

JUSTICE FORECLOSED

How Wall Street's Appetite
for Subprime Mortgages
Ended Up Hurting Black
and Latino Communities

October 2012



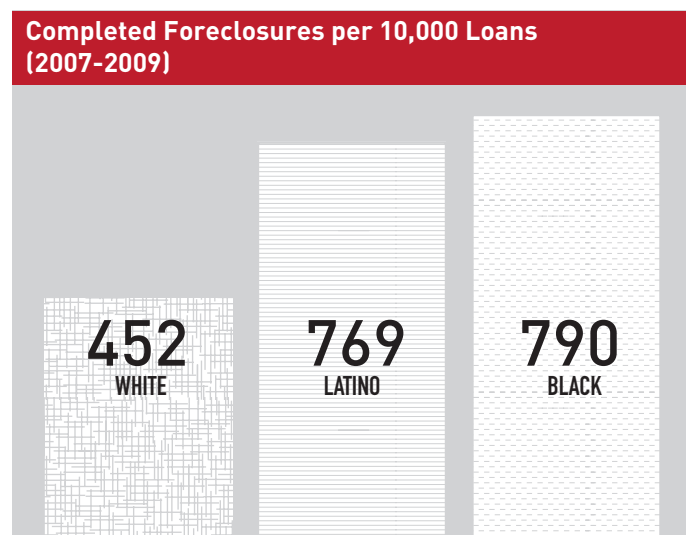
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INTRODUCTION

In the five years since the housing bubble burst, at least 3.5 million households have lost their homes to foreclosure. There are some signs that the economy may be on the mend: foreclosure filings are down; existing home sales have improved; orders for new homes are up; and late payments on mortgages have reached the lowest level in three years. These hopeful indications, however, do not obscure the fact that there are still millions of homes in foreclosure, which means that millions of families have lost their homes or are at risk of losing them.

The crisis is clearly an economic issue. But it's also about civil rights: Black and Latino homeowners, and the communities they live in, were disproportionately affected by the foreclosure crisis and its aftermath. Nearly 8 percent of both blacks and Latinos who took out mortgages recently have lost their homes to foreclosure. Only 4.5 percent of whites did.¹



Foreclosures by Race and Ethnicity: The Demographics of a Crisis, Center for Responsible Lending

These trends can be seen repeated around the country, particularly in areas with high concentrations of black and Latino communities. In Miami-Dade County, Florida, for example, one in 212 homes got a foreclosure filing notice in August 2012.² In the city of Homestead—a city in Miami-Dade where the population is 63 percent Latino and 20 percent black—the number goes up to one in 127 homes.

How did this dismal situation come about? By now, most people know the basic outlines of the financial crisis, and even that blacks and Latinos were hit harder than whites by the housing bust. But fewer understand the ways that reckless business decisions by big banks—designed to maximize profits, regardless of the consequences for communities of color—ended up having particularly harsh effects in those very communities.

In this report, we look at how, by creating a market for risky mortgages, the securitization industry encouraged predatory lending in communities of color that in turn helped fuel the housing boom and subsequent bust, and how the bust will continue to affect these communities for years, if not generations, to come.

In many cases, families poured retirement savings and other assets into their homes in an effort to save them; for others, the house itself was the retirement savings, or the inheritance, or both. Further, we look at how the drop in housing prices and the boom in foreclosures decimated property tax revenues, which has meant that cities and counties have had to cut services to residents, all at a time when more people are relying on those services to survive. There are other ancillary effects, too: large numbers of foreclosures in a neighborhood reduce property values, area businesses suffer, and schools are faced with the challenges of an unstable student population.

THE HOUSING CRISIS AND RACE

Predatory lending in communities of color didn't start with the housing bubble. In fact, lenders began pushing these kinds of predatory loans on minority homebuyers as far back as the 1990s.³ But major changes on Wall Street—namely the development and subsequent growth of the securitization industry—completely changed the business of predatory lending.

And existing problems, namely intensive geographic segregation, set up minority neighborhoods to be targeted by lenders.

In a 2010 study called *Racial Segregation and the American Foreclosure Crisis*,⁴ sociologists Jacob Rugh and Douglas Massey documented how existing segregation of black and Latino communities essentially set up these communities to be targeted for bad loans. This, in turn, “racialized the ensuing foreclosure crisis and focused its negative consequences disproportionately on black borrowers and homeowners.”⁵

Thus, this modern-day form of housing discrimination has roots in America’s history of institutionalized racism. Segregation in housing, both formal and informal, dates to the period immediately following the Civil War. Many Southern—and a few Northern—legislatures passed “Black Codes,” laws designed to uphold legal discrimination and limit economic opportunities for blacks. The Jim Crow laws, direct descendants of the Black Codes, further institutionalized housing segregation by making it illegal to rent certain properties to blacks. The Louisiana Jim Crow laws, for instance, stated that “any person...who shall rent any part of any such building to a negro person or a negro family when such building is already in whole or in part in occupancy by a white person or white family shall be guilty of a misdemeanor.”⁶ At the same time, many white neighborhoods enacted housing covenants—rules that, for example, made it illegal for owners to sell to black buyers.

Then, as the use of mortgages grew, so did redlining—the practice of limiting or denying financial services based on a neighborhood’s characteristics, rather than on the borrower. The term derives from the literal practice of marking such neighborhoods in red on a map. That is, instead of trying to decide whether an individual homebuyer is likely to repay the loan, the lender says that an entire—usually minority—neighborhood is a bad credit risk, and refuses to lend there.

This kind of institutionalized discrimination meant that, for decades, black homebuyers did not have the same access to credit as white families. Not only

was it hard for black families to get home loans, but when they could get them, the terms were much worse than those offered to white families in similar circumstances. It wasn’t until the 1968 Fair Housing Act that redlining and other forms of discrimination in mortgage lending became illegal. However, redlining persisted into the 1980s.

Subprime loans and predatory loans often go hand in hand. Subprime loans are not always predatory; predatory loans, though, are almost always subprime.

Subprime loans usually have higher interest rates than prime ones. But there’s nothing inherently wrong with them: They were designed as a way to offer loans to people with low credit scores, while mitigating risk for the lender.

Predatory loans are deceptive. They might have unnecessarily high fees or a complicated resetting interest rate. Sometimes, they’re designed to fail—that is, the terms may be so onerous that the lender actually expects the borrower to default.

And a straightforward subprime loan can become predatory, depending how it’s used: For example, during the housing boom, many unscrupulous lenders pushed subprime loans on black and Latino borrowers who, in fact, qualified for loans with better rates.

The problem was intensified because, without support from mainstream financial institutions, many in minority communities turned to alternative financial systems—for example, because there were few, if any, local banks in these communities, many turned to mortgage brokers. As a result, minority homebuyers were particularly vulnerable when lenders, with the help of mortgage brokers, began targeting them for mortgages during the housing boom.

HOW THE BUBBLE BURST

The market for securitized mortgages drove the explosive growth of subprime loans. The collapse of that market played a key part in the 2008 credit crisis and the recession that followed.

For many years, homebuyers received loans from the local bank. And banks couldn't lend out more money until they were repaid. That meant banks were limited in how much they could lend. But it also meant the connection between borrower and lender was close; which, among other things, meant that banks were invested, quite literally, in the people to whom they lent money.

When mortgages are securitized, the relationship between the homeowner and the person (or company) who lends the money is essentially non-existent.

In its simplest form, securitization works like this: mortgages are put together into a large bunch or pool. The pools are divided into pieces, or tranches. Investors—usually institutional ones, like pension funds—buy a share of a tranche, the way they buy shares of a corporation's stock. The tranches are arranged by risk and investors who buy from riskier tranches expect higher returns. Every month, when homeowners make their mortgage payments, the investors in the mortgage-backed securities get a payment.

When mortgages are securitized, the relationship between the homeowner and the person (or company) who lends the money is essentially non-existent. Securitization, and the resulting anonymity, is not necessarily bad. When the first mortgages were securitized, in the late 1960s, government-sponsored enterprises such as Fannie Mae (and Ginnie Mae and Freddie Mac) were careful to only securitize mortgages with strict lending standards. And when investment banks started securitizing private mortgages about a decade later, they, too, followed strict standards. But soon, banks started loosening their standards, pooling and selling ever-riskier mortgages.

A MARKET RUN AMOK

In 2003 and 2004, as the market for mortgage-backed securities started growing rapidly, banks needed to find more mortgages to securitize.⁷ And because there was a market even for risky mortgages, banks came up with loan products for every segment of borrowers, and then went looking for potential homebuyers to whom they could lend money.

There was an added incentive for the banks, which was that they made money securitizing the loans. So, it encouraged lenders to make more and more risky loans. As Adam Levitin and Susan Wachter wrote in the *Georgetown Law Journal*: The “fee-based business model of private-label securitization encouraged greater supply of mortgage credit, in order to generate mortgages for securitization to generate fee income for financial institution intermediaries.” In other words, investment banks encouraged lenders to lend more, so that they could earn more money by securitizing the loans.

Why did banks encourage lenders to target people for loans they couldn't afford? In his book *The Big Short*,⁸ journalist Michael Lewis explains that to Wall Street, people with little in the way of credit history were a good thing: “...[A] Jamaican baby nurse or Mexican strawberry picker with an income of \$14,000 looking to borrow three-quarters of a million dollars, when filtered through the models at Moody's and S&P [credit rating agencies] became suddenly more useful from a credit-rigging point of view.”

And lenders obliged: By the time the housing market began to collapse and the bubble burst, subprime lending was worth \$600 billion, or about a fifth of the housing market.⁹

MINORITY NEIGHBORHOODS: AN EASY TARGET

As the market for mortgage-backed securities grew dramatically, investment banks had to find more and more mortgages to turn into securities. They found a ready market in minority neighborhoods around the country, neighborhoods that, due in large part to redlining, had been short on credit for years. It quickly turned into a “reverse redlining” free-for-all,

in which neighborhoods that for decades hadn't been able to get credit were suddenly flooded with high-cost loans.

As early as 2000, the government concluded that minority borrowers were more likely than comparable white homebuyers to get a subprime loan and those loans would have higher interest rates. By the time the housing bubble burst in 2007, both black and Latino borrowers were twice as likely as white borrowers to receive a subprime loan.¹⁰ And not only were people of color more likely to receive subprime loans, but the terms tended to be more predatory than those given to whites. Since the housing market collapsed, black homeowners are 76 percent more likely than white homeowners to have lost their home to foreclosure; the number for Latino homeowners is 71 percent.¹¹

Minority borrowers generally received loans through brokers, both because those were most easily available and because there was a cultural precedent. Colvin Grannum, who grew up in a black neighborhood in New York, and now runs one of the country's oldest urban redevelopment organizations told *The New York Times*: "I don't want to say it's in the cultural DNA, but a lot of us who are older than 30 have some memory of disappointment or humiliation related to banks. The white guy in the suit with the same income gets the loan and you don't? So you turn to local brokers, even if they don't offer the best rates."¹²


One reason brokers didn't offer the best rates is that the industry offered all kinds of financial incentives for them to push worse loan terms on their clients. As Tony Paschal, a former loan officer for Wells Fargo testified recently: "*Since loan officers made more money when they charged higher interest rates and fees to borrowers, there was a great financial incentive to put as many minority borrowers as possible into subprime loans and to charge these borrowers higher rates and fees.*"¹³ As a result, many minority borrowers ended up in subprime loans even though they could have and should have qualified for prime loans.

Our district manager told us to conceal the details of the loan. He thought that these customers could be "talked into anything."

Lenders pushed brokers to give borrowers the hard sell. Doris Dancy, a former credit manager for Wells Fargo testified: "*Many of the mostly African American customers who came into the office were not experienced in applying for loans. They did not understand a lot of the terms of the loans that managers wanted us to get them to apply for. Our district manager told us to conceal the details of the loan. He thought that these customers could be 'talked into anything.'* The way he pressured us to do all of these unethical things was as aggressive as a wolf. There was no compassion for these individuals who came to us trusting our advice."¹⁴

This summer, Wells Fargo agreed to pay \$175 million to settle allegations that they charged black and Latino borrowers higher rates for loans during the housing boom. The Department of Justice accused the bank of steering roughly 4,000 nonwhite borrowers into subprime mortgages.

Bank of America and others have also settled allegations about discrimination in lending during the housing boom. But those settlements are largely irrelevant to minority communities that were devastated by the housing bust.



When Rita Winters' husband died, she used the life insurance money to put a down payment on her dream house in Prince George's County, Maryland. A few years later, she refinanced with a loan that turned out to be predatory. She can't afford the payments anymore, and the bank is foreclosing.

IN MARYLAND, LOSING A FOOTHOLD IN THE MIDDLE CLASS

For years, Rita Winters and her husband, John Winters, Sr., would play a sort of a game. She would describe her dream house. And her husband, an engineer, would draw it for her. The idea was that when he retired, they would buy a piece of land, maybe in southern Maryland, and build it.

It didn't quite happen that way. Her husband died suddenly in 2001. A year later, Rita moved into her dream house, a brand-new, 5-bedroom, 4-and-a-half bathroom brick Colonial in Prince George's County, Maryland.

But these days, the dream is gone. And the house may soon be, too. She refinanced in 2007 with an expensive loan that she can no longer afford. The bank has started the foreclosure process.

"Every time I go out, I look," said Rita, now 65 and retired. "Is there going to be a [foreclosure notice] out there?" If it finally does appear, she will lose

her home, whose value she was also counting on as a retirement fund and her children's inheritance. But she and her family—two grown sons and three grandchildren—may also lose something else: their foothold in the middle class.

... one of the most devastating and lasting effects, especially for black families, may be the loss of intergenerational wealth.

A LOSS THAT IMPACTS GENERATIONS

The foreclosure crisis wreaked all kinds of havoc, particularly in minority communities. But one of the most devastating and lasting effects, especially for black families, may be the loss of intergenerational wealth. That money, passed from parents to children, or grandparents to grandchildren, can be seed money for young people who are just starting out.

We tend to focus on income, but it's really wealth—that is, house, car, retirement accounts, savings accounts, etc.—that determines life's opportunities: it can sustain people during a stretch of unemployment or a bout of serious illness. It defines the opportunities we can give our children. And, both directly and indirectly, it can help future generations acquire *more* wealth.

"The loss of your home, regardless of race, is horrendous. The difference is that blacks are more vulnerable, because of their wealth position initially," said Darrick Hamilton, a professor of economics and urban policy at the New School.¹⁵

Statistically, black families went into the housing boom with less wealth. During the boom, black communities were targeted heavily with predatory loans, one of the reasons those same communities have been disproportionately affected by the foreclosure crisis. At the same time, home equity makes up a much bigger chunk of black families' assets, so, for a black family, losing the house can be that much more devastating financially.

FROM MODEST BEGINNINGS, MODEST DREAMS

Rita Winters and her husband both grew up "blue collar, middle class," in Washington, D.C. She was one of four children of an assembly line worker and a self-employed house painter. He was one of six children. His father was a factory worker, his mother cleaned houses. None of their parents went to college, and none owned a home. "When you're blue collar," she said, "you don't have extra. You have enough to survive. My mother had dreams, [but she] didn't have the income to [realize] the dreams she wanted."

Rita and Johnny, Sr. met in high school. They both went on to college: she became an accountant, he an engineer. They had two children, Johnny, Jr., and Tremaine. They bought a modest house in a working class, mostly black neighborhood in Washington, D.C., where they lived for almost 30 years, saving money and drawing up plans for their dream house.

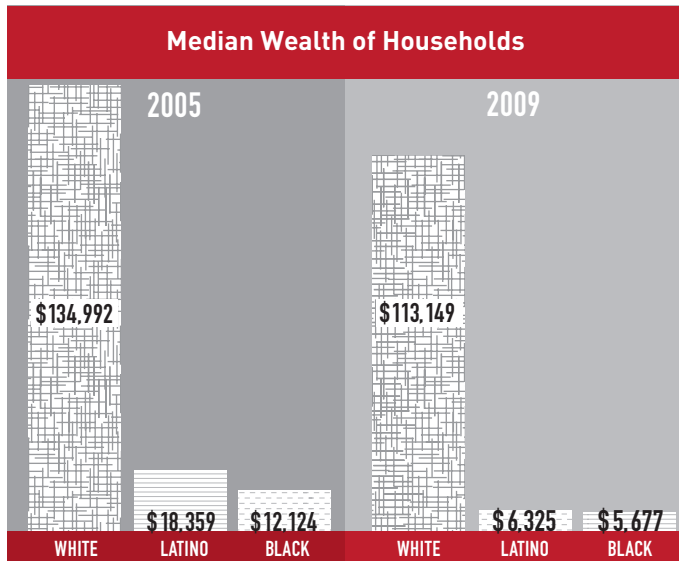
Although both came from families where there were aunts, uncles and other relatives with college educations and professional degrees, they were the first of their immediate families to make it solidly into the middle class. But now, for Rita Winters and countless other black families, the housing crisis is threatening to push them back out of it.

BLACK WEALTH VS. WHITE WEALTH: A WIDENING GAP

The hourly wage gap—the difference in pay between black and white workers—has been shrinking over the decades. But the wealth gap—the difference in a family's total assets, things like houses, cars, retirement accounts, savings accounts and the like—is growing dramatically. In 2005, before the recession began, the median black household had a net worth of \$12,124. The average white household had a net worth of \$134,992, 10 times bigger than black households. (The median Hispanic household had a net worth of \$18,359 in 2005.)¹⁶

And while all groups lost assets during the recession, the difference between the two groups opened into an astonishing chasm: In 2009, the median black family

was worth \$5,677, while the median white family was worth \$113,149. That is to say, white families had a median net worth 20 times greater than black families.¹⁷



Source: Pew Research Center tabulations of Survey of Income and Program Participation data

There are a multitude of reasons for the wealth gap, including a historical gap in the opportunities to earn money, and the possibility of acquiring assets. The New School’s Hamilton points out that you need money to make more money: “In a white young adult household, you are starting with some endowment [in the form of gifts or inheritance from previous generations] so you can engage in wealth creation. Black families don’t have the endowment to get into the asset game.”

“If you’re living paycheck to paycheck,” he said, “you can’t buy stocks. There’s a risk involved in purchasing stocks, so you have to acquire a certain level of wealth to be able to absorb the risk. If you have a thousand dollars in savings, it might not make sense to put it into stocks.”

In terms of intergenerational wealth transfers—whether in the form of inheritance or simply as financial gifts from parents or grandparents to the next generations—the housing crisis will have disproportionate and long-lasting implications for black families. Here’s why: Black families are less likely than white families to own their homes. But

among those that do, much more of their equity tends to be in their houses. In 2005, almost 60 percent of black household wealth was in home equity, which meant that when the housing market collapsed, so did their portfolios. By comparison, in 2005, whites held only about 45 percent of their assets in home equity. And because whites own more stocks—and the stock market has mostly regained its losses from the recession—their portfolios have recovered better.¹⁸

Melvin Oliver, a sociologist at University of California Santa Barbara, and co-author of *Black Wealth, White Wealth*, talked about the significance of home equity. “I think of home ownership as the first step to wealth accumulation, because with home ownership and equity you have so many options afterwards. Leaving your home to your next generation is a huge legacy you can leave. Using the equity in your home to help your children achieve an education is a big advantage. You can use it to take advantage of important opportunities.”¹⁹

Those are opportunities that future generations of many families, including the Winters family, may lose out on.

HOW RITA FOUND HER DREAM HOUSE

In late 2001, Johnny Winters, Sr. collapsed while playing tennis and died. But the Winters’ older son, Johnny, Jr., still wanted his mother to have her dream. He and his mother pooled the money from his father’s life insurance, and made a \$150,000 down payment on Rita’s dream home. The 6,000-square-foot red brick house—which cost almost \$630,000—was to be the first in a fancy new development in southern Prince George’s County, Maryland. (Although it’s the least wealthy of the D.C. suburbs, Prince George’s County has long been the wealthiest majority black county in the country.)

The plan was simple. Like so many homebuyers at the height of the boom, the Winterses figured the market would keep going up. Rita and Johnny would live in the house for five years, after which they would sell it and make a nice profit. The earnings

would help support Rita in her retirement, and be a solid asset for Johnny, Jr. and his grown daughter, Shamika. In the meantime, their combined income of about \$160,000 a year—hers from a commercial cleaning business she'd started with her late husband, and he from his management job at a health care management company—seemed like plenty to cover the monthly payments, which were less than \$2,000 a month.



Winters' son, Johnny, Jr., helped his mother buy the house. He and his 26-year-old daughter Shamika also live there. The family has been saving money for a deposit on a rental apartment in case they are forced to move.

Rita referred to herself as a “renter with benefits,” meaning nobody plans to stay in a house for the length of a mortgage anymore, but that the tax incentives that come with owning a home make it worthwhile. She knew there were risks involved, but they seemed minimal. And she was willing to accept them: “If the Lord let me stay here two days, I’ve done something a lot of people haven’t. I’ve lived in my dream house.”

In retrospect, of course, the plan seemed doomed to fail. But between 2001 and 2006, housing prices in Prince George’s County more than doubled. The value of the Winters’ house went up by even more than that: They paid \$625,000 for it in 2002. In 2007, it was appraised at \$1.5 million. “Logically thinking, you would say this bubble has to burst,” Rita reflected. “Reality? You’re not saying this bubble is going to burst.”

THE BEGINNING OF THE END

If things had gone according to plan, and the Winterses had sold the house in 2007, they would have made a solid profit. But just when they should have been thinking about cashing out, Winters’ commercial cleaning business ran into some trouble, leaving her on the hook for more than \$80,000. She needed a loan to pay it off: “A friend of a friend said, ‘it would be easier to borrow against your house than to take a [business] loan.’” She looked at the interest rates and the loan payments and decided it made sense.

It was easy to find a broker to help with the refinancing. Like other black and Latino communities across the country, Prince George’s County was inundated with mortgage brokers looking for potential clients. Subprime lenders targeted black and Hispanic communities—which had historically had fewer opportunities to borrow money—for high-cost and risky loan products, such as interest-only loans and adjustable rate mortgages whose payments would balloon after a few months (or in some cases, even, weeks or days.)

After a flurry of phone calls and faxes, Rita refinanced their house for \$682,500, using some of the money to pay off the debt and a few remaining bills. The broker who came by their house to close the deal was in and out in less than an hour. Rita remembers flipping through the pages of the loan document. But she was only worried about one number, the new monthly payment of \$3,839. “All you’re looking at is, can I afford it?” And the answer, then, was yes.

But the loan from Wells Fargo was an expensive one: the lender charged \$20,000 in origination fees for the interest-only loan. And since it was based only on Rita’s income from her cleaning business (roughly \$85,000 a year), the payments far exceeded what she could afford. Most counselors say a good rule of thumb is to spend no more than a third of your income on housing; these payments were more than 50 percent of Rita’s income.

Wells Fargo, meanwhile, did what so many other lenders did with mortgages like the Winters’. It

packaged it—along with thousands of others—and turned it into a mortgage-backed security. That means that all kinds of investors own the loan on the house that the Winterses are so desperately trying to hold on to.

Rita says she knew what she was getting into when she took out the loan, and that she was still optimistically expecting the value of her house to keep rising. But, as the Center for Responsible Lending documented in its report, “Lost Ground” (2011), black and Latino borrowers were much more likely to get loans with high interest rates, and other onerous terms than whites, regardless of their creditworthiness.²⁰ (In fact, black and Latino borrowers with good credit were given loans with high interest rates three times as often as white borrowers.)

Rita and her son managed to cover the new mortgage payments for a while. But the family’s circumstances changed, and in mid-2010, Wells Fargo initiated foreclosure proceedings.

GROUND ZERO FOR FORECLOSURES

Prince George’s County saw the largest drop in home values of anywhere in the state. (Between 2005 and 2009, the median home price in Maryland overall fell nearly 11 percent.)²¹ This year, the Winterses house was appraised for tax purposes at \$986,000. But the market seems unlikely to be able to bear that amount: In 2010, they attempted a short sale, putting the house up for sale for about \$500,000. The house sat on the market for a year before they gave up.

The family has been fighting the foreclosure for two years. They have tried—and failed—twice to get a modification. They have also tried twice—and, again, failed—to get help from the Neighborhood Assistance Corporation of America, an organization that supports home ownership.

Right now, the Winters family—Rita, Johnny, Jr., and his daughter, Shamika, who is 26 and about to start a job as a medical assistant—are waiting to see what happens. They have money set aside to pay a security

deposit on a rental apartment, if the foreclosure goes through. Now retired, Rita gets a monthly pension of \$3,600 from her job as an accountant for the government, and a small stipend from Social Security. But that is about all they have.

If they lose the home, they will lose something else with it: Rita’s chance to pass on some wealth to her children and grandchildren.



Monica and Carlos Saavedra bought a house in Moreno Valley, California at the height of the housing boom. They planned to sell it after a few years, and use the money to pay for college for their three kids, Jackelyn (13), Steven (17), and Alan (6).

Photo: Leslie Berkman

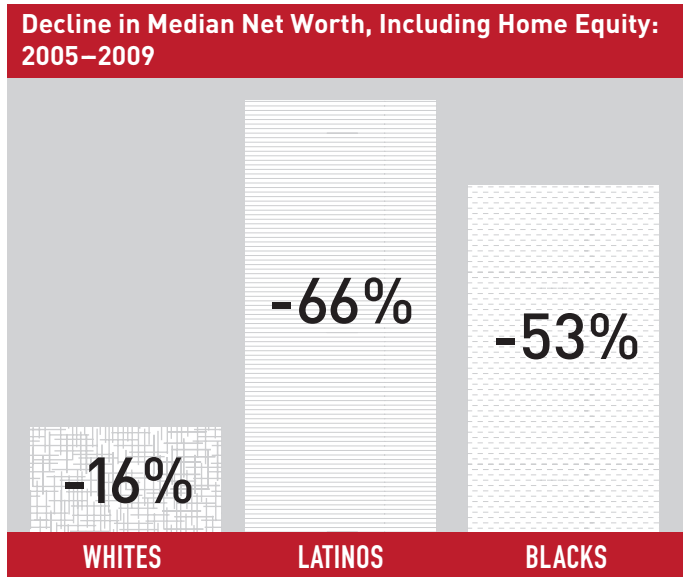
IN SOUTHERN CALIFORNIA, RIDING THE REAL ESTATE ROLLER COASTER

When Monica Saavedra and her husband Carlos went looking for a new home in 2006, they wanted something that would be big enough for themselves and their three children. “Everybody wants a beautiful house,” she said. They found one on Willow Leaf Road, near the end of a cul-de-sac in a new development: four bedrooms and four bathrooms, a large kitchen, formal dining and living rooms, and a family room with a fireplace. The price tag was \$506,000.

At the time, Monica Saavedra was earning just over \$21,000 as a packer in a warehouse. Carlos was earning less than \$30,000 a year as a truck driver. None of that seemed to matter to the loan officer, who gave Monica two mortgages with a combined monthly payment of \$3,518. (The Saavedras’ combined monthly income was \$4,100 a month, before taxes.)

The broker assured them that refinancing would be possible soon if they could manage to make the

payments for a while. The Saavedras managed to make mortgage payments for a year, then spent another three years trying to negotiate a modification with the lender. But in April 2012, the bank finally foreclosed, and the Saavedras were forced to move to a small rental in a much worse neighborhood.



Source: Pew Research Center tabulations of Survey of Income and Program Participation data from the 2004 and 2008 panels

LATINOS AND BAD LOANS: A COMMON SCENARIO

The Saavedras' story was repeated over and over in the Latino communities of California, Nevada, Arizona, and other states. And it's a scenario that had—and is still having—significant effects on those communities.

Like black borrowers, Latinos were much more likely to get loans with high interest rates and other negative features, such as penalties for paying off the balance early and adjustable rates. As a result, heavily minority neighborhoods and neighborhoods with high concentrations of low- or middle-income residents have had much higher foreclosure rates. By 2011, almost 25 percent of loans originated between 2004 and 2008 in low-income neighborhoods and 20 percent of loans originated in that stretch in heavily minority neighborhoods were either in foreclosure or were seriously delinquent.²²

Almost 12 percent of Latino homeowners lost their homes in the housing crisis, which is more than

either blacks or whites. Latinos were hit especially hard not only because they were targeted for bad loans, but also because they were heavily concentrated in states with some of the highest foreclosure rates, such as Arizona, California, Florida and Nevada.

Almost 12 percent of Latino homeowners lost their homes in the housing crisis, which is more than either blacks or whites.

THE SAAVEDRAS' STORY

Monica and Carlos Saavedra both moved to the United States from Mexico almost 20 years ago. They lived in Orange County in rented apartments until 2002, when they bought their first house and moved to Moreno Valley with their children.



Photo: Leslie Berkman

The broker who arranged the Saavedras' mortgage for the \$506,000 house lied about their income, which was only around \$50,000 a year. The family cut back and rented out rooms to make the payments. But earlier this year, the bank foreclosed, and the family moved to a small rental house in a worse neighborhood with worse schools.

That house cost \$125,000. The housing boom was just getting going, and by the time they sold it two years later, its value had doubled. Suddenly, real estate seemed like the answer to one of their biggest dilemmas: how to finance college educations for their three children, Steven (17), Jackelyn (13), and Alan (6). "We had bought a house before and we sold it and got more money," said Monica. "We thought it would be the same [with subsequent houses]."

When they found the house on Willow Leaf Road, it had just been built. Because of her husband's

complicated credit situation, Monica Saavedra applied alone for a loan from the builder, DH Horton, one of the largest builders of new homes in the country. Like most of the big homebuilders, it offered loans to buyers, and offered incentives to take their loans, instead of from a bank. It's a practice that was common during the housing boom: The builder, usually working with an outside lender, offers incentives to the buyer to borrow directly. The Department of Housing and Urban Development and others have criticized the arrangement, since the builder has every incentive to charge as much as possible. And the loans, particularly the second loan, tend to be punitively expensive.

Because she had no money to put down, Monica Saavedra was given two loans. It's a setup known as an 80-20: One mortgage covers 80 percent of the cost of the home, and a second one—sometimes called a piggyback mortgage—covers the balance. These kinds of loans can help people like the Saavedras buy a home when they don't have money for a down payment. But such loans invariably come with high interest rates and onerous terms. And if the house loses any value, then the homeowner is left underwater—that is, owing more on the house than it is worth.

In the Saavedras' case, the first loan, which had an interest rate of 7.375 percent, was interest-only for the first ten years. The payments—which started at \$3,518 a month—would go up to \$4,260 a month when the principal kicked in. The second loan had an interest rate of 11.875 percent. That loan required the family to pay off the balance of the loan in full—\$87,000—after 15 years.

Monica Saavedra, who speaks little English, said she didn't understand the terms of the loan. She also said she gave the loan officer pay stubs and tax forms to document her income. But she later discovered that he'd left the income box empty on her loan application. He also reassured her that she could lower her monthly payments by refinancing the loans soon. And, when a \$9,000 bill arrived in the mail, she realized their monthly payments didn't include taxes. After a year, the Saavedras' hours were cut and they

soon realized that they wouldn't be able to afford the house. They still tried to make it work. They took in renters. They stopped taking trips to Mexico, where they would go to visit family. They stopped going out to dinner and they bought fewer clothes for their kids. The clothing they did buy, they purchased in bigger sizes so they would last longer. Both started working overtime, and Carlos learned to do his own home repairs.

"We are people who try to work hard," he said. "We tried to invest in houses, not to be lazy, but for our children to go to school, so they can have a better life."

The Saavedras actually managed to make payments for another year. But they couldn't keep it up after they, and their renters, lost their jobs. Soon after, they tried to refinance the loans. But they discovered that the house they had bought for more than a half a million dollars wasn't worth anywhere near that anymore. (At the foreclosure auction, in May of this year, it sold for \$189,000. Another family bought it soon after for \$252,000.)

Like other lenders, the company, DH Horton, usually sold those mortgages to the secondary market where they were packaged and sold to investors.

A NEIGHBORHOOD IN DECLINE

In one house on the Saavedras' block, Carlos and Jenny Martinez are living as renters in the home they once owned. Carlos Martinez said he's given up trying to keep track of his neighbors, who come and go as houses are foreclosed on or sold. "You worry about yourself," he said.

That kind of indifference worries the mayor of Moreno Valley, Richard Stewart. "You can drive down a street and see who's renting," he said. "The lawns, they're not maintained. They want to save their water bill. Why should they put money into a lawn when they don't own the house? And why should a landlord put money into a lawn when he's not living there?"

Moreno Valley, a city of around 200,000, is part of the Inland Empire, a vast swath of distant Los Angeles suburbs. At the time of the last census, in 2010,

it was more than half Latino, with a growing black population. And like other majority minority areas, it suffered dramatically during the housing crisis. The area was hit with a one-two punch, since many people worked in construction, and then lost their jobs when the housing market collapsed.

Between 2006 and 2009, the average home price in Moreno Valley dropped by three quarters: from \$405,000 to \$104,000. (Prices have gone up slightly since then; earlier this year, the average home price was more than \$150,000.)

Property tax revenues dropped almost 30 percent as a result of the crisis. (Lower property values means lower taxes, plus people who are underwater with their homes sometimes decide not to pay their property taxes.)

As a result, the city has had to make all kinds of cuts: city workers have been furloughed one day a week; City Hall is now closed on Fridays. The city has been keeping vehicles like street cleaners and garbage trucks longer. Meanwhile, it's also being forced to spend more on code enforcement, to keep up the neighborhoods, and to keep the squatters out.

Riverside County, too, has been forced to make changes. At last fall's budget meeting, the Riverside County Executive Officer told the Board of Supervisors the county was short \$4.5 million, thanks to falling property values. Assessed property values in Riverside fell 10.5 percent in the 2009-2010 fiscal year and 4.5 percent last year. They're expected to drop by 1.5 percent this year.²³ Since 2007, the county has lost more than \$200 million in revenue as a result of falling property tax revenue.²⁴

But it's not just the government that feels the strain. Not surprisingly, foreclosures can also affect the people who manage to keep their houses. With vacant properties can come blight, and increased property crime, all of which help lower property values. One 2005 study showed that a foreclosure within an eighth of a mile (roughly a city block) results in a roughly one percent drop in the value of a home. And when you

talk about low- and moderate-income neighborhoods, having a foreclosure nearby can reduce property values by almost 1.5 percent.²⁵

The upheaval around foreclosures—not least the fact that families often have to move—can have serious effects on schools. Students who are forced to switch schools partway through the school year tend to get worse grades, and are less likely to graduate.²⁶ In Moreno Valley, the superintendent, Judy White, says that she's seeing more students change schools and even school districts. Her district has had to conduct more frequent assessments to make sure that students are in the right classes and grades.

STILL STRUGGLING, STILL HOPEFUL

When the Saavedra family lost their home this spring, they moved to a two-bedroom house in a rougher part of town. "The first time we came here, I cried," said Jackelyn, 13. Carlos says he's seen people selling drugs in the parking lot next door. And because he's worried about people smoking marijuana outside, he's hesitant to let their 6-year-old, Alan, play outdoors.

Monica has found a new job, as a cosmetologist in a beauty salon. Carlos, though, is still looking for a new job. The family has been trying to find another place to live. But it's hard to rent anything new, given their credit history and the current state of their finances.

Someday, though, they hope that they'll be able to live the American Dream, and buy another house: "We are going to buy something we can afford," Carlos said. "With all we have learned, it is going to be better."

A NATION IN FORECLOSURE: AN OVERVIEW

NEVADA

At its worst point, one in 11 Nevada homes was in some stage of foreclosure. In Las Vegas and surrounding Clark County—where a quarter of household heads are immigrants—the number is closer to one in nine.

Twenty percent of Nevada's foreclosures are among Latino borrowers, as are almost 20 percent of loans that are seriously delinquent, while white borrowers account for only about 14 percent of foreclosures and 13 percent of seriously delinquent loans.

Earlier this year, Nevada's Attorney General, Catherine Cortez Masto, negotiated for her state to get roughly \$1.5 billion of the \$25 billion settlement that Bank of America, JPMorgan Chase, Wells Fargo, Citigroup and Ally Financial agreed to pay for foreclosure-related abuses. But Senator Harry Reid and others say it's not enough: The "settlement is a welcome step forward in our efforts to help struggling homeowners and hold big banks accountable for their abusive foreclosure practices across the country, especially in Nevada. But we still have much more work to do to help homeowners get back on their feet."

DETROIT, MICHIGAN

During the month of August 2007, foreclosure notices were served on 260 Detroit homes per day. It is, as the *Detroit News* reported "the equivalent of wiping out two subdivisions every 24 hours." Between 2005 and 2007, more than 70,000 homes in Metro Detroit were foreclosed on.³⁰

Unlike California or Florida, where steep run-ups in housing prices preceded the crash, Michigan's housing crash was more about mortgages than about housing values. "It was our one-state recession," investment adviser John Kloster told *The Detroit News*. "People trying to maintain their lifestyles, and money that was incredibly easy to borrow."

But, as in other states, minorities are disproportionately represented in those foreclosures. Between 2004 and 2008, a third of black homeowners were foreclosed on, even though they only make up 28 percent of borrowers. More than a quarter of Latinos were foreclosed on; they make up just over two percent of borrowers.³¹

COLORADO

A 2008 study by Colorado state officials revealed a high density of subprime loans in heavily minority communities.²⁸ The study also suggested that black and Latino borrowers were twice as likely to receive subprime loans as white borrowers. For borrowers with higher incomes—more than \$100,000 a year—Latino and black borrowers were more than twice as likely to get a subprime loan as a white borrower of similar means.

In the Denver area, Latino borrowers accounted for around 11 percent of all mortgages issued between 2004 and 2008. But they account for more than three times as many foreclosures as white borrowers, and about twice as many delinquent loans.²⁹

CLEVELAND, OHIO

In 2008, the city of Cleveland filed a lawsuit against more than 20 banks and other financial institutions, accusing them of flooding the city's housing market with subprime loans they knew borrowers couldn't repay. The suit claims the loans pushed many borrowers to abandon their homes, leaving blocks and blocks of empty houses.

"We've torn down 1,000 abandoned houses, and haven't even made a dent," Cleveland's mayor, Frank G. Jackson told *The New York Times*.²⁷ Black borrowers received 13 percent of loans in Cleveland, but account for 18 percent of foreclosures and 20 percent of delinquent loans.

NEW YORK CITY

In New York City, black households that earn more than \$68,000 a year are almost five times as likely to have a high-interest, subprime mortgage as white households earning the same. "There is no question that if you live in a predominantly African-American or Latino neighborhood, you're going to be paying more for your mortgage," Sarah Ludwig, director of the Neighborhood Economic Development Advocacy Project told *The New York Times*.³³

"My district feels like Ground Zero. In military terms, we are being pillaged," Councilman James Sanders Jr., who represents parts of Queens that were heavily hit by the housing crisis, told *The New York Times*.³⁴

Although New York was not hit as hard as other states by the foreclosure crisis, black and Latino borrowers in the city are three times as likely as white New Yorkers to have been foreclosed on. And they are more than twice as likely as white New Yorkers to be seriously delinquent on their loans.

FLORIDA

More than half the loans issued in Florida during the housing boom went to Latinos. Now, many of the state's foreclosures are on Latino borrowers; Latinos also represent many of the loans that are seriously delinquent. (Seriously delinquent loans are those in danger of being foreclosed on.)

"They were overselling the American dream," Orlando mortgage lender José Hoyos told the *Orlando Sentinel* in 2009. Lenders would tell prospects, "You are a janitor? Oh, no, no, no—you own a

janitorial business. No, you don't have to put any money down."³²

This year, Wells Fargo agreed to pay more \$175 million to settle charges that it pushed about 4,000 minority borrowers into subprime loans, while giving prime loans to white borrowers with roughly the same credit profiles. And last year, Bank of America said it would pay \$335 million after accusations that its lending arm, Countrywide Financial, charged higher rates and fees to more than 200,000 minority borrowers across the country.

CONCLUSION AND POLICY RECOMMENDATIONS

The foreclosure crisis has hurt communities and families all over the country, but, as this report demonstrates, its impact has not been equal. Black and Latino families have absorbed especially harsh consequences, and the effects have rippled through entire communities and exacerbated wealth gaps between white and minority families.

There is no question that Wall Street caused the racially uneven consequences of the foreclosure crisis by creating a market that made reverse redlining and other forms of discriminatory lending profitable. Subprime lenders built their business to accommodate Wall Street demand, and when investment banks signaled their insatiable appetites for risky loans, lenders structured their business accordingly. That meant exploiting long-standing discrimination to target communities of color for predatory loans.

THE BOTTOM LINE: WALL STREET IS NOT ABOVE THE LAW

Federal antidiscrimination laws apply to investment institutions when they interact with the housing market. Securitization practices that result in discrimination violate the law, and institutions that used those practices should be held accountable.

Besides enforcing existing antidiscrimination laws, here are some specific federal policy recommendations aimed at putting an end to predatory lending and racial bias and discrimination in the banking industry:

- The Department of Justice, through the Civil Rights Division's Housing and Civil Enforcement Section, should **expand the Fair Housing Testing Program to detect violations of the Fair Housing Act**, particularly in and around neighborhoods where there has been a concentration of foreclosures resulting in a local foreclosure rate that is significantly higher than the national average.
- Congress should **increase the civil penalties for violations of the Fair Housing Act and the Equal Credit Opportunity Act**, so that financial institutions are sufficiently deterred from practices that have a discriminatory purpose or effect, and so there is an incentive to develop strong internal controls to prevent discrimination in transactions in the housing finance market.¹
- The Consumer Financial Protection Bureau should **issue final rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act in order to provide for increased transparency and consumer choice in the housing finance market**, as well as stronger accountability measures for financial institutions. These final rules should mandate an effective upfront determination that the consumer will actually be able to repay the mortgage over the life of the loan, and require the financial institution to engage in early intervention and appropriate loss mitigation efforts to prevent foreclosure when a homeowner is delinquent on payments.
- Congress should **increase funding for the Department of Justice to investigate and prosecute violations of the Fair Housing Act and the Equal Credit Opportunity Act**, and **increase funding for the Consumer Financial Protection Bureau** to implement and enforce laws to create more transparency and accountability for financial institutions interacting with the housing market.
- The Department of Justice and the Department of Housing and Urban Development should **issue a joint policy statement or guidance document on the Fair Housing Act and the Equal Credit Opportunity Act** for financial institutions interacting with the housing market through the purchasing and trading of mortgage-backed securities (the secondary mortgage market), in order to ensure that these institutions understand their legal obligations and can proactively institute measures to remedy or prevent future discrimination.

- The Department of Housing and Urban Development (HUD) should issue a final rule to reflect the federal courts' long-standing, widely accepted interpretation of the disparate impact theory under the Fair Housing Act. Specifically, HUD **should issue regulations that reflect the unanimous interpretation that the Fair Housing Act prohibits housing practices with a discriminatory effect**, even where there is no intent to discriminate, and establish a uniform national standard on the burden of proof courts should apply when determining whether a facially neutral housing practice with a discriminatory effect violates the FHA. (Although HUD issued such a proposed regulation on November 16, 2011, it has not yet been finalized by the agency. This regulation should apply to all HUD programs.)
- Congress should **amend the Home Mortgage Disclosure Act** to affirmatively require financial institutions interacting with the housing market through the purchasing and trading of mortgage-backed securities (the secondary mortgage market) to report the same characteristics of the borrower that financial institutions originating the loans are required to report under Regulation C—including **ethnicity, race, sex, age, and income**—in order to ensure that patterns of discrimination are promptly identified, appropriately addressed, and remedied.

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Conclusion and Policy Recommendations

1. The Fair Housing Act provides an escalating fine for discriminatory housing violations: beginning at \$16,000 for the first violation, increasing to \$37,500 for a second adjudicated violation, and \$65,000 for each additional adjudicated violation occurring in the seven-year period preceding the current charge of discrimination. 24 CFR 180.671(a). There is no limit on the maximum charge if multiple violations occur (or multiple violators) and each violation may be charged the maximum fine. However, an individual discriminatory housing practice is defined as "a single, continuous uninterrupted transaction or occurrence," and "even if such a transaction or occurrence violates more than one provision of the Fair Housing Act, violates a provision more than once, or

violates the fair housing rights of more than one person, it constitutes only one separate and distinct discriminatory housing practice.” This means that a discriminatory housing practice could be against hundreds of individuals, and a financial institution would only face a single fine of \$16,000. 24 CFR 180.671(b). The Equal Credit Opportunity Act provides a fine limited to \$10,000 in individual actions and the lesser of \$500,000 or 1 percent of the creditor’s net worth in class actions for violations of the act. 15 USC § 1691e.



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