

# 4.0 Lending Practices

A key aspect of fair housing choice is equal access to credit for the purchase of a home. This chapter reviews the lending practices of financial institutions and the access to financing for all households, particularly minority households and those with very low- or low-incomes.

## Legislative Protection

In the past, financial institutions did not always employ fair lending practices. Credit market distortions and other activities such as “redlining” prevented some groups from having equal access to credit. The Community Reinvestment Act (CRA) in 1977 and the subsequent Home Mortgage Disclosure Act were designed to improve access to credit for all members of the community.

### Community Reinvestment Act

The Community Reinvestment Act (CRA) is intended to encourage regulated financial institutions to help meet the credit needs of entire communities, including very low- and low-income households. Depending on the type of institution and total assets, a lender may be examined by different supervising agencies for its CRA performance.

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CRA rating does not offer insights regarding lending performance at specific locations.

CRA ratings are provided by the Federal Reserve Board (FRB), Federal Financial Institutions Examination Council (FFIEC), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC). However, the CRA rating is an overall rating for an institution and does not provide insights regarding the lending performance at specific locations by the institution.

## Home Mortgage Disclosure Act

In tandem with the CRA, the Home Mortgage Disclosure Act (HMDA) requires lending institutions to make annual public disclosures of their home mortgage lending activity. Under HMDA, lenders are required to disclose information on the disposition of home loan applications and on the race or national origin, gender, and annual income of loan applicants.

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Two types of lending – conventional and government-backed – are discussed in this chapter.

Detailed 2001 HMDA data for conventional and government-backed home purchase loans in Los Angeles County were examined. Two types of lending – conventional and government-backed lending – are discussed in this chapter. Conventional financing is market-rate loans provided by private lending institutions such as banks, mortgage companies, savings and loans, and thrift institutions. To assist very low- and low-income households that may have difficulty in obtaining home mortgage financing in the private market due to income and equity issues, several government agencies offer loan products that have below-market interest rates and are insured (“backed”) by the agencies. Sources of government-backed financing include the Federal Housing Administration, the Department of Veterans Affairs, and the Rural Housing Services/Farm Service Agency (RHA/FSA). Often, government-backed loans are offered to consumers through private lending institutions.

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HMDA data can indicate potential problems but cannot conclude redlining or discrimination.

HMDA data provides some insight into the lending patterns that exist in a community. However, HMDA data are only an indicator of potential problems; the data cannot be used to conclude definite redlining or discrimination practices.

# Conventional Loans

Los Angeles County has an extremely active housing market, as evidenced by a high number of home mortgage loan applications. Not only do new homes become available daily, the resale market is also busy. In 2001, almost 170,000 loan applications for conventional home mortgage financing were filed in Los Angeles County (Table 4-1). Overall, 73 percent of the loan applications were approved and 14 percent were denied. Most loan applications were filed for homes in Supervisorial Districts 3 and 5.

Loan approvals vary by Supervisorial District, with cities and unincorporated areas within District 5 (San Gabriel Valley and northeastern Los Angeles communities) and District 4 (South Bay and beach cities) exhibiting the highest approval rates. In comparison, loan applications in District 2 (East Los Angeles and South Central Los Angeles) and District 1 (East Los Angeles and Southeast Los Angeles) have lower approval rates than the countywide average. The difference between the highest approval rate in District 4 and the lowest in District 2 is more than ten percentage points.

Supervisorial District 4 had the highest loan approval rate, while District 2 had the lowest. The difference is more than 10 percentage points.

**Table 4-1**  
**Disposition of Conventional Home Purchase Loan Applications**  
**in Los Angeles County by Supervisorial District**

Supervisorial District	Conventional Home Purchase Loans							
	Approvals <sup>1</sup>		Denials		Other <sup>2</sup>		Total	
	#	%	#	%	#	%	#	%
District 1	12,464	70%	3,083	17%	2,388	13%	17,935	100%
District 2	15,121	66%	4,655	20%	3,325	14%	23,101	100%
District 3	30,694	73%	5,712	14%	5,622	13%	42,028	100%
District 4	28,068	77%	4,561	12%	4,057	11%	36,686	100%
District 5	37,752	76%	6,117	12%	6,053	12%	49,922	100%
Total County <sup>3</sup>	124,099	73%	24,128	14%	21,445	13%	169,672	100%

Notes:

1. Approved loans include both originated loans and loans approved by the lenders but not accepted by the applicants. Originated loans are those approved by the lenders and purchased by the applicants.
2. Other includes applications withdrawn by applicant or incomplete applications.
3. County numbers and percentages do not represent the sum of all the individual cities and unincorporated areas due to the fact that areas may share census tracts.

Source: Home Mortgage Disclosure Act (HMDA), 2001.

## Disposition of Loan Applications by Race of Applicant

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Loan application approval rates vary across racial groups and districts.

Across the County, White residents submitted the most home loan applications at 43 percent of all applications, followed by Hispanics at 19 percent, Asians at 13 percent, and Blacks at 6 percent. Native American households accounted for less than one percent of all applicants.

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Hispanics and Blacks appeared to be under-represented in the homebuyer market.

Within Los Angeles County, White households represented the largest racial/ethnic group at 42 percent of all households, followed by Hispanic households at 32 percent, Asian households at 12 percent, and Black households at 11 percent of the County households (2000 Census).<sup>1</sup> American Indian and other ethnic groups accounted for 3 percent of all households. Comparing the racial/ethnic distribution of the loan applicants with that of the total households, Hispanics and Blacks appear to be under-represented in the homebuyer market.

Approval rates vary across racial groups and by District (Table 4-2). At the high end, 77 percent of the loan applications in District 4 were approved, while only 66 percent in District 2 were approved. Joint applicants and Asian applicants had the highest approval rates, with both achieving approval rates of 79 percent. White applicants had the second highest approval rate at 77 percent, while the approval rate for Hispanic applicants was 68 percent. The approval rate for Black applicants was 61 percent.

- **District 1** had the fewest number of applications (18,000) among all Districts and one of the lower approval rates (70 percent). Asian households had the highest approval rate at 81 percent, followed by White and Native American applicants at 73 and 72 percent, respectively. However, the number of Native American applicants is limited. The approval rate for Hispanic applicants was 66 percent, while Black applicants had the lowest approval rate at 61 percent.
- **District 2** had the lowest district-wide approval rate in the County, with 66 percent of the 23,000 loan applications approved. Joint applicants had the highest approval rate, with 79 percent of the applications approved. White and Asian applicants (73 percent) were the only other group with more than 70 percent of the applications approved, while Blacks again had the lowest approval rate at 60 percent.

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<sup>1</sup> In terms of population, White residents represented 34 percent of the County population in 2000, compared to 43 percent of Hispanic residents. This discrepancy in household and population representation directly reflects the larger average household size of Hispanics.

- **District 3** had over 42,000 applicants and an approval rate of 73 percent, mirroring the countywide approval rate. White applicants had the highest approval rate at 76 percent, followed by joint applicants at 75 percent and Asian households at 73 percent. Black households had the lowest approval rate at 62 percent, while Hispanic households had an approval rate of 68 percent.
- **District 4** had the highest district-wide approval rate in the County, with 77 of all loan applications approved. Asian, White, and joint applicants had the highest approval rates in the District at approximately 80 percent. Hispanic households achieved an approval rate of 71 percent. As is the case throughout the County, Black households had the lowest approval rate among all racial/ethnic groups at 64 percent.
- **District 5** had the largest number of home loan applications in the County (almost 50,000) and had the second highest approval rate at 76 percent. Asian households had the highest approval rate at 81 percent, followed closely by joint applicants (80 percent) and White applicants (78 percent). Hispanic households had an approval rate of 72 percent, with Black households achieving the lowest approval rate at 63 percent.

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Consistently, Black applicants had the lowest approval rates across all districts.

**Table 4-2**  
**Disposition of Conventional Home Purchase Loan Applications**  
**by Race of Applicant**

Race of Applicant	Percent Approved by District					Total County
	District 1	District 2	District 3	District 4	District 5	
Native American	72%	57%	69%	68%	74%	68%
Asian	81%	73%	73%	81%	81%	79%
Black	61%	60%	62%	64%	63%	61%
Hispanic	66%	65%	68%	71%	72%	68%
White	73%	73%	76%	80%	78%	77%
Joint	75%	79%	75%	81%	80%	79%
Other	69%	62%	68%	74%	72%	70%
N/A	59%	57%	67%	72%	69%	66%
Total	70%	66%	73%	77%	76%	73%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

## Disposition of Loan Applications by Applicant Income

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 District 2 had the lowest approval rates for applicants across all income levels.

Income is one of the most important factors for determining access to credit. As can be expected, the approval rate increases as applicant income increases, and the denial rate decreases as applicant income increases (Table 4-3). Applicants in Districts 4 and 5 generally had higher approval rates across all income levels than applicants in other districts. District 2 had the lowest approval rates across all income levels.

**Table 4-3**  
**Disposition of Conventional Home Purchase Loan Applications by Applicant Income**

District	<i>Loan Approvals by Income</i>			Total District
	Low/Mod (0-80% MFI)	Middle (81-120% MFI)	Upper (>120% MFI)	
District 1	66%	71%	72%	69%
District 2	61%	65%	69%	66%
District 3	63%	72%	75%	73%
District 4	68%	75%	79%	77%
District 5	67%	74%	78%	76%
Total County	65%	71%	76%	73%
District	<i>Loan Denials by Income</i>			
District 1	21%	18%	15%	17%
District 2	25%	22%	17%	20%
District 3	23%	15%	12%	14%
District 4	21%	14%	11%	12%
District 5	22%	14%	10%	12%
Total County	22%	17%	12%	14%
District	<i>Other: Incomplete/Withdrawn Applications by Income</i>			
District 1	13%	11%	13%	13%
District 2	14%	14%	14%	14%
District 3	19%	13%	13%	13%
District 4	12%	12%	10%	11%
District 5	11%	12%	12%	12%
Total County	13%	12%	12%	13%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

## Race Differences by Income of Applicant

Many significant differences in approval and denial rates are not revealed through analysis of loan applications on an aggregate level. For this reason, analyzing race details by income is important in revealing differences among applicants of different races but in the same income level. While this analysis provides a more in-depth look at lending patterns, it still cannot provide a concrete source or reason for any discrepancy. The analysis is only intended to identify potential areas of concern to assist the County in targeting assistance, outreach, and education programs, and to identify potential areas that require monitoring. As illustrated in Table 4-4, approval rates vary widely among ethnic groups of the same income levels. Black applicants consistently received the lowest approval rate regardless of income, while White and Asian applicants have consistently high approval rates.

Consistently, Black applicants received the lowest approval rates regardless of income even in districts where approval rates are generally higher.

**Table 4-4**  
**Approval Rates of Conventional Home Purchase Loan Applications by Applicant Race and Income**

District	Ethnicity	Approval Rate by Income		
		Low/Mod (<80% MFI)	Middle (80-120% MFI)	Upper (>120% MFI)
District 1	Asian	81%	84%	80%
	Black	59%	59%	64%
	Hispanic	66%	68%	68%
	White	68%	76%	74%
District 2	Asian	66%	72%	75%
	Black	58%	60%	61%
	Hispanic	67%	67%	64%
	White	59%	71%	75%
District 3	Asian	68%	72%	76%
	Black	47%	64%	64%
	Hispanic	61%	71%	69%
	White	70%	75%	77%
District 4	Asian	78%	81%	83%
	Black	61%	63%	66%
	Hispanic	65%	71%	74%
	White	73%	79%	81%
District 5	Asian	79%	81%	82%
	Black	61%	63%	64%
	Hispanic	67%	71%	75%
	White	71%	77%	80%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

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A tester declined to authorize a credit check, but the loan officer pre-qualified that person for a loan anyway. Four days later, the same loan officer met with another tester of a different race than the first tester and refused to provide any information or service on the basis of needing to do credit check first.

A loan officer informed a tester that a community is concentrated with minorities and that homes quickly sell to relatives of existing residents. The loan officer steered the tester to other communities where the tester could live quietly in a safe neighborhood.

-- *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*

## Discriminatory Lending

*All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions* is a recent study completed by HUD in 2002 to assess discrimination and impediments in the mortgage lending process. The study utilized paired testing for determining whether minority homebuyers receive the same treatment and information as Whites at the pre-application phase of the mortgage lending process. The study conducted the tests in Los Angeles and Chicago.

The report found that Black and Hispanic homebuyers in Los Angeles face a significant risk of unequal treatment when they visit mainstream mortgage lending institutions to make pre-application inquiries. Discriminatory treatment at this early stage in the mortgage lending process has the potential to discourage some minorities from continuing their housing search, to limit their search to lower cost homes than they could actually afford, and to prevent them from choosing the most favorable loan products.

Within Los Angeles, unequal treatment takes different forms:

- Blacks were offered less coaching than comparable White homebuyers, and were more likely to be encouraged to consider an FHA loan.
- Hispanics were denied basic information about loan amount and house price, told about fewer products, and received less follow-up compared to White homebuyers.

These patterns of unequal treatment occurred regardless of whether the two members of a tester pair met with the same loan officer or with different loan officers.

## Disposition of Loan Applications by Gender

Historically, females tended to have limited access to mortgage financing compare to males. According to the 2001 HMDA data, while it still holds true that female applicants comprised a smaller proportion of loan applicants in all districts, female applicants achieved higher rates of loan approval than male applicants, except in District 1 (Table 4-5). In general, joint applicants typically achieve the highest approval rates.

**Table 4-5**  
**Approval Rates by Gender and Supervisorial District**

District	Appl'ns	% Approved	Male Applicants		Female Applicants	
			Appl'ns	% Approved	Appl'ns	% Approved
District 1	17,935	70%	6,142	73%	3,903	68%
District 2	23,101	66%	7,983	62%	6,491	65%
District 3	42,028	73%	15,370	71%	9,538	73%
District 4	36,686	77%	10,260	72%	7,448	76%
District 5	49,922	76%	13,469	72%	9,906	74%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

## Lending in Low/Moderate Income and Minority Neighborhoods

HMDA data may be used to measure lending activities in low and moderate income neighborhoods and in minority concentrated areas (Table 4-6). Given the demographic and economic profiles of the districts, lending in low- and moderate-income neighborhoods and minority-concentrated neighborhoods constituted only a fraction of the lending activities in Districts 3, 4, and 5. The more affluent District 4 (South Bay and beach cities) demonstrated a pronounced difference between the overall approval rate and the approval rate realized in low- and moderate-income neighborhoods (13 percentage points). All other districts showed a difference of approximately five percentage points. With regard to minority-concentrated areas, the differences in approval rates were small (less than five percentage points in all cases).

**Table 4-6**  
**Lending to Low/Moderate Income and Minority Neighborhoods by Supervisorial District**

District	Appl'ns	% Approved	Low/Moderate Income Neighborhoods		Minority Neighborhoods (> 50% Minority)	
			Appl'ns	% Approved	Appl'ns	% Approved
District 1	17,935	70%	7,138	65%	16,659	69%
District 2	23,101	66%	10,268	59%	18,259	62%
District 3	42,028	73%	3,992	68%	8,319	69%
District 4	36,686	77%	3,442	64%	11,049	74%
District 5	49,922	76%	2,166	71%	14,982	77%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

# Government-Backed Loans

Government-backed loans showed higher approval rates, compared to conventional financing.

Government-backed loans offer an alternative to conventional financing. Relative to conventional financing, government-backed lending had higher approval rates, particularly in the District 5, where the approval rate was almost five percentage points higher than conventional loan applications (Table 4-7). Low- and moderate-income households (up to 80 percent County MFI) benefited greatly from government-backed loans, as their approval rates were much higher than for conventional loans. This pattern was most noticeable in Districts 2, where low- and moderate-income households had the same approval rate as upper-income households.

**Table 4-7**  
Disposition of Government-Backed Home Purchase Loan Applications by Applicant Income

District	Loan Approvals by Income			Total District
	Low/Mod (0-80% MFI)	Middle (81-120% MFI)	Upper (> 120% MFI)	
District 1	72%	77%	74%	73%
District 2	68%	72%	68%	68%
District 3	74%	79%	76%	76%
District 4	71%	78%	80%	75%
District 5	79%	82%	83%	80%
Total County	73%	77%	77%	74%
District	Loan Denials by Income			Total District
District 1	13%	11%	14%	
District 2	15%	14%	15%	15%
District 3	12%	11%	10%	11%
District 4	13%	9%	9%	11%
District 5	9%	7%	7%	8%
Total County	13%	10%	11%	12%
District	Other: Incomplete/Withdrawn Applications by Income			Total District
District 1	15%	13%	12%	
District 2	17%	15%	17%	17%
District 3	15%	10%	14%	13%
District 4	16%	13%	11%	14%
District 5	12%	11%	10%	12%
Total County	15%	12%	13%	14%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

Along with the higher approval rates, the government-backed financing also had fewer withdrawn or closed applications than conventional lending. This was especially true among low- and moderate-income applicants. For conventional loan applications, low- and moderate-income applicants generally had a higher percentage of loan applications withdrawn or closed due to incomplete information than applicants of other income levels. With government-backed financing, the disparity is less pronounced.

## Race Differences by Income

As was the case among conventional home loans, approval rates for government-backed loans tend to vary among ethnic groups of similar income levels (Table 4-8). In general, upper-income Whites and Asian applicants had higher approval rates than other ethnic groups. However, unlike conventional home loans, this pattern was not consistent throughout all income levels. Approval rates varied more widely among different ethnic groups in the low- and moderate-income category. In some cases such as within District 1 and 2, low- and moderate-income Black and Hispanic applicants had higher approval rates than all other groups.

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Low- and moderate-income Black applicants in District 1 and District 2 had the highest approval rates, in contrast with the pattern for conventional lending.

## FHA Foreclosures and Frauds

While government-backed financing represents an important alternative source of financing to low- and moderate-income households, it is also a market where many borrowers have been abused. The high default rate of FHA loans in the seven Southern California counties – 50 percent higher than the national rate – prompted HUD to launch a Housing Fraud Initiative.

In 1998, HUD began an initiative to address fraud in programs administered by the federal agency. The “Housing Fraud Initiative” investigation involved the Federal Bureau of Investigation, Internal Revenue Service and U.S. Attorney’s Office, and uncovered over \$110 million in fraud involving three types of schemes:

- Originating fraudulent loans that allowed unqualified borrowers to obtain mortgages insured by the Federal Housing Administration;
- A scam in which real estate professionals obtain mortgages in the names of fictitious borrowers; and
- Cases of equity skimming, in which an owner sells a property to a so-called “straw buyer” at an inflated price. The straw buyer then defaults, but the seller has already profited.

**Table 4-8**  
**Approval Rates of Government-Backed Home Purchase**  
**Loan Applications by Applicant Race and Income**

District	Ethnicity	Approval Rate by Income		
		Low/Mod (<80% MFI)	Middle (80-120% MFI)	Upper (>120% MFI)
District 1	Asian	80%	85%	83%
	Black	81%	68%	69%
	Hispanic	71%	77%	73%
	White	71%	77%	75%
District 2	Asian	64%	82%	78%
	Black	69%	69%	69%
	Hispanic	69%	71%	63%
	White	65%	72%	74%
District 3	Asian	64%	74%	80%
	Black	51%	76%	71%
	Hispanic	75%	79%	78%
	White	81%	84%	74%
District 4	Asian	60%	83%	83%
	Black	70%	75%	76%
	Hispanic	70%	77%	79%
	White	81%	81%	81%
District 5	Asian	75%	78%	87%
	Black	73%	80%	74%
	Hispanic	77%	83%	81%
	White	85%	84%	85%

Source: Home Mortgage Disclosure Act (HMDA), 2001.

# Performance By Lender

According to the 2001 HMDA data, the top lenders in the County included the following:

- Bank of America
- Countrywide
- Washington Mutual
- World Savings Bank
- North American Mortgage
- Citimortgage
- Greenpoint Mortgage
- Metrociti Mortgage

Countrywide and Washington Mutual were among the top five lenders in all five Districts, while Bank of America was a top lender in four of the five Districts (Table 4-9). In contrast, Citimortgage was a top lender only in District 1 and Metrociti Mortgage among the top five lenders only in District 3.

Among the top five lenders, Washington Mutual and Bank of America had the highest approval rates, while World Savings Bank and Greenpoint Mortgage had the lowest. Citimortgage, which is active only in District 1, had an astoundingly high approval rate of 90 percent.

Understanding the homebuying process and the income/equity requirements, as well as financial responsibility, is important to successfully achieve a home purchase loan. Many households, particularly those entering the homeownership market the first time, lack financial knowledge to deal with the homebuying process. District 2, where a large number of low- and moderate-income households reside, had not only the highest loan denial rates but also the highest rates of withdrawn or incomplete applications. Specifically, withdrawn/closed applications represented 27 percent of all applications to World Savings Bank for mortgage lending. In fact, as a top lender in four districts, World Savings Bank had the highest rates of withdrawn or closed applications in all districts. Similarly, Countrywide had among the lowest denial rates across all districts, but a large proportion of the applications were withdrawn or closed due to incomplete information, resulting in low approval rates. Potentially a reflection of this pattern, Countrywide received a corporation-wide CRA rating of "Needs to Improve." Greenpoint Mortgage, most active in Districts 2 and 3, had low approval rates due to both high denial rates and high withdrawn rates.

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Some of the most active lenders in the County had low approval rates due in part to denials but also to a large proportion of withdrawn and incomplete applications. Refer to discussions later on the CRA rating of top lenders.

**Table 4-9**  
**Disposition of Conventional Home Purchase Loans**  
**by Lending Institution**

Lender Name	Total Apps.	% of total	Approved		Denied		Withdrawn or Closed	
			#	%	#	%	#	%
<b>District 1</b>								
Bank of America	1,378	8%	1,037	75%	232	17%	109	8%
Washington Mutual	1,317	7%	1,009	77%	153	12%	155	12%
Countrywide	1,263	7%	980	78%	53	4%	230	18%
North American Mortgage	733	4%	581	79%	55	8%	97	13%
Citimortgage	688	4%	619	90%	30	4%	39	6%
<b>District Total</b>	<b>17,935</b>	<b>100%</b>	<b>12,464</b>	<b>70%</b>	<b>3,083</b>	<b>17%</b>	<b>2,388</b>	<b>13%</b>
<b>District 2</b>								
Bank of America	1,923	8%	1,487	77%	292	15%	144	8%
Countrywide	1,721	7%	1,233	73%	90	5%	398	23%
Washington Mutual	1,427	6%	1,110	78%	153	11%	164	12%
Greenpoint Mortgage	1,111	5%	612	55%	288	26%	211	19%
World Savings Bank	946	4%	580	61%	110	12%	256	27%
<b>Total</b>	<b>23,101</b>	<b>100%</b>	<b>15,121</b>	<b>66%</b>	<b>4,655</b>	<b>20%</b>	<b>3,325</b>	<b>14%</b>
<b>District 3</b>								
Washington Mutual	3,478	8%	2,790	80%	434	13%	254	7%
Metrociti Mortgage	2,792	7%	2,241	80%	9	0%	542	19%
Countrywide	2,784	7%	2,129	76%	112	4%	543	20%
World Savings Bank	2,420	6%	1,633	67%	236	10%	551	23%
Greenpoint Mortgage	2,193	5%	1,299	59%	392	18%	502	23%
<b>Total</b>	<b>42,028</b>	<b>100%</b>	<b>30,694</b>	<b>73%</b>	<b>5,712</b>	<b>14%</b>	<b>5,622</b>	<b>13%</b>
<b>District 4</b>								
Washington Mutual	2,745	7%	2,282	83%	247	9%	216	8%
Countrywide	2,661	7%	2,129	80%	96	4%	436	16%
Bank of America	2,421	7%	1,933	80%	238	10%	250	10%
World Savings Bank	1,861	5%	1,345	72%	141	8%	375	20%
North American Mortgage	1,665	5%	1,367	82%	159	10%	139	8%
<b>Total</b>	<b>36,686</b>	<b>100%</b>	<b>28,068</b>	<b>77%</b>	<b>4,561</b>	<b>12%</b>	<b>4,057</b>	<b>11%</b>
<b>District 5</b>								
Countrywide	4,206	8%	3,390	81%	135	3%	681	16%
Washington Mutual	3,231	6%	2,692	83%	277	9%	262	8%
Bank of America	2,589	5%	2,011	78%	326	13%	252	10%
North American Mortgage	2,390	5%	1,994	83%	144	6%	252	11%
World Savings Bank	2,202	4%	1,481	67%	191	9%	530	24%
<b>Total</b>	<b>49,922</b>	<b>100%</b>	<b>37,752</b>	<b>76%</b>	<b>6,117</b>	<b>12%</b>	<b>6,053</b>	<b>12%</b>

Source: Home Mortgage Disclosure Act (HMDA), 2001.

## CRA Rating

CRA performance reviews of financial institutions are conducted by the Federal Reserve Board (FRB), Federal Financial Institutions Examination Council (FFIEC), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC). CRA ratings are provided for the main or regional headquarters of the financial institutions. Among the top five lenders active in each of the five Supervisorial Districts, the performance of four lenders - Washington Mutual, Bank of America, Countrywide Home and Loan, and World Savings Bank - was evaluated. OTS awarded an "outstanding" rating for Washington Mutual, Bank of America, and World Savings Bank. However, Countrywide Thrift and Loan received a "Needs to Improve" CRA rating.

## The Subprime Lending Market

In general, lending institutions are divided into two categories based on the type of loans or mortgages they offer: *prime* and *subprime*. According to the Federal Reserve, prime mortgages are offered to persons with excellent credit and employment history and income adequate to support the loan amount. Subprime loans are loans to borrowers who have less-than-perfect credit history, poor employment history, or other factors such as limited income. These borrowers typically do not satisfy the standard Fannie Mae or Freddie Mac underwriting guidelines. In general, the quality of the loan defines the loan as subprime. Subprime loans usually have an interest rate of at least one to six percentage points above that of a prime mortgage.

Another important distinction is the lack of regulatory oversight of many lending institutions that originate subprime loans. According to a Federal Reserve report, many subprime lenders are not owned by regulated financial institutions. Unlike banks and savings and loans, which must submit regular regulatory compliance audits and whose activities are overseen by a variety of institutions such as the FDIC and OTS, many subprime lenders are not subject to rigorous oversight. Independent mortgage companies do most of the subprime lending in the United States, and only the Federal Trade Commission (FTC), which has limited resources for the immense market it monitors, regulates subprime lenders.<sup>2</sup>

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Oversight of subprime  
lenders is limited.

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<sup>2</sup> Federal Reserve Governor Edward M Gramlich, "Predatory Lending" *Cascade* (Federal Reserve Bank of Philadelphia), Summer/Fall, 2000.

An important trend to note, however, is that an increasing number of large banks such as Citibank have entered the subprime market either directly or through the acquisition of other financial institutions.

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Subprime lenders serve an important segment of the market, particularly for those with less-than-desirable credit and employment history. However, due to the lack of monitoring, some subprime lenders engage in abusive practices.

Subprime lenders play an important role in the market by providing financing to those persons who might not otherwise be able to obtain credit from the prime market. The subprime market not only serves those who may have past credit problems or other financial risk factors, but many others as well. For example, the subprime market may be more attractive to a borrower who may have a good credit history but may not have sufficient assets. Similarly, the subprime market may be more attractive to someone who is self-employed, has variable income, or simply wants to limit disclosure of a financial situation. Evidence shows that some subprime lenders, which generally operate outside the federal regulatory structure, engage in abusive practices that strip borrowers' home equity and place them at increased risk of foreclosure.<sup>3</sup>

Though the subprime market usually follows the same guiding principles as the prime market, a number of specific risk factors are associated with this market. According to a joint HUD/Department of the Treasury report, subprime lending generally has the following characteristics:<sup>4</sup>

- **Higher Risk:** Lenders experience higher loan defaults and losses by subprime borrowers than by prime borrowers.
- **Lower Loan Amounts:** On average, loans in the subprime mortgage market are smaller than loans in the prime market. Estimates for average subprime loan size range between \$58,000 and \$85,000, compared to an average of \$133,000 for all mortgages.
- **Higher costs to originate:** Subprime loans may be more costly to originate than prime loans since they often require additional review of credit history, a higher rate of rejected or withdrawn applications, and fixed costs, such as appraisals, that represent a higher percentage of a smaller loan.
- **Faster prepayments:** Subprime mortgages tend to be prepaid at a much faster rate than prime mortgages.
- **Higher Fees:** Subprime loans tend to have significantly higher fees due to the factors listed above.

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<sup>3</sup> U.S. Department of Housing and Urban Development. *Unequal Burden In Los Angeles: Income and Racial Disparities in Subprime Lending*. April 2000.

<sup>4</sup> U.S. Department of Housing and Urban Development and the U.S. Department of Treasury, *Curbing Predatory Home Mortgage Lending*. June 2000.

Within Los Angeles, there has been an overall growth in subprime lending over the last several years, with the number of subprime loans concentrated in low-income neighborhoods. A recent HUD study, *Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending*, indicates that inner-city Black and low-income neighborhoods concentrated in or around the South Central Los Angeles area disproportionately rely upon subprime lenders, especially with respect to the refinance credit market. This most likely occurs because these areas tend to have a higher concentration of lower income households, and lenders may consider these borrowers to be a higher credit risk and therefore less likely to qualify for prime loans. (As evidenced in Table 4-6 presented earlier, District 2 [South Central] had a significantly lower loan approval rate in low- and moderate-income neighborhoods.) However, a lack of lending competition from lenders in certain areas may increase the chances that borrowers are exposed to predatory lending practices by certain subprime lenders. Key findings from the study indicate:

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Black and low-income neighborhoods in and around South Central Los Angeles disproportionately rely on subprime lending.

- Subprime loans are two times more likely in low-income neighborhoods in Los Angeles than in upper-income neighborhoods.
- Subprime loans are almost four times more likely in Black neighborhoods in Los Angeles than in White neighborhoods.
- Upper-income Black borrowers in Los Angeles are almost twice as likely as low-income White borrowers to have subprime loans.

## Predatory Lending

The following discussion provides an overview of predatory lending, examples of predatory lending practices, recent trends, and existing and proposed regulations. Whenever possible, information specific to Los Angeles County is included.

### Defining Predatory Lending

With an active housing market, potential predatory lending practices by financial institutions may arise. Predatory lending occurs when potential buyers are looking to purchase a new home, or when existing homeowners refinance their home to consolidate current debts such as credit cards and car payments. Predatory lending involves abusive loan practices usually targeting minority and/or low-income homeowners or those with less-than-perfect credit history.

Predatory lending often is difficult to define since a 15-percent interest rate on a loan to one person could be predatory while it might be appropriate for another, based on the borrower's risk factors. Predatory lending has become a growing issue in California due to the state's tight housing market, high home costs, and large minority population – typical targets for predatory lending practices.

On August 10, 2000, the Federal Home Loan Mortgage Corporation, commonly known as Freddie Mac, announced its campaign to alert Americans of the dangers of predatory lending through its "Don't Borrow Trouble" campaign. The "Don't Borrow Trouble" campaign used the model pioneered in Boston – through ads, Internet websites, public service announcements in English and Spanish, and a toll free number for referrals – to alert the public of predatory lending practices. The City of Los Angeles is one of the 12 pilot cities chosen by Freddie Mac for this campaign. Similar efforts were not available countywide.

The following set of general definitions for predatory lending is provided by the Federal Home Loan Mortgage Corporation (Freddie Mac):

- **High Interest Rates:** Interest rates that are more than seven to eight percentage points above market rates.
- **Excessive Fees:** For example, fees charged up-front without lowering the interest rate; costs and fees above normal.
- **Negative Amortization:** Repayment schedules set up so that the monthly payment fails to pay off accrued interest and actually increases the original amount borrowed.
- **Balloon Payments:** In this payment structure, the balance due on the mortgage must be paid at the end of the loan, usually 15 years. At the end of the loan, the balloon payment that is suddenly due will be a large sum of money, probably beyond one's ability to repay, forcing the borrower to borrow more money to pay back the loan.
- **High Loan-to-Value (LTV) Loans:** Loans that are more than 100 percent LTV may lock the borrower into additional debt.
- **Credit Insurance:** Life, accident, and health insurance should not be included as a condition of a loan. It will increase the total amount the borrower owes.

- **Mandatory Arbitration:** Loan contracts requiring mandatory, binding arbitration instead of the court system. Arbitration is more favorable to lenders than to consumers.
- **High-Pressure Sales Tactics:** Frequent calls and letters asking the borrower to refinance.<sup>5</sup>

## Examples of Predatory Lending

As defined above, predatory lending includes a wide variety of improper practices. In fact, over 39 different types of predatory lending have been documented involving all aspects of the lending process, from origination to the collection of the loan.<sup>6</sup> These practices typically target and steer low-income, minorities, or the elderly to high-rate lenders.<sup>7</sup>

In particular, HUD has raised concern about two categories of improper or predatory lending practices. The first type, which generally is easier to identify, involves blatant fraud or acts of deception such as forging signatures or obtaining signatures on blank documents, falsifying loan applicant income or appraised value of the property, or employing bait and switch tactics.

A second type, which is often more difficult to identify, involves various manipulative practices that cause borrowers to enter into abusive loans. Common abusive loans include:

- **Equity Stripping:** This type of practice occurs when a loan is based on the equity of a home rather than the borrower's ability to repay. This type of loan often has high fees, prepayment penalties, and different terms and conditions than a regular home loan.
- **Packing:** This involves the practice of adding credit insurance or other extras into the loan. The supplements to the loan are often very profitable to the lenders and are typically financed in a single up-front or balloon payment.

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<sup>5</sup> "Don't Borrow Trouble" Federal Home Loan Mortgage Corporation. 2002.

<sup>6</sup> Bill Brennan of Atlanta Legal Aid, Testimony before the U.S. Senate Special Committee on Aging, March 16, 1998.

<sup>7</sup> Testimony of Assistant Secretary for Housing/Federal Housing Commissioner William Apgar before the House Committee on Banking and Financial Services, May 24, 2000.

- **Flipping:** This practice is a form of equity stripping and happens when a lender convinces a borrower to repeatedly refinance a loan within a short period of time. The lender typically charges high points and fees each time as part of the mortgage.<sup>8</sup>

## Protections Against Predatory Lending

### Federal Legislative Changes and Actions

Predatory lending is a growing fair housing issue. However, no law currently administered by the Federal Reserve Board contains a statutory or regulatory definition of predatory lending. Predatory lenders who discriminate receive some scrutiny under the Fair Housing Act of 1968, which requires equal treatment in terms and conditions of housing opportunities and credit regardless of race, religion, color, national origin, family status, or disability. This applies to loan originators as well as the secondary market. The Equal Credit Opportunity Act of 1972 requires equal treatment in loan terms and availability of credit for all of the above protected categories, as well as age, sex, and marital status. Lenders that engage in predatory lending would violate these acts, if they target Black, Hispanic or elderly households to buy higher priced and unnecessary loan products; treat loans for protected classes differently than those of comparably credit-worthy applicants; or have policies or practices that have a disproportionate effect on the protected classes.

In addition, the Truth in Lending Act (TILA) promotes the informed use of consumer credit, through disclosure of loan costs and terms. To comply with this act, lenders must disclose information about payment schedules, prepayment penalties, and the total cost of credit. In 1994, Congress amended the TILA in response to abusive lending practices. The new legislation, referred to as the Home Ownership and Equity Protection Act (HOEPA), provides new information to protect borrowers. HOEPA identifies a specific class of high-cost mortgage loans that may put consumers at risk of losing their homes. HOEPA requires disclosure of information if the annual percentage rate (APR) is ten percentage points above the prime or if fees are above eight percent of the loan amount. HOEPA also prohibits balloon payments for short-term loans. In addition, for covered loans, HOEPA provides a warning if the lender has a lien on the borrower's home and the borrower could lose the home if default on the loan payment.<sup>9</sup>

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<sup>8</sup> Dan Tatar, Community Affairs Office of the Federal Reserve Bank of Richmond, "Predatory Lending: The American Nightmare," *Marketwise*, Winter 2001.

<sup>9</sup> Federal Reserve Governor Edward M. Gramlich, "Predatory Lending" *Cascade* (Federal Reserve Bank of Philadelphia), Summer/Fall 2000.

Furthermore, HUD, in conjunction with the U.S. Department of Treasury, formed the Joint-Task Force on Predatory Lending in 2000. The Task Force conducted an in-depth investigation of the problem and issued recommendations to Congress regarding improving consumer literacy and disclosure, reforming sales practices, improving market structure, and restricting abusive terms and conditions.

### State of California AB 489 (as amended by AB 344)

Following North Carolina's lead, in September 2001, California became the second state to pass a law banning predatory lending. The law enables state regulators and the Attorney General to attempt to prevent "predatory" lending practices by authorizing the state to enforce and levy penalties against licensees that do not comply with the provisions of this bill. The law provides protections against predatory lending to consumers across the state as summarized below:

- **Financing of Credit Insurance:** On all home loans, the bill prohibits the financing of single premium credit insurance policies into the loans. Credit insurance policies on home loans may still be sold as long as they are paid off monthly like other insurance.
- **Covered loans:** The legislation's other protections apply to home loans with very high fees and rates when the total loan amount is \$250,000 or below. For borrowers in these higher-cost home loans, the bill extends additional consumer protections against some of the most abusive practices.
- **Financing of Points and Fees:** The bill prohibits the financing of lender and broker fees beyond 6 percent of the original loan amount, minus the fees.
- **Steering:** The bill prohibits borrowers in covered loans from being steered or counseled into loans with rates above what is appropriate for their credit risk, according to the lender's classifications.
- **Ability to Repay:** The bill prohibits lenders from making a covered loan, knowing that the borrower cannot repay.
- **Home Improvement Contracts:** The bill prevents home improvement contractors from getting paid directly out of the proceeds of covered loans. The loan proceeds must go directly to the borrower, or otherwise must be paid out to an escrow account or to the borrower and contractor jointly only in increments with written certification that the work has been finished.

- **Fiduciary Responsibility of Brokers:** The legislation establishes that any mortgage broker providing a covered loan has a responsibility to protect the borrower's financial interests, regardless of any of the broker's other financial relationships (including their status as an agent of the lender), and that any violation of those duties constitutes a violation of the law.
- **Loan Flipping:** The bill prohibits covered loans where there is no clear benefit to the borrower, taking into account the costs of the loans, but also the borrower's reasons for seeking it.
- **Prepayment Penalties:** When a prepayment penalty is included in a loan, the borrower must pay a penalty to refinance out of that loan into another loan within a certain time period. In the prime market, prepayment penalties are generally accompanied by a slightly lower interest rate on the loan. But in the subprime market, these penalties are commonly used to trap borrowers at higher interest rates than they should be paying or force them to pay an extra fee to receive a loan with a more reasonable interest rate. The bill sets restrictions on some of the worst abuses - limiting such penalties on covered loans to no longer than three years and requiring the originator to offer a choice of a loan without a prepayment penalty at least three days before closing.
- **Balloon Payments:** No balloon payments are allowed in the first five years of the loan, as in the federal Home Ownership Equity Protection Act (HOEPA).
- **Negative Amortization:** The principal amounts of second mortgages may not increase over the course of a covered loan.
- **Prepaid Payments.:** Prepaid installments may not be financed into the loan, resulting in extra interest charges.
- **Call Provisions:** Call provisions, which permit the lender to call in the entire balance of the loan immediately, may not be included in covered loans.
- **Interest Rate Changes upon Default:** The interest rate may not increase as a result of the borrower defaulting.
- **Encouragement of Default:** A lender or broker may not encourage a consumer to default on the consumer's existing home loan when soliciting to refinance the consumer into a new covered loan.

- **Disclosures.** Originators of covered loans are required to provide borrowers with one page of disclosures about the availability of loan counseling services and other information about the loan.

## Local Efforts

The cities of Los Angeles and Oakland have recently passed local ordinances to curb predatory lending practices. In November of 2002, by a vote of 11 to 0, the Los Angeles City Council approved a new ordinance to protect homeowners from losing their homes and equity to unfair predatory loans. Given that the City of Los Angeles has unique conditions, including an aging housing stock and diverse population, the Council found that many residents were particularly susceptible to predatory lenders.<sup>10</sup> It was also found that neither the state nor the federal law adequately addressed the unique circumstances found in Los Angeles, and special protection and regulations are needed. The measure approved by the City Council will provide broader provisions to consumers than the California State legislation. The Los Angeles City ordinance applies to home loans with points and fees above four percent of the loan amount and/or an interest rate above 11 percent. On loans with higher costs, it provides the following protections:

- **Reasonable and Tangible Net Borrower Benefit:** Borrowers must receive a “reasonable and tangible net benefit” when refinancing into a high-cost home loan, preventing predatory loans where borrowers are convinced to refinance primarily to generate revenues for unscrupulous lender or brokers.
- **No Lending without Home Loan Counseling:** Borrowers being offered a high-cost loan will sit down with an independent, certified loan counselor who will explain the costs and impact of their loan.
- **Ability to Pay:** High cost loans must be based on the borrower’s ability to repay, not on the borrower’s equity in the house and may not be made solely to finance at a high fee to be passed on to the secondary market.

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<sup>10</sup> “Anti-Predatory Loan Ordinance of the City of Los Angeles.” November 21, 2002.

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