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Subprime Lending in the City of Cleveland and Cuyahoga County

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Housing Research & Advocacy Center

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Jeffrey D. Dillman[1]

Introduction

The effects of the current economic crisis have had devastating effects on nearly every area of the country. States such as Arizona, California, Florida, and Nevada, where "exotic" loans such as option-ARMs and interest-only mortgages were common, have faced unprecedented foreclosure rates and declines in property values. While the decline in property values in many Rust Belt cities have not been as great, the economic situation in many of these cities is in many ways equally, if not more, desperate. Having suffered through the decline in industrial manufacturing and resulting population loss, many of these cities never experienced the huge increase in home prices that had occurred on the coasts. An examination of the rise in subprime lending in the City of Cleveland and surrounding Cuyahoga County, Ohio, provides a useful example of what many of these older industrial cities have faced over the past fifteen years and of the challenges that the current crisis presents.

Cleveland reached its peak in population in 1950, when it was the seventh largest city in the nation with a population of 914,808. However, beginning in the 1950s, Clevelanders began to leave the city, first to the inner ring suburbs, and eventually to regions further and further away. By 2000, Cleveland's population was 478,403, and by 2005-2007, it was estimated to be down to 405,014, just 44% of its peak in 1950.[2]

In some Cleveland neighborhoods, the decline has been profound. For example, the population of the Fairfax neighborhood on the east side of Cleveland dropped from 39,380 in 1950 to 7,352 in 2000, an 81.3% decline. The population declines in the adjacent neighborhoods (which were between 93% and 97% African American in 2000) were nearly as high, with the Central neighborhood experiencing a population decrease of 82.6% compared to 1950, the Hough neighborhood a 75.1% decrease, and the Kinsman neighborhood a 73.6% decrease.[3]

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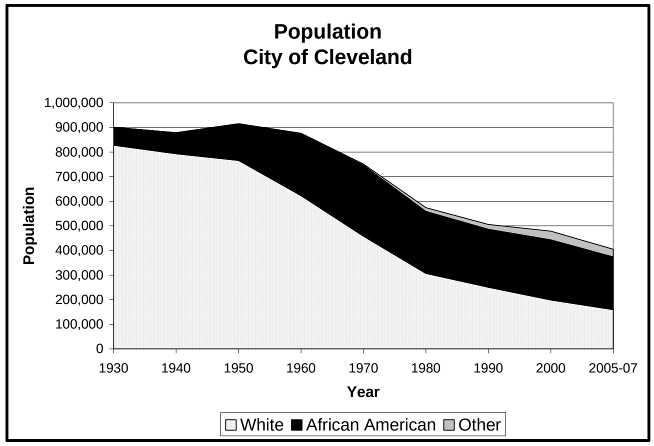
[2] U.S. Census Bureau, "Historical Census Statistics on Population Totals by Race, 1790 to 1990, and by Hispanic Origin, 1970 to 1990, For Large Cities And Other Urban Places in the United States," Population Division Working Paper No. 76, February 2005, Table 36; U.S. Census Bureau, Census 2000; U.S. Census Bureau, "Population of the 100 Largest Cities and Other Urban Places in the United States: 1790 to 1990," Population Division Working Paper No. 27, June 1998, Table 1.

[3] Randell McShepard & Fran Stewart, "Rebuilding Blocks: Efforts to Revive Cleveland Must Start by Treating What Ails Neighborhoods," (PolicyBridge, October 2009), pp. 5-6.

The vast majority of the decline in Cleveland's population has been due to the decrease in its white population, as can be seen in Figure 1.[4] In 1930, whites accounted for 91.90% of the City's population, with African Americans making up 8.00%. By 1950, the African American population of Cleveland had doubled to 16.20%, while the white population had dropped to 83.70%. In the next 30 years, Cleveland's African American population grew from 148,199 to 251,334, while the white population decreased dramatically, going from 765,694 to 306,995. Although the rate of white flight decreased somewhat after 1980, the overall number of white residents, as well as the percentage of whites in the City, continued to decrease so that by the 2005-07 period, African Americans outnumbered whites, accounting for 52.80% of the population (at 213,847) compared to 39.40% (at 149,576).

Figure 1



Cleveland was not alone in this trend. Census data shows that many Rust Belt cities followed this same trajectory, reaching their peak population in the 1950s or 1960s, followed by declines that by 2000 ranged from 49% to 80% of their peaks.[5] (See Table 1.) While cities such as Chicago and Milwaukee have retained much of their peak population, others, such as Buffalo, Detroit, and Pittsburgh have experienced large population declines similar to Cleveland.

Table 1

Population of Selected Rust Belt Cities

	Maximum Population		2000 Population	
City	**Number**	**Year**	**Number**	**% of Max.**
Akron	290,351	1960	217,074	74.76
Albany	134,995	1950	95,658	70.86
Buffalo	580,132	1950	292,648	50.45
Chicago	3,620,962	1950	2,896,016	79.98
Cleveland	914,808	1950	478,403	52.30
Detroit	1,849,568	1950	951,270	51.43
Milwaukee	741,324	1960	596,974	80.53
Pittsburgh	676,806	1950	334,563	49.43

Source: U.S. Census.

These changes in Cleveland's population coincided with persistent racial segregation for African Americans. Prior to the Civil War, African Americans in Cleveland "did not reside in

[4] U.S. Census Bureau, "Historical Census Statistics on Population Totals by Race, 1790 to 1990, and by Hispanic Origin, 1970 to 1990, For Large Cities And Other Urban Places in the United States," Population Division Working Paper No. 76, February 2005, Table 36; U.S. Census Bureau, Census 2000 (for 2000 data); U.S. Census Bureau, 2005-07 American Community Survey 3-Year Estimates.

[5] U.S. Census Bureau, "Population of the 100 Largest Cities and Other Urban Places in the United States: 1790 to 1990," Population Division Working Paper No. 27, June 1998, Table 23 (for maximum data); U.S. Census Bureau, Census 2000 (for 2000 data).

ghettos but lived throughout the city."[6] By the 1870s, however, the "ghettoization of African Americans [in Cleveland] had begun," and what had been referred to as the "city of immigrants" became "the segregated city."[7] The "Great Migration of the World War I era accelerated the residential segregation … and [by] 1930, twelve census tracts on the city's East Side were between 60 and 90 percent black."[8] In contrast to white ethnics, Cleveland's African American population increased in size while becoming more, rather than less, segregated.[9]

An examination of the dissimilarity segregation index shows dramatically the spatial segregation African Americans faced – and continue to face – in Cleveland. The dissimilarity index measures the percentage of a group's population that would have to move in order to have that group evenly spread throughout an area. A score of 100 indicates complete segregation and that all of a group's population would have to move in order to achieve integration, while a score of zero would indicate that the area is completely integrated.[10] While the methodology has varied somewhat over the years,[11] as can be seen in Table 2, African Americans experienced increasing segregation in Cleveland from 1870 through 1940, when the level reached 92.0, indicating that 92% of African Americans would have to move in order for them to be integrated evenly throughout the community.

Table 2

African-American Segregation in Cleveland
(Dissimilarity Index)

		Unit of analysis
1870	49.0	ward
1910	69.0	ward
1940	92.0	block
1950	91.5	block
1960	91.3	block
1970	89.0	block
1980	85.4	tract
1990	82.4	tract
2000	76.8	tract

While the number dropped somewhat from 1980 through 2000, the overall rate of segregation still placed the Cleveland metropolitan area as the sixth-most segregated region in the country for African Americans based on the dissimilarity index, and the third-most segregated area in

[6] David C. Perry, "Cleveland: Journey to Maturity," in *Cleveland: A Metropolitan Reader*, W. Dennis Keating, Norman Krumholz, & David C. Perry, eds. (Kent, OH: Kent State University Press, 1995), p. 22. During this pre-Civil War period, African Americans made up less than two percent of the population. Id.
[7] Id., citing Kenneth L. Kusmer, *A Ghetto Takes Shape: Black Cleveland, 1870*-1930 (Urbana: University of Illinois Press, 1976), p. 17.
[8] Edward M. Miggins, "Between Spires & Stacks," in *Cleveland: A Metropolitan Reader*, W. Dennis Keating, Norman Krumholz, & David C. Perry, eds., p. 193.
[9] Id.
[10] U.S. Census Bureau, "Racial and Ethnic Residential Segregation in the United States: 1980-2000," August 2002, p. 8.
[11] Sources: 1870 and 1910 data: Douglas S. Massey & Nancy A. Denton, *American Apartheid: Segregation and the Making of the Underclass* (Cambridge, MA: Harvard University Press, 1993), p. 21, Table 2.1; 1940-1970: Massey & Denton, *American Apartheid*, p. 47, Table 2.3; 1980-2000: U.S. Census Bureau, "Racial and Ethnic Residential Segregation in the United States: 1980-2000," August 2002, p. 69, Table 5-4. As Massey & Denton note (p. 31), the unit of analysis can affect the dissimilarity index rates, with the shift from wards to blocks adding at least 10 points to the index. The change from block to tract likely resulted in a decrease in the scores from 1970 to 1980. *See, e.g.*, John Iceland & Erika Steinmetz, "The Effects of Using Census Block Groups Instead of Census Tracts When Examining Residential Housing Patterns," U.S. Census Bureau Working Paper, July 2003. In addition, the earlier analyses examined the City of Cleveland only, while the 1980-2000 analysis covered the entire Metropolitan Statistical Area, which includes five counties.

the country considering an average of five segregation indices.[12] During this period, the Cleveland Metropolitan Statistical Area (MSA) actually became more segregated for Hispanics/Latinos, with the dissimilarity index increasing from 57.5 in 1980 to 57.7 in 2000, although the region moved from being the seventh-most segregated area for Hispanics/Latinos to the eleventh-most, reflecting an increase in segregation in other areas.[13] While this does indicate some improvement in terms of racial segregation of African Americans, that progress has been extremely slow, and at current rates, it will take decades, if not centuries, for the region to become integrated.

The Rise of Subprime Lending

The mortgage lending industry has undergone profound changes in the past fifty years. Historically, mortgage lending was conducted by depository institutions – savings and loans, banks, and credit unions – who primarily offered 30-year fixed rate mortgages. Loan decisions were, on paper at least, made based on the borrower's ability to repay (evaluated primarily based on income) and the value of the collateral (i.e., the value of the home being purchased or refinanced). Evaluating these variables often entailed examining a borrower's debt-to-income (DTI) ratio, to ensure that the borrower had sufficient income to pay the loan as well as any other debts and expenses and therefore would be unlikely to default on the loan. The value of the collateral was measured using loan-to-value (LTV) ratios, to ensure that, if the borrower did default, there was sufficient equity to allow the lender to recoup its investment after foreclosing on the property. The underlying assumption of these considerations was that lenders wanted to ensure that borrowers had sufficient money to repay their loans. In the event that a prospective borrower did not meet the underwriting criteria set by the lender, he or she was denied a loan.

This lending system worked well for many middle and upper income borrowers, especially whites, allowing them to become homeowners and accumulate wealth through the process. But residents of African American and Latino neighborhoods often were denied access to mortgage credit through redlining based on the perceived risk of lending money in those neighborhoods.[14] Redlining dates at least to the 1930s, through the rating system devised by the Home Owners Loan Corporation (HOLC) that coded the riskiest urban neighborhoods, which would receive few if any loans, with the color red. Citing the research of Kenneth Jackson, Douglas Massey notes, "Black neighborhoods [were] always coded red, and even those with small percentages of black residents were usually rated as hazardous and placed in the lowest category."[15] Although the HOLC did not invent the racialized standards that correlated real estate value to whiteness, it played a key role in institutionalizing them in policies which would later be adopted by federal

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[12] U.S. Census Bureau, "Racial and Ethnic Residential Segregation," p. 69, Table 5-4.

[13] Jeffrey D. Dillman, Carrie Pleasants & Samantha Hoover, "The State of Fair Housing in Northeast Ohio: April 2009," p. 20, citing U.S. Census Bureau, "Racial and Ethnic Segregation in the United States: 1980-2000."

[14] *See*, *e.g.*, HUD Preamble I, 53 Fed. Reg. 44998 (November 7, 1988).

[15] *See*, *generally*, Douglas S. Massey, "Origins of Economic Disparities," in *Segregation: The Rising Costs for America*, James H. Carr & Nandinee K. Kutty, eds. (New York: Routledge, 2008), 69-71.

agencies such as the Federal Housing Administration (FHA) and Veterans Administration (VA). For example, a 1939 FHA underwriting manual warned against "inharmonious racial or nationality groups" and stated that for neighborhoods to retain stability (and therefore property values), "It is necessary that properties shall continue to be occupied by the same social and racial classes."[16]

The social movements of the 1960s and early 1970s gave rise to an attempt to prohibit some of the more abusive of these practices through the passage of the federal Fair Housing Act,[17] the Equal Credit Opportunity Act,[18] the Home Mortgage Disclosure Act (HMDA),[19] and the Community Reinvestment Act (CRA).[20] Despite these statutes, numerous researchers have found continuing racial and ethnic disparities in mortgage lending.[21] Early research into mortgage lending disparities often examined differences in loan denial rates in order to help gauge possible discrimination. To the extent that African Americans or Latinos (or other racial and ethnic groups) were denied loans at a

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[16] Id. at 71-72.

[17] 42 U.S.C. §3601, *et seq*. Passed in 1968, the Fair Housing Act prohibited discrimination based on race, color, religion, and national origin. Later amendments prohibited discrimination based on sex (Housing and Community Development Act of 1974, Pub. L. No. 93-383, §808), as well as familial status and handicap (Fair Housing Amendments Act of 1988, Pub. L. No. 100-430).

[18] 15 U.S.C. §1691, *et seq.* The Equal Credit Opportunity Act (ECOA), passed in 1974, prohibits discrimination in the extension of credit based upon race, color, religion, national origin, sex, marital status, and age.

[19] 12 U.S.C. §2801, *et seq.* HMDA, passed in 1975, requires most mortgage lenders located in metropolitan areas, including depository institutions as well as non-depository mortgage and consumer finance companies, to report certain data regarding their mortgage loan applications and originations to the federal government and members of the public. While reporting requirements vary by year, they generally require a lender to report information on all applications received and loans made for home purchase, refinance, and home improvement loans. Lenders without offices in a metropolitan areas and/or who originate or accept fewer than five applications in a metropolitan area are exempt from HMDA reporting requirements. In addition, lenders with small assets size are not required to report data for the following year. *See, e.g.*, FFIEC, "2006 Reporting Criteria for Depository Institutions," and "2006 Reporting Criteria for Nondepository Institutions," available at http://www.ffiec/gov/hmda/reportde2006.htm and http://www.ffiec.gov/hmda/reportno2006.htm. Although not all lenders are required to provide data under the Act, HMDA data is generally regarded as providing the most thorough information available on mortgage lending. Data reported include the race, ethnicity, gender, and income of an applicant; the disposition of the application; and, since 2004, whether or not an originated loan constituted was "high-cost."

[20] Passed in 1977, the Community Reinvestment Act (CRA), 12 U.S.C. §2901, *et seq.*, was intended to address the failure of many banks and thrifts (savings and loans) to adequately invest in low- and moderate-income neighborhoods by requiring periodic examinations of their lending practices in such communities and considering the results of such exams when federal regulators evaluated whether to approve mergers and other actions by those institutions. While the CRA has resulted in substantial investments in such communities, the exams have been criticized as *pro forma*, with virtually every institution receiving a high score, much like Garrison Keillor's Lake Wobegon, where every child is above average.

[21] *See, e.g.*, National Community Reinvestment Coalition, "Income is No Shield Against Racial Differences in Lending II: A Comparison of High-Cost Lending in America's Metropolitan Areas," July 2008; Allen J. Fishbein and Patrick Woodall, "Subprime Locations: Patterns in Geographic Disparity in Subprime Lending," Consumer Federation of America, September 5, 2006; Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," Center for Responsible Lending, May 31, 2006; Alicia H. Munnell, Lynn E. Browne, James McEneaney & Geoffrey M.B. Tootell, "Mortgage Lending in Boston: Interpreting the HMDA Data," Federal Reserve Bank of Boston Working Paper No. 92-7 (1992).

disproportionate rate compared to whites, this provided evidence of possible discrimination in the mortgage lending market in that members of these groups were not being provided with adequate access to credit.[22]

In the 1980s and 1990s, the traditional system of lending through depository institutions evolved in several important ways. Risk-based pricing was introduced, which allowed lenders to offer mortgage products to individuals who might not otherwise have qualified for a loan. Through risk-based pricing, a lender uses a consumer's credit report and other similar data in "setting or adjusting the price and other terms of credit offered or extended to a particular consumer."[23] The theory behind this lending model is that some borrowers might not have adequate income or other credit profile characteristics to qualify for a traditional (prime) 30-year fixed rate loan. But rather than simply deny them the loan, the lender offers the borrower a loan at a *higher* rate. Because these loans are made to borrowers whose credit profiles are lower than that used for traditional prime borrowers, they are considered "subprime." The theory behind charging more for such a loan is that the increased cost is designed to help protect the lender from the higher risk of default on the part of the borrower. That is, because the borrower's credit risk is higher than a "prime" borrower's, there is a higher risk that he or she will default on the loan.[24]

While subprime loans were a logical product on one level, they also contained an inherent contradiction. The higher interest rate of a subprime loan makes the loan more expensive overall, generally with higher monthly payments and other onerous terms, *which themselves make default more likely*. Thus the very borrower who might have a harder time successfully purchasing a home and making the required payments on his or her mortgage loan is given a loan with higher payments than a borrower with higher income.[25]

This rise in subprime lending also coincided with, and was furthered by, the rise of mortgage brokers (independent salespeople who worked to obtain loans for borrowers). Although many borrowers assumed mortgage brokers were looking out for their best interests, trying to find them loans with the best rates and other features, compensation

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[22] *See*, *e.g.*, 42 U.S.C. §3605. See also HUD, "Unequal Burden: Income and Racial Disparities in Subprime Lending in America (April 2000), available at http://www.huduser.org/Publications/pdf/unequal_full.pdf; Alicia H. Munnell, et al., "Mortgage Lending in Boston," Federal Reserve Bank of Boston Working Paper No. 92-7 (1992).

[23] *See* Federal Reserve Board and Federal Trade Commission, Press Release, "Agencies Issue Proposed Rules on Risk-Based Pricing Notices," May 8, 2008, available at http://www.federalreserve.gov/newsevents/press/bcreg/20080508a.htm.

[24] This increased credit risk was sometimes based on "objective" criteria, such as higher debt-to-income ratios and loan-to-value ratios. In theory, a higher DTI ratio signifies that a borrower has less income available with which to pay the mortgage loan and other living expenses and therefore is more likely to miss a payment and default on the loan. A higher LTV ratio signifies that the borrower has invested less of his or her money in the property. This could result both in the borrower being more likely to "walk away" in the event he or she has financial difficulties as well as the lender being unable to fully recoup its loan costs in the event of foreclosure, as the cost of the outstanding loan balance and the foreclosure costs could be greater than the value of the property.

[25] Elizabeth Renuart, "Toward One Competitive and Fair Mortgage Market: Suggested Reforms in *A Tale of Three Markets* Point in the Right Direction," 82 *Texas Law Review* 421, 427 (2003).

structures often paid brokers more in the event that a borrower was in a less suitable higher-cost loan. For example, brokers paid through a "yield spread premium" were paid a fee ("premium") for putting a borrower in a *higher* interest rate loan than he or she qualified for based on credit. In addition, most brokers' fees were based on a percentage of the loan principal, giving them an incentive to push individuals into borrowing more money than they otherwise might need, including obtaining cash back in the transaction, refinancing other debt (credit card, car loan, etc.) or completely refinancing an existing mortgage loan rather than obtaining a second mortgage to make repairs. While encouraging borrowers to take on increased debt through increasing the amount borrowed and increasing the interest rate put borrowers at greater risk for default, independent mortgage brokers did not bear any risk for this action, having made their profit and completed their transaction at the time of origination.

The rise of the secondary mortgage market and securitization also changed incentives in the mortgage industry. Whereas in the past, the originating lender often retained the loan on its books and/or continued to service it throughout its life, by the 1990s, an increasing percentage of loans were either sold on the secondary market or securitized into investments to be sold on Wall Street. In both scenarios, the originating lender sold the loan shortly after it was made (sometimes on the same day) and therefore bore little if any risk in the event of a borrower's default. Thus, incentives to ensure that a borrower would repay the loan and that the collateral was sufficient were greatly diminished, if not removed altogether.[26]

Whereas redlining had resulted in a denial of credit to minority neighborhoods, the changes in the mortgage industry described above contributed to the rise of what came to be known as "reverse redlining." In contrast to traditional redlining, reverse redlining was a deliberate targeting of these neighborhoods by mortgage lenders (often non-depositories, although some depository institutions did engage in the practice either directly or through nondepository subprime affiliates). These neighborhoods, often historically deprived of adequate access to credit, were preyed upon by these lenders, who pushed predatory and subprime loans on individuals who had few if any other options for obtaining mortgage credit.[27] The effects of reverse redlining can be seen when one considers the fact that up to one-half of all subprime borrowers could qualify for a prime-rate loan with a lower interest rate.[28]

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[26] While some of the securitization agreements did contain features requiring originating lenders to buy back underperforming or defaulting loans, in practice these clauses did not result in originating lenders making loans in a more responsible manner. For a discussion of market failures in subprime and predatory lending, *see* Kathleen C. Engel and Patricia A. McCoy, "A Tale of Three Markets: The Law and Economics of Predatory Lending," 80 *Texas Law Review* 1255, 1280-1297.

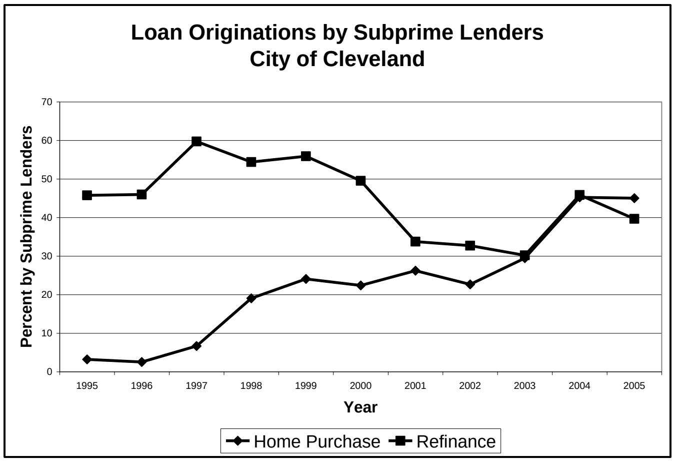
[27] *See* Ray Brescia, "Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis," 2 *Albany Government Law Review* 164, 179 (2009).

[28] *See* Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families, Chapter 5 (September 1996), available at http://www.freddiemac.com/corporate/reports/moseley/chap5.htm ("Preliminary Freddie Mac estimates suggest that between 10 and 35 percent of borrowers who obtained mortgages in the subprime market could have qualified for a conventional loan. A recent poll of the 50 most active subprime lenders supports this conclusion. The survey found that up to 50 percent of subprime mortgages could qualify as investment-

Subprime Lending in Cleveland: 1995-2005

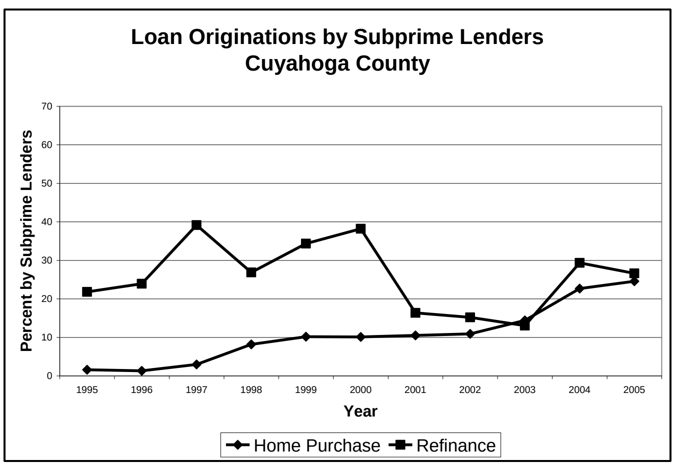
The effect of the changes in the mortgage industry described above can be seen in the growth of lending by subprime lenders in the Cleveland region from the mid-1990s to the mid-2000s.[29] In 1995 in the City of Cleveland, only 3.23% of home purchase loans were made by subprime lenders. By 1998, this had increased to 19.07%, and from 1999 through 2003, the percentage remained in the lower twenties, until 2003, when it increased to 29.46%, followed by a jump to 45.26% in 2004. Home purchase lending by subprime lenders showed similar increases in Cuyahoga County, although the overall percentages were lower. (See Figures 2 and 3.)

Figure 2



Throughout this same period, the percentage of refinance loans made by subprime lenders was higher overall, starting at 45.78% in Cleveland in 1995 and remaining in the forty and fifty percent range through 2000, after which they decreased to the lower thirties before rising back to 45.87% in 2004. Cuyahoga County refinance loan originations by subprime lenders showed a similar trend, although, as with home purchase loan originations, the overall rate was lower than in Cleveland.

Figure 3



grade mortgages, although some of these loans would fail to meet certain secondary market criteria.") and Remarks Prepared for Delivery by Franklin D. Raines, Chairman and CEO, Fannie Mae, Rainbow/PUSH Wall Street Project Conference, New York, NY, January 14, 2000 ("[A]bout half of the borrowers in the high-cost subprime market could qualify for lower-cost conventional financing.").

[29] During this period, information on whether a loan was prime or subprime (or high-cost or not high-cost) was not available publicly. However, the U.S. Department of Housing and Urban Development maintained a list of "subprime lenders." These lenders, who were primarily self-identified, made primarily subprime loans. While counting loans by subprime lenders likely undercounts many subprime loans (i.e. it does not include a subprime loan made by a prime lender) and overcounts others (i.e. assumes that all loans made by these institutions were subprime), over time it gives a picture of the overall trend in subprime lending.

The higher rates of subprime refinance lending compared to home purchase lending in the mid-1990s is likely a result of the way the predatory and subprime lenders operated during this period. Much of the initial growth in this sector of the lending industry occurred in the early-to-mid 1990s, when brokers and lenders used public records to identify individuals who had equity in their homes. These borrowers, disproportionately elderly and/or long-time homeowners, were targeted for refinancings that extracted home equity that had been built up over many years. Many of these initial lenders and brokers were relatively small operators who utilized public records to identify their targets who they reached through mail, phone, and door-to-door solicitations. As the industry grew and consolidated in the late 1990s, it became more mainstream, with television, radio, and print advertising, thereby spreading to include a much larger percentage of home purchase loans.

As was noted above, subprime lending carries in increased risk of default, as borrowers who obtain such loans must generally devote a larger amount of money to housing costs in the form of higher monthly payments compared to a prime-rate loan.

Recent Mortgage Lending Trends in the Cleveland Area

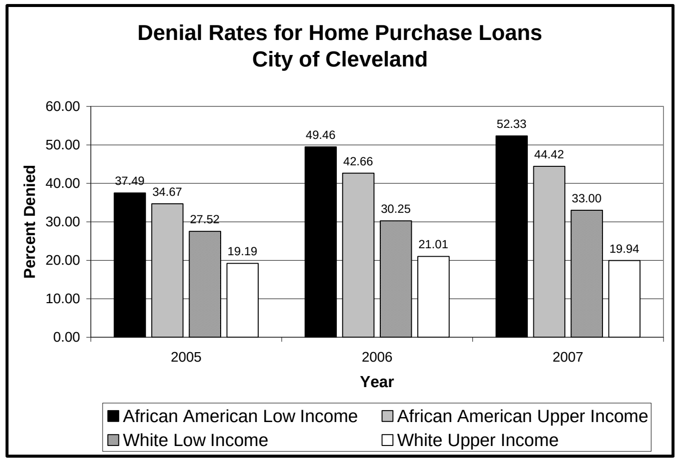
The concept of "fair lending" encompasses two important elements: access to credit (i.e. whether lending is made available to groups in an equitable manner) and the terms of that credit (i.e. is that lending made on "fair" terms). An examination of mortgage lending in the City of Cleveland and Cuyahoga County in recent years provides evidence of persistent racial disparities on both of these measures of fair lending. The data used for this analysis consisted of home purchase and refinance loans reported by lenders under the Home Mortgage Disclosure Act (HMDA) for the years 2005, 2006, and 2007 in the City of Cleveland and Cuyahoga County for one to four unit properties. Access to credit was examined by considering denial rates by racial and ethnic group to determine whether members of certain groups were denied mortgages disproportionately compared to members of other groups.[30] The terms of credit were evaluated by examining high-cost lending rates, to evaluate whether these groups received a disproportionate percentage of mortgage loans with high interest rates, compared to prime-rate loans.

[30] For reasons of space, this paper focuses on racial disparities between whites and African Americans. HMDA data reveal that Latinos/Hispanics, who made up 4.1% of the population of Cuyahoga County in 2007, were also denied loans at higher rates than whites, although at a much lower rate than African Americans. For details on mortgage lending by Latinos in Northeast Ohio and throughout the state, *see* Housing Research & Advocacy Center, "Persisting Racial and Ethnic Disparities in Ohio Mortgage Lending," February 2009, available at www.thehousingcenter.org/Publications/Research-Reports.html.

Denial Rates

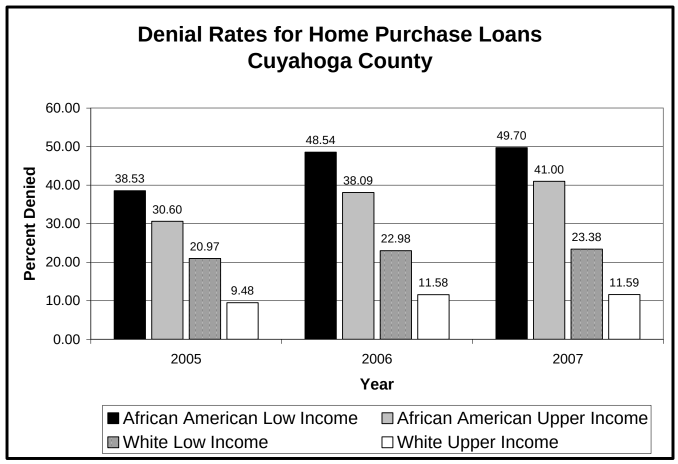
The greatest racial disparities in denial rates were found in home purchase loans. In the City of Cleveland for each of the years from 2005 through 2007, not only were African Americans denied home purchase loans more often than whites when comparing the same income groups, but *upper income* African Americans were denied home purchase loans more often than *low income* whites.[31]

Figure 4



For example, in 2005, upper income African Americans were denied home purchase loans 34.67% of the time, compared to 27.52% of the time for low income whites and 19.19% of the time for upper income whites. In 2006, the disparity increased, with upper income African Americans being denied home purchase loans 42.66% of the time, compared to 30.25% for low income whites and 21.01% for upper income whites. Although the disparity decreased somewhat in 2007, even in this year, upper income African Americans were denied home purchase loans at more than twice the rate of upper income whites and at one and one-quarter times the rate of low income whites (44.42% of the time compared to 33.00%). (See Figure 4.)

Figure 5



In Cuyahoga County, the racial disparities in home purchase lending were even greater than in the City of Cleveland. (See Figure 5.) Upper income African Americans were denied loans at one and one-half times the rate of low income whites (and at over three times the rate of upper income whites) in each year from 2005 through 2007. For example, in 2005, upper income African Americans were denied home purchase loans 30.60% of the time, compared to 20.97% of the time for low income whites and 9.48% of the time for upper income whites. This disparity increased in each of the following years, so that by 2007, upper income African Americans were denied home purchase loans at one and three-quarters times the rate of low income whites (41.00% of the time compared to 23.38%).

[31] "Upper income" individuals had incomes at least 120% of the median rate for the region, while "low income" individuals earned less than 50% of the median income.

Figure 6

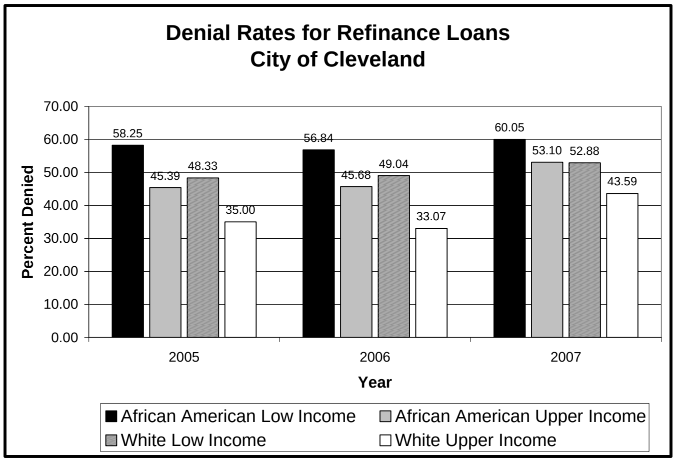
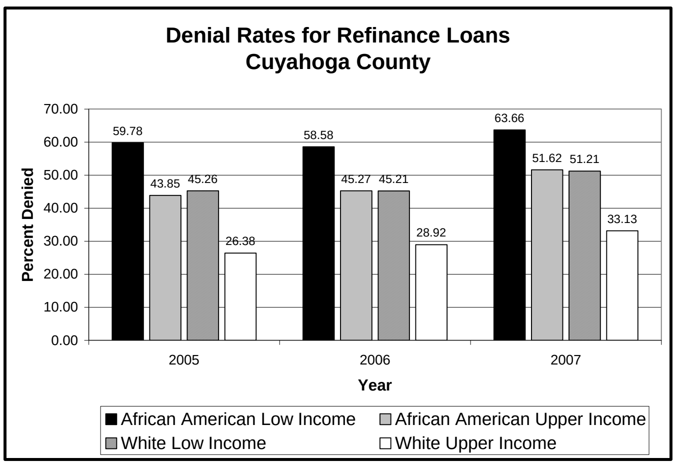


Figure 7



Refinance lending in the City of Cleveland showed much smaller racial disparities. (See Figure 6.) As with home purchase lending, African Americans at each income level were denied more refinance loans than whites at the same level. The denial rates of upper income African Americans were slightly lower than that for low income whites for the years 2005 and 2006 and approximately the same in 2007, although in each of these years, African Americans were denied loans at higher rates than whites within each income group. In Cuyahoga County, racial disparities in refinance lending was also much smaller than for home purchase lending, with upper income African Americans being denied loans at approximately the same rates as low income whites for each of the years. (See Figure 7.)

While the disparities in denial rates were smaller for refinance lending than home purchase lending, the existence of these disparities at all is cause for concern. One would expect that upper income individuals of any race would be denied fewer loans than low income individuals, and the fact that the denial rates for upper income African Americans were even close to that for low income whites is troubling.

Discussions with local advocates provide a possible explanation for some of the difference in disparity rates between home purchase and refinance lending disparities. As can be seen from the figures above, overall denial rates for both African Americans and whites are much higher for refinance loans compared to home purchase loans. Thus, the smaller racial disparities between African Americans and whites in refinance lending are due in some part to the higher denial rates of whites in obtaining these loans.

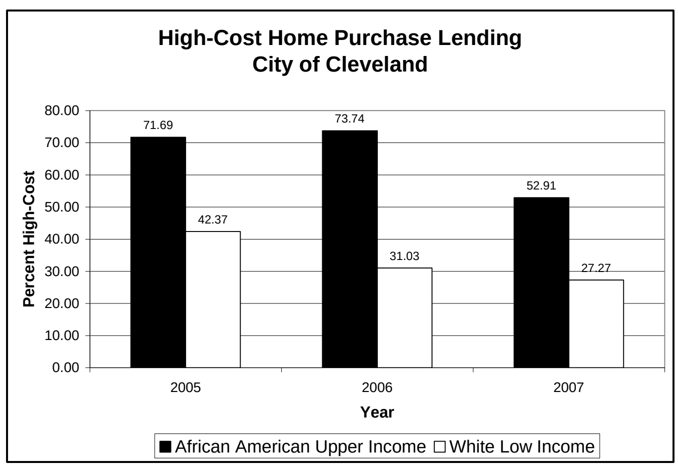
High-Cost Lending Rates

An examination of high-cost lending rates in both Cleveland and Cuyahoga County also reveal widespread racial disparities between whites and African Americans.[32] For the years 2005, 2006, and 2007, African Americans in every income group in Cleveland received more high-cost home purchase and refinance loans than whites of comparable incomes.

Overall in the City of Cleveland, 55.44% of all home purchase loans were high-cost in 2005. For African Americans, the rate was 71.96%, compared to 38.26% for whites and 37.16% for Hispanics/Latinos. In Cuyahoga County in 2005, 33.57% of all home purchase loans were high-cost. Although the overall rate was lower in Cuyahoga County, the racial disparities between races was higher, with African Americans receiving high-cost loans 65.57% of the time, compared to 20.04% for whites and 16.43% for Hispanics/Latinos. The primary reason for the increased disparity in Cuyahoga County compared to the City of Cleveland is that the rates of high-cost lending for whites in the County were substantially lower than the rates in Cleveland (20.04% compared to 38.26%).

Even more disturbing, upper income African Americans received more high-cost home purchase and refinance loans than low income whites. For example, in 2005, upper income African Americans received high-cost home purchase loans at over one and one-half times the rate of low income whites in the City of Cleveland (71.69% of the time compared to 42.37%); in 2006, upper income African Americans received high-cost home purchase loans 73.74% of the time, compared to 31.03% for low income whites; and in 2007, the rates were 52.91% and 27.27%, respectively. (See Figure 8.) While these numbers do show a large decrease in high-cost lending to upper income African Americans in 2007, it is disturbing that this group, with incomes of at least 120% of the area median income, wound up with high-cost

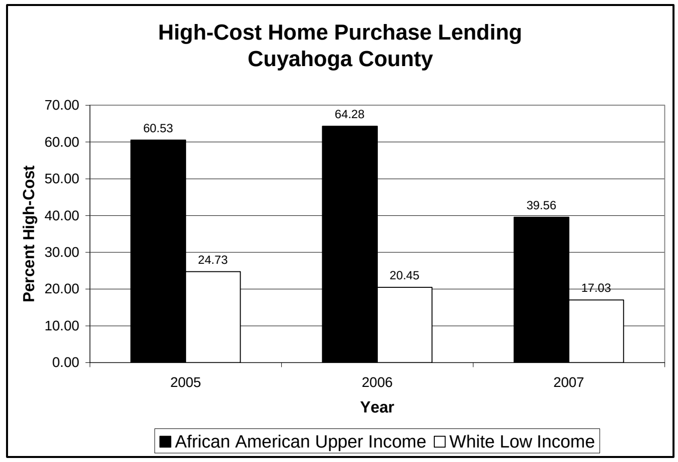
Figure 8



[32] High-cost lending refers to lending in which the interest rate is at least 3% (or, for second-lien mortgages, 5%) above the rate on Treasury securities of comparable maturity. This rate was chosen by the Federal Reserve Board for all HMDA-reporting lenders as the threshold for lenders to report certain pricing information about their mortgage loans to the federal government beginning with the 2004 HMDA submissions. The Federal Reserve Board indicated that it chose the 3% and 5% thresholds in the belief that it would exclude the vast majority of prime-rate loans and include the vast majority of subprime-rate loans. Federal Reserve Board, "Frequently Asked Questions About the New HMDA Data," p. 4, *available at* http://www.federalreserve.gov/boarddocs/Press/bcreg/2006/20060403/attachmen.pdf. "High-cost" lending is not synonymous with "subprime lending." High-cost lending is a narrower category than "subprime" lending.

loans at nearly twice the rate of whites whose income was less than 50% of the median income.

Figure 9



Although the rates of high-cost lending in Cuyahoga County were somewhat lower for each racial group compared to their rates in Cleveland, the disparities *between* African Americans and whites in the County as a whole were greater. In Cuyahoga County in 2005, upper income African Americans received high-cost home purchase loans 60.53% of the time, almost two and one-half times the rate for low income whites (24.73%). In 2006, upper income African Americans received high-cost home purchase loans at over three times the rate of low income whites (64.28% compared to 20.45%). By 2007, the rates of high-cost home purchase lending for both groups had decreased significantly, although upper income African Americans were still more than twice as likely to obtain such loans (39.56%) compared to low income whites (17.03%).[33] (See Figure 9.)

Refinance lending in both Cleveland and Cuyahoga County revealed similar, although somewhat smaller, disparities between African Americans and whites throughout this time period, with upper income African Americans receiving more high-cost loans than low income whites. (See Figures 10 and 11.) As with home purchase lending, the rates of high-cost lending were higher for both African Americans and whites in the City of Cleveland compared to the County as a whole, although the disparities between upper income African Americans and low income whites were greater in the County.

Figure 10

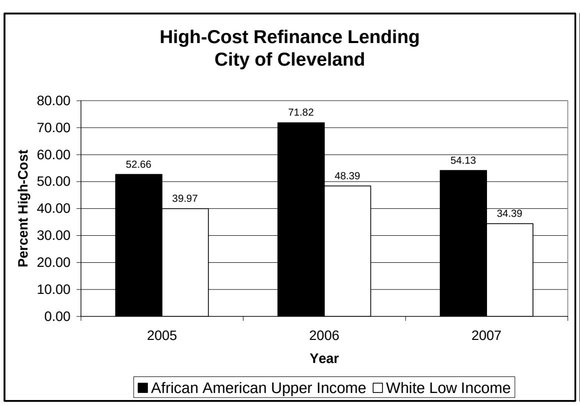
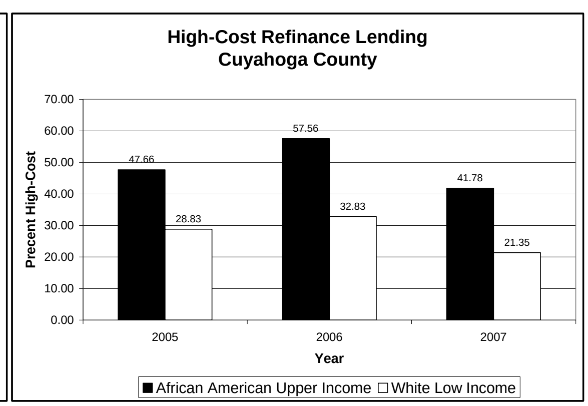


Figure 11



[33] Interestingly, upper income African Americans received high-cost loans at a higher rate than lower income African Americans. The HMDA data do not provide an explanation for this result, which is inconsistent with what one would expect.

The Effects of Unfair Lending on Cleveland

The effects of the extremely high rates of subprime lending, as well as the racial disparities in mortgage lending in Cleveland and Cuyahoga County, can be felt throughout the region. During much of the current decade, Ohio has had one of the highest foreclosure rates in the nation.

Figure 12

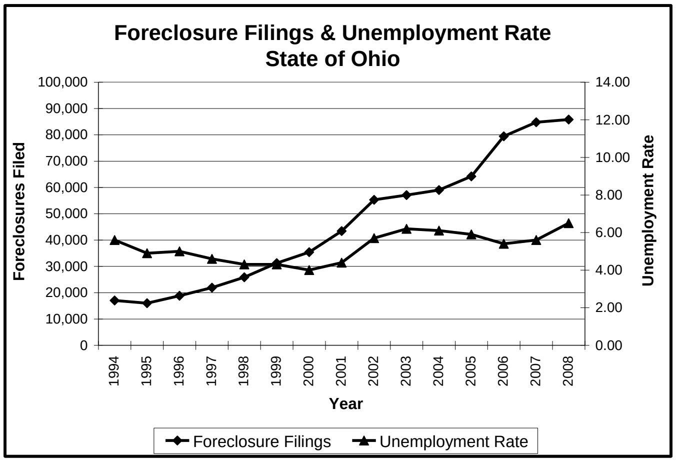
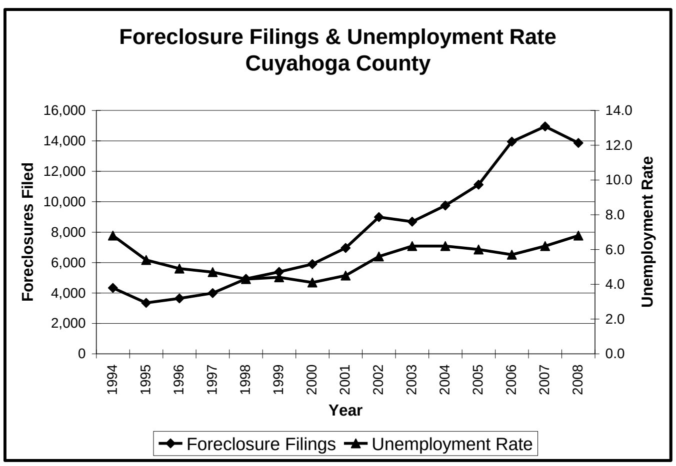


Figure 13



Economic changes, such as the decline in manufacturing, the rise in unemployment, and the rise of poverty in the region – in 2008, 30.3% of Clevelanders had incomes below the poverty level – certainly played a part in the growth in foreclosures.[34] Yet statewide as well as local data show that the number of foreclosures has climbed regardless of the change in the unemployment rate for the past fifteen years. In fact, even as unemployment decreased from 5.6% in 1994 to 4.0% in 2000, Ohio's foreclosure rate doubled in the same period, rising from 17,026 to 35,377. By 2006, with unemployment at 5.4% statewide – still below the rate in 1994 – foreclosures had doubled again, reaching 79,435.[35] (See Figure 12.)

Moreover, these trends are also reflected in local data, which show that Cuyahoga County experienced a similar rise in foreclosure filings starting in 1994, when there were 4,335 foreclosures filed, to 2007, when the number reached 14,946. As with statewide foreclosures, this growth occurred irrespective of the change in the County's unemployment rate, growing particularly quickly from 2003 to 2007, at a time when the unemployment rate went from 6.2% down to 5.7% in 2006 and then back to 6.2% in 2007.[36] (See Figure 13.)

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[34] See McShepard & Stewart, "Rebuilding Blocks," p. 9.
[35] In 2007, there were 84,751 foreclosures statewide, and in 2008, the number reached 85,782.
[36] In Ohio, foreclosure cases are filed in county Courts of Common Pleas. Prior to November 1, 2005, foreclosure filings in Cuyahoga County Common Pleas Court were not searchable based on the location of

A recent study by researchers at Case Western Reserve University made clear the relationship between mortgage lending and foreclosures, and particularly the racial disparities discussed above. The study examined the relationship between high-cost lending and foreclosure filings in Cuyahoga County in 2005 and 2006, finding that

> by far the strongest predictor of a loan foreclosing is its status as a high cost subprime loan. Holding other factors constant, home purchase loans that were high cost subprime had an 816 percent higher chance of going into foreclosure than other loans. Indeed, subprime lending accounted for 84 percent of the foreclosures on home purchase and refinance loans [in 2005 and 2006].[37]

The researchers further noted that the racial disparity in loan originations, in which African Americans (even with upper incomes) received more high-cost loans than whites, was reflected in foreclosure rates: "African American borrowers had the highest foreclosure rates (28.25 percent), Non-Hispanic whites had the lowest (7.58 percent), and Hispanic borrowers had moderate foreclosure rates (12.83 percent)."[38]

Research from the Federal Reserve Bank of Cleveland similarly found a strong correlation between race and foreclosure filings in Cuyahoga County: the neighborhoods with the highest foreclosure rates had the highest percentage of high-cost loans and the highest percentage of African American residents. Moreover, these neighborhoods were concentrated mainly in the City of Cleveland's east side, which is home to a high percentage of African American residents.[39]

Although the City of Cleveland, and especially the predominantly African American east side, has suffered the effects of subprime lending and the foreclosure crisis more greatly than Cuyahoga County as a whole, recent data suggests that suburban areas (and the whiter west side of Cleveland) will likely see an increasing impact in their communities in the future. According to data provided by the Center on Urban Poverty and Community Development at Case Western Reserve University, while nearly twice the number of mortgage loans in the east side of Cleveland are "at risk" of foreclosure in the next two years compared to the predominantly white west side, the rates on the east side

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the property, but only based on the address of the property owner, making it difficult to determine foreclosure trends in the City of Cleveland.

[37] Claudia Coulton, Tsui Chan, Michael Schramm, Kristen Mikelbank, "Pathways to Foreclosure: A Longitudinal Study of Mortgage Loans, Cleveland and Cuyahoga County, 2005-2008" (June 2008), p. 1. The study noted that the 84% figure was an underestimate of the total impact, because some of the loans originated in 2005 and 2006, the years studied, were likely to go into foreclosure in the future.

[38] Id., p. 7.

[39] Lisa Nelson, "Foreclosure Filings in Cuyahoga County: A Look Behind the Numbers," Federal Reserve Bank of Cleveland, Fall 2008, available at http://www.clevelandfed.org/Our_Region/Community_Development/Publications/Behind_the_Numbers/2008/0908/BTN_20080929.cfm.

appear to be slowing.[40] Additionally, there are now more "at risk" loans in the suburbs of Cuyahoga County (13,756 loans) compared to the City of Cleveland (10,438).[41]

The rise in foreclosures has contributed to a widespread decline in the quality of life in many Cleveland and Cuyahoga County neighborhoods, as foreclosures lead to increases in vacant and abandoned property which contribute to crime and other social costs. According to an estimate from Cuyahoga County Treasurer Jim Rokakis, in 2009 there were approximately 15,000 vacant properties awaiting demolition in the County, with 10,000 to 11,000 of those in the City of Cleveland.[42] Moreover, vacancies have been increasing in length. In the City of Cleveland, "36.6% of all vacant residential addresses have been empty for three years or more."[43]

The high number of these foreclosures has also contributed to a decrease in property values. Although the overall volume of property sales in Cuyahoga County has changed little from 2000 to the present, the percentage of transactions involving properties that have undergone a foreclosure has skyrocketed. In 2000, 92% of sales in Cuyahoga County, and 84% of sales in the City of Cleveland, involved properties that were not tainted by foreclosure.[44] By 2008, only 52% of County sales and 29% of Cleveland sales were not tainted by foreclosure. Research by the Woodstock Institute has shown that in Chicago, foreclosures can decrease property values of properties within an eighth of a mile by as much as 0.9-1.136%.[45] Locally, the huge increase in the number of sales involving foreclosed homes is reflected in a corresponding drop in sales prices during the same period. In Cuyahoga County, the median sales price of single family homes dropped from $102,000 in 2000 to $72,000 in 2008, while in the City of Cleveland it dropped from $65,000 in 2000 to $13,000 in 2008. Removing properties tainted by foreclosure, however, shows that countywide, the median sales price increased from $107,000 in 2000 to $125,000 in 2008, while values in Cleveland decreased slightly from $67,000 in 2000 to $65,000 in 2008.[46]

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[40] On the east side, 6,700 loans were considered "at risk," compared to 3,700 on the west side. The report considers loans to be "at risk" if they are an adjustable rate mortgage, a high-cost mortgage, a mortgage from a subprime lender, or are already in active foreclosure. Frank Ford, "Foreclosure and Housing Market Facts and Trends: Cleveland and Cuyahoga County, October 1, 2009 (unpublished report relying on data from NEO CANDO data system, Center on Urban Poverty and Community Development, Case Western Reserve University), p. 1.
[41] Id., p. 1.
[42] McShepard & Stewart, "Rebuilding Blocks," pp. 12-13.
[43] Id., p. 7.
[44] Properties were considered "tainted" by foreclosure if there was a sheriff's deed recorded for the property during the time period 1995-2009, indicating that the property had been sold at a sheriff's sale during this time period.
[45] Dan Immergluck and Geoff Smith, "There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values" (June 2005), available at http://www.woodstockinst.org/for-the-press/press-releases/new-research-illustrates-devastating-impact-of-foreclosures-on-property-values/.
[46] Frank Ford, "Foreclosure and Housing Market Facts and Trends: Cleveland and Cuyahoga County, p. 2.

Conclusion

Addressing the racially disparate subprime lending and the resulting foreclosure crisis will require a broad-based effort. While there were many causes to this crisis – including actions by governments at all levels as well as private individuals and institutions such as mortgage brokers, lenders, loan servicers, and those involved in the Wall Street securitization process – an underlying assumption of much of the mortgage lending industry in the past 30 years (and the economy more broadly) has been that the market does better than government in evaluating risk, offering financial products to consumers, and regulating itself.

This assumption derives from a discourse, initially promoted by conservatives in the 1980s but often adopted by liberals since that time, that not only delegitimizes the state as a potential solution to social problems but considers government itself as the problem. The belief that government could help bring about a more equitable society has been replaced by a narrative of individualism and laissez faire capitalism, with the market as the solution. Thus, we are left to attempt to provide market incentives to reduce discrimination, to support integration, to build accessible housing, and so on.[47]

In order to succeed in addressing the racial disparities in mortgage lending and the foreclosure crisis in the country, advocates must directly challenge this conservative narrative. In the wake of the global financial crisis, much of the public seems to intuitively grasp that "the market" failed. However, the response even of many in the Obama Administration has been tepid, offering what are often minor adjustments in policy without fundamentally challenging the conservative narrative about government. Ending housing discrimination and segregation is inherently a radical act, and one that is threatening to those who support and benefit from such conditions. Just as the gains of the Civil Rights and other social movements were won with broad-based progressive activism, challenging and ending housing discrimination and segregation will likewise require advocates to become activists.

[47] *See* Jeffrey D. Dillman, "New Strategies for Old Problems: The Fair Housing Act at 40," 57 *Cleveland State Law Review* 197, 206-07 (2009).

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