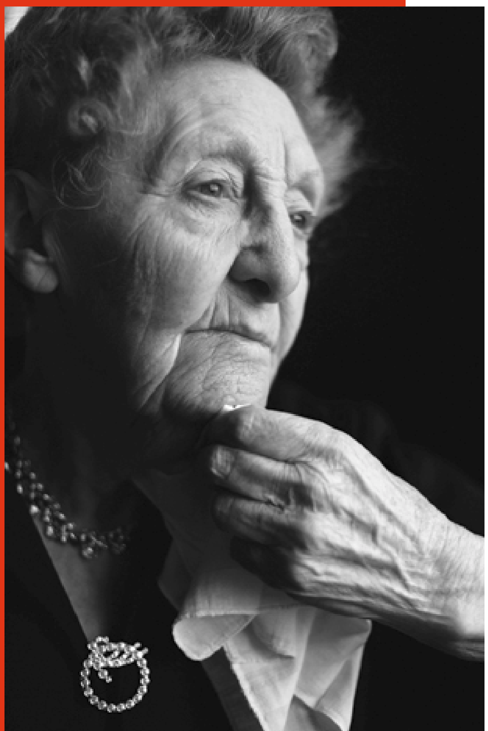
Elderly in the Subprime Market



Subprime loans are concentrated in geographical areas with a higher concentration of elderly residents. Even after accounting for race, income and other factors, the likelihood of getting a subprime loan increases as the age of residents increases.

Generally, older homeowners have substantial home equity built up, making them a target for attractive sounding offers. Subprime lenders appeal to homeowners through phone and mail solicitation, offering tens of thousands in quick cash. And Texas law does not adequately protect the elderly from high fees and loans they cannot afford to repay.

The Consumers Union Study

This study analyzes Texas refinance loans from 1997 to 2000.[1] We identify subprime lending (loans from HUD identified subprime companies) at the state and city (MSA) level. With 2000 census information about tracts, we identify patterns of subprime lending using standard regression techniques and cross tabulations.

Home Mortgage Disclosure Act (HMDA) data does not include information about the age of the borrower. Therefore, as a surrogate for borrower age, we examined the concentration of elderly people in tracts where homeowners have refinanced their homes. We compared lending in tracts with the lowest concentration of seniors (the quintile of records where the population over 65 is less than 4.3406 percent) to lending in tracts with the highest concentration of seniors (the quintile of records where greater than 13.7322 percent of the population is 65 or older) and to the minority concentration.

To compare subprime and prime loans by both the age and racial characteristics of the tract, we combined four years of HMDA data. This ensures a large enough loan pool for comparison even in high elderly/high minority areas where lending is historically sparce. This means that the absolute ratio we calculate for supprime penetration is significantly lower than the 2000 subprime penetration rates calculated by other researchers.[2] The rapid rise of subprime lending in Texas over the period of this study means that subprime penetration rates for 2000 are higher than the four year averages presented here.

To gain an understanding of point-of-sale lending practices that might lead large numbers of people into the high priced subprime market, we also reviewed consumer complaints filed with the Office of the Consumer Credit Commissioner. This information is essentially anecdotal and incorporated here only to suggest possible reasons why so many people take high priced home loans.

Finding: Neighborhoods with a high concentration of elders show higher subprime penetration regardless of race

As expected, minority areas have much higher subprime penetration. But we also found that *at every level of minority concentration, the subprime penetration is greater for the tracts with an older population* (see Chart 1, p. 2). Even in predominantly white areas, subprime lenders made a much larger share of the loans in the tracts with more elderly residents.

The highest minority and elderly census tracts showed a supbrime penetration over the four year period greater than 70 percent. Since subprime refinance in Texas has increased in each year of the study, subprime lending in these high elderly/high minority neighborhoods is now likely to be above 70 percent.

To get more information about the subprime activity in tracts with a high elderly and high minority population, we examined two urban areas, Dallas and Austin, and then looked at some individual census tracts.

The distinction between low elderly and high elderly neighborhoods in Dallas

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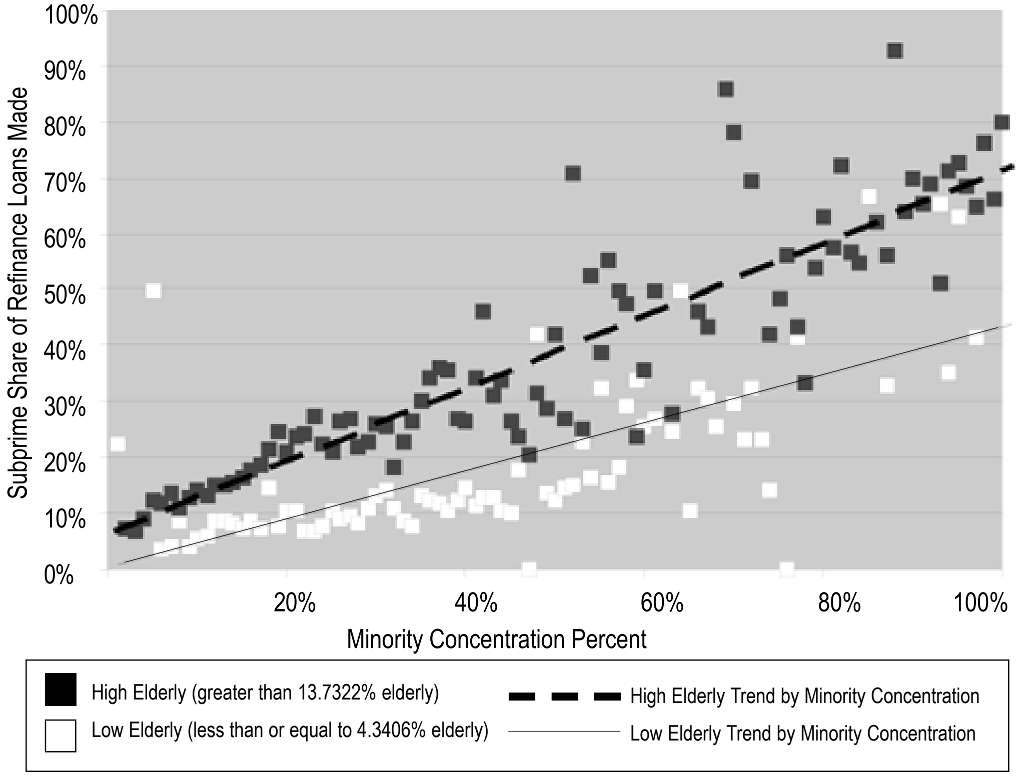
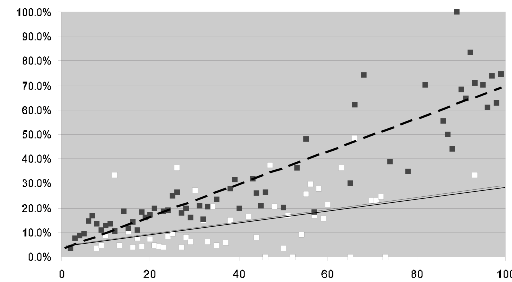
Chart 1: Neighborhoods with higher elderly population have higher subprime penetration; highest subprime penetration corresponds to high elderly and high minority tracts

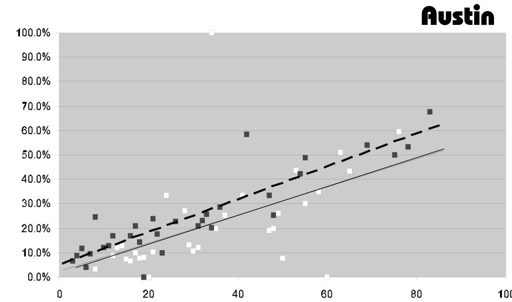


Consumers Union ranked 402,639 single family, owner occupied refinance loan records from 1997-2000 (not including manufactured home loans) by concentration of elderly in the home's census tract, then compared the bottom quintile of loans (80,508 loans in tracts with less than 4.3406% over 65) to the top quintile of loans (80,550 loans in tracts with greater than 13.7322% elderly).

Dallas

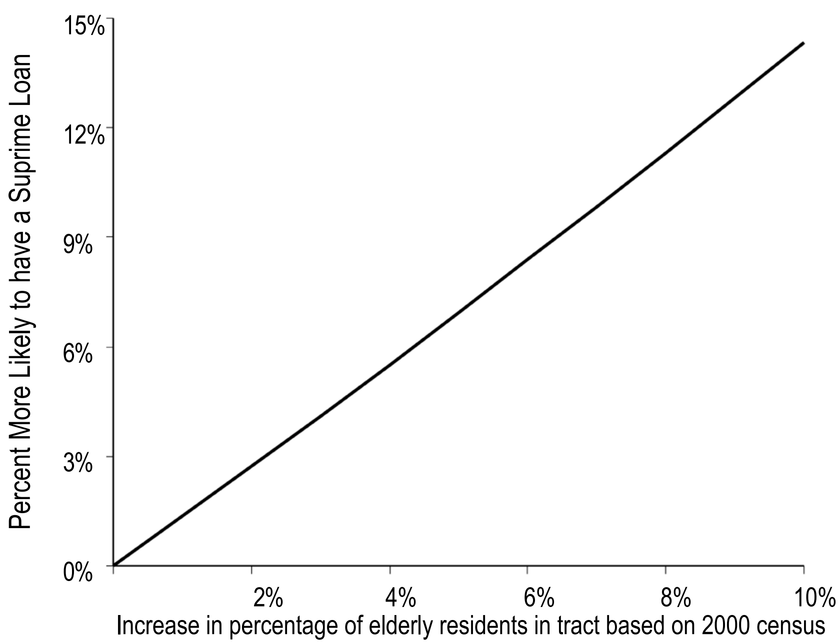


Austin



tracks closely with the statewide finding--high elderly neighborhoods see more subprime lending at every minority concentration, and borrowers in high elderly/high minority areas took refinance loans from subprime companies most of the time. In Austin the distinction between high elderly and low elderly tracts is much less marked, although high minority/high elderly tracts also show high subprime penetration.

Chart 2: After factoring out other tract demographics, loan size, and the income, race and sex of the borrower, we still find that as the percentage of elderly residents increases in a neighborhood, subprime penetration increases



Finding: Black women borrowing in selected high elderly/high minority tracts get loans from subprime companies

Within these two urban areas, a handful of high elderly/high minority census tracts had a relatively high volume of refinance lending for closer study. Within these sample tracts, Black women took a disproportionate share of loans from subprime companies--a finding related to the broader findings of our report on women borrowers in this packet.

The population of tract 88.01 in South Central Dallas (54 refinance loans total: 43 from subprime companies) is 24.6 percent over 65 and 95.3 percent Black. Refinance borrowers in this tract were nearly all Black (or race information was not reported), and almost two thirds of the Black borrowers were women. Almost all of the Black women borrowers (17 of 20) in this high elderly tract took refinance loans from subprime companies--including Aames Funding, Full Spectrum Lending and Long Beach Mortgage.

Tract 112.00 (79 refinance loans: 54 from subprime companies) lies further to the

South in South Dallas, bordered by IH35 and I20 on the South and West. This area is 79 percent Black and 14 percent Hispanic. Again, refinance borrowers in this area were nearly all Black, but more were men than women (23 women, 28 men). The Black male borrowers took loans from subprime companies about half the time (15 subprime: 13 prime), but the Black women borrowed mainly from subprime companies (17 subprime: 6 prime). Subprime loans were spread among a number of lenders, including Ameriquest, Aames, and Long Beach Mortgage.

Two East Austin neighborhoods flanking Martin Luther King Blvd, from IH35 to Webberville Road are both high elderly and high minority areas with a high subprime penetration. 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.

A large number of subprime companies are active in these two contiguous Austin neighborhoods, led by Ameriquest and Aames Financial. Bank owned subprime companies, including Citifinancial, Bank One Financial Services and NationsCredit are also active here.

These small vingnetts of urban minority tracts with a high concentration of elderly people support the findings of a recent American Association of Retired Persons (AARP) national survey of older refinance borrowers. AARP found that older borrowers who were women, widowed, Black and less educated held a significantly greater share of subprime loans. More than half the older subprime borrowers surveyed reported responding to advertisements or sales calls guaranteeing approval.[3]

Finding: Even factoring out gender, income and more, a higher concentration of elderly people in a neighborhood significantly predicts higher subprime penetration

To determine the significance of only the concentration of elderly people for subprime lending, Consumers Union predicted the probability that a consumer would end up with a subprime refinance loan holding constant other factors: the race of the borrower, the gender of the borrower, the minority concentration and income of the neighborhood, borrower income, loan amount, population density, and the loan to income ratio.

We find that *for every 1 percent increase in the concentration of people over 65 in a neighborhood, a borrower's likelihood of taking a refinance loan from a subprime company increases by 1.3%.*

We believe this analysis--while testing an indirect factor (the concentration of elderly in the census tract where a home is refinanced)--indicates a relationship between borrower age and subprime lending.

Further research along the lines of the recent AARP survey can fill in details about individual elderly borrowers who end up with subprime loans.

Some anecdotal information is also available. Consumers Union reviewed 40 consumer complaints about home equity lending filed with the Office of the Consumer Credit Commissioner (OCCC). Most complainants did not provide their age, but some of the complaints touch on subjects familiar to older people--fixed income and the high costs associated with subprime lending.

Ability to Pay

As most subprime lenders will explain, risk-based pricing is not necessarily a bad thing. Subprime lending—the practice of setting a higher price on a loan to a riskier borrower—has enabled families with a history of credit problems to get homes.

On the other hand, some people may be borrowing more or at higher cost than they can afford to repay. Lenders emphasize that the value of the home matters more than other factors in loan approval.

Aames Funding sends direct mail offers to homes in East Austin touting easy access to loans in excess of $20,000. " Even if you have credit problems," says one letter, "we can probably still help you out. That's because it's your equity, not your income or credit that matters most."[4] But home equity loans must be repaid, so a consumer's ability to repay is critical.

Mrs. T. of Lubbock, Texas was 79 years old and still working when she applied for a home equity loan with Conseco. Conseco based its loan offer on her credit (she was an A-2 borrower) and her current earned income and debts. But at $463 per month, the new loan cost more than she would be able to pay once she finally retired.

"I am making the payment now because I am still working," she wrote to the OCCC. "but, at 79, I may have to stop working any day. $463 a month for 20 years is too much...if I could pay that long, and I will not live to 99."

In May 2001, Conseco had offered her a cash-out refinance, initially promising $6,000

that she could use to install central air conditioning. But by the time the prepaid points and fees were paid, her cash amounted to only $2,848—not enough to pay for the central air. And her new loan bears an interest rate of nearly 14 percent.

Although her settlement charges amounted to more than 8 percent of the new loan amount, her loan did not violate any existing constitutional protections because most of the fees (an origination fee to the lender and "points") do not count towards the 3 percent fee cap. They are "interest" incorporated into the APR.

"I realize I should not have signed a contract like this. But I did not realize my mistake until my children told me I had been fleeced by Conseco," she wrote. "...It should be against the law for someone to take advantage of naive seniors."[5]

Texas did not pass, among its home equity protections, a requirement that lenders evaluate a person's ability to repay the note. Without such a protection, some lenders might make loans based largely on the available equity in the home. Since the home can be repossessed in the event of default, the lender is protected...but the consumer is ruined.

Consumer Protections

Texas did pass several important consumer protections that have helped some elderly people. A home equity loan may be rescinded within three days of closing if the consumer doesn't like the final terms of the loan agreement. This allows people to get out of home equity loans if they determine it costs too much.

An elderly Waco couple, Mr. and Mrs. R., refinanced their home in April, 2000 with Beneficial. With only $18,350 left on their existing mortgage, they borrowed $27,259 to pay off two credit cards, a small Beneficial loan, and take some cash out.

But the new home loan bore an interest rate of 15.98 percent APR, nearly 6 percent higher than their existing home loan. Settlement fees, totaling 11.5 percent of the amount borrowed, included more than $2,500 in "points" and credit life insurance (neither fee counts towards the fee cap set in Texas law). The new settlement charges actually totaled more than they owed on loans they were paying off.

Furthermore, the couple believed that Beneficial intended to back date the loan documents. Mr. R told the OCCC that the broker told them to "come by Saturday morning, 4/29/00, and pick up the check and sign the other check for pay-off and we will back date this so we closed. (sic)" They wanted to cancel the transaction within their three day recission period.

Beneficial denied any effort to backdate the loan documents. The couple signed a request to rescind their loan contract and Beneficial cancelled the transaction. The OCCC sent a followup letter to the company advising them to "again advise your branch employees of the impropriety of backdating loan documents."[6]

For this couple, the right to cancel the loan allowed them to back out of a deal that offered a relatively small benefit at a very high cost.

Recommendations

Since elderly people on a fixed income are unlikely to be able to come up with more money to pay for a new, more expensive mortgage the Texas Legislature should set special standards for high cost loans--loans with an interest rate that equals or exceeds six percentage points over the weekly average yield on five year treasury bills or contains fees in excess of three percent of the loan amount. These standards should:

- prohibit lending without due regard to repayment ability;
- 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. Current Texas law limits fees to three percent of the loan amount, but lender origination fees and points are not counted in that cap. Therefore, fees quickly rise to eight or ten percent of the loan and are usually financed by increasing the amount borrowed to cover the higher costs.
- require loan counseling for any borrower getting a high cost loan during the existing 12 day waiting period before the loan closes; and
- retain existing waiting periods and right of recission so that buyers can get out of a bad loan after they've seen and digested the final terms and conditions presented at closing.

End Notes

[1] Owner occupied, single family, refinance home loans made in tracted areas of the state where 2000 census information is available for the age and race of residents (402,639 loans). We excluded refinance loans made by HUD identified manufactured home specialty lenders. The crosstabulation used to create scatter charts (page 2) incorporates 98 percent of all single family, non-manufactured, refinance loans made in Texas during this period (a total of 409,354 loans).

In order to factor in more borrower information and census data, additional records were eliminated for the regression analysis. Consumers Union's regression model is based on a logistic regression of 262,329 refinance loans originated in Texas over 1997-2000 as reported under HMDA. The base of data is smaller because we eliminated all loans where the lender did not report the race or gender of the borrower, and where income or loan amount were not reported or reported as zero.

The regression controls for the sex, race and income of the borrower, the size of the loan, the size of the loan in relation to the income of the borrower, the presence of a co-applicant, the racial composition and population density of the home's census tract, as well as the relative wealth of that tract to the rest of the MSA. The logistic model successfully predicts the outcome 74 percent of the time.

[2] Bradford, Calvin, Risk or Race? Racial Disparities and the Subprime Refinance Market, Center for Community Change, May 2002. Finds subprime penetration rates of more than 40 percent in several Texas cities by 2000, and rates of more than 60 percent among Black borrowers in selected Texas MSAs. Over all, Consumers Union finds that refinance loans by subprime companies grew from 6.3 percent of the statewide refinance market in 1997 to 34.8 percent in 2000. The total number of refinance loans made by subprime companies increased from 2454 loans in 1997 to 23,300 loans in 2000.

[3] Hermansen, Sharon, "Older Subprime Refinance Mortgage Borrowers," AARP, July 2002. Fifty four percent of older subprime borrowers reported taking the loan as a result of an ad or sales call touting guaranteed approval. Far fewer prime borrowers selected their loan company on the basis of such an offer.

[4] Aames Funding, "Dear Preferred Home-owner," Austin, Texas, no date.

[5] Consumer Complaint, OCCC, Lubbock, Texas, 12/27/2001.

[6] Consumer Complaint, OCCC, Waco, Texas, 4/26/2000.