

The Changing Face of Inequality in Home Mortgage Lending in Indiana

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A newer variation of this paper is available that examines all United States MSAs. This older version may be useful to those who are specifically interested in Indiana or who want additional background information on subprime and manufactured housing lending that has been cut from later versions.

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Abstract

American homeownership has long been characterized by racial, ethnic and geographic inequality. Inequality in home ownership, in turn, has contributed to racial and class segregation and inequality in other aspects of American life. Recently, however, there have been signs of apparent progress, as minorities and low-income groups have achieved all time record high rates of homeownership. To explain these developments, we compare and contrast classical economic theories, which suggest that banking deregulation and increased competition have eliminated whatever discrimination may have existed in home mortgage lending, with sociological theories of networks that argue industry restructuring can disrupt markets and social relationships and create new opportunities for exploitation. We argue that, as the old inequality in home mortgage lending has slowly diminished, a new inequality has emerged, characterized by less favorable loan terms, sometimes-problematic forms of housing, and a lack of adequate consumer protection from predatory and abusive practices.

Specifically, we describe trends in subprime and manufactured housing lending in the state of Indiana. Our study finds that such loans accounted for half or more of the gains made by underserved markets between 1992 and 1999. Subprime lenders made particularly strong inroads among minority markets at all income levels. We discuss how the old inequality helped to make the new inequality possible, and how the new inequality in home mortgage lending is part of a much larger phenomenon in which apparent gains made by minorities and low income groups have come at a far higher cost than gains made by other segments of society.

The Changing Face of Inequality in Home Mortgage Lending in Indiana

American homeownership has long been characterized by racial, ethnic and geographic inequality. Today, while more than 70% of all non-Hispanic white households own their own home, fewer than 50% of African American and Hispanic households do (HUD¹ 1999, 1995a). Gaps exist regardless of income levels, with both higher income and lower income minorities being less likely to own their own homes than white households with comparable incomes (HUD, 1995a).

This inequality in home ownership has contributed to inequality in other aspects of American life. As Massey and Denton (1993) and Feagin (1999) note, factors that have adversely affected minority home ownership have also contributed to racial and class segregation. An overwhelming majority of urban African Americans live in areas that are residentially segregated, and poor blacks are far more likely to live in poor neighborhoods (and suffer from the problems associated with them) than are poor whites (Massey and Evers, 1990).

Recently, however, there have been signs of apparent progress. Homeownership rose steadily during the 1990s. As the Department of Housing and Urban Development recently noted (10/26/2000), the percentage of households owning their own homes reached an all-time record high of 67.2% in September 2000. Much of this growth was fueled by disproportionate gains for minorities. A total of almost 40% of the net new homeowners during 1994 through 1999 were minorities (Joint Center for Housing Studies of Harvard University, 2000), even though minorities accounted for only 23% of the population (HUD, 4/26/2000).

In this paper, we compare, contrast, and ultimately integrate two alternative theoretical explanations for these developments. Classical economic theories (e.g. Becker, 1957) imply that banking deregulation and increased competition have eliminated whatever discrimination may have existed in home mortgage lending. Sociological network theories (e.g. Tillman and Indergaard, 1999), on the other hand, argue that industry restructuring can disrupt markets and social relationships and create new opportunities for exploitation.

We argue that both perspectives offer insight into recent developments. Many of the recent homeownership gains represent real progress and, should they continue, inequalities in rates of homeownership will further diminish. But, as the old inequality has slowly diminished, a new inequality has also emerged, characterized by less favorable loan terms, sometimes-problematic forms of housing, and a lack of adequate consumer protection from predatory and abusive practices. While we might reasonably argue that the new forms of inequality are better than the old, we must not lose sight of the fact that it is inequality nonetheless: recent gains in homeownership for underserved markets have come with a price.

Specifically, we describe recent trends in subprime and manufactured housing lending. By providing loans that traditional lenders have been reluctant to make, both types of “specialized” lending can be praised for expanding homeownership opportunities. Manufactured housing in particular has made homeownership possible for many who could otherwise never afford it. But, each of these has its drawbacks. We illustrate the increasing importance of each of these forms of

¹ For convenience, the U.S. Department of Housing and Urban Development will be referred to as HUD throughout most of the text.

lending via a case study analysis of home finance lending in Indiana during the years 1992-1999. We describe how and why inequality in homeownership has changed across time, how the old inequality helped to make the new inequality possible, and how the new inequality in home mortgage lending is part of a much larger phenomenon in which apparent gains made by minorities and low income groups have come at a far higher cost than gains made by other segments of society.

The Old Inequality: Redlining and Denial

The Nature & Extent of the Old Inequality. A good portion of the 20th century was characterized by legal and official discrimination and inequality. During the 1930's, the Federal Housing Administration (FHA) promoted the use of color coded maps to indicate the 'credit-worthiness' of neighborhoods. Neighborhoods with white and black residents were typically considered less credit worthy than their all-white counterparts (Farley and Frey 1994). Racially mixed neighborhoods were highlighted on maps in red, which led to the current term 'redlining' (Farley and Frey 1994).

The discriminatory practices inherent in federal mortgage lending policies and agencies continued to promote housing segregation after World War II. Federal agencies strongly endorsed redlining, and the ethical standards of the National Association of Real Estate Boards actually prohibited its members from introducing minorities into white neighborhoods (Farley and Frey, 1994). Then, with the passage of the 1968 Civil Rights Act and Equal Opportunity Act, mortgage discrimination based on race became illegal.

Nevertheless, various authors have made it abundantly clear that whites and blacks experience different results when it comes to obtaining a home mortgage. Ross and Yinger (1999b) identify several types of research that have been done on home mortgage lending. Two of the most common have been studies of *outcome-based redlining* and *loan denial*.

Outcome-based redlining is said to occur when minority neighborhoods receive a smaller flow of mortgage funds than comparable white neighborhoods. For example, in a study of Baltimore, Shlay (1987) concluded that racial composition played a large and independent role in explaining disparities in residential mortgage distribution among neighborhoods. Dedman (1988) discovered that between 1981 and 1986, Atlanta financial institutions made five times as many home loans per 1,000 housing units in white neighborhoods as in black neighborhoods having a similar income level. Studies of several other cities have also shown large racial differences in home mortgage lending across neighborhoods (see Nesiba, 1996, for a review). Based on such research, Massey and Denton (1993) conclude that

Despite the diverse array of characteristics that have been controlled in different studies, one result consistently emerges: black and racially mixed neighborhoods receive less credit, fewer federally insured loans, fewer home improvement loans, and less total mortgage money than socioeconomically comparable white neighborhoods. (P. 106)

Loan denial studies, on the other hand, take a more individual-level approach, examining intergroup differences in loan denial. Numerous studies have shown that blacks have much higher denial rates than seemingly-comparable whites (e.g. Schaefer and Ladd, 1981). Throughout the 1990s the loan rejection rate for blacks seeking conventional home purchase

mortgages was twice the rate for whites (Ross and Yinger, 1999b). As Ross and Yinger (1999b) point out though, most studies of loan denial have lacked information on the credit histories of applicants. They note that this is important because minority applicants often have poorer credit histories than do white applicants. Hence, studies may overstate the impact of discrimination or even make false claims that it exists when it does not.

Many therefore regard the Federal Reserve Bank of Boston's "Mortgage Lending in Boston: Interpreting HMDA Data" (Munnell, Tootell, Browne, and McEneaney, 1996) as the most persuasive study of racial discrimination in residential lending. Like many other researchers, the Boston Fed uses data that lenders are required to provide under the Home Mortgage Disclosure Act (HMDA). This includes information on the demographic characteristics of the applicant and the property to be purchased, but does not include credit history or other key variables. But, rather than using HMDA data alone, these researchers supplement HMDA with actual loan application data from Boston-area financial institutions, adding the variables that lenders themselves identified as important for making their decisions. The authors conclude that even if two mortgage applicants are identical financially, a minority applicant is 60 percent more likely to be rejected than a comparable white applicant.

As Ross and Yinger (1999a) point out, the Boston Fed study has been subjected to a phenomenal and perhaps unprecedented amount of criticism. Critics have argued that the data had errors, variables were omitted, and that models were mis-specified in various ways. Based on their own re-analysis of the data, Ross and Yinger find that, on some points, the critics are simply wrong; but in other cases, the Boston Fed study could overstate discrimination. Nevertheless, Ross and Yinger conclude that the Boston Fed study builds a *prima facie* case that discrimination exists, and that no critic has demonstrated that the observed intergroup differences in loan approval can be justified in business terms. Based on her review of the literature, Ladd (1998) similarly concludes that the Boston Fed Study provides persuasive evidence that Boston area lenders discriminated against minorities in 1990.

Consequences of the Old Inequality. The consequences of the old inequality have been well documented. Even though studies show a widespread desire across demographic groups for achieving homeownership (Fannie Mae Foundation, 1998), both higher income and lower income minorities are less likely to own their own homes than white households with comparable incomes (HUD, 1995a). Similarly, homeownership rates are much lower in cities than in suburbs (50% versus 73.2%) and central city residents of all income levels are less likely to own a home than suburban residents with similar incomes (HUD, 1999).

These disparities are unfortunate, because the benefits of homeownership to both individuals and society are well known. Home ownership is one of the primary means for accumulating wealth in the United States. Homeowners enjoy better living conditions than renters and have a higher sense of overall well being (Turner and Skidmore, 1999). Additionally, homeowners tend to be more involved in their communities, helping to promote strong neighborhoods and good schools (Turner and Skidmore, 1999; HUD, 1999). Finally, home ownership contributes to economic growth through the construction of new homes, the rehabilitation of old ones, and by creating demand for household goods and services (HUD, 1995a).

Feagin (1999) discusses how blacks in particular have been hurt by their lack of homeownership. According to Feagin, studies show that “Discrimination [by lenders and appraisers] affects all African Americans, including middle-class African Americans, wherever they buy homes” (p. 82). He further claims that, because discriminatory practices limit the ability of Black Americans to build up housing equity, “Black parents often have been unable to provide the kind of education or other cultural advantages necessary for their children to compete equally and fairly with whites” (p. 86).

As Massey and Denton (1993) note, another related consequence of housing inequality has been racial segregation and the problems associated with it. Pervasive discrimination systematically channels money away from integrated areas, causing blacks to be the most spatially isolated population in U.S. History. Residential segregation, in turn, has also led to class segregation for blacks. While poor whites are seldom highly concentrated, poor African American families are likely to live in census tracts where approximately 30% of the families are poor. This racial and class segregation builds “mutually reinforcing and self-feeding spirals of decline into black neighborhoods” (Massey and Denton, 1993, p.2). Massey and Denton therefore conclude (p. viii) that “racial residential segregation is the principal structural feature of American society responsible for the perpetuation of urban poverty and represents a primary cause of racial inequality in the United States.” Feagin (1999) makes similar claims, arguing that housing discrimination and the residential segregation it produces has created barriers to jobs and has isolated whites from blacks, severely limiting whites’ understanding of critical racial issues.

Recent Changes in Inequality. The old inequality has been around for many decades. However, there seems to have been dramatic change in the home mortgage market in recent years.

The proportion of total mortgage lending going to lower income families and minorities increased substantially during the 1990s. From 1993 to 1999, the number of home purchase loans to Hispanics rose 121.4%; to Native Americans, 118.9%; to blacks, 91%; to Asians, 70.1%; but for whites, the gain was only 33.1% (Federal Financial Institutions Examination Council, 8/8/2000; Day, 8/9/2000). As a result, the homeownership rate for minorities grew about twice as fast between the end of 1994 and September 2000 as did the homeownership rate for the nation as a whole (HUD, 10/26/2000).²

Thanks to these gains, in September 2000 homeownership rates were at an all time high for central cities (51.9%), minorities (48.2%), Hispanics (46.7%), and households with less than the median income for the quarter (52.2%). While it did not break the record (which was set earlier in the year), the Black non-Hispanic homeownership rate of 47.3% was substantially higher than the 42.9% rate of four years earlier (HUD, 10/26/2000).

This progress must be kept in perspective. While minorities, central cities, and lower-income individuals made advances, they continued to lag well behind the nation as a whole, where the overall homeownership rate was 67.2%. Given that relatively few members of any group or race

² In the fourth quarter of 1994, the national homeownership rate was 64.2%; in the third quarter of 2000 it was 67.7%. Hence, the increase in the national homeownership rate was $67.7\%/64.2\% = 1.0545$ or 5.45%. For minorities, the corresponding calculation is $48.2\%/43.7\% = 1.103$ or 10.3%. For black, non-Hispanic it is $47.3\%/42.9\% = 1.103$ or 10.3%.

buy a house in any given year, if current trends continue it will still take several years for past inequalities to be eliminated. Nevertheless, after decades of receiving relatively few home purchase loans, it is striking that minorities and other members of underserved markets have now suddenly started to do so much better.

It will be important to see whether the 2000 census shows that changes in homeownership have also been accompanied by changes in racial and class segregation. However, there is already some limited evidence to suggest that this could be the case. In a study of hypersegregated St. Louis during the early 1990s, Macdonald (1998) found that trends towards greater residential integration had accompanied recent mortgage market reforms. As black application and approval rates went up, blacks became more likely to apply for loans in predominantly white tracts.

Economic Versus Sociological Explanations. Why has racial, economic, and geographic inequality in home mortgage lending persisted for so long – and why have there been such dramatic changes in such a relatively short period? In order to answer that question, it is important to first understand that the American finance industry has undergone major changes in just the last few decades.

As Campen (1998) notes, prior to 1975, the finance industry was highly compartmentalized, with different types of institutions providing specific services and only limited competition with each other. Thrift institutions provided three-fifths of all home mortgage loans. By the 1990s, however, lending institutions were far less specialized, and thrifts were only the third largest provider of home mortgages, behind mortgage companies and commercial banks.

These changes were largely a result of banking deregulation, which increased the range of products and services that could be offered by banks and other financial institutions, eliminated interest rate ceilings, and greatly expanded the geographical areas in which individual companies could operate. As a result, the banking industry became far more competitive, and not all institutions were able to survive. Between 1983 and 1992, an average of almost three commercial institutions *a week* failed, compared to an average of about five *per year* in the 1960s and 1970s. Bank failures combined with mergers have resulted in a forty percent decline in the number of banking institutions in the past twenty years, with most of that decline occurring just since 1993 (Avery et al, 1999).

What are the implications of this restructuring for low income and minority borrowers? Classical economic theories and contemporary sociological network theories offer very different answers.

As Nesiba (1996) notes, classical economic perspectives generally deny that discrimination in lending exists in the first place – or that if it does, they say it will not persist for long. For example, according to Becker (1957), discrimination is a taste for which an individual must either pay or forfeit income in order to have the privilege of not associating with certain persons. Lenders who unfairly reject or charge higher rates to minority group members will eventually be driven out of the market by their competitors.

Hence, according to Becker's and other classical economic perspectives, biased lending patterns are generally not a result of prejudice. Rather, they are rational actions taken by lenders as they try to minimize their risks and maximize their profits. Should the underlying economic basis for these actions change, the biased lending patterns would presumably change as well. If, by some chance, a lender does engage in discriminatory actions for non-rational reasons, that lender will be economically punished and eventually driven out of the market.

Nesiba (1996) challenges these economic arguments and offers several critiques. For example, theoretically, he takes exception to Becker's notion that discriminatory lenders will be forced out of the market. It would be irrational for a small lender to try to make loans in an area that was being discriminated against by big lenders. This is because the small lender would be unable to stop the decline in home values caused by the big lender's redlining behavior. A market leader's beliefs can hence create a self-fulfilling prophecy.

Empirically, Nesiba cites, as we do, the long-standing research in home mortgage lending that implies that discrimination does exist. With empirical trends having recently changed, however, the possibility arises that, thanks to deregulation, markets are finally starting to operate the way economic theorists said they always should. According to this view, legal limits on the range of services lenders can offer and on the geographic areas in which they can operate have artificially constrained competition. Now, freed from excessive government regulation, new lenders are finally starting to reach out to the markets that have been ignored in the past. Supporters of this view say that freeing up the market geographically leads to increased competition, increased services, improved credit availability and a more efficient allocation of financial resources (Mengle, 1990; Evanoff and Fortier, 1986). As a result, the economy as a whole, including small businesses, minority neighborhoods and taxpayers are all better off with fewer, larger financial institutions.

Hence, classical economic theories offer one possible and very positive explanation for recent increases in lending to underserved markets. Tillman and Indergaard (1999), however, present a theoretical perspective that offers a radically different interpretation for the possible effects of finance industry change.

Tillman and Indergaard (1999) use sociological theories of networks to explain how economic restructuring in an industry can lead to crime and exploitation. They specifically focus on fraud in the health insurance industry, but the potential implications of their perspective go far beyond that. They raise several issues that may be relevant for the home mortgage finance industry.

As Tillman and Indergaard explain (p. 574),

Social networks and institutions allow market actors to anticipate the motives and behaviors of potential partners (Fligstein 1997; Granovetter 1985; Tilly and Tilly 1998). In their absence, actors likely will need intermediaries but will have little basis for evaluating the trustworthiness of potential agents.

Tillman and Indergaard further argue that, with economic restructuring, corporations "have abandoned markets or segments where they once supplied products or services;" and that "such changes and related regulatory shifts are creating opportunities for crimes that cannot be

explained by theories grounded in an earlier period.” More specifically, they argue that market shifts disrupt networks. Social ties and understandings that guide transactions are eroded. Further, deregulation in an industry can create the opportunity for widespread misdeeds. New market actors can step in and exploit the situation. While they may be “untrustworthy agents,” they can gain trust because they are being evaluated by individuals who are at a structural disadvantage. These untrustworthy agents, or “bogus brokers” as Tillman and Indergaard call them, benefit from having information denied to other parties. The disrupted economic context in which they operate, regulatory shifts, and ambiguous laws make it difficult for regulators and prosecutors to control their activities.

Tillman and Indergaard were specifically talking about issues of crime and fraud in the health insurance industry. As we will see, crime and fraud are issues in home mortgage lending today, but we do not want to use such language to describe all of the changes that have occurred in the home finance industry. Nor do we want to claim that classical economic perspectives are without merit, because we do believe that many members of underserved markets have benefited from industry changes. Nevertheless, we believe that the Tillman and Indergaard perspective helps to supplement and provide an alternative to classical economic theory in explaining how underserved markets have been affected by recent changes in the finance industry. While generally not illegal, industry changes have nonetheless made it possible for new forms of inequality to develop. As we show next, economic restructuring and the disrupting of old networks have created additional opportunities for loans to underserved markets, but the nature of these loans is often very different from those made to other borrowers.

The New Inequality: Subprime Lending and Manufactured Housing

In the Boston Fed Study (Munnell et al, 1996) the authors early on state one of their critical assumptions.

It is assumed that both the mortgage rate and the rate at which lenders borrow are set by competition in the industry. Since the choice variable for the lender is not the interest rate but whether to grant the mortgage at all, mortgage applications are accepted or rejected at the mortgage market rate (p. 27).

That assumption may have been largely true in 1990, when the authors collected their data. But, it is certainly not true today. Lenders can and do vary the interest rates they charge their customers. Rather than be rejected, as they have been in the past, many borrowers can get a loan, if they are willing to pay a higher interest rate and/or buy cheaper forms of housing. Subprime and manufactured housing lending (collectively referred to as “specialized lending”) have made this possible. We discuss each of these in turn.

Subprime Lending. Subprime lending has historically referred to loans where a borrower has a blemished (or non-existent) credit record and a lender makes a higher fee, higher interest rate loan to compensate for the greater risk of delinquency and higher costs of loan servicing and collection. Subprime mortgage lending is commonly referred to as “B and C” lending which refers to lenders’ classification of a borrower’s creditworthiness. Although there is some ambiguity to what is meant by subprime mortgage lending, Davidson (1995) and Mahalik and Robinson (1998) agree that loans are characterized as “B and C” when these loans have a greater likelihood of delinquency than the traditional A-rated borrower.

It is difficult to pin down the exact size and rate of increase in B and C loans because a standard definition of subprime or B and C loans does not exist. In addition, lenders lack specific reporting requirements regarding these types of loans (Mahalik and Robinson, 1998). Nevertheless, there is widespread consensus that subprime lending increased dramatically during the 1990s. HUD estimates that home mortgage subprime lending went from \$20 billion in 1993 to \$150 billion in 1998. Perhaps because of differing definitions or methods, Davidson (1995) and Merrick (1999) provide even higher estimates.

While some have praised subprime lenders for providing home ownership opportunities to low income and minority borrowers (Milwaukee Journal Sentinel 5/18/99), others have expressed concern. In particular, there is fear that some subprime lenders engage in “predatory” practices (Immergluck and Wiles, Nov 1999; Bradley and Skillern, 2000; Consumer Reports, July 1998; Goldstein, Oct 1999; Apgar 5/24/2000; Medine, 5/24/2000). These practices include *reverse redlining*, where lenders target minority, elderly and low-income homeowners, charging them high interest rates and fees that are unrelated to the credit risk posed by the borrower; *negative amortization*, where payments are structured so they do not even cover interest, causing the principal balance to increase; *prepayment penalties* that keep borrowers from refinancing at lower rates; *excessive fees*, sometimes exceeding 10% of the loan amount; *loan flipping*, where creditors pressure borrowers to repeatedly refinance their loans (often because they cannot afford the payments on their previous loans), providing the creditor with additional income from points and fees charged; and *asset based lending*, where the loan is based not on the ability to repay but on the equity in one’s home.

According to the Woodstock Institute (Immergluck and Wiles, Nov 1999), these abusive lending practices lead to strains in household finances, worsened credit problems, foreclosures, abandoned homes and blighted neighborhoods. Apgar (5/24/2000) concurs, adding that foreclosures coming out of the subprime market “not only ruin the financial future of individual families, they threaten to destabilize entire communities.”

The topic of “reverse redlining,” the targeting of borrowers for reasons other than the quality of their credit (Goldstein, Oct 1999), has been of particular concern to policymakers and researchers lately. A study of Chicago done by the Woodstock Institute (Immergluck and Wiles, Nov 1999) found that lenders active in white and upper income communities tended to be much less active in lower income and minority neighborhoods. Lenders active in lower income and minority areas tended to be mortgage and finance companies subject to less regulation than banks and thrifts. As a result, 90% of whites in Chicago borrowed from prime lenders; but even in middle income neighborhoods, 50% of middle-income blacks borrowed from subprime lenders.

Further, it may also be the case that blacks and whites are treated differently when they apply to subprime lenders. Preliminary tests of lending discrimination done by the National Fair Housing Alliance indicate that creditworthy whites who approach subprime lenders are referred more often to prime lenders, who offer better terms. Creditworthy blacks are not given this advice (Dedman, 11/14/1999).

The less desirable aspects of subprime lending might be worth it to many borrowers if that was the only way they could get a home. But, what makes things even worse is that many borrowers

have no need to be in the subprime market in the first place. David Medine (5/24/2000), the Associate Director for Financial Practices of the Federal Trade Commission's Bureau of Consumer Protection, says that many of those living in areas where traditional banking services are in short supply (e.g. lower-income and minority neighborhoods) tend to turn to subprime lenders regardless of whether they would qualify for less expensive loans. Franklin Raines, CEO of Fannie Mae, estimates that about half the borrowers in the high-cost subprime market could qualify for lower-cost conventional financing (Raines, 2000). Based on market trends, Williams, McConnell and Nesiba (2001) argue that subprime lenders in Indiana may have recently stolen away borrowers who otherwise would have gone to more traditional lenders.

When assessing the above issues concerning subprime and predatory lending, several caveats need to be kept in mind. First, subprime lending need not be predatory. For those who do not meet the credit standards of the prime market, subprime lending can make it possible to buy a new home, improve an existing home, or refinance their mortgage to increase cash on hand (HUD, April 2000). Further, above average interest rates are not in and of themselves evidence of predatory lending. Such rates may simply reflect the greater risks associated with subprime lending (Goldstein, Oct 1999). According to Goldstein, lending becomes predatory when it preys on borrowers lack of information to manipulate them into loans they cannot afford or which have terms that are significantly less advantageous than a loan for which they are qualified.

Second, the greatest attention and concern about predatory lending has been with regards to home refinance. In refinance loans, borrowers run the risk of losing part or all of the equity they have built in their homes. Equity-rich homeowners, such as the elderly, or the forty percent of people with incomes below the poverty level who own their own homes, are said to be favorites of predatory lenders (Goldstein, Oct 1999; Consumer Reports, July 1998). Nevertheless, home purchase borrowers also stand to suffer from subprime loans if they pay unnecessarily high interest rates or excessive fees. Further, as we will see, one cannot adequately understand recent trends in home ownership without considering the increasingly important role played by subprime lenders. Therefore, while most subprime lending studies focus on refinance loans, we think it is important to look at both home purchase and refinance lending.

Third, as Goldstein (Oct 1999) notes, it is difficult to know just how prevalent predatory practices are. Consumers may not realize they have been treated unfairly, and if they do, they may not report it. Hence, there has been debate about how common predatory lending is. Hugh Miller (6/15/99), the President and Chief Executive of Delta Financial Corporation, attacks the "myth" of predatory lending. He claims that lenders lose thousands of dollars every time they foreclose or make loans that people cannot afford.

Others, however, strongly disagree. The Inner City Press, for example (1999; also see Lee, May 1999) points out that Delta Funding (a wholly owned subsidiary of Miller's Delta Financial) has been the subject of numerous legal actions. In August 1999, Delta was sued for discrimination by the New York State Attorney General, who asked that the company be placed in receivership because it was unlikely to alter its lending practices. Only a few months earlier, Delta paid \$6 million to alleged victims of biased and predatory lending. Delta has also been the subject of several other legal actions. Goldstein (Oct 1999), Fagan (10/14/1999), Consumer Reports (July

1998), and Apgar (5/24/2000) cite several other instances where borrowers have been abused or lenders sued over their practices.

Many in Washington agree that problems are widespread. In testimony before Congress, William Apgar (5/24/2000), HUD's Assistant Secretary for Housing, said there could be little doubt that predatory lending practices are on the rise. The most dramatic evidence of this, he argued, is a recent doubling of foreclosure rates, with subprime lenders accounting for a large share of the increase. Apgar further claimed that

Predatory lenders target untold numbers of the most vulnerable homeowners... loading them down with debt, and stripping them of equity...for millions of low- and moderate-income families, minorities, seniors, and others not served well by the primary market place, predatory lending threatens to turn the American dream of homeownership into an American nightmare.

Similar sentiments are heard across the country. Maryland Senator Barbara Mikulski calls the rise in predatory lending "a virus and it's spreading nationwide" (The Times Online, 3/30/2000). In hearings before the New York State legislature, Assemblyman Scott Springer stated "Examples of people scammed by mortgage brokers abound" while Pamela Sah of South Brooklyn Legal Services claimed "the problem is enormous" (Timmons, 6/9/99). Bill Brennan of the Atlanta Legal Aid Society contends that "the subprime mortgage-lending industry is riddled throughout with abusive, predatory lending practices" although those practices are not always illegal (Consumer Reports, July 1998).

Concern has also been expressed about the growing ties between traditional and subprime lenders. For example, citizen groups have protested Wells Fargo's proposed acquisition of First Security Corp. Based on analysis of 1999 HMDA Data, Inner City Press Executive Director Matthew Lee claims that "Wells Fargo redlines communities of color across the United States" and then "targets these communities with high interest rate subprime loans" (Garver, 8/8/2000). Protests have also been raised about Citigroup's planned acquisition of Associates First Capital Corp. Associates, a subprime lender that was founded in Indiana, has been named in more than 700 private lawsuits (Oppel and McGeehan, 10/22/00). Brennan of the Atlanta Legal Aid Society claims that "Associates is the worst predatory lender in America, and it's outrageous that the biggest, most powerful bank in America is buying it" (Julavits, 9/11/2000).

In both of the above cases the companies involved have either defended their practices or promised to make reforms. Nevertheless, rightly or wrongly, such complaints seem to be increasingly common. For example, a recent report by the U.S. General Accounting Office (1999; also Brockman, 11/17/99) noted that predatory lending issues were raised in five of six bank mergers studied.

At a minimum, the fact that as many as half of all subprime borrowers could get better interest rates elsewhere is a cause for concern (Raines, 2000). When combined with the apparent use of predatory practices by some, and the racially disparate impact of subprime lending, these concerns become even greater.

Manufactured Housing. Manufactured housing (MH) has provided another avenue by which underserved markets have gained access to homeownership. Like subprime loans, the interest

rates on manufactured home loans tend to be higher. But, the lower costs of manufactured homes still make them an attractive option to many.

Manufactured homes, also often called (although not always correctly) mobile homes, are built in factories according to national standards, transported to a location on its own wheels, and installed semi-permanently to the location with steel straps (Bradley 1997; Consumer Reports, Feb 1998). Though they are built with wheels, the majority of such homes remain in one location (Bradley 1997). Federal law enacted in 1976 and 1994 regulates the home's design, construction, strength, energy efficiency and quality, which differ from those applied to conventional housing.

Manufactured homes are more affordable than traditional houses. For those who purchased their manufactured homes in 1998, the average cost (not including land) was \$43,800. The average cost of site-built homes in 1998 (again excluding land) was \$136,425 (Manufactured Housing Institute, 2000b and 2000c). Such price differences were not unique to 1998. As Vermeer and Louie (1997) note, average sales prices for new, single-family site-built housing units have historically been nearly four times higher than prices for new manufactured homes. This, of course, partly reflects differences in unit size, quality, and other factors. But, price estimates that combine structure, transport, installation, land, and site development costs suggest that the total purchase price of a manufactured home may be as little as 75% of the cost of a site-built home of comparable size and quality.

Manufactured housing is cheaper for several reasons. High-volume buying, factory line production, a limited number of floor plans and design options, and the need for a less skilled work force are all factors that help to reduce costs (Vermeer and Louie, 1997). For some purchasers, affordability is further enhanced by the fact that borrowers can make as little as a 5 percent down payment on most manufactured homes (Consumer Reports, Feb 1998).

The early manufactured homes were of poor quality, with most homes built before 1980 lasting only a decade (Bradley 1997). However, the construction and materials used in manufactured homes have improved in recent years (Consumer Reports, Feb 1998), and current "factory-built" homes should last forty to fifty years (Bradley 1997). In addition to more durable materials and construction, manufactured homes currently come with more features than in the past. Their size has also increased, reaching a median size of 1355 square feet by 1997 (Bradley 1997).

After years of declining sales, manufactured housing enjoyed a rebirth in the 1990s. According to the Manufactured Housing Institute (2000b), in 1970 401,190 manufactured homes were shipped nationwide. By 1991 manufactured homes shipments had fallen to 170,713, a decline of 57 percent in a little more than two decades. However, from 1991-1996, shipments of manufactured houses steadily increased. They reached 363,411 shipments in 1996, an increase of 113 percent in 5 years. Shipments were slightly lower in 1999, at 348,671 homes, but manufactured homes still constituted 20.7% of all new single-family housing starts (Manufactured Housing Institute, 2000a).

Today, approximately 19 million people live full-time in over eight million manufactured homes across the nation (Manufactured Housing Institute, 2000c). Their demographic characteristics differ sharply from other homeowners. Owners of manufactured homes tend to be older and less

well off financially than homeowners in general. In 1995 the median household income of manufactured-home owners was \$22,000, just slightly more than half the \$42,000 median for all other homeowners. Differences in wealth were even greater, with MH owners having a median net worth of nearly \$27,000 compared to \$117,000 for others (Canner, Passmore and Laderman, 1999).

Many have applauded the recent growth in the manufactured housing market. Professional Builder Magazine (Matesi, Jan 2000), for example, commended the Manufactured Housing Institute for showing that manufactured housing was a practical means of providing desirable, much needed single-family housing at a reasonable price for inner-city residents. A survey done by Consumer Reports (Feb 1998) found that 82% of manufactured housing homeowners were largely satisfied with their dwellings.

Factory-built homes do provide a low-cost housing alternative, and the overall quality of manufactured homes has greatly improved since the 1970s. Nevertheless, concerns persist. Based on its two-year study of the industry, Consumer Reports (Feb 1998) warned that it is still “buyer beware” in the market for mobile homes. Similarly, Joe Perkins (AARP, 1999), President of the AARP (formerly the American Association of Retired Persons) cautioned that

Manufactured housing is affordable housing, but there is more to affordability than a low price. Mobile home buyers are not protected sufficiently now and will not be in the future without tougher standards.

Based on their investigations, Consumer Reports (Feb 1998) and the AARP (1999) identify a number of concerns with manufactured housing. First, there are often problems with the construction, installation and safety of manufactured homes. The AARP found that three quarters of the manufactured home owners it surveyed reported significant problems with their homes. While 95% of the homes carried a warranty, only a third of the homes with problems were successfully repaired under that warranty. Commenting on the AARP findings, George Corey, a technology consultant who helped write the 1974 law on manufactured housing, claimed that “People would be outraged” if three quarters of those who bought \$35,000-\$40,000 cars reported problems with them (Fleishman, 10/2/99).

Consumer Reports (Feb 1998) also found that a majority of manufactured home owners reported at least one major problem. According to the state and federal regulators that Consumer Reports talked to, manufactured homes are often installed incorrectly, resulting in more than half the problems that consumers report. Poor installation can lead to major safety problems: for example, when Hurricane Andrew hit Florida in 1992 half the mobile homes in the southern part of Dade County were destroyed compared to only 28% of the contractor-built homes. Earthquakes in Southern California in 1994 produced similar destruction. Yet, as Consumer Reports notes, there are no federal guidelines on the installation of manufactured housing, and only 23 states license or certify installers.

Based on such problems, the AARP concludes that there is a critical deficiency in the quality assurance regulations administered by HUD and that consumers are being hurt by a lack of construction and safety standards enforcement. Consumer Reports similarly argues that regulations on the construction of manufactured housing have not had a major overhaul in 20 years and badly need to be upgraded. (As we will discuss later, the Manufactured Housing

Improvement Act, passed in December 2000, will attempt to address some of these issues in coming years.)

Second, the low purchase costs of manufactured housing are partially offset by higher costs elsewhere. Insurance premiums may be 20% higher than for a traditional home. The interest rates for manufactured homes average 3 percentage points more than most fixed-rate mortgages (Bradley 1997; Consumer Reports, Feb 1998). Most manufactured and/or mobile homes are not permanently attached to a foundation and hence do not meet the underwriting standards for a standard mortgage loan.

Also contributing to higher interest rates is the fact that, as Mortgage Marketplace magazine (9/7/98) points out, there is very little competition in the manufactured housing finance industry, with relatively few lenders being active. Even though they receive government benefits worth billions of dollars and are supposed to promote homeownership in exchange, the Government Sponsored Enterprises Fannie Mae and Freddie Mac have historically had little to do with manufactured housing loans. As a result, many manufactured home owners are stuck with loans at high interest rates, even though their credit is good and they have been in their homes for years (Mortgage Marketplace, 9/7/98). The GSEs have been criticized for this lack of involvement: for example, Congressman Barney Frank (9/7/98) argues that manufactured housing owners are generally not wealthy, and they deserve the same sorts of benefits that the GSEs provide to other segments of the American Housing Finance system.

Third, Consumer Reports (Feb 1998) found that half the homeowners in their survey leased the land on which their homes were located. This left them vulnerable to sudden and sometimes dramatic rent increases. Owners who cannot afford such increases must either pay to move their homes or else sell them, often to their landlords at distress prices. Also, because they must approve new tenants, abusive landlords can set up roadblocks to sales and force owners to sell their homes to park operators at a discount (Hill-Holtzman, 11/18/1999). In Florida, 40,000 people signed petitions to Governor Jeb Bush complaining about chronic, unfair rent increases (Smith, 11/28/1999). Consumer Reports (Feb 1998) and Patty (1/24/1999) offer several anecdotal examples of abusive landlords.

Finally, the resale value for used factory-built homes has historically been low (Consumer Reports, Feb 1998). Consumer Reports found that two-thirds of its survey respondents said their homes would sell for less than they had paid for them. Some, however, contend that this is changing, particularly for homes with fixed foundations (Baldwin, 1999).

In short, the rise of manufactured housing has been both beneficial and problematic. For many, it has made home ownership affordable. At the same time, inadequate federal regulations and a lack of consumer protection have exposed many home owners to problems that might have been avoidable.

Assessing the New Inequality

Several recent studies have examined various aspects of subprime and manufactured housing lending. Some have provided descriptions of changes in the volume of specialized lending across time (Scheesele, 1999; Canner, Passmore and Lademore, 1999). Others have provided

descriptive snapshots of subprime lending nationwide, particularly refinance lending, in a single year (HUD, April 2000). Still others have been case studies of subprime lending in a single city in a single year (HUD, May 2000a through 2000e; Immergluck and Wiles, Nov 1999).

Our study contributes greatly to this discussion. We analyze a state, Indiana, which is both larger than many of the individual cities that have been studied in the past and that is also more representative of the nation as a whole. Through a longitudinal analysis of both subprime and manufactured housing lending and both home purchase and refinance loans, we provide one of the broadest empirical examinations to date of the tremendous impact specialized lenders have had on home ownership for low income and minority neighborhoods and individuals. In particular, we show that, while both subprime and manufactured housing lenders have greatly increased their number of loans to underserved markets as a whole, there have been major racial differences in the groups they have dealt with. We further show that income alone cannot account for racial differences in the types of borrowers served by specialized and traditional lenders. Perhaps most critically, we place these developments in a sociological, historical and theoretical perspective that has been missing from the public debate.

Study Design /Methods and Data

This section is divided into three parts: (1) definition of types of underserved markets, (2) demographic information about Indiana MSAs, and (3) description of data sources.

Types of Underserved Markets. Different authors define underserved markets in various ways. For our purposes, we will use official government definitions outlined by HUD and then supplement them with other commonly used definitions. These definitions were originally outlined by HUD in its Final Rule (1995b) for setting up lending guidelines for Government Sponsored Enterprises but they provide a convenient and reasonable means for assessing the performance of other types of lenders.

In *Very low income families*, income is not in excess of 60 percent of area median income. For *Low income families in low income areas*, family income is not in excess of 80 percent of area median income, and the median income of the census tract does not exceed 80 percent of the area median income. *Targeted (or underserved) areas* are central cities, rural areas, and other underserved areas. More specifically, a “central city” or “other underserved area” is a census tract with a median income at or below 120 percent of the metropolitan area and a minority population of 30 percent or greater; or, a census tract with a median income at or below 90 percent of median income of the metropolitan area. Because these categories often overlap and because we found that lending patterns and trends for one of the underserved markets were often similar for the others, we combine the above into a single category we call *Final Rule Underserved Markets*. That is, any very-low-income-borrower, or any low-income-borrower in a low-income area, or anyone seeking to buy property in a targeted area, is considered a member of a Final Rule Underserved Market.

The three underserved markets listed in the Final Rule primarily emphasize economic factors in defining markets. To these, we add two race-related underserved markets that are often examined in studies of home mortgage lending. Following practices used in published government Home Mortgage Disclosure Act reports, we define a loan application as *Black* if the

applicant is black and the co-applicant (if any) is not white³. *Minority neighborhoods* are defined as census tracts that are more than 30 percent non-white.

These race-related markets have received enormous attention in home mortgage lending research; but again, there is overlap between these markets and the ones defined in the Final Rule. As we will see, however, there are important differences in how subprime and manufactured housing lenders relate to these minority markets.

Indiana MSAs. This study consists of a detailed statistical analysis of all MSAs in the State of Indiana. Indiana represents one of the largest and most geographically diverse areas that has been studied in the home mortgage literature (other than national studies, which tend to address a narrower range of issues). Many reports have been done of individual cities, such as New York, Los Angeles, Chicago, Boston, Baltimore and Detroit (see Nesiba, 1996, for a review). Indiana is larger than most of these; indeed, if the metropolitan areas of Indiana were a single city, it would be the second largest in the United States, about the same size as Los Angeles. Further, multi-city studies often look only at large metropolitan areas (see, for example, Milczarski, Myers and Silver, 1998); Indiana, on the other hand, has MSAs that range in size from as little as 96,000 to over 1.2 million.

In addition, as a whole Indiana is fairly representative of the entire United States. According to the 1990 Census, the population of Indiana was approximately 5,540,000⁴, or about 1/50th of the nation's population. Indiana 1990 average family income of \$34,082 was similar to the national median family income of \$35,225. The state also ranks roughly in the middle nationally on percentage of population living in Metropolitan areas (71 percent – #23 among all states), percentage of persons below the poverty level (13 percent – #19), employment to population ratio (63 percent – #32), and average individual annual pay of \$21,700 (#24). The state as a whole is somewhat less diverse than the nation in terms of its racial and ethnic population, but within the state there is great variability. In 1990, only 1.8 percent of Indiana residents were of Hispanic origin, compared to 8.8 percent nationwide. Also, 7.8 percent of the Indiana population was African American compared with 12.3 percent nationwide. However, within Indiana both the Gary and Indianapolis MSAs, with almost 2 million people between them, had African American populations that exceeded the national average.

We hasten to add, though, that just as it is difficult to tell how prevalent predatory and abusive tactics are nationwide, it is even more difficult to tell how common such practices are in a specific state. We have chosen Indiana, not because we have reason to think that lending abuses are particularly severe or even typical there, but because demographically it reflects the nation as a whole. Certainly, complaints and concerns have been raised about predatory lending in the state (Venetis, 8/7/2000; Lipp, 8/17/2000; Johnson, 3/19/2000). Further, some of the lenders who have been accused of abusive practices in other parts of the country are also active in Indiana. But, as is the case nationwide, even if there were no abusive or predatory tactics in the state, the fact that so many borrowers are turning to specialized lenders, especially when many might be able to get better terms elsewhere, makes the state worthy of study.

³ Previous analyses of ours have shown that, with regards to denial rates and other important factors, “joint” applications (black and white co-applicants) are much more similar to “white” applications (both applicants white) than they are to “black” applications (black applicant and black or other minority co-applicant).

⁴ About two-thirds of Indiana's population live in one of the state's thirteen MSAs that are studied in this analysis.

Data. Data were collected for each of the years 1992-1999, which, as we will see, was a period of rapid and dramatic change in home mortgage lending. Data came from several sources.

HMDA LOAN APPLICATION REGISTERS AND TRANSMITTAL SHEETS. Starting in 1990, most lenders were required to provide information on every home mortgage application they received. The information includes the type of loan (conventional, FHA or VA), the requested amount, the final disposition of the application (e.g., approved, denied, withdrawn, not accepted), the census tract in which the desired property was located, and the income, race and gender of the applicant(s). The HMDA transmittal sheets (one record per lender per year) indicate the lender's name, address, and parent company (if any).

CENSUS TRACT DATA. Census tract data makes it possible to identify underserved areas and whether or not an individual's income is low relative to the area he or she lives in. Census tract data in this study comes from several sources. The HMDA data includes key information on census tracts, making it possible to determine whether a neighborhood is low-income or minority. Following the official HMDA reports, this study uses the MSA median family income when classifying applicants into income categories. These numbers are based on HUD estimates that change yearly. Starting in 1996, HUD started classifying tracts as "targeted" based on the guidelines contained in the final rule.

MANUFACTURED HOUSING AND SUBPRIME LOANS. HUD (2000a) has developed a list of lenders who specialize in subprime and manufactured housing loans. This list can be linked with the HMDA data to identify loans as being either subprime or MH.

A few cautions concerning this list is in order. Unfortunately, the HUD list cannot identify subprime and manufactured housing loans made by traditional lenders. Hence, not all specialized loans will be identified in our analysis. One consequence is that our analysis will, if anything, understate the importance of these loans to underserved markets. However, as the Woodstock Institute (Immergluck and Wiles, Nov 1999) points out, subprime lending done by prime lenders is probably less prone to abuse, since prime lenders also offer lower-cost products, work less with brokers, and are often subject to greater regulatory scrutiny.

Also, given that HUD did not begin coding lenders until 1996, one can surmise that its application to previous years may have a higher likelihood of being miscoded than does the more recent data. Further, as Scheessele (1999) points out, the rise in the reported number of subprime and manufactured housing loans nationwide may be partially due to the fact that more subprime and manufactured housing lenders are reporting to HMDA than did in the past.⁵ However, the trends we find are consistent with both the industry statistics we cited earlier and with HUD's estimates on the nationwide rise in subprime lending. Hence, we are confident that the primary trends and conclusions discussed here are not materially influenced by any of the shortcomings in the data.

SAMPLE SELECTION. The following criteria were used for selecting loans in our analysis, all of which are common in home mortgage lending research. First, all loans are for owner-occupied

⁵ In separate correspondence, Scheessele indicates that he thinks increased popularity, rather than better HMDA coverage, is the main factor behind the reported increases in specialized lending.

home purchases or for home refinance. Home improvement loans are excluded. Second, loan records with high loan-to-income ratios (6 or above) or missing income data are excluded because they are likely caused by data errors. Third, the case must be from an Indiana MSA, as HMDA data are of little use for studying non-MSA areas. Additionally, the case must include census tract information, as it is necessary to determine whether a loan is to an underserved market. Fourth, only applications that resulted in either originations or denials are included. Withdrawals, loans not accepted, and files closed for incompleteness are excluded, since the disposition of these types of applications may be due to factors not under the control of the lender (e.g. the applicant changes his or her mind about wanting the home). Fifth, we exclude Jumbo loans (mortgages over \$240,000 in 1999). These loans constitute a very small percentage of Indiana home mortgage loans. Finally, we look only at conventional loans and exclude government-backed FHA and VA loans.

RESULTS

Our analysis is three-fold. First, we present trends in number of loans made and in market share in Indiana for the years 1992-1999. We show how specialized lenders have gained an increasing share of the conventional home mortgage purchase and refinance markets, and that these gains have been particularly great among members of underserved populations, accounting for half or more of the advances those groups made in home ownership. Second, we examine how race and income variables are jointly related to specialized markets. In particular, we show that income alone cannot account for differences in the types of lenders used by blacks versus others. Finally, we show that the growth of specialized lenders has had a major impact on loan denial rates. Since, as noted earlier, many studies have focused on denial rates, failure to consider the increasing role of specialized lenders can produce very misleading conclusions.

Trends in # of Loans and Market Share. Table 1 presents the number of loans made by each type of lender to each type of market for the years 1992-1999 in Indiana. The next to last column shows the change in the number of loans made between 1992 and 1999. The final column shows how much of the change in the total number of loans to a market came from each type of lender. Results are presented for all markets combined and for the three types of underserved markets we previously identified: (1) the economically-defined markets listed in HUD's 1995 final rule, (2) blacks, and (3) minority neighborhoods, defined as those census tracts in which 30% or more of the population is non-white. Statistics are presented separately for home purchase and home refinance loans.

Table 1 about here

For home purchase loans, three major findings are immediately apparent.

First, the number of home purchase loans increased during the 1990s, but the greatest gains occurred in underserved markets. Overall, there were 33,471 home purchase loans made in 1992, compared to 52,569 loans in 1999 – an increase of more than 19,000, or 57%. But, during this same period of time, the number of loans to Final Rule Markets (6,901 in 1992, 15,859 in 1999) and minority neighborhoods (947 in 1992, 2,081 in 1999) more than doubled, while the number of loans to blacks (538 in 1992, 1,810 in 1999) more than tripled. Hence, as was the case

nationwide, members of Indiana's underserved markets made disproportionate gains in home ownership during the 1990s.

A second finding is also apparent from the top half of the table: about one half or more of the gains made in underserved markets came as a direct result of increased activity by specialized lenders. Specialized lenders accounted for 39.1% (19.8% for subprime, 19.3% for MH) of all the additional loans made in 1999 as compared to 1992. However, they accounted for more than half of the additional loans that went to Final Rule Markets, almost one half of the additional loans to blacks, and more than two-thirds of the new loans to minority neighborhoods.

Third, while subprime and manufactured housing lenders contributed about equally to the total number of additional loans made overall and to Final Rule Markets, subprime lenders played by far the larger role in the increased lending to blacks and minority neighborhoods. Subprime lenders made 60.6% of the additional loans to minority neighborhoods and 44.8% of the additional loans to blacks. The corresponding figures for manufactured housing lenders were only 7.1% and 2.2%.

Hence, *underserved markets in Indiana made gains in home purchasing during the 1990s; but for about one half or more of those borrowers, the progress came with a price.* At a minimum, most of them probably paid the higher interest rates charged by subprime and manufactured housing lenders. If Raines (2000) from Fannie Mae and Medine (5/24/2000) from the FTC are correct, many of those borrowers could have qualified for a better deal from a traditional lender. Some of those underserved market borrowers may also have encountered, or run the risk of encountering, the other problems we noted earlier, such as predatory lending practices and a lack of consumer protection. In particular, black applicants and applicants from minority neighborhoods may have paid a higher price than was necessary.

The bottom half of Table 1 presents the corresponding results for refinance loans. Unlike home purchase loans, the number of refinance loans does not increase steadily from one year to the next. This is because, for many, the decision to refinance is heavily influenced by interest rates: they refinance because they want a lower interest rate than they are currently paying, and hence will only refinance when rates are lower. It is not surprising then that, when interest rates fell in 1993 and 1998 (Federal Reserve Board, 10/30/2000) the total number of refinance loans increased sharply. It may also be that interest rates have a greater impact on the number of refinancings done by traditional lenders than they have on subprime lenders. Another reason to refinance is to get cash back that can be used for other purposes, and this may be more important than interest rates to those who borrow from subprime lenders.

The importance of interest rates makes across time comparisons of the volume of refinance lending more difficult, and results can differ depending on which years are used for reference. Nevertheless, it is apparent from Table 1 that subprime lenders played an increasingly important role across time in refinance lending to underserved markets and to blacks and minority neighborhoods in particular. In 1999, they accounted for one- half to two-thirds of all the additional loans that went to those markets. The year 1999 is somewhat unusual in that the

number of refinance loans made by traditional lenders plummeted after interest rates increased.⁶ However, the results for underserved markets are similar if 1997 or 1998 are used as the cutoff years instead.

So, for both home purchase and refinance lending, the patterns are the same. Underserved markets made gains in the number of loans they received. But, a substantial portion of those gains, about one half or more, came as a result of increased activity by specialized lenders that are known for charging higher fees and interest rates than traditional lenders.

Table 2 provides another means of assessing the influence of specialized lenders on home mortgage lending in Indiana during the 1990s. Table 2 presents trends in market share of home purchase and refinance loans. It shows how specialized lenders' share of the overall conventional home purchase market has changed across time. Figures 1 and 2 present key information from Table 2 in graphic form for the home purchase loans of subprime lenders and manufactured housing lenders respectively. The results are clear and striking.

Table 2 and Figures 1 and 2 about here

In 1992, subprime and manufactured housing lenders together held less than 2% of the overall home purchase market. These numbers gradually increased, however, and by 1999 specialized lenders held 15.2% of the market. For much of the decade, the greatest growth occurred among manufactured housing lenders. But, in 1998, subprime lenders enjoyed a major surge and were about even with MH lenders in 1999.

The growth did not occur equally among all types of borrowers. As the table and figures show, growth was particularly great in underserved markets. In 1992, specialized lenders made just 3.1% of the loans to final rule underserved markets. By 1999, they controlled almost one third of the market. Again, during most of this time, MH lenders had the larger share, but by 1999 subprime lenders had achieved parity.

As Figures 1 and 2 help to make especially clear, there were both similarities and differences with the trends for blacks and minority neighborhoods. In both cases, specialized lenders held less than 4% of the market in 1992 and over one third of the market by 1999. However, subprime lenders were far more dominant than MH lenders in these minority markets, holding about one third of each by 1999. While manufactured housing lenders made some gains during this period, they actually had much smaller shares of these minority markets than they did of the overall market, suggesting that manufactured housing was less appealing to blacks than it was to whites or other minorities.

The bottom half of Table 2, and Figures 3 and 4, present comparable information for refinance loans in Indiana.

⁶ For traditional lenders, the overall decline in refinance lending between 1998 and 1999 was much greater than the decline in lending to underserved markets. This probably reflects the fact that those who wanted lower interest rates were more likely to do so in 1998 than in 1999. Also, like subprime lenders, in 1999 traditional lenders were probably attracting many borrowers who wanted cash back from their houses. They may have also been getting borrowers who initially financed in the subprime market and could now qualify for the lower interest rates of traditional lenders.

Figures 3 and 4 about here

Shifts were even more dramatic in this segment of the housing market, with subprime lenders clearly dominating the changes. The manufactured housing refinance market was virtually nonexistent in the early part of the decades, and still quite small, less than 2%, by 1999. By way of contrast, after making less than 1% of all refinance loans in 1992, subprime lenders controlled more than 20% of the market in 1999. As was the case with home purchase loans, the gains were greatest among underserved markets. By 1997, subprime lenders were making about one third or more of all the refinance loans to Final Rule underserved markets. But, even more dramatically, *by 1997 subprime lenders were making more than half of all the refinance loans that went to blacks and minority neighborhoods*. Hence, in less than a decade, subprime lenders went from a very small role in minority markets to being the dominant force in them.

Pervasiveness of Racial Disparities Across Income Levels. As the preceding tables make clear, while subprime lenders made major advances in underserved markets between 1992 and 1999, their gains were particularly pronounced in minority markets. As Table 2 shows, in 1999 subprime lenders captured 15.1% of the home purchase lending to Final Rule Underserved markets, but over 30% of the market for blacks and minority neighborhoods. Similarly, by 1999 subprime lenders made about one third of all the refinance loans to Final Rule markets, but more than half the loans to minority markets. One possible explanation is that income differences across races and neighborhoods accounted for differences in the types of lenders that groups turned to. To examine this possibility, Table 3 further clarifies the roles that specialized lenders were playing in minority markets by 1999.

Table 3 about here

The top half of Table 3 presents 1999 specialized lenders' market share broken down by the race and income of applicants. *At every income level, and for both home purchase and refinance loans, blacks are far more likely than others to get their loans from a subprime lender*. For example, at the lowest income level, almost half of all blacks (48.9%) get their home purchase loans from a subprime lender, compared to less than 11% of members from other racial groups. Further, even at the highest income level, blacks are more than four times as likely to get their loans from a subprime lender as are others: 13.6% of higher-income blacks received their purchase loan from a subprime lender compared to only 3% of higher-income members of other racial groups. For refinance loans, blacks are always at least twice as likely as others of comparable incomes to borrow from a subprime lender. Indeed, subprime lenders have captured almost one third of the refinance business of highest-income blacks.

The bottom half of Table 3 provides similar information for minority neighborhoods and applicant income. Again, borrowers from minority neighborhoods at every income level are far more likely to turn to a subprime lender than are borrowers from non-minority neighborhoods.

Table 3 also illustrates the relative weakness of manufactured housing lenders in minority markets. At every income level, blacks are less likely than others to get their home purchase or refinance loan from a manufactured housing lender. The same is generally true for minority

tracts, although there are a few income categories where members of minority tracts are slightly more likely than others to turn to a MH lender.

Hence, the great success of subprime lenders in minority markets reflects, in part, their ability to disproportionately attract members of those markets regardless of income. At every income level, blacks and residents of minority neighborhoods are more likely to turn to subprime lenders than are others. The race and income patterns that the Woodstock Institute (Immergluck and Wiles, Nov 1999) found for Chicago are paralleled in Indiana.

While the above analysis helps to show the pervasiveness of racial differences in specialized market lending, we do not claim that it explains them. For example, as has been done in studies of denial rates, it could be argued that unmeasured individual characteristics, such as credit histories, account for these racial differences. We note several things in response.

First, in loan denial studies, an explanation which could show that there were no racial differences in denial rates once relevant variables were controlled would also serve as a justification for them: blacks are denied more often because, based on their credit histories and other factors, they deserved to be denied more often. With regards to the new inequality, however, completely explaining why there were racial differences would not mean that blacks therefore deserved to pay unnecessarily high interest rates and fees and be exposed to predatory lending practices. Second, given that the Boston Fed study (1996) showed that significant racial differences in denial rates persisted even after all relevant variables were controlled, we strongly suspect that the same would also be true of subprime and manufactured housing lending. Third, the racial differences go in opposite directions for subprime and manufactured housing lending. It is unclear how factors such as credit histories could account for this. In our closing discussion, we will return to this topic, and argue that other sociological and demographic factors likely account for observed racial differences.

Denial Rates. There is one other aspect of lending trends that demands attention. So far, we have focused on market share and numbers of loans made. In effect, this is an analysis of loan applications that were approved. However, as noted earlier, many studies have focused on denial rates, and, in particular, the differences between black and white denial rates. Specialized lenders had a major impact on denial rates, and researchers need to be aware of this if they are to understand denial rate trends during the 1990s.

Table 4 shows the overall denial rates for different types of lenders and markets for the years 1992-1999. Because racial differences in denial rates have been of greatest interest to researchers and policy makers, we will focus on the trends for blacks, which are graphically illustrated in Figures 5 and 6.

Table 4 and Figure 5 about here

As the top half of Table 4 and figure 5 show, the home purchase black denial rate for traditional lenders was fairly steady over the decade. Their denial rate was actually lower in 1999 than it was in 1992 (26.2% in 1992 versus 20.7% in 1999), and 4.4 percentage points higher than 1995 (16.3%), the year in which denial rates were lowest. By way of contrast, the denial rates for all lenders went up much more, from a low of 18.3% in 1995 to 38.1% in 1999. Specialized lenders

accounted for this. Partly, their own denial rates went up a bit, but even more critically, they were getting more and more applications. As a result, their market share went up, and the overall denial rate went up too.

In other words, most of the increases in home purchase denial rates that occurred during the late 1990s were due to specialized lenders. The denial rates of traditional lenders varied only modestly during this time. Specialized lenders, with their high denial rates and increasing market share, caused most of the overall doubling in denial rates that occurred.⁷

Figure 6 about here

The bottom half of Table 4 and Figure 6 show a slightly different picture for refinance loans. Here, the black denial rate for traditional lenders doubled between 1992 and 1999. But, the overall denial rate went up even more. The increasing denial rates for subprime lenders and their increasing market share primarily accounted for this.

Discussion

Previous studies have documented the rise of subprime and manufactured housing lenders during the 1990s. We add to that discussion by distinguishing between different types of lenders and underserved markets, and by discussing the implications of these trends for borrowers. Our study also makes an important theoretical contribution by comparing, contrasting, and ultimately integrating classical economic theories with sociological theories of networks. As we will see, this theoretical contribution goes well beyond just the study of home mortgage lending.

Key Findings. Empirically, three major findings stand out from our study.

First, subprime and manufactured housing lenders dramatically increased their share of the Indiana home mortgage market between 1992 and 1999, with their gains being particularly great among underserved markets. As a result, they accounted for much of the gains in home ownership made by those groups. In 1992, specialized lenders held less than 2% of the overall home purchase market; by 1999 it was 15.2%. Further, by 1999 specialized lenders had captured a third or more of the loans made to underserved markets. *Together, specialized lenders accounted for one half or more of the new loans that underserved markets received between 1992 and 1999.* Gains were even greater for home refinance loans.

Second, there were many similarities in the types of markets served by subprime and manufactured housing lenders. There were, however, major differences with regards to race. Subprime lenders captured a large share of the market for minority borrowers and minority neighborhoods. These gains cannot be attributed simply to racial differences in income. *At every income level, and for both home purchase and refinance loans, blacks and residents of minority neighborhoods were far more likely than others to get their loans from a subprime lender.* Manufactured housing lenders, on the other hand, actually trailed traditional lenders in

⁷ Also, as Scheessele (1999) notes, manufactured home retailers typically send the same application to many lenders simultaneously. Hence, the increase in denial rates is somewhat deceptive because it is produced, in part, by individuals who were denied repeatedly by different lenders but who may have eventually gotten a loan from somewhere.

serving minority markets. While white borrowers may have at least benefited from the lower cost of manufactured housing, black borrowers generally did not.

Third, specialized lenders had a dramatic impact on home purchase denial rates. *The doubling in overall denial rates that occurred during this period of time was almost entirely due to the increased activity of subprime and manufactured housing lenders.* Specialized lenders also had a strong impact on denial rates for refinance loans.

Sociological Implications. What are the substantive implications of these findings? At a minimum, our results highlight methodological issues that researchers need to be concerned about. For example, any analysis of denial rates runs the risk of being highly misleading if the role of specialized lenders is not considered. As we saw, while overall home purchase denial rates rose in Indiana during the 1990s, it was not because traditional lenders were suddenly becoming more demanding. Rather, it was because of the dramatic increase in applications made to subprime and manufactured housing lenders.

Far more critical, however, are the implications of these findings for inequality in home mortgage lending. Inequality in home mortgage lending has historically been characterized by a failure of underserved markets to get home loans. During the 1990s, this old inequality, while still present, started to weaken as specialized lenders helped to produce homeownership gains for underserved markets that outstripped the gains made by others. However, these advances were not quite what they seemed.

To begin with, in general it is unclear whether home ownership produced by specialized lending has the same kinds of benefits as home ownership funded by traditional lenders. We earlier noted the many benefits of home ownership, such as the accumulation of wealth. However, the higher interest rates charged by specialized lenders, combined with the potential loss of equity from subprime home refinance, can work against the accumulation of wealth. Further, as Vermeer and Louie (1997) note, while manufactured homes may be cheaper to acquire, their true costs are unclear because of the uncertainty concerning unit durability and appreciation. Manufactured housing has historically declined in value (Consumer Reports, Feb 1998), although that may be starting to change (Baldwin, 1999).

We also noted that removing barriers to home ownership could reduce racial segregation and the many problems associated with it. But, by targeting minority neighborhoods, subprime lenders may increase rates of home ownership in those areas, but do little to increase racial integration. Manufactured housing draws so few borrowers from minority markets that it is unlikely to be having much of an effect on decreasing segregation. Indeed, our study, and others (Vermeer and Louie, 1997) suggest that the black share of the manufactured housing market is actually declining across time. The 2000 Census will hopefully provide clearer insights as to whether advances in home ownership have been accompanied by declines in racial segregation.

Hence, while home ownership in general is desirable, it is not clear how much of its benefits go to those borrowing from specialized lenders, even when predatory or abusive practices are not present.

In the specific case of manufactured housing, thousands of individuals achieved homeownership via the purchase of lower cost homes, homes that are generally of far better quality than their counterparts of 25 years ago. In exchange, however, some may have risked or experienced installation, construction and safety problems, higher interest rates and insurance premiums, low resale values, problems with landlords, and other consumer protection problems. For many if not most, this still may have been preferable to the apartments or homes they might have otherwise rented or purchased. Nevertheless, potential purchasers of manufactured homes should carefully consider the pros and cons raised by such sources as the AARP and Consumer Reports, and do what they can to protect themselves or find superior options.

Given the rapid growth of manufactured housing, the relative exclusion of blacks from this form of housing may also be a matter of concern. In Indiana, we found that very few blacks received manufactured housing loans, and other studies suggest that the same is true nationwide (Vermeer and Louie, 1997). Perhaps this simply reflects a lack of interest among blacks for manufactured housing, but the reasons for these racial disparities need to be closer examined. To the extent that manufactured housing offered affordable housing, blacks in Indiana generally did not benefit from it.

The low cost of manufactured housing may be enough to offset many of its problems. But, for subprime lending, there is no such compensating factor. The alleged “predatory practices” of some lenders have raised great concern. Critics point out or allege that subprime borrowers may face higher interest rates, exorbitant fees, the loss of their property, and other abusive practices. Even in the absence of such practices, the fact that half or more of subprime borrowers could probably qualify for better deals elsewhere (Raines, 2000; Medine, 5/24/2000), and that subprime lenders may actually be stealing away borrowers from traditional lenders (Williams et. al., 2001; Mahalik and Robinson, 1998) are reasons for concern.

In short, the apparent progress of the past decade is not all that it seems. The old inequality, which denied many the right to home ownership, has slowly diminished. The result has been record growth in the rates of home ownership for minorities and other members of underserved markets. But, for many of these homeowners, a new inequality has replaced the old. This new inequality is characterized by less desirable loan terms, exposure to predatory practices, and a lack of consumer protection. While we might reasonably argue that the new inequality is better than the old, we must not lose sight of the fact that it is inequality nonetheless: recent gains in homeownership for underserved markets have come with a price.

Explanations for Inequality. In light of the evidence we have presented, we again ask, why has the new inequality emerged? Earlier, we compared and contrasted classic economic theories (which imply that banking deregulation and increased competition did away with whatever discrimination may have existed in home mortgage lending), with the sociological networking perspective of Tillman and Indergaard (which suggests that economic restructuring can disrupt markets and social relationships and create new opportunities for exploitation). We think both perspectives offer insights into the changes that occurred in home mortgage lending during the 1990s.

As classic economic theories suggest, industry deregulation did lead to increased competition in home mortgage lending. Markets that had long been ignored suddenly found a multitude of

lenders willing to serve them. In the past, riskier borrowers were simply denied loans; but in the newly competitive market place, subprime lenders arose who would offer loans to those borrowers willing to pay a higher rate of interest. Manufactured housing also increased dramatically in response to consumer demands for more affordable forms of housing. As a result, thousands of individuals who probably never could have gotten loans in the past were able to achieve homeownership.

For many, perhaps most, members of underserved markets, these were positive developments, or at least better than the alternative of getting no home at all. But, there was also a dark side to these changes. Just as Tillman and Indergaard found in the health insurance field, economic restructuring in the home finance industry was accompanied by disrupted markets and social relationships, the withdrawal of many traditional providers, a lack of regulation, and customers who were at a structural disadvantage when dealing with the new entities that sought their business.

As Campen (1999) notes, deregulation in the 1980s led many banks to close branches located in inner cities and to relocate them in higher-income areas regarded as more likely to generate profitable business. Subprime lenders took their place. These lenders are not well regulated. Despite the recent explosion in subprime lending, the Federal Trade Commission has fewer than forty people on staff to cover predatory lending (Immergluck and Wiles, Nov 1999). Many banks own subprime affiliates; but because these affiliates are mortgage and finance companies, they are not subject to the same degree of regulation as their parent company (Immergluck and Wiles, Nov 1999).

Similar to what Tillman and Indergaard found in the health insurance industry, borrowers from these lenders were often at a structural disadvantage in their dealings with them. Lacking information or access to alternatives, as many as half of those turning to subprime lenders could have qualified for a better deal elsewhere (Raines, 2000). If companies were forced to offer borrowers prime loans if they were eligible, many predatory practices might be eliminated (Brockman, 11/17/99).

While it is unfair to label all subprime lenders as “bogus brokers,” the disrupted market situation they operated in, ambiguous laws, ineffective regulation, and consumers’ lack of knowledge did allow the worst lenders to engage in predatory practices. These practices led borrowers to pay excessive fees and sometimes lose their homes completely. Because of “reverse redlining,” minorities, the elderly, and low-income individuals may have been especially likely to have been victimized.

Increases in manufactured housing were probably much more beneficial to underserved markets. But even here, a lack of government regulation and consumer protection sometimes resulted in unsafe installations, frequent defects that should have been covered by warranties but weren’t, and exposure to abusive landlords. The limited number of financial institutions that were active in the manufactured housing market also made these loans more expensive than they could have been.

Hence, classical economic theories such as Becker's help to explain why lending to underserved markets increased during the 1990s, while sociological network theories such as Tillman and Indergaard's help to explain why these changes were not universally beneficial.

Neither perspective, however, clearly explains why there were strong racial differences in underserved market lending. Our own analysis shows the pervasiveness of racial differences across income levels. As noted before, some of these differences may be due to unmeasured variables, such as credit histories. Given that the Boston Fed study showed that substantial racial differences in denial rates remained even after controlling for credit histories and other relevant individual characteristics, we think it unlikely that such variables can account for all of the racial differences in subprime lending. Further, differences in credit histories would not seem to explain why blacks are more likely to use subprime lending but less likely to turn to manufactured housing. We therefore argue that a new sociological/demographic explanation helps to provide part of the answer: The old inequality helped to make the new inequality possible.

As Massey and Denton note (1993), African Americans are heavily segregated in America, in part because traditional lenders have failed to meet their needs. Because blacks are disproportionately located in low-income areas, they have been more likely than whites to have their networks of service providers disrupted as traditional lenders have withdrawn from their neighborhoods. Further, residential segregation makes it easier for lenders to target borrowers by race and income. As Matthew Lee of the Inner City Press notes (May 1999; see also SMR Research Corporation, 2000),

Mailboxes in moderate income neighborhoods are full of pitches from subprime lenders. As the subprime industry has gotten more sophisticated, direct marketing has become focused on communities whose residents have already shown a taste or need for high interest rate loans.

As Lee (1999) further argues, race appears to be a key factor in this targeting of areas, as subprime marketing is disproportionately concentrated in minority census tracts. Such strategic placement of offices and direct marketing efforts to minority areas would be far more difficult, of course, if the old inequality had not helped create these neighborhoods in the first place.

The old inequality may also help to explain why, at least in Indiana, manufactured housing lenders have not done more with minority markets. Manufactured housing tends to be located in rural areas and in the rural outskirts of the nation's metropolitan areas (Vermeer and Louie, 1997). This is partly because of zoning restrictions and negative stereotypes that have worked against the use of manufactured housing in urban settings. Blacks, on the other hand, are heavily concentrated in cities. This racial segregation may have left blacks disinclined to take advantage of manufactured housing opportunities or made them harder to market to. Factors that have kept blacks out of other neighborhoods may have also worked against them getting into areas with clusters of manufactured housing.

As Vermeer and Louie (1997) note, more study needs to be done to find out why the manufactured housing industry is not reaching minority populations. While manufactured housing has its own problems, it would seem to be superior to the subprime lending that blacks are so heavily reliant on.

The Future of the New Inequality. Is the new inequality destined to continue? Luckily, there seems to be a growing awareness that something can and should be done. A joint taskforce of the Departments of HUD and Treasury has recently announced recommendations for curbing predatory lending (HUD and Treasury, 2000). In December 2000 Congress passed the Manufactured Housing Improvement Act (Manufactured Housing Institute, 12/07/2000). The act calls on HUD to update construction and safety standards in a timely fashion. It also requires states to institute installation programs meeting certain minimal standards and to establish resolution programs for handling customer complaints in the first year after installation. HUD has also proposed that the GSEs be more active in the subprime and manufactured housing markets (HUD 2000b), and the GSEs have already started to take new initiatives toward them (National Mortgage News, 8/7/2000; Mortgage Marketplace 9/7/1998; Brockman 11/3/1998, 9/10/1999). Lind (2000) argues that the entry of the GSEs into subprime markets should be beneficial because the GSEs attach conditions to their purchases that curb predatory lending.

If successful, these initiatives offer hope that the new inequality in home mortgage lending will not last as long as the old inequality has. But for now, the ultimate fate of these efforts remains to be seen.

The Broader Picture. So far, we have focused on a description of the trends in specialized lending and the implications those have for housing inequality. We now contend that increases in specialized mortgage lending are only part of a much larger phenomenon. For the same theoretical reasons we have already outlined, economic restructuring, the disruption of old networks of service providers, deregulation and weak regulation have all combined to offer both new opportunities for members of underserved markets as well as new forms of exploitation.

During roughly the same period that specialized lenders have seen rapid growth, traditional banking services have declined in the nation's central cities (Squires and O'Connor, 1998; Branch, 6/8/1998). Banking deregulation led many lenders to close their branches there (Consumer Reports, July 1998). In their place has arisen a new system of "fringe banking" composed of check-cashing/payday loan businesses. As Donna Tanoue of the FDIC notes (Tanoue, 6/13/200), such businesses have gone from a few hundred outlets in the mid-1990s to approximately 10,000 branches in 2000, with a projected 25,000 stores in 2002. They provide services that were almost exclusively offered by traditional lenders just a few years ago, but charge considerably more for doing so (Squires and O'Connor, 1998).

Check cashing/payday loan businesses are disproportionately located in low income and minority neighborhoods. For example, in their study of Milwaukee, Squires and O'Connor (1998) found that there were more than two to three times as many check-cashing outlets in communities with large numbers of African Americans as there were in predominantly white areas. Even more strikingly, in African-American communities there was *one* bank for every check cashing business compared to *fifteen* banks for each check-cashing business in predominantly white areas. Not surprisingly, the core customer of these businesses is typically nonwhite, has less than a college education, and has a household income under \$35,000 (Branch, 6/8/98).

Part of the income of these businesses comes from cashing payroll and personal checks, for which they charge fees that are several times higher than those charged by traditional lenders

(Squires and O'Connor, 1998; Branch, 6/8/98). Payday loans, however, are by far the most controversial service they offer. With a payday loan, a borrower writes a lender a check, with the mutual understanding that it will not be cashed until the next payday, usually in two weeks. The lender charges a "service fee," typically \$15 for every \$100 loaned (Fox, November 1998). This amounts to an annual percentage rate (APR) of 391%.

Because many borrowers are unable to repay their loans, they frequently roll them over (Fox, 1998). A study of Indiana found that 91% of borrowers renewed their payday loans, typically ten times per customer. They thus incur new "service fees" that can cause the APR to exceed 1,000 percent (Consumer Reports, March 2000; Timmons, 3/10/1999). Critics such as the Woodstock Institute (Hochstein, 3/15/2000) argue that, as a result, payday lending exploits the poor and traps them in a cycle of debt.

Because their charges are labeled as "fees" rather than interest, or because states provide little or no restrictions on them, payday lenders are often able to avoid state regulation. Even when states do cap interest rates, the Internet, with its lack of geographic barriers, provides a means by which payday lenders can do business anyway (Kong, 6/18/2000).

As Jean Ann Fox (Branch, 6/8/98) of the Consumer Federation of America notes, the result may be that we are moving towards a polarized system where "middle class people will be served by one federally insured system, and moderate-income people will have to rely on costly fringe bankers." Squires and O'Connor (1998) add that

A two-tiered banking system--just like the dual housing market, segregated school systems, and segmented labor markets--constitute critical institutionalized barriers confronting cities in their efforts to bring hope to their most depressed areas and revitalize metropolitan economies... Residents of distressed communities deserve better. The health of the nation's cities depends on it.

Critics claim that this two-tiered system, this "new inequality" as we have called it, is also present in still other areas of lending. Black plaintiffs have recently sued automobile finance companies, claiming that blacks were charged higher interest rates for their loans than comparable white borrowers (Henriques, 10/22/2000). Subprime lenders, with their higher rates, are also starting to make a significant number of automobile loans (Consumer Reports, July 1998). The rent-to-own industry, which attracts 3 million people and \$4 billion in business a year, has been criticized for prices that are two to five times greater than those charged at retail; forty-five states have laws that say such rates are not "interest" but rather service fees (Consumer Reports, July 1998). Pawnshops and high-rate credit cards are still other examples of how the poor can obtain loans, but at a far higher cost than is paid by others.

Such developments all have their supporters, who claim that abuses do not exist or that valuable services are being provided. Payday loans can spare consumers from hefty fees for bounced checks (Timmons, 3/10/99) and they may help people deal with day-to-day credit needs during emergencies (Tanoue, 6/13/2000). Squires and O'Connor (1998) found that part of the popularity of check cashing businesses was due to their convenient hours and locations. Dallas money manager Frederick "Shad" Rowe (Branch, 6/8/98) conceded that, "Yes, the effective interest rates are astronomical" but defended the payday loan industry by arguing that "But it's better than going to a loan shark. I'm sure it is."

Nevertheless, many may join with Iowa assistant attorney general Kathleen Keest (Consumer Reports, July 1998) in asking, “Why, for the poor, does every commercial transaction have to be an exercise in self-defense?” Greater federal and state oversight that limited interest rates and curbed other abuses would seem to be called for (Kong, 6/18/2000; Consumer Reports, July 1998, March 2000; Tanoue, 6/13/2000). Further, as Squires and O’Connor (1998) note, if traditional lenders made more of an effort in low income and minority neighborhoods, many of these problems might be avoided. Indeed, this could well be to lenders’ benefit. Bob Gnaisda of the public interest Greenlining Institute claims that banks are missing a \$5 billion opportunity on check-cashing services alone, while economist John Caskey contends that banks could think of new products and deliver them more cheaply than a check-casher could (Branch, 6/8/98).

Conclusion

Both the privileged and less-privileged segments of society have recently seen major changes in the financial and lending options available to them. The last 30 years have seen the rise of numerous financial instruments, products, and services that have increased access, increased savings returns, and lowered borrowing costs for middle and upper income groups. These include money market mutual funds, money market deposit accounts, growth in mutual funds, IRAs, 401K plans, internet brokerage and banking services, and the increased securitization of home mortgage and small business loans. Upper income people in particular have benefited from greater access, control, and options for their savings and borrowing needs.

Lower income and minority groups have also seen changes in the financial options available to them, but their choices are of a very different nature. They have watched as limited numbers of bank branches are closed in their neighborhoods. In their place they have witnessed rapid increases in check cashing outlets, pawnshops, high rate credit card companies, as well as the rapid spread of subprime and manufactured housing lending. As conventional financial institutions grow more distant and/or less responsive to the needs of lower income consumers, these potential savers and borrowers are forced to “choose” to meet their financial services needs with institutions who target their neighborhoods with higher fee, unfavorable term borrowing opportunities. The growing digital divide only exacerbates this growing degree of financial services segmentation and institutionalizes the new inequality in unanticipated ways. The rise of internet banking could create further class divisions.

One of the key contributions of this work is showing how both classical economic theories and contemporary sociological network theories offer insights as to why these changes in inequality have occurred. As classical economic theory would predict, a deregulated marketplace has made it possible for low income and minority groups to get credit like never before. This has helped them to achieve record rates of home ownership and to also get loans for any number of other purposes. But, as sociological network theories suggest, the new lenders are quite unlike the old ones. As a result, the gains made by underserved markets have come in very different ways than those made by the rest of American society. For better or for worse, as the old inequalities have slowly diminished, new inequalities have replaced them.

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⁸ Wherever possible, we have given URLs for information that can also or only be found on the World Wide Web. The content and location of those pages may of course have changed since the last time we accessed them. In a few cases, when it was not possible to determine when a web page was created, we have assumed that it originated in the year during which we first accessed the material. Other sources may be available on the Internet via paid services such as Ebscohost and Lexis/Nexis.

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Table 1: Number of Conventional Home Purchase and Refinance Loans
Subprime, Manufactured Housing, and Traditional Lenders
Indiana, 1992-1999

Home Purchase Loans										
All Markets	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	278	572	686	749	507	858	2,301	4,050	3,772	19.8%
MH	232	528	804	1,526	2,102	2,163	2,923	3,919	3,687	19.3%
Traditional	32,961	37,590	41,383	40,169	43,884	39,600	45,358	44,600	11,639	60.9%
Total	33,471	38,690	42,873	42,444	46,493	42,621	50,582	52,569	19,098	
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	82	140	259	414	219	433	1,214	2,395	2,313	25.8%
MH	130	300	430	830	1,183	1,200	1,731	2,408	2,278	25.4%
Traditional	6,689	8,473	10,844	10,518	11,189	10,054	11,274	11,056	4,367	48.7%
Total	6,901	8,913	11,533	11,762	12,591	11,687	14,219	15,859	8,958	
Blacks	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	20	16	41	83	47	137	345	590	570	44.8%
MH		5	6	18	27	33	41	28	28	2.2%
Traditional	518	777	1,351	1,457	1,250	1,065	1,022	1,192	674	53.0%
Total	538	798	1,398	1,558	1,324	1,235	1,408	1,810	1,272	
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	20	29	53	146	54	149	384	707	687	60.6%
MH	6	7	10	23	33	53	64	87	81	7.1%
Traditional	921	1,190	1,567	1,630	1,436	1,165	1,267	1,287	366	32.3%
Total	947	1,226	1,630	1,799	1,523	1,367	1,715	2,081	1,134	

Home Refinance Loans										
All Markets	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	503	1,385	1,651	3,488	6,318	13,585	18,371	16,647	16,144	114.1%
MH		45	165	108	124	248	951	801	801	5.7%
Traditional	58,417	74,502	29,729	21,613	42,503	38,713	90,489	55,620	-2,797	-19.8%
Total	58,920	75,932	31,545	25,209	48,945	52,546	109,811	73,068	14,148	
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	189	588	870	2,015	3,779	7,832	10,945	10,324	10,135	53.9%
MH		23	82	55	65	112	470	459	459	2.4%
Traditional	9,289	12,126	8,991	6,868	13,283	12,519	22,008	17,487	8,198	43.6%
Total	9,478	12,737	9,943	8,938	17,127	20,463	33,423	28,270	18,792	
Blacks	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	64	209	310	524	1,024	1,893	2,325	2,241	2,177	60.9%
MH		1	1		3	1	2	1	1	0.0%
Traditional	677	1,045	1,309	971	2,040	1,673	1,938	2,074	1,397	39.1%
Total	741	1,255	1,620	1,495	3,067	3,567	4,265	4,316	3,575	
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999	Change, 1999-1992	% of total change
Subprime	72	233	257	774	1,329	2,661	3,972	3,604	3,532	68.7%
MH			7		17	19	112	128	128	2.5%
Traditional	1,469	2,023	1,867	1,606	2,954	2,541	2,991	2,950	1,481	28.8%
Total	1,541	2,256	2,131	2,380	4,300	5,221	7,075	6,682	5,141	

Table 2: Market Share for Subprime, Manufactured Housing, and Traditional Lenders
Conventional Home Purchase and Refinance Loans
Indiana, 1992-1999

Home Purchase Loans								
All Markets	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	0.8%	1.5%	1.6%	1.8%	1.1%	2.0%	4.5%	7.7%
MH	0.7%	1.4%	1.9%	3.6%	4.5%	5.1%	5.8%	7.5%
Traditional	98.5%	97.2%	96.5%	94.6%	94.4%	92.9%	89.7%	84.8%
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	1.2%	1.6%	2.2%	3.5%	1.7%	3.7%	8.5%	15.1%
MH	1.9%	3.4%	3.7%	7.1%	9.4%	10.3%	12.2%	15.2%
Traditional	96.9%	95.1%	94.0%	89.4%	88.9%	86.0%	79.3%	69.7%
Blacks	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	3.7%	2.0%	2.9%	5.3%	3.5%	11.1%	24.5%	32.6%
MH		0.6%	0.4%	1.2%	2.0%	2.7%	2.9%	1.5%
Traditional	96.3%	97.4%	96.6%	93.5%	94.4%	86.2%	72.6%	65.9%
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	2.1%	2.4%	3.3%	8.1%	3.5%	10.9%	22.4%	34.0%
MH	0.6%	0.6%	0.6%	1.3%	2.2%	3.9%	3.7%	4.2%
Traditional	97.3%	97.1%	96.1%	90.6%	94.3%	85.2%	73.9%	61.8%

Home Refinance Loans								
All Markets	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	0.9%	1.8%	5.2%	13.8%	12.9%	25.9%	16.7%	22.8%
MH	0.0%	0.1%	0.5%	0.4%	0.3%	0.5%	0.9%	1.1%
Traditional	99.1%	98.1%	94.2%	85.7%	86.8%	73.7%	82.4%	76.1%
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	2.0%	4.6%	8.7%	22.5%	22.1%	38.3%	32.7%	36.5%
MH	0.0%	0.2%	0.8%	0.6%	0.4%	0.5%	1.4%	1.6%
Traditional	98.0%	95.2%	90.4%	76.8%	77.6%	61.2%	65.8%	61.9%
Blacks	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	8.6%	16.7%	19.1%	35.1%	33.4%	53.1%	54.5%	51.9%
MH	0.0%	0.1%	0.1%	0.0%	0.1%	0.0%	0.0%	0.0%
Traditional	91.4%	83.3%	80.8%	64.9%	66.5%	46.9%	45.4%	48.1%
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	4.7%	10.3%	12.1%	32.5%	30.9%	51.0%	56.1%	53.9%
MH	0.0%	0.0%	0.3%	0.0%	0.4%	0.4%	1.6%	1.9%
Traditional	95.3%	89.7%	87.6%	67.5%	68.7%	48.7%	42.3%	44.1%

Table 3: Specialized Lenders Market Share
Race of Applicant & Racial Composition of Neighborhood by Income of Applicant
Indiana, 1999 Only

Race of Applicant							
Type of Loan	Applicant's Income	Type of Lender					
		Subprime			Manufactured Housing		
		Not Black	Black	All	Not Black	Black	All
Home Purchase	<= 60% of MSA Median	10.6%	48.9%	12.8%	20.2%	3.1%	19.2%
	60%-80% of MSA Median	7.4%	38.7%	8.5%	11.7%	1.7%	11.3%
	80%-100% of MSA Median	5.4%	30.8%	6.2%	7.9%	1.5%	
	100%-120% of MSA Median	3.7%	26.0%	4.5%	3.9%		3.8%
	> 120% of MSA Median	3.0%	13.6%	3.3%	1.8%	0.4%	1.7%
Refinance	<= 60% of MSA Median	28.6%	62.0%	33.5%	0.4%	0.1%	0.4%
	60%-80% of MSA Median	20.7%	55.4%	23.4%	0.3%		0.3%
	80%-100% of MSA Median	15.0%	48.2%	16.8%	0.2%		0.2%
	100%-120% of MSA Median	12.5%	42.6%	13.8%	0.1%		0.1%
	> 120% of MSA Median	7.8%	31.0%	8.6%	0.1%		0.0%

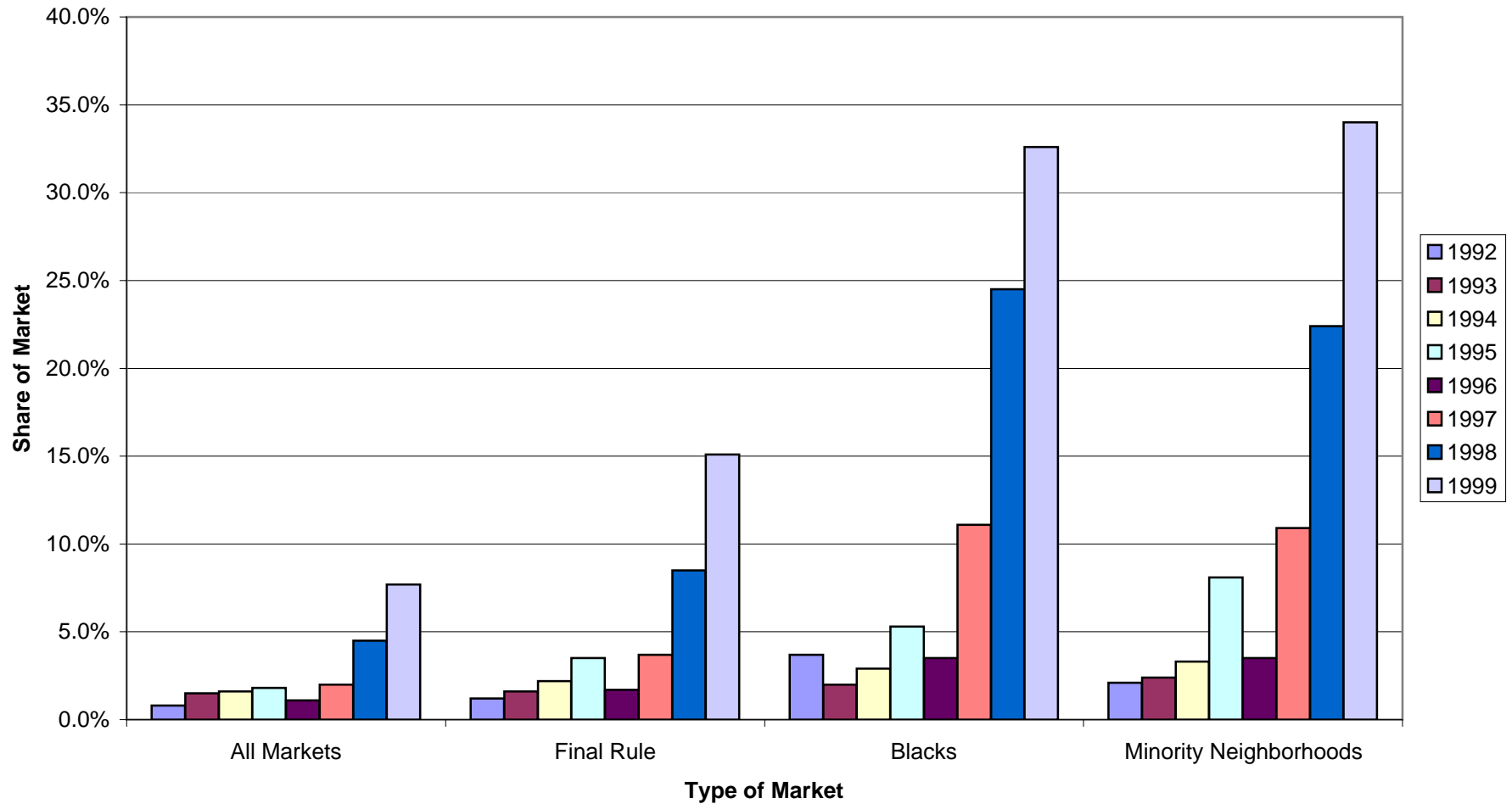
Racial Composition of Neighborhood (Not Minority/ Minority)							
Type of Loan	Applicant's Income	Type of Lender					
		Subprime			Manufactured Housing		
		Not Min	Min	All	Not Min	Min	All
Home Purchase	<= 60% of MSA Median	12.6%	45.9%	15.2%	19.6%	4.4%	18.4%
	60%-80% of MSA Median	8.8%	37.9%	10.3%	11.2%	5.2%	10.9%
	80%-100% of MSA Median	6.4%	30.7%	7.3%	7.4%	3.8%	7.3%
	100%-120% of MSA Median	4.6%	26.9%	5.1%	3.7%	3.1%	3.6%
	> 120% of MSA Median	3.6%	11.9%	3.7%	1.6%	3.4%	1.6%
Refinance	<= 60% of MSA Median	33.9%	63.1%	39.6%	1.6%	1.5%	1.6%
	60%-80% of MSA Median	25.3%	54.0%	28.3%	1.2%	1.5%	1.3%
	80%-100% of MSA Median	19.1%	47.5%	21.2%	1.1%	3.3%	1.3%
	100%-120% of MSA Median	15.9%	44.8%	17.5%	0.9%	2.6%	1.0%
	> 120% of MSA Median	10.5%	32.5%	11.3%	0.6%	2.3%	0.6%

Table 4: Denial Rates for Subprime, Manufactured Housing, and Traditional Lenders
 Conventional Home Purchase and Refinance Loans
 Indiana, 1992-1999

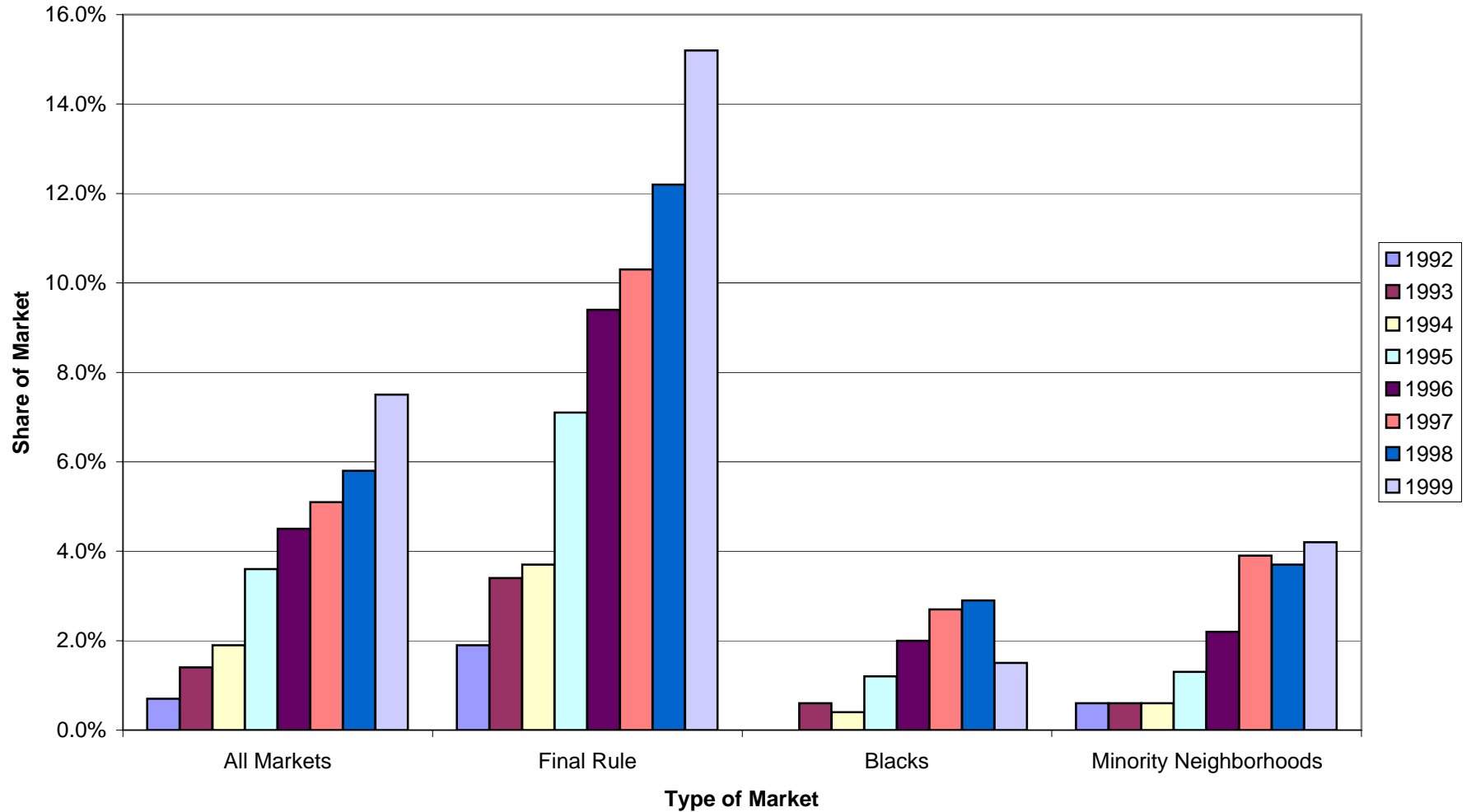
Home Purchase								
All Markets	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	14.5%	15.8%	19.1%	36.8%	44.3%	46.3%	50.1%	44.6%
MH	56.5%	59.8%	59.4%	61.4%	71.2%	76.0%	73.7%	72.3%
Traditional	10.7%	8.9%	9.5%	10.4%	11.7%	13.9%	10.6%	10.0%
All Lenders	11.3%	10.6%	11.7%	15.0%	19.7%	24.7%	23.9%	26.0%
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	25.5%	25.9%	26.2%	43.2%	53.4%	51.2%	54.4%	47.5%
MH	59.4%	64.5%	63.4%	64.5%	73.9%	79.0%	76.2%	74.7%
Traditional	23.0%	17.4%	17.8%	19.1%	22.1%	26.1%	19.7%	19.2%
All Lenders	24.3%	21.1%	21.6%	26.8%	35.0%	42.2%	40.7%	42.9%
Blacks	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	13.0%	27.3%	25.5%	32.0%	50.0%	46.7%	43.0%	48.7%
MH		44.4%	70.0%	60.9%	76.3%	84.4%	82.5%	89.7%
Traditional	26.2%	19.3%	18.7%	16.3%	17.9%	21.8%	20.6%	20.7%
All Lenders	25.9%	19.7%	19.5%	18.3%	23.5%	32.5%	33.8%	38.1%
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	25.9%	25.6%	32.1%	27.4%	63.5%	54.2%	51.5%	53.7%
MH	53.8%	76.7%	71.4%	78.9%	85.1%	84.2%	86.1%	80.4%
Traditional	22.2%	18.7%	20.2%	18.5%	19.5%	21.9%	22.7%	22.0%
All Lenders	22.6%	20.0%	21.5%	22.2%	29.3%	36.4%	40.7%	42.5%

Home Refinance								
All Markets	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	39.8%	25.5%	40.7%	49.7%	50.8%	54.0%	58.6%	59.4%
MH		30.8%	48.9%	50.7%	61.8%	63.7%	67.0%	71.2%
Traditional	6.6%	5.2%	13.6%	14.7%	18.8%	20.8%	11.5%	20.9%
All Lenders	7.0%	5.7%	16.0%	22.4%	25.2%	33.6%	26.6%	35.9%
Final Rule	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	54.6%	34.4%	46.2%	55.8%	51.4%	53.9%	60.4%	59.8%
MH	100.0%	30.3%	52.9%	55.6%	64.5%	70.5%	70.5%	73.4%
Traditional	12.0%	10.3%	22.1%	23.2%	27.4%	29.0%	18.5%	30.5%
All Lenders	13.6%	11.9%	25.4%	34.4%	34.8%	41.6%	40.5%	46.3%
Blacks	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	38.5%	20.8%	25.3%	30.9%	42.7%	50.3%	54.3%	58.2%
MH			66.7%	100.0%	70.0%	91.7%	81.8%	80.0%
Traditional	17.4%	15.2%	23.5%	28.7%	33.4%	33.1%	29.9%	36.0%
All Lenders	19.8%	16.2%	23.9%	29.5%	36.9%	43.6%	45.7%	49.9%
Minority Neighborhoods	1992	1993	1994	1995	1996	1997	1998	1999
Subprime	46.3%	37.4%	49.7%	48.1%	50.5%	55.2%	60.3%	61.2%
MH			30.0%	100.0%	48.5%	78.7%	68.1%	68.2%
Traditional	13.5%	12.6%	30.7%	30.7%	35.9%	37.6%	29.8%	41.4%
All Lenders	15.9%	16.0%	33.8%	37.5%	41.3%	48.4%	51.6%	54.6%

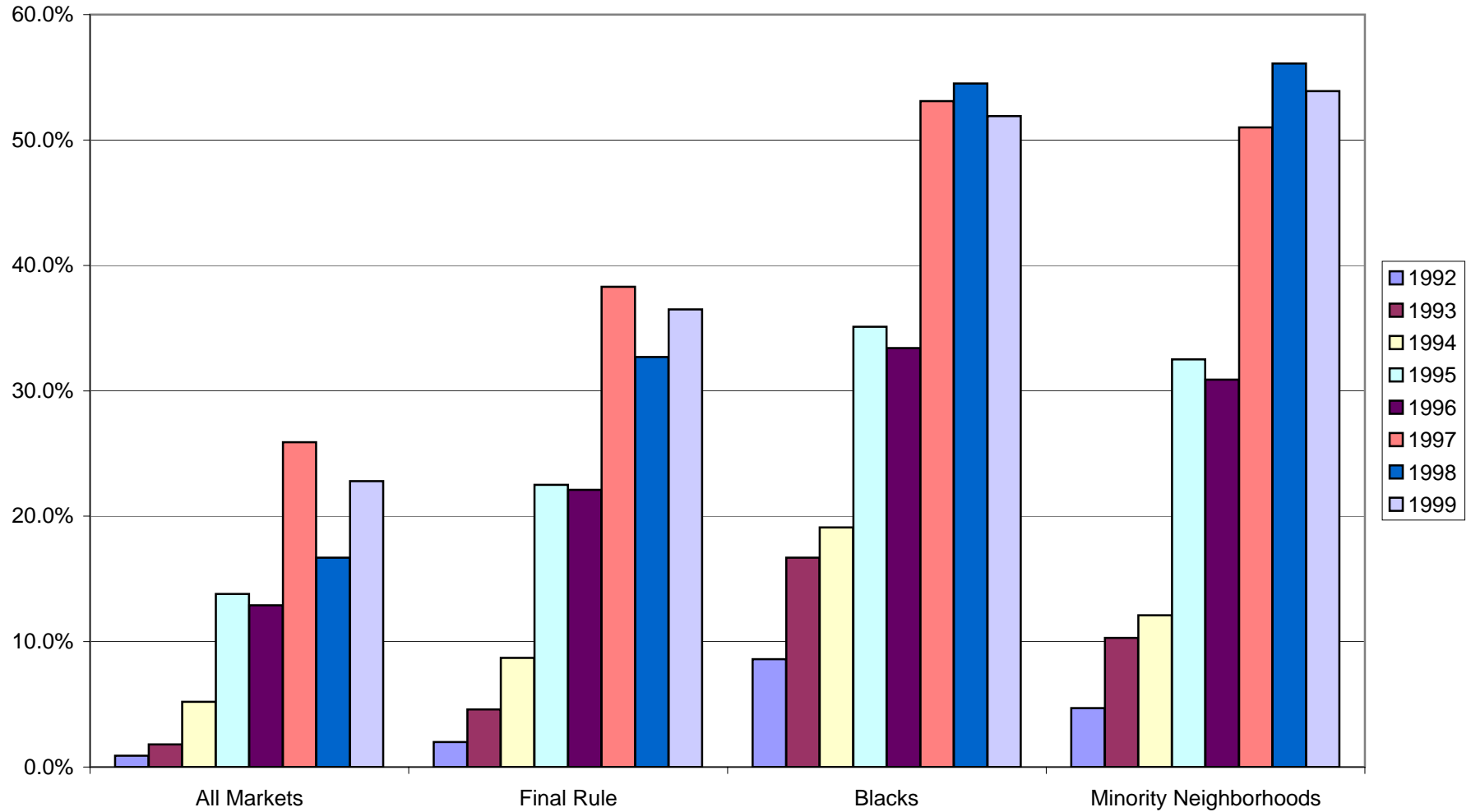
**Figure 1: Subprime Lenders Market Share
Conventional Home Purchase Loans
Indiana, 1992-1999**



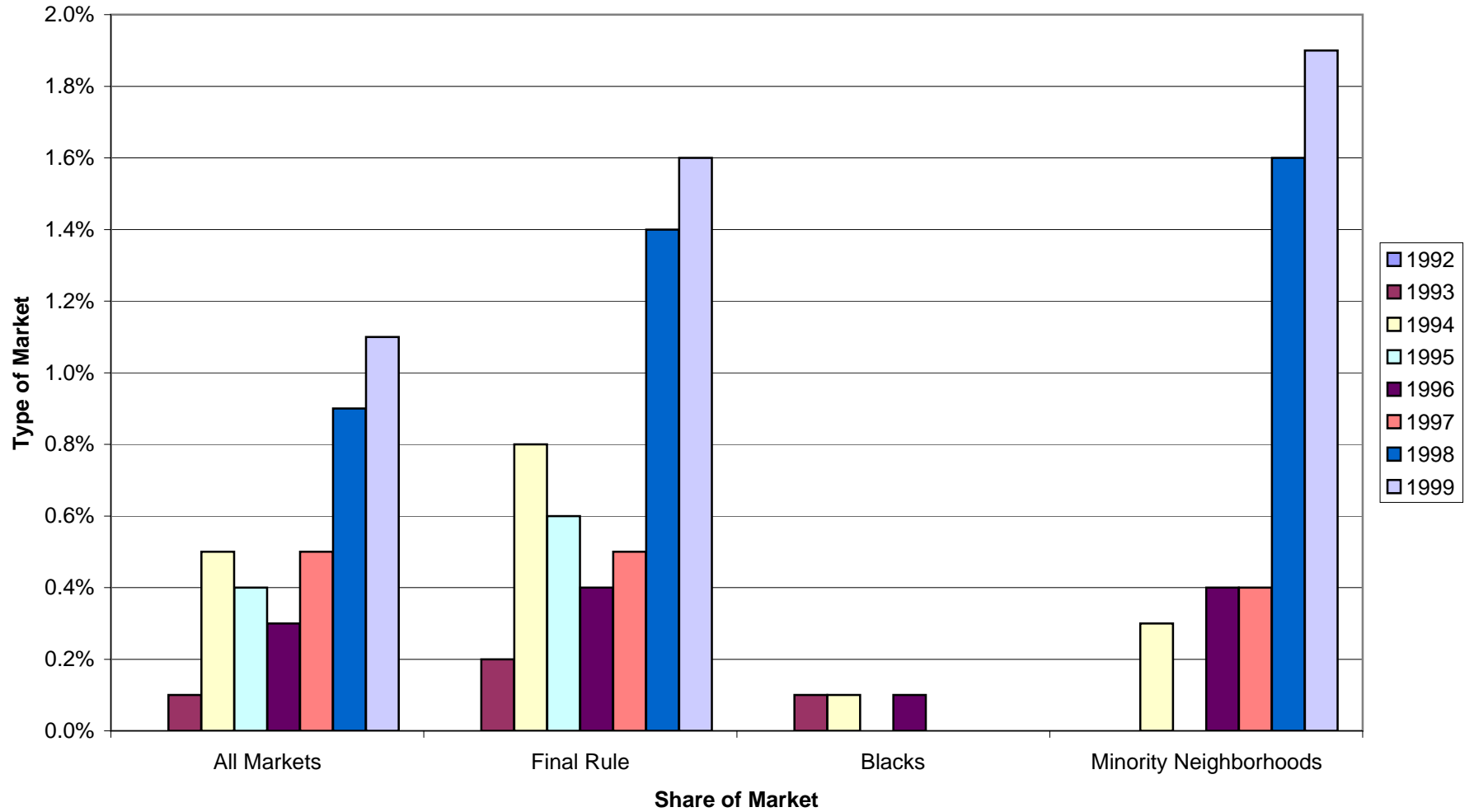
**Figure 2: Manufactured Housing Lenders Market Share
Conventional Home Purchase Loans
Indiana, 1992-1999**



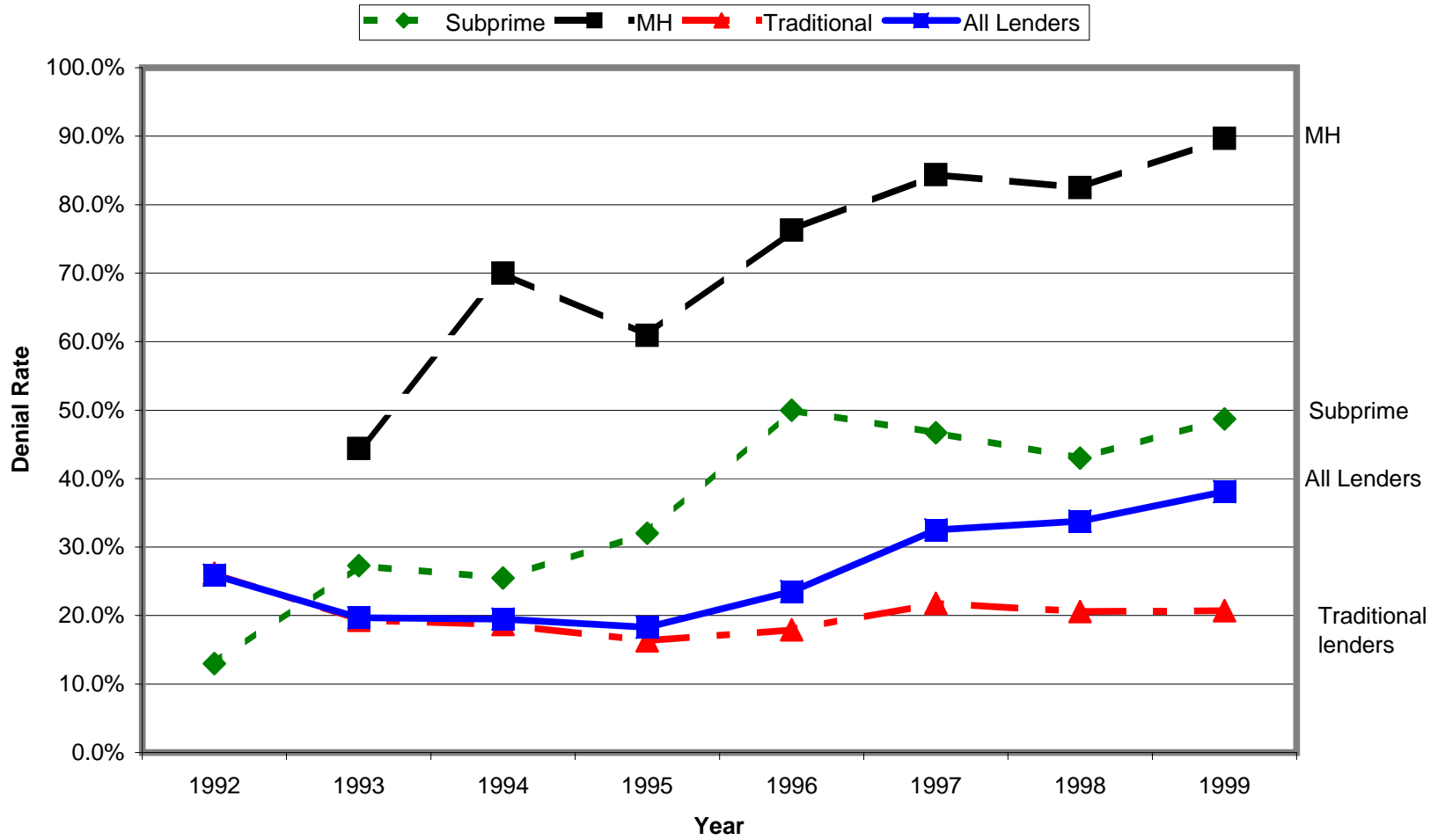
**Figure 3: Subprime Lenders Market Share
Conventional Refinance Loans
Indiana, 1992-1999**



**Figure 4: Manufactured Housing Lenders Market Share
Conventional Refinance Loans
Indiana, 1992-1999**



**Figure 5: Black Denial Rates
Conventional Home Purchase Loans
Indiana, 1992-1999**



**Figure 6: Black Denial Rates
Conventional Refinance Loans
Indiana, 1992-1999**

