103,591	373,258	563,798	540,901	24,621	25,025	8,631,194
2013	6,180,657	385,566	575,751	453,210	24,336	23,696	7,643,216
	69,562,101	**6,244,472**	**8,527,437**	**4,412,461**	**295,583**	**351,267**	**89,393,321**

*Source: 2004-2013 HMDA Data from LendingPatterns.com *Not Including Multi-Race, Unknown/NA/ loans*

Table 2: Fannie Mae # Loans Bought by Race and Ethnicity

Year	White	Black	Hispanic	Asian	Native American	Hawaiian
2,004	1,762,382	114,283	182,766	119,619	7,110	9,672
2,005	1,643,571	113,185	180,279	99,387	5,897	8,790
2,006	1,245,418	106,751	156,143	73,823	4,733	6,262
2,007	1,363,820	133,248	183,197	81,511	4,871	6,993
2,008	1,072,383	59,847	100,533	87,837	3,223	4,795
2,009	2,001,976	93,258	139,546	151,245	5,918	7,878
2,010	1,333,277	35,362	69,034	147,087	3,122	4,314
2,011	1,355,708	43,270	82,321	132,344	3,594	4,342
2,012	2,297,935	74,930	143,931	246,226	5,647	7,644
2,013	1,888,777	81,391	155,809	190,298	5,738	7,413
	15,965,247	**855,525**	**1,393,559**	**1,329,377**	**49,853**	**68,103**

Source: 2004-2013 HMDA Data from LendingPatterns.com

Table 3: Fannie Mae $ and # Units of White Loan Purchases (2004-2013)

Year	$ Volume	Units
2004	275,230,907,000	1,762,382
2005	281,557,818,000	1,643,571
2006	225,074,093,000	1,245,418
2007	262,922,082,000	1,363,820
2008	222,487,661,000	1,072,383
2009	418,874,551,000	2,001,976
2010	280,285,679,000	1,333,277
2011	271,201,690,000	1,355,708
2012	476,589,546,000	2,297,935
2013	380,672,526,000	1,888,777
	$3,094,896,553,000	**15,965,247**

Table 4: Fannie Mae $ and # Units of Black Loan Purchases (2004-2013)

Year	$ Volume	Units
2004	16,434,970,000	114,283
2005	18,106,707,000	113,185
2006	18,250,419,000	106,751
2007	23,962,972,000	133,248
2008	10,916,021,000	59,847
2009	17,498,445,000	93,258
2010	6,488,115,000	35,362
2011	7,551,680,000	43,270
2012	13,362,929,000	74,930
2013	13,991,287,000	81,391
	$146,563,545,000	**855,525**

should be their duty to know all demographic segments are being served by their mortgage purchases. Moreover, they should know the geographic distribution of the loans they buy and understand whether they are serving the home financing needs of all Americans in all communities. The monitoring activities need not be from the perspective of legal compliance, but more so from a practical matter of knowing whether they are enabling lenders through their loan purchase activities to continue to serve black borrowers and, consequently, the geographical areas where blacks live, buy, and refinance homes.

In effect, when they buy loans from lenders, Fannie Mae and Freddie Mac are redistributing public benefits obtained from direct government support with taxpayer dollars. By continuing to buy loans from lenders that are not originating loans to blacks of the type that the Enterprises buy, they are enabling lenders who help to perpetuate and exacerbate racial lending disparities. The Enterprises could develop specific strategies to help lenders improve their performance, similar to what they use to do with the various community lending programs.

WHY ALL THE FUSS?

By any measure, blacks have had the most disparate outcomes in home mortgage lending experience. Whether measured by the number of loans, origination rates, denial rates, APR, or points and fees, most research on the subject tends to point to adverse outcomes for African-Americans. This does not means the adverse outcomes are due to discrimination.

Nevertheless, the disparities alone tend to move researchers and investigators to probe further.

Table 1 is a summary of the number of loans made to each racial group from 2004-2013. It includes all loans, regardless of type (conventional and government), purpose (home purchase, refinance, and home improvement), property type (1-4 family, multi-family, and manufactured housing), lien status (first and second lien) as well as prime and subprime rate loans. The only exclusions are multi-race, and loans with "Unknown/NA" race and ethnicity.

A close look at Table 1 reveals that since the financial crisis of 2008, with the exception of Native Americans and Hawaiians, blacks received fewer loans than non-Hispanic whites, Hispanics, or Asians. This is an indication that blacks have not participated in the housing recovery to the same extent as other major racial or ethnic groups. Although prior to 2008 blacks received more loans than Asians, it should be noted that in 2005 and 2006, unlike any other racial group, more than half of the loans to blacks were higher-cost subprime rate loans. In addition, after the market crash, when subprime loans decreased precipitously, loans made to blacks disproportionately shifted towards government loans. Thus, in effect, over the last 10 years, loans to blacks have been disproportionately either subprime and/or government loans, i.e., not the conventional conforming prime rate loans that Fannie Mae and Freddie Mac primarily buy.

FANNIE MAE AND FREDDIE MAC RECORD OF BUYING LOANS TO BLACKS FROM LENDERS

According to the Home Mortgage Disclosure Act (HMDA) data, during the period of 2004-2013 Fannie Mae bought 15,965,247 non-Hispanic white loans from lenders worth over $3 trillion. By comparison, Fannie Mae bought 855,525 black loans worth $147 billion. This amounts to 18.65 times more white loans than black. Some would say this is a disparity supported and underwritten by the federal government.

FREDDIE MAC SUMMARY OF LOAN PURCHASE ACTIVITY 2004-2013

Table 5, 6, and 7 below show the number of loans Freddie Mac purchased from approved lenders by race and ethnicity. Between 2004 and 2013, Freddie Mac bought 9,963,127 non-Hispanic white loans from lenders worth $1.8 trillion compared to 401,149 black loans valued at $70 billion. This amounts to 24.85 times more dollars that flowed to white borrowers as compared to black. As with Fannie Mae, the white lending trend is positive at Freddie Mac for both dollars and the number of loans. For blacks, the trend for both dollars and the number of loans is negative.

From these lending differences, major questions abound:

Question: Are the differences in loan type outcomes legally justifiable from a fair lending standpoint?

Answer: There are no easy answers. On the surface at the macro level, it looks like a dual mortgage market; FHA/subprime for blacks and conventional subprime for whites. The truth may be that in many, if not most cases, you will find other factors like low credit scores or undue reliance on third party referrals influencing the outcomes.

Question: Are the differences based on blacks self-selecting higher-cost loans due to actual or perceived limited funds for down payments and/or poorer credit qualifications? ▻

Table 5: Freddie Mac # Loans by Race and Ethnicity

Year	White	Black	Hispanic	Asian	Native Am.	Hawaiian
2,004	1,132,984	49,161	80,730	61,907	3,721	4,335
2,005	1,061,116	50,407	87,614	56,135	3,360	4,432
2,006	867,746	48,731	78,925	50,148	2,960	3,646
2,007	955,410	69,603	106,371	52,225	3,229	4,280
2,008	701,479	35,417	62,097	48,720	2,107	2,764
2,009	1,303,000	28,851	54,358	95,941	2,830	3,443
2,010	975,020	21,852	39,553	83,748	2,045	2,742
2,011	763,920	20,465	37,045	76,526	1,645	2,182
2,012	1,146,822	35,531	67,365	106,819	2,445	3,472
2,013	1,055,630	41,131	74,675	93,619	2,714	3,656
	9,963,127	401,149	688,733	725,788	27,056	34,952

Source: 2004-2013 HMDA Data from LendingPatterns.com

Table 6: Freddie Mac $ and # Units of White Loan Purchases (2004-2013)

Year	$ Volume	Units
2004	174,440,440,000	1,132,984
2005	180,037,348,000	1,061,116
2006	157,910,090,000	867,746
2007	178,733,225,000	955,410
2008	139,624,850,000	701,479
2009	266,607,373,000	1,303,000
2010	188,510,198,000	975,020
2011	148,990,352,000	763,920
2012	229,708,925,000	1,146,822
2013	208,592,042,000	1,055,630
	$1,873,154,843,000	9,963,127

Table 7: Freddie Mac $ and # Units of Black Loan Purchases (2004-2013)

Year	$ Volume	Units
2004	7,228,329,000	49,161
2005	8,362,326,000	50,407
2006	8,698,187,000	48,731
2007	12,544,878,000	69,603
2008	6,375,929,000	35,417
2009	5,360,491,000	28,851
2010	3,934,077,000	21,852
2011	3,524,346,000	20,465
2012	6,386,857,000	35,531
2013	7,178,383,000	41,131
	$69,593,803,000	401,149

Answer: This is an area where lenders can make a difference by making sure early in the application process that each applicant is presented with all conventional financing options and their associated costs, including private mortgage insurance.

Question: To what extent does limited financial literacy play a role in the black applicant's ability to choose the best option?

Answer: We know financial literacy plays a role. But do you really need to be a mortgage expert for something you are going to do every now and then? What's really needed is for applicants to have an unbiased resource to turn to for advice and who knows the mortgage game. By default, we have delegated the trusted advisor responsibility to the loan officer who has a conflict of interest.

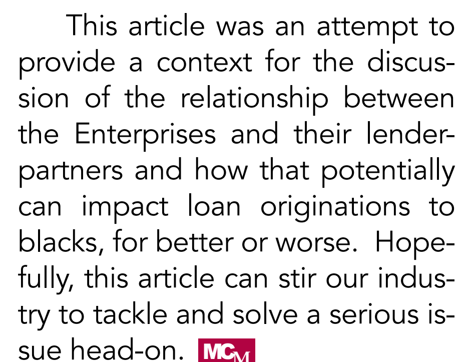
Question: What role, if any, do the Enterprises and underwriting and pricing policies play in the lenders loan origination practices?

Answer: To date, this subject has been more or less off-limits. We know credit overlays imposed by lenders are a direct response to the uncertainty posed by the risk of loan repurchases demanded by the Enterprises. Moreover, lender rate sheet adjustments typically follow an Enterprise's published loan-level pricing matrices.

Question: Is there a risk for the lender that these differences may be characterized as discrimination in the form of loan steering , redlining, or both?

Answer: Yes, the risk of disparities being characterized as discrimination is more likely when the disparities are so great that they are unlikely to occur by chance. Obtaining the right answers to these questions will depend on a careful study of all parties involved: borrower, lender, and the Enterprises. Each lender will need to engage in self-monitoring to arrive at its own conclusions.

This article was an attempt to provide a context for the discussion of the relationship between the Enterprises and their lender-partners and how that potentially can impact loan originations to blacks, for better or worse. Hopefully, this article can stir our industry to tackle and solve a serious issue head-on. MCM



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