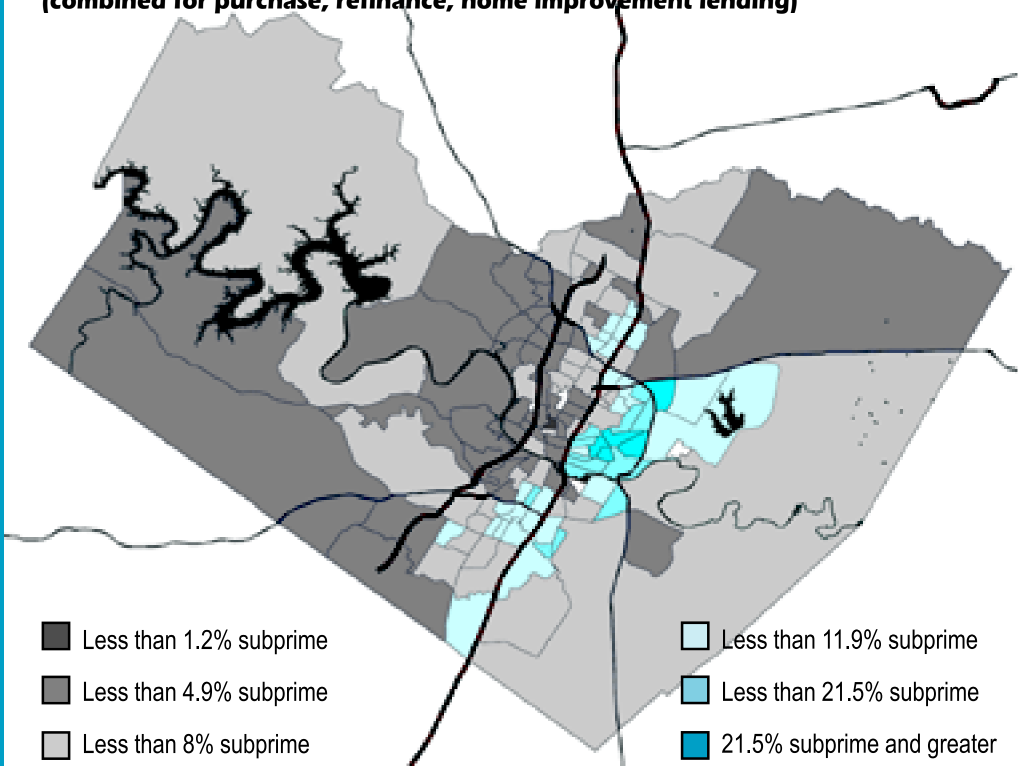
Austin Focus Study

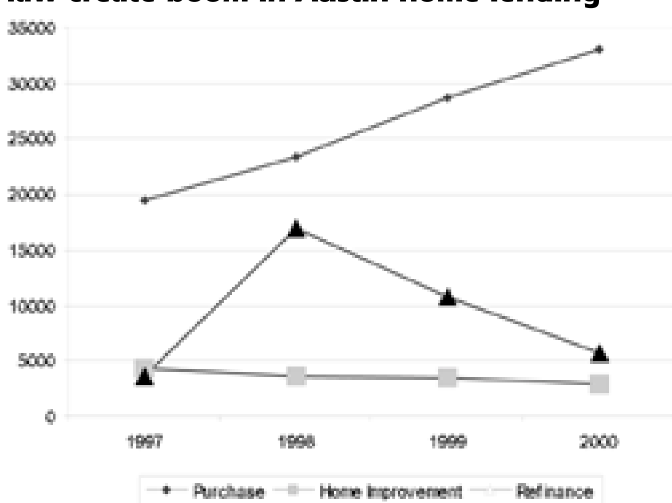
Austin Subprime Lending Patterns, 1997-2000
(combined for purchase, refinance, home improvement lending)



Rapid growth and a hot housing market resulted in rapidly increased lending since 1997—but thousands of Austin families now carry the heavy burden of high cost home debt as subprime lenders filled the gaps left by the prime market. As foreclosure postings rise steeply across Central Texas,[1] it's time to examine the potential impact of high cost home lending.

Austin remains a sharply divided city, with growth and prosperity disproportionately spread across the western hills while subprime lending is concentrated in the heavily minority near east central neighborhoods. Manufactured home lending dominates neighborhoods further east. Both subprime and manufactured home loans cost consumers more in long term interest and fees.

Hot housing market and 1998 home equity law create boom in Austin home lending



The Consumers Union study

This study uses 1997 to 2000 Home Mortgage Disclosure Act (HMDA) data to identify lending patterns for Austinites who purchased or refinanced a home.

Specifically, we identify patterns of subprime lending by borrower gender, race, and geographical area. Where necessary we combine four years of HMDA data to identify patterns in areas where lending is historically sparce (lower income areas, high minority areas) and patterns among individual lenders.[2]

Market growth

Austin's home loan market continued to grow through 2000, despite signs of an economic slowdown. The number of loans made increased by nearly 20 percent in 1998, 22.9% in 1999, and that burning growth only slowed down slightly by 2000.

Refinance lending peaked in 1998, due to low interest rates and the introduction of home equity lending, and has now dropped back again. Home improvement lending started to decline with the opening of the new home equity market and continues to decline, indicating a shift from home improvement loans to cash-out home equity lending.

Subprime lending boom

Prior to implementation of the new home equity laws, Texans bought, sold and refinanced their homes with very little help from the subprime mortgage industry. In 1997, loans from HUD- identified subprime companies in Austin accounted for 5.8 percent of all single family home secured loans.

That has now changed. By 2000, subprime companies made nearly 10 percent of all loans in Austin, and 28.4 percent of refinance loans. More than 4,000 families took a potentially high cost home loan from a subprime company.

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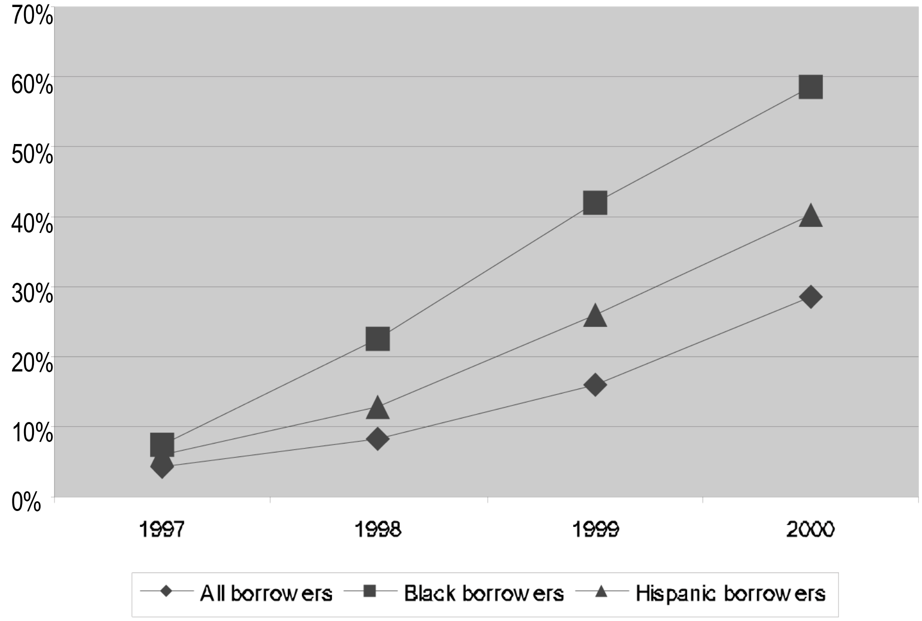
Subprime refinance lending grows to nearly 30% of all refinance lending by 2000, and nearly 60% of lending to Black borrowers



Prime lenders show greatest disparity, manufactured home lenders least disparity, between denial rates for White and minority borrowers

Purchase Loans	Prime Lender Denial Rate	Subprime Lender Denial Rate	MH Lenders Denial Rate	Prime Lender Denial Ratio	Subprime Lender Denial Ratio	MH Lender Denial Ratio
White Borrower	9.1%	19.5%	60.6%	NA	NA	NA
Black Borrower	20.5%	30.9%	73.2%	**2.25**	**1.58**	**1.21**
Hispanic Borrower	19.1%	30.5%	68.6%	**2.10**	**1.56**	**1.13**
Refinance Loans	**Prime Lender Denial Rate**	**Subprime Lender Denial Rate**	**MH Lenders Denial Rate**	**Prime Lender Denial Ratio**	**Subprime Lender Denial Ratio**	**MH Lender Denial Ratio**
White Borrower	13%	34.2%	NA	NA	NA	NA
Black Borrower	25.5%	42.5%	NA	**1.96**	**1.24**	NA
Hispanic Borrower	23.7%	38.6%	NA	**1.83**	**1.13**	NA

Disparities remain, even among borrowers earning more than $60,000

Purchase Loans	Prime Lender Denial Rate	Subprime Lender Denial Rate	MH Lenders Denial Rate	Prime Lender Denial Ratio	Subprime Lender Denial Ratio	MH Lender Denial Ratio
White Borrower	6.5%	14.9%	46.7%	NA	NA	NA
Black Borrower	12.6%	20.7%	62.4%	**1.94**	**1.39**	**1.33**
Hispanic Borrower	11%	16.2%	58%	**1.70**	**1.09**	**1.24**
Refinance Loans	**Prime Lender Denial Rate**	**Subprime Lender Denial Rate**	**MH Lenders Denial Rate**	**Prime Lender Denial Ratio**	**Subprime Lender Denial Ratio**	**MH Lender Denial Ratio**
White Borrower	11.3%	30.2%	NA	NA	NA	NA
Black Borrower	22.3%	38.3%	NA	**1.97**	**1.27**	NA
Hispanic Borrower	19.4%	32.8%	NA	**1.71**	**1.08**	NA

Market gaps

In a hot housing market, who are the people who turn to subprime lenders? Some of the same people we have found to be underserved in the past.

Lending levels: Black and Hispanic families take home loans at a much lower rate than Whites compared to their proportion in the population. While the total *number* of home purchase loans made to minority borrowers increased from 1997 to 2000, the proportion of purchase loans going to Black and Hispanic borrowers actually decreased over that period. By 2000, only 3.3 percent of home purchase loans were made to Black borrowers, although Blacks represent 8.1 percent of the Austin/ San Marcos MSA population. Similarly, lenders made only 10.8 percent of purchase loans to Hispanic applicants, although Hispanics represent 26.2 percent of the population in this area.[3]

On the other hand, in the refinance market (where subprime lenders are most active) Black and Hispanic borrowers now represent a higher proportion of the overall loan pool than they did in 1997--and more than 40 percent of these borrowers are taking their loans from subprime companies. Subprime lenders appear to be successfully finding a new market for refinance loans among underserved minority borrowers.

Denial Rates (see tables left): Over the four year period, prime lenders denied Black and Hispanic applicants at nearly double the rate they denied White applicants (the denial ratio). Subprime companies also denied minorities at a higher rate than White applicants, but the gap was smaller. Only manufactured housing lenders denied White and minority applicants at about the same rate.[4]

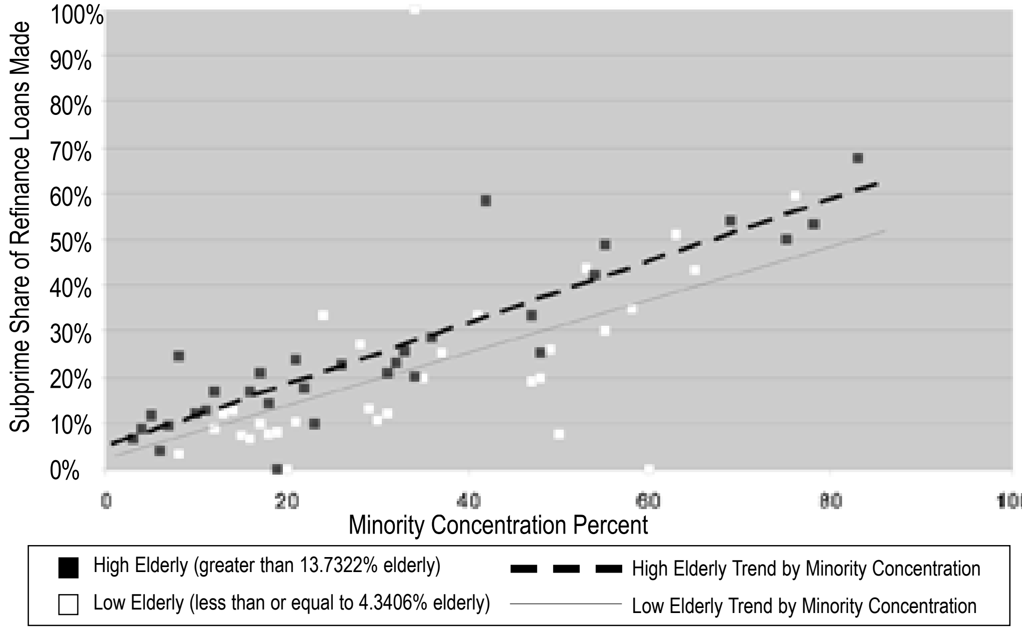
At higher income levels (families earning more than 60k, or 1.5 times the state median income) subprime lender denial rates for minority borrowers are more similar to denial rates for Whites, while denial rates for prime lenders remain much higher. These findings indicate little change in the market since our 2000 analysis, which found high denial disparities even at the highest income levels (families earning more than $100,000 per year).

Conventional and FHA: Lenders offer most borrowers conventional loans, but approve a disproportionate number of FHA loans for minority borrowers. FHA loans typically cost more than conventional credit because borrowers must pay an FHA insurance premium of 2.5 percent of the loan amount up front and an insurance premium every month over the life of the loan. Borrowers with conventional credit may cancel Private Mortgage Insurance once they have adequate equity in their homes.

The majority of home purchase borrowers in the Austin San Marcos MSA (76.3 percent in 2000) obtained conventional loans and only 18.8 percent ended up with FHA loans. But 36.8 percent of home purchase loans to Black borrowers and 37.9 percent of loans to Hispanic borrowers were FHA loans in 2000. This is nearly the same share we reported two years ago.

On the other hand, almost all refinance loans to almost all borrowers were conventional loans. This may be partially explained, to the potential detriment of some credit worthy borrowers, by the sharp rise in subprime refinance.

Neighborhoods with higher elderly population have higher subprime penetration; highest subprime penetration corresponds to high elderly and high minority tracts



Subprime market segments

In order to look more closely at subprime activity in the Austin San Marcos MSA, we combined four years of MSA level HMDA data and information from the new census. We found that subprime lending was concentrated among minority borrowers, women borrowers, and borrowers in neighborhoods with a higher concentration of elderly people.

The chart (*right above*) describes the distribution of subprime loans according to the minority and elderly concentration in the census tract. High elderly tracts generally have a somewhat higher subprime penetration rate than low elderly tracts, and that rate increases as the minority concentration increases. In other words, tracts that are both high elderly and high minority tend to have higher subprime penetration, with some exceptions.

Nine Austin census tracts had a very high concentration of subprime refinance loans (more than 45 percent of loan volume over four years) and enough loans for closer study. All these tracts are east of IH35 and generally correspond to the East Austin high subprime areas on the map, p. 1 (representing subprime purchase, refinance and home improvement combined).

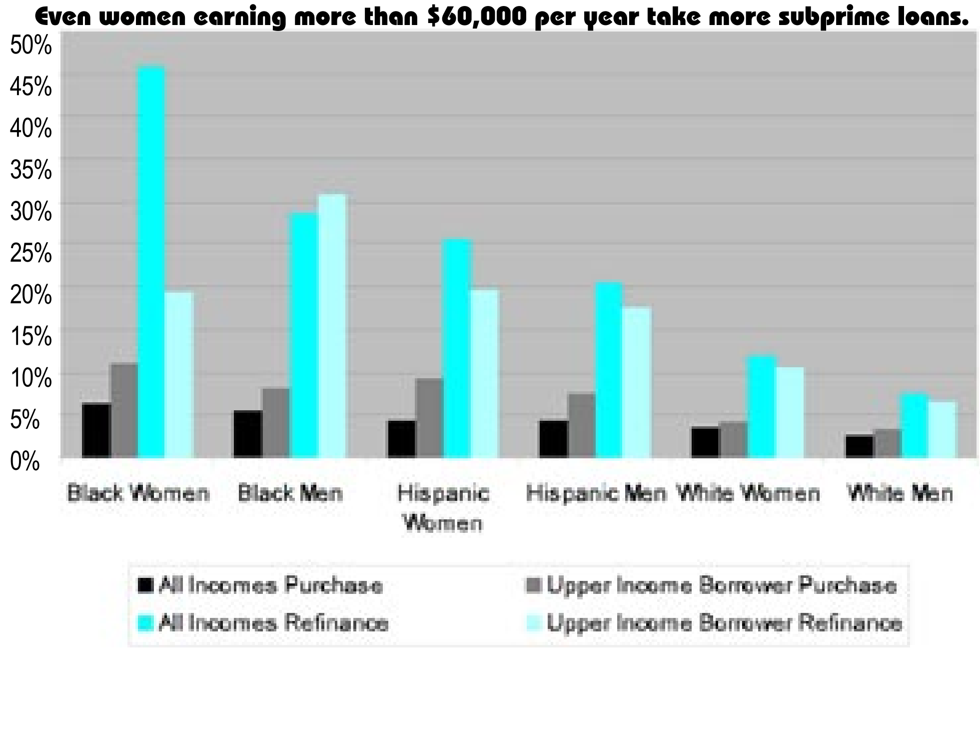
Within these high subprime tracts, Black women took a disproportionate share of loans from subprime companies (74 percent of loans to Black women in these tracts were subprime compared to 58.8 percent over the sample). Black men also took loans from subprime companies at a higher than average rate for this area (64 percent).

Two of these East Austin neighborhoods flank Martin Luther King Blvd, from IH35 to Webberville Road. From IH35 east to Airport Blvd., north of Martin Luther King Blvd, lies tract 4.02 (41 refinance loans: 20 subprime). This is a mixed ethnic area, 37 percent Black and 26 percent Hispanic, with 16.8 percent of the population over 65. These borrowers were also ethnically mixed, about one third Black, one third White and a few Hispanic or race unreported. But ten of 15 Black borrowers took loans from subprime companies, compared to only 2 of 13 White borrowers.

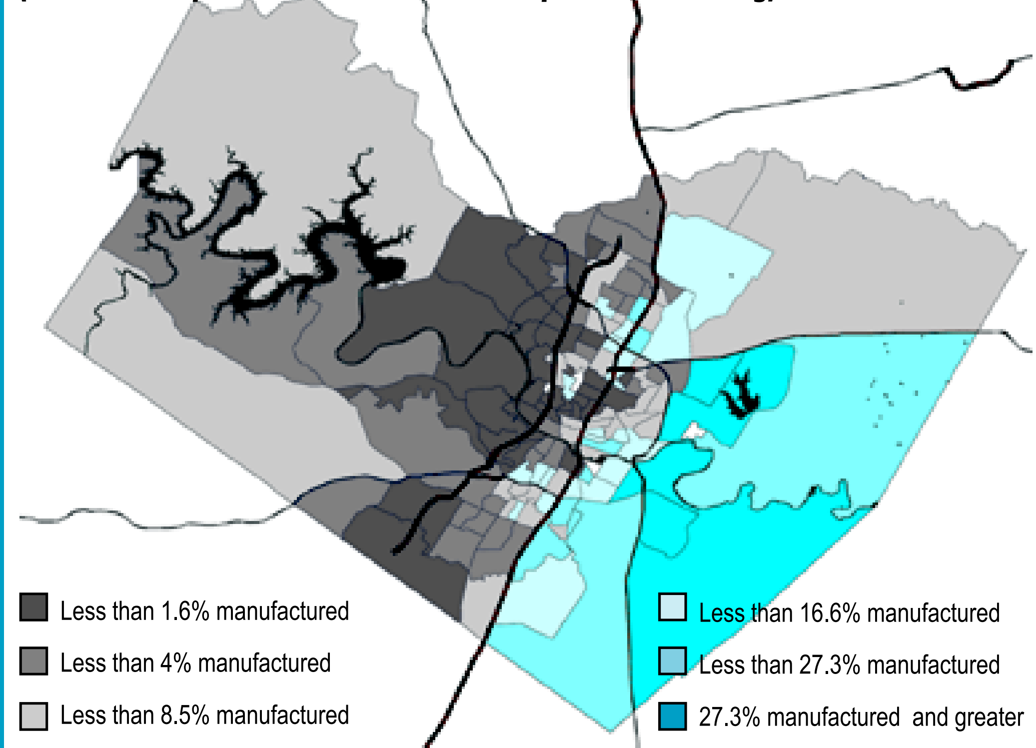
East of Airport Blvd, tract 21.09 (59 refinance loans: 40 from subprime companies) is 67 percent Black and 27 percent Hispanic, with 16.7 percent of the population over age 65. Nearly all of these refinance borrowers were Black (where race was identified), evenly split between men and women. Black women borrowed from subprime companies slightly more often than Black men.

While women took an only slightly greater share of subprime home purchase

Women take a higher share of subprime loans than men in every racial category. Even women earning more than $60,000 per year take more subprime loans.



Austin Manufactured Housing Patterns, 1997-2000
(combined for purchase, refinance, home improvement lending)



and home improvement loans, women received a far larger share of refinance loans from subprime companies. While 10.2 percent of men took refinance loans from subprime lenders, 16.9 percent of women did.

Further, while subprime companies made only 7.5 percent of the refinance loans to White male borrowers over the four year period, these companies made 45.4 percent of the refinance loans to Black women. Black women got a far higher share of subprime loans than Black men.

Because women still make less than men, we re-examined the same data for all borrowers earning more than $60,000 annually (1.5 times the state median family income). Generally, higher income women still took loans from subprime companies at a higher rate than their male counterparts, -- with the notable exception that high income Black men took a greater share of subprime refinance loans than high income Black women. Higher income minority women took subprime loans at higher rates than White women.

Austin major lenders

The top fifteen Austin home purchase lenders in 2000 were all prime lenders, and many of these lenders had a lower share of the minority borrower market than their share of the Austin market as a whole.

Of the major bank lenders at the top of the Austin area market, Wells Fargo, Bank United and Guaranty Federal made relatively few loans to minority borrowers. On the other hand, Bank of America made more loans to Hispanic applicants than its Austin marketshare.

Several prime mortgage companies specializing in FHA and VA loans made a notably greater share of loans to minority borrowers than their overall Austin marketshare--in line with our earlier findings that minority borrowers take FHA loans at a greater rate than White borrowers. National City Mortgage, a conventional mortgage lender, penetrated the market for both Black and Hispanic borrowers at a higher rate than its overall share as well.

Almost all the top fifteen Austin refinance lenders in 2000 made as great or greater a share of refinance loans to minority borrowers as their overall marketshare. Only Wells Fargo and Flagstar made relatively few refinance loans to minority borrowers. Bank One made more refinance loans to Hispanic borrowers than its overall share of the Austin refinance market.

On the other hand, five of the top fifteen refinance lenders in Austin were subprime companies, and these five companies alone made nearly half the refinance loans to Black borrowers and a quarter of the refinance loans to Hispanic borrowers. The top subprime refinance lender, Ameriquest, makes fixed and variable rate loans at initial rates ranging from 6 percent to 14.99 percent, with an average rate of 8 to 9.5 percent. In recent securitizations, about a quarter of borrowers have credit scores over 650.[5]

High cost refinance loans

When Texas inaugurated home equity lending, the state capped fees that could be charged at closing, gave consumers a 12 day "cooling off" period to consider the loan terms and a three day right of recission after closing. These protections were intended to prevent predatory practices from taking hold.

Yet today, closing costs routinely exceed the three percent cap set out in the Texas Constitution, and other problems have emerged. For example, an Austin couple reported paying a ten percent "loan origination fee" totaling $5,000 for a home equity loan. Unfortunately, the Office of Consumer Credit wrote them back to say that an "origination fee" paid to a lender (rather than a broker) is actually not a fee. Instead it is prepaid interest, and interest charges are not included in the three percent fee cap. Without an effective fee cap, consumers

For home purchase, prime lenders show smaller share of minority market except for FHA/VA lenders, who serve more minority borrowers

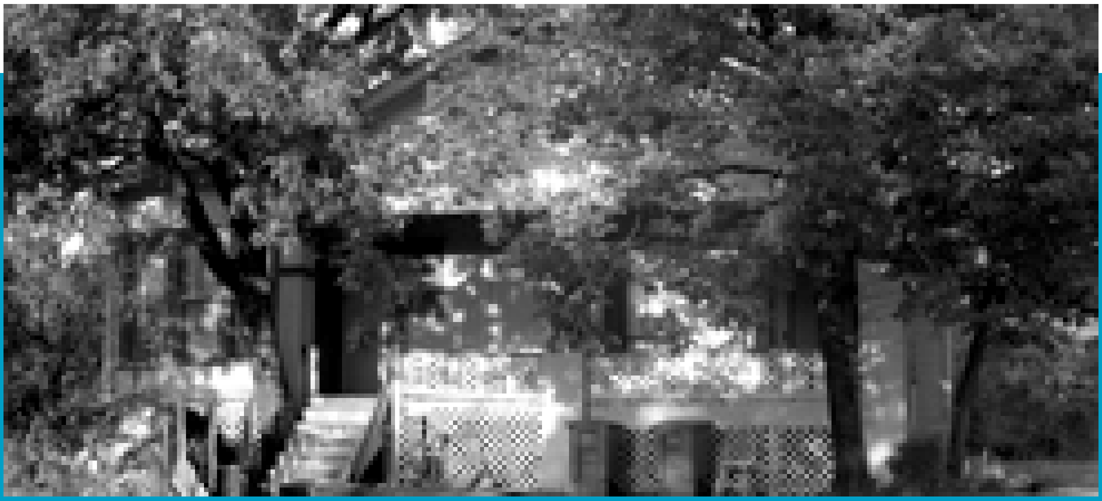
Top Purchase Lender Name	Lender Type	2000 Loans Made	2000 Austin Market Share	2000 Market Share: Black Borrowers	2000 Market Share: Hispanic Borrowers
COUNTRYWIDE HOME LOANS	Prime Mortgage Lender	2470	6.9%	4.8%	4.4%
WELLS FARGO HOME MORTGAGE	Prime Bank Lender	2371	6.6%	3.7%	2.8%
BANK UNITED	Prime Bank Lender	1558	4.4%	1.7%	1.5%
CH MORTGAGE COMPANY I LTD.	FHA/VA Lender	1477	4.1%	9.7%	6.5%
STERLING CAPITAL MORTGAGE CO.	FHA/VA Lender	1041	2.9%	7.6%	6.2%
BANK OF AMERICA, N.A.	Prime Bank Lender	955	2.7%	1.6%	3.2%
NORTH AMERICAN MORTGAGE CO.	Prime Mortgage Lender	954	2.7%	1.5%	3.1%
CONSECO FINANCE SERVICING CORP	Manufactured Home Lender	940	2.6%	2.9%	3.7%
NATIONAL CITY MORTGAGE COMPANY	Prime Mortgage Lender	921	2.6%	3%	2.4%
GUARANTY FEDERAL BANK, F.S.B.	Prime Bank Lender	806	2.3%	1%	.9%
CENDANT MORTGAGE	Prime Mortgage Lender	805	2.3%	.3%	.3%
CHASE MANHATTAN MORTGAGE CORP	Prime Mortgage Lender	752	2.1%	1.4%	1.8%
CTX MORTGAGE COMPANY	Prime Mortgage Lender	697	2.0%	3.5%	2.1%
CROSSLAND MORTGAGE CORPORATION	Prime Mortgage Lender	696	1.9%	2.1%	2.7%
KAUFMAN & BROAD MORTGAGE CO.	FHA/VA Lender	678	1.9%	6.9%	3%

report paying thousands at closing for subprime refinance loans. And once they have made the mistake of taking a high cost refinance loan in the first place, it may cost thousands more in new closing charges to get out of that loan and take a new one at a lower interest rate.

This same Austin couple also reported that the lender required them to pay off unsecured debt as a condition of approval. Texas law currently states that a lender may not require a borrower to "apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender." The state takes the position that a lender "could require direct payment to creditors, especially if that action is needed to attain the desired income to debt ratio."

Recommendations

Home equity is the one of the most important ways families develop wealth over the long term. High cost refinance turns



Top refinance lenders to minority borrowers are subprime companies

Top Refinance Lender Name	Lender Type	2000 Loans Made	2000 Austin Market Share	2000 Market Share: Black Borrowers	2000 Market Share: Hispanic Borrowers
BANK ONE, TEXAS, NA	Prime Bank Lender	510	8.6%	6.7%	10.8%
WELLS FARGO BANK TEXAS, NA	Prime Bank Lender	401	6.8%	1.4%	4.7%
AMERIQUEST MORTGAGE COMPANY	Subprime Lender	315	5.3%	16%	8.6%
BANK OF AMERICA, N.A.	Prime Bank Lender	260	4.4%	2.8%	7.7%
BANK ONE, NA	Prime Bank Lender	251	4.2%	5.3%	6%
NEW CENTURY MORTGAGE CORP.	Subprime Lender	221	3.7%	10.6%	7.4%
COUNTRYWIDE HOME LOANS	Prime Mortgage Lender	197	3.3%	2.1%	3.3%
FLAGSTAR BANK, FSB	Prime Bank Lender	180	3.0%	1.4%	2%
NATIONAL CITY MORTGAGE COMPANY	Prime Mortgage Lender	163	2.8%	2.5%	1.8%
WELLS FARGO HOME MORTGAGE	Prime Bank Lender	148	2.5%	1.4%	1.5%
CONSECO FINANCE SERVICING CORP	Manufactured Housing Lender	144	2.4%	0%	0%
AAMES FUNDING CORPORATION	Subprime Lender	128	2.2%	11%	4.8%
LONG BEACH MORTGAGE COMPANY	Subprime Lender	127	2.1%	4.3%	2.3%
CROSSLAND MORTGAGE CORPORATION	Prime Mortgage Lender	109	1.8%	1.1%	2.1%
THE CIT GROUP/CONSUMER FINANCE	Subprime Lender	109	1.8%	4.3%	2.3%

family wealth into cash, cash that is frequently turned back over to the lender in high loan fees.

To prevent the stripping of equity from the most vulnerable families, the Texas Legislature should reduce the fees associated with high cost home refinance. The AARP, the National Consumer Law Center (NCLC) and others have defined loans as "high cost" if they have an interest rate that equals or exceeds six percentage points over the weekly average yield on five year treasury bills (currently about 3.5 percent but more typically ranging from 4 to 6.5 percent over the period of this study). These groups also define "high cost" as loans that contain fees in excess of three percent of the loan amount.[10] The Texas Legislature should set standards for "high cost" loans:

- prohibit the financing of fees, closing costs, or other lender charges (including "prepaid" points) if the fees rise above three percent of the loan amount (including lender fees).
- require loan counseling for any borrower getting a high cost loan during the existing 12 day waiting period before the loan closes; and
- prohibit lending without due regard to repayment ability.

For all home equity lending we recommend:

- limiting "discount points" to legitimate charges that actually provide a substantial benefit to consumers. The AARP, the Self Help Credit Union and NCLC have created standards for "Bona Fide Discount Points" that would eliminate many of the problem fees consumers face at closing.

Notes

[1] Breyer, Michelle, "Foreclosure sale a boon for the savy," Austin American Statesman, October 2, 2002.

[2] Owner occupied, single family refinance, purchase and home improvement loans, excluding loans made by HUD identified manufactured home lenders unless noted (a total of 156,112 loans over four years).

[3] Office of the State Demographer, "Projections of the Population of Texas and Counties in Texas by Age, Sex and Race/Ethnicity for 2000-2040," December 2001, Austin-San Marcos MSA.

[4] In order to retain a significant baseline of subprime, minority, high income borrowers for denial rate comparison, we elected in this analysis to combine four years of data for the Austin area.

[5] Ameriquest Mortgage Prospectus, Form 424, Securities and Exchange Commission, June 21, 2001, September 2001, June 2, 2002, and August 21, 2002.

[6] Consumer Complaint, Office of the Consumer Credit Commissioner, 1/25/1999.