

## **Racial Discrimination in Mortgage Lending Is There a Problem Here?**

Is there racial discrimination in the mortgage lending market of America, and if so, is the problem eroding as time heals old prejudices and misconceptions? This is the central question to be addressed in this paper, along with other branching questions that begin to surface as research and statistical methods are analyzed and questioned for biases and tampering to prove personal beliefs. Some of the subtopics included in this paper will be the definition of discrimination, including statistical discrimination and the types of mortgage loans that are available to mortgage seeking individuals. Also important as a question of defining discrimination are the geographic component of mortgage loans and the redlining of minority neighborhoods. Is it discriminatory to lend on the basis of the neighborhood the borrower wishes to buy a home in? Another subtopic related to the reporting requirements set forth by the Home Mortgage Disclosure Act of 1975 is the disappearance of ethnicity reporting on mortgage applications. As we shall see, this idea of non-reporting has some implications for Gary Becker's theory of discrimination that strict requirements for reporting and the deregulation of the mortgage market will decrease discrimination. The last subtopic is what different legislative acts has accomplished to aid the fight against discrimination in the mortgage lending market and some of the implications that it places on Becker's theory.

In researching the topic of racial discrimination in the mortgage lending market, it has become very apparent that discrimination in mortgage markets has been a severe problem in this country in the past. This is not hard to believe as pointed out in Cloud and Galster's article, "What Do We Know About Racial Discrimination In Mortgage Markets?", as they make mention of the "backdrop" of racial discrimination in our society (Cloud and Galster 1993). The point that Cloud and Galster make is very strong: "Any discussion of racial discrimination in the mortgage lending market must be cognizant of the fact that racial discrimination continues to pervade virtually all aspects of our society" (Cloud and Galster 1993). This of course is a controversial topic in today's society, however it is hard to dispute the fact that racial discrimination exists in America. This idea is supported by the appearance of discrimination in all steps of the lending process. Cloud and Galster make the point with their research of the pre-

application stage of the lending process and the discrimination that minorities face when dealing with people or organizations face to face; this becomes an even bigger problem when fear of discrimination leads to nondisclosure which we will discuss later.

The extent to which it is getting better is yet to be decided. Some economists, such as Gary Becker believe that it is getting better. His theory is that the free market which relies on supply and demand and the efficiency of business will make discriminatory actions unprofitable for business and thus the free market will remove prejudice tastes for us. Becker's beliefs are the basis of another journal article used in my research, "Credit rationing, deregulation, and race in mortgage lending in the United States: 1960 – 1990," written by Mocan, Smith, and Tevebaugh. This article points out the existence of racial discrimination in the mortgage lending market during the first period tested, (1960 – 1979), by using statistical methods of econometrics to model the mortgage lending process. The model takes many variables into consideration so that controlling for the effects of race is possible. The results of this article coincided with Becker's belief that the discrimination of race in mortgage lending disappeared in the second period tested (1980 – 1990). The research showed that

In the later period, 1980-90, the evidence indicates that race no longer constitutes a significant determinant of the probability of obtaining conventional financing. In its place, education, price of the home, down payment and property appreciation emerge as the significant factors in lending decisions (Mocan, Smith, and Tevebaugh 1997).

This research bases the idea of discrimination on the ability of a minority citizen to obtain a conventional mortgage vs. a FHA mortgage. This raises another topic that will be covered in a later portion of this paper. A noticeable connection can be seen between this article and Cloud and Galster's article in that the so called "backdrop" of racial discrimination in our society was much worse in the earlier period of this research than in the later, possibly affecting the stability of Mocan, Smith, and Tevebaugh's research. Discrimination in this country is still bad; however it has gotten at least a little better in our society with the increase in importance of social diversity among the younger generations of this country.

As mentioned earlier, one of the subtopics that arose while researching is how discrimination is defined. This is alluded to in a couple of the articles used in my research. It

was mentioned in Helen Ladd's article, "Evidence on Discrimination in Mortgage Lending." Ladd's article points to a very important topic when discussing discrimination, "whether prejudice must be put ahead of profit for behavior to be labeled as discrimination, or whether lenders can be labeled as discriminators even if their intent is to increase profits" (Ladd 1998). The point Ladd is making is that lenders participating in statistical discrimination are sometimes not thought of as prejudicially discriminating against minorities, they are just looking for safe profits. The basic idea here is to lower the risk of lending money to people that can be categorized as a higher risk because of their race. This topic was covered in class toward the end of the term and it makes very good sense. If this type of discrimination is left to be handled by Becker's theory that the market will clear discrimination, it will never happen because it is profitable to statistically discriminate against certain groups because the overall risk of the group as a whole tells you that none of them are a safe bet. This is also talked about in Gabriel and Rosenthal's article, "Credit Rationing, Race, and the Mortgage Market." The conclusion to Gabriel and Rosenthal's article is that, "non-whites are significantly less likely to obtain conventional financing than whites, even after controlling for various proxies for default risk; these results are troubling, and suggest that race effects in the mortgage market may persist for reasons unrelated to borrower default risk" (Gabriel and Rosenthal 1991). This supports the idea that racial discrimination does exist in the mortgage lending market.

Another important implication of defining discrimination came up in Mocan, Smith, and Tevebaugh's article concerning the types of loans that were available to minorities because of the supposed risk involved with lending to minorities. This type of discrimination changes the idea from being able to get a mortgage loan to being able to get a certain type of mortgage loan. The main controversy here is over the ability of minorities to get a conventional vs. a FHA mortgage loan. Mocan, Smith, and Tevebaugh summed up the definition and problems with FHA loans: "FHA financing fully insures the lender against default risk, but is typically more expensive and subject to lending ceilings" (Mocan, Smith, and Tevebaugh 1997). As you can see the implication of the discrimination here is that some minorities that are qualified financially for conventional mortgages are only being offered FHA loans because lenders may see them as being part of a high risk group. This goes back to statistical discrimination which we just talked

about. Another controversy around the definition of discrimination is based around the idea of lender redlining of primarily minority or low income neighborhoods. The idea behind redlining is that lenders redline certain neighborhoods that are minority or lower income areas and then don't lend for mortgages in those areas because of the high default risk. The question of definition here is whether lenders are discriminating against minorities or just trying to lower their risk of default on loans they give out. Statistical discrimination keeps coming back. This problem was taken care of with some legislation called The Community Reinvestment Act of 1977, which basically sets affirmative action on lenders to reinvest in local community by giving loans in supposed minority and poor neighborhoods. The point here is not so much the actual events as much as the idea that different people view discrimination in different ways which makes this a very difficult topic to unravel. You could make the comparison of businessmen to thinking people, and minorities and advocates of no racism as feeling people, they can simple interpret things differently which doesn't make one right and the other wrong; it just makes the problem a lot harder to handle.

Another subtopic that was uncovered while researching this topic is the idea presented in Wyly and Holloway's article, "The Disappearance of Race in Mortgage Lending." This article points out a recent problem found with the HMDA's requirements for reporting demographic information on mortgage applications. The Home Mortgage Disclosure Act was first enacted in 1975; however in 1989 it was reworked and began to require lenders to report the ethnicity of applicants. This was meant to be used as a monitoring tool for racial discrimination by lenders. The rules for disclosure were left with a couple of loopholes, one of which is that if the application is done over the telephone the applicant can choose to not disclose their ethnicity and if it is turned into the lender via mail or the internet the same problem applies. The reason that this causes a loophole is that "the HMDA files contain no information on the medium through which an application was filed—making it impossible to distinguish between individuals who chose not to supply the information and those who were not asked" (Wyly and Holloway 2002). Also the past discrimination of minorities has pushed many away from disclosing their ethnicity to organizations for fear of being discriminated against. The lenders don't want anyone to know if they have been discriminating against minorities, so if the box isn't checked then no one is any

wiser. This article goes on to use econometric modeling to estimate the ethnicity of non-reported applicants. Although this is simply a model and it doesn't show the true ethnicity of applicants, it does show us that the approximately one third of the applicants that don't have a reported ethnicity are believed to be African American. The big give away to the existence of this problem may have been, "The second-largest racial-ethnic group among homeowners and homebuyers seeking institutional mortgage credit is now officially known as "Not Reported" (Wyly and Holloway 2002).

The last subtopic included in this paper will be how legislative actions have supported the fight against racial discrimination in the mortgage lending market. Some of these have been mentioned earlier in this work, so I may be brief in describing them. The Fair Housing Act of 1968 is a large part of the FHA loan structure that insures lenders on loans; it also structured rules that lenders are subject to regarding non discriminatory behavior. Another piece of legislation is the Home Mortgage Disclosure Act of 1975; this act was reworked in 1989 and also made some large steps toward requirement for lenders regarding nondiscriminatory treatment of minorities, as well as creating the reporting requirements that lenders have to follow so that racial discrimination can be tracked. Another legislative work was the Community Reinvestment Act which was already mentioned earlier, and has played a large roll in requiring lenders to supply mortgages to lower income and primarily minority neighborhoods. Also the Equal Credit Opportunity Act of 1976 was enacted which made it illegal for creditors to discriminate "on the basis of race, color, religion, national origin, sex or marital status, or age" (Ladd 1998). These legislative works did many more things than were listed here, but the pieces that pertain to this discussion are all that we are really concerned with.

The research articles that I chose to use for this article are all academic journal articles. The popular press is full of articles that have no backbone or academic strength, so I chose to stay away from them for fear of bias. The journals all seem to have good practical research to back them up and none of them seemed to be too extremely biased. This is a very hard topic to not carry a bias on because of the emotional feelings that are placed on the treatment of human beings. I don't think that any of the journals are flat out biased or wrong; however, there was one article that seemed to conflict and possible neglect to look at the entire picture. Mocan,

Smith, and Tevebaugh's article uses Gary Becker's theory, and in their conclusion they decide that Becker's theory is true because the variable of race is no longer significant. This may be true; however, all of the other articles say that racism is still significant. The main problem is that their research said nothing about the impact of the legislation that we discussed earlier having an effect on this change in racial significance, and legislation has nothing to do with the free market. Also their research was done in 1997, and since then the idea of non-disclosure surfaced in 2002. The articles used here seem to all have a good basis, with exception of the one, and I don't feel that the authors carry a significant bias that interrupted their research or conclusions.

In conclusion to this paper we can definitely say that there is discrimination in the mortgage lending market. There has been discrimination in the past and there is still some discrimination in the present. It appears that the problem is getting better through an increase in awareness and legislation. The Federal Government and its agencies that have been passing legislation to aid the struggle against this discrimination have been of great help in leveling the playing field for minorities. We have seen that some of this legislation has some loopholes, but most all legislation in this country has loopholes when it first comes off the table, so as this is taken care of, we should see great returns from this type of action. Also as we have seen from the article the idea that the market will take care of mortgage lending discrimination is not all that convincing, in fact it isn't true and therefore we have to lean on the government for legislation on this topic. As I mentioned earlier this is a very emotional topic and far from simplistic. However, I think that with the younger generations beginning to step into influential positions in the country we are going to see more things changing in the near future. As the youth of today grow with an increasing awareness of racial prejudice we can expect to see their future influence have a large impact on the decrease of racial discrimination in all facets of life and consequently the mortgage lending market. We can always help by not acting in this fashion, because if everyone were to act in a civil manner then this wouldn't be an issue at all.

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