

Minorities Didn't Pay Higher Subprime Rates, Fed Study Shows

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Borrowers from minorities didn't pay higher interest rates for subprime mortgages, a New York Federal Reserve Bank study shows, contradicting findings indicating those people were targets of expensive credit.

The report published yesterday was based on findings from more than 75,000 adjustable-rate subprime loans. Other private and government research has shown minority borrowers and neighborhoods might have been targeted from 2004 to 2006, the peak period for subprime lending.

The study merges data on the race, ethnicity and gender of borrowers as reported by lenders under the Home Mortgage Disclosure Act with data on mortgage pricing and risk variables such as credit scores as reported by the mortgage research firm First American LoanPerformance.

The results "provide no evidence of adverse pricing by race, ethnicity or sex of the borrower" for either the initial interest rate or the rate to which the loan subsequently adjusted, the study said. "If any pricing differential exists, minority borrowers appear to pay slightly lower rates."

The study was conducted by Joseph Tracy, director of research at the New York Fed, Andrew Haughwout, head of microeconomics and regional studies at the New York Fed, and Christopher Mayer, a professor of real estate finance and economics and vice dean of the Columbia University Business School.

The authors said they were not able to determine whether minority borrowers were forced to pay higher upfront costs in points or fees, or whether the subprime borrowers might have qualified for less expensive conforming loans.

Discrimination

Without such data, the study isn't very useful in determining whether there was discrimination in the mortgage market, according to [Sarah Ludwig](#), co-director of the [Neighborhood Economic Development Advocacy Project](#) in New York and a former member of the Fed's Consumer Advisory Council.

"If you don't have information on two of the biggest areas of abuse, you have to wonder how definitive a report like this is," Ludwig said.

The researchers focused on so-called 2/28 mortgages originated in August 2005. In a 2/28, borrowers are charged an initial rate that resets every two years. That type of mortgage accounted for approximately 80 percent of subprime variable-rate loans and more than half of all subprime loans outstanding at the end of 2007, the authors said. August was the peak month for subprime loan origination.

While prior studies had shown borrowers in minority neighborhoods paid more for such loans, they were not able to factor in borrowers' credit scores or the ratio of the home loan amount to the value of the home.

'No Appreciable Differences'

After controlling for those factors, the New York Fed study found black and Hispanic borrowers paid initial rates about 2.5 basis points lower than a mean initial mortgage rate of 7.3 percent. A basis point is 0.01 of a percentage point. Asian borrowers paid about 3 basis points more than the mean, while there were "no appreciable differences" in lending terms by gender, the study said.

The authors also found 2/28 mortgages were cheaper in zip codes with higher percentages of black, Hispanic, and Asian residents.

"These results suggest the possibility that subprime lending did serve as a positive supply shock for credit in locations with higher unemployment rates and minority residents," the study said.

Many subprime mortgages were issued with little or no documentation of borrowers' credit background or income, and the study did find such loans were initially priced about 50 basis points higher, and had a higher reset margin of around 40 basis points.

2/28 Mortgages

For most 2/28 mortgages, however, initial and reset rates declined as the size of the loan rose. Each additional \$10,000 in principal reduced the interest rate by 0.8 to 1.7 basis points, the study said. Interest rates were also lower on loans with prepayment penalties, lower in markets that had seen faster home price appreciation, and lower for refinanced mortgages compared with mortgages for new purchases.

The lack of data on upfront costs is an "important caveat" to their findings, Tracy, Haughwout, and Mayer said, and they are expanding their study to try to come up with the information. Still, they said, while policy makers today are focused on limiting subprime lending in the future, "it is important to understand any positives that may have also occurred along with the downsides of subprime lending."