

A Look at Minority Mortgage Loan Denials

Interim Report
By the
Massachusetts Community & Banking Council

June 2004

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MASSACHUSETTS COMMUNITY & BANKING COUNCIL

The Massachusetts Community & Banking Council (MCBC) thanks the following members of MCBC's Mortgage Lending Committee for their assistance in the preparation of this report: Jim Campen, Gaston Institute, UMass/Boston; Timothy DeLessio, Federal Deposit Insurance Corporation; David Harris, Fair Housing Center of Greater Boston; Janna Peckham, Citizens' Housing & Planning Association; Esther Schlorholtz, Boston Private Bank & Trust Company and Kathleen Tullberg of MCBC.

MCBC depends on the financial support of its bank members to produce reports like *A Look at Minority Mortgage Loan Denials*. We thank the following banks for their 2004 membership:

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Eagle Bank	State Street Bank
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INTRODUCTION

In March 2004, the Massachusetts Community & Banking Council sponsored a Roundtable Discussion on minority mortgage loan denials. The purpose of the discussion was to learn more about the reasons for denials and to identify strategies that may help reduce those numbers. The discussion was attended by over 50 bankers, homebuyer counselors, representatives from community-based organizations, public officials, regulators and other interested parties.

This report is intended to share the experience and findings of that meeting.

BACKGROUND

Massachusetts Community & Banking Council

The Massachusetts Community & Banking Council (MCBC) was established in 1990 to encourage community investment in low- and moderate-income and minority neighborhoods. MCBC brings together community and bank representatives to promote a better understanding of the credit and financial needs of lower-income neighborhoods and provides information, assistance and direction to banks and community groups in addressing those needs.

MCBC's Mortgage Lending Committee, which includes bankers, housing advocates and city and state officials, works to expand homeownership opportunities and to sustain home ownership in low- and moderate-income neighborhoods. In January 2004, MCBC published its tenth annual update on mortgage lending patterns in Greater Boston. More than 350 copies of *Changing Patterns X* were distributed to bankers, community organizations, housing advocates and public officials.

Further information on MCBC, including copies of all MCBC reports, are available on MCBC's website at www.masscommunityandbanking.org.

MCBC Report

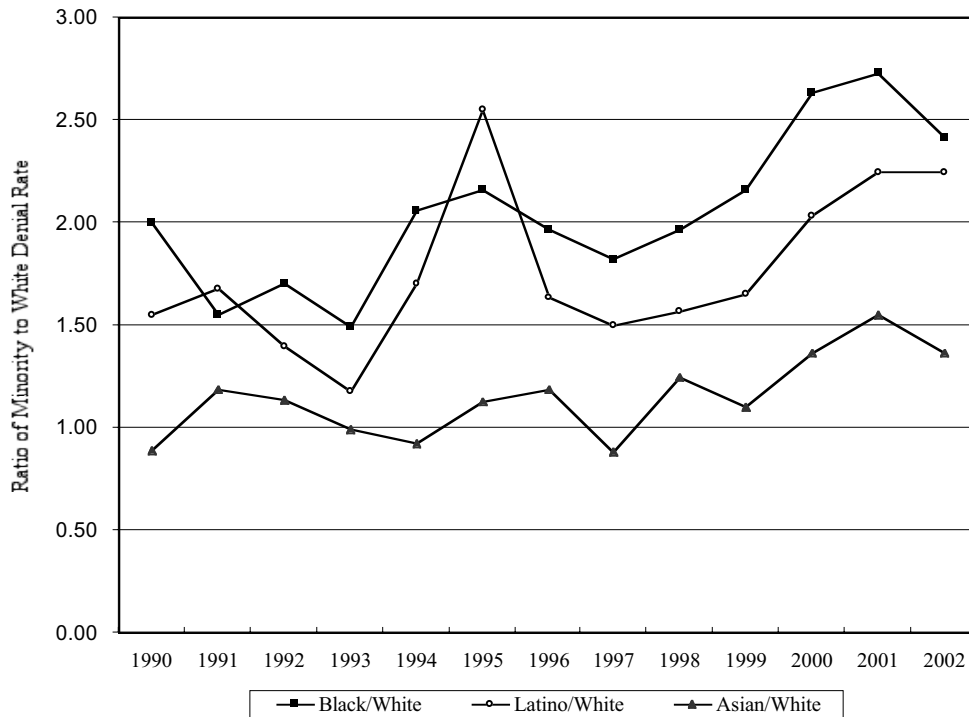
Changing Patterns X: Mortgage Lending to Traditionally Underserved Borrowers & Neighborhoods in Greater Boston, 1990-2002 analyzed mortgage lending by race and income and the comparative performance of major types of lenders in 108 individual communities in and around Boston.

The report found:

- Black and Latino households in the city of Boston continued to receive far less than their proportionate share of home-purchase loans.
- Denial rates for blacks and Latinos in the city of Boston and in the broader metropolitan area continued to be far greater than those for whites (even for applicants at the same income level).
- Massachusetts banks directed a substantially greater share of their total loans to traditionally underserved borrowers and neighborhoods than did mortgage companies and out-of-state banks, while banks represent a smaller and smaller share of the mortgage market.

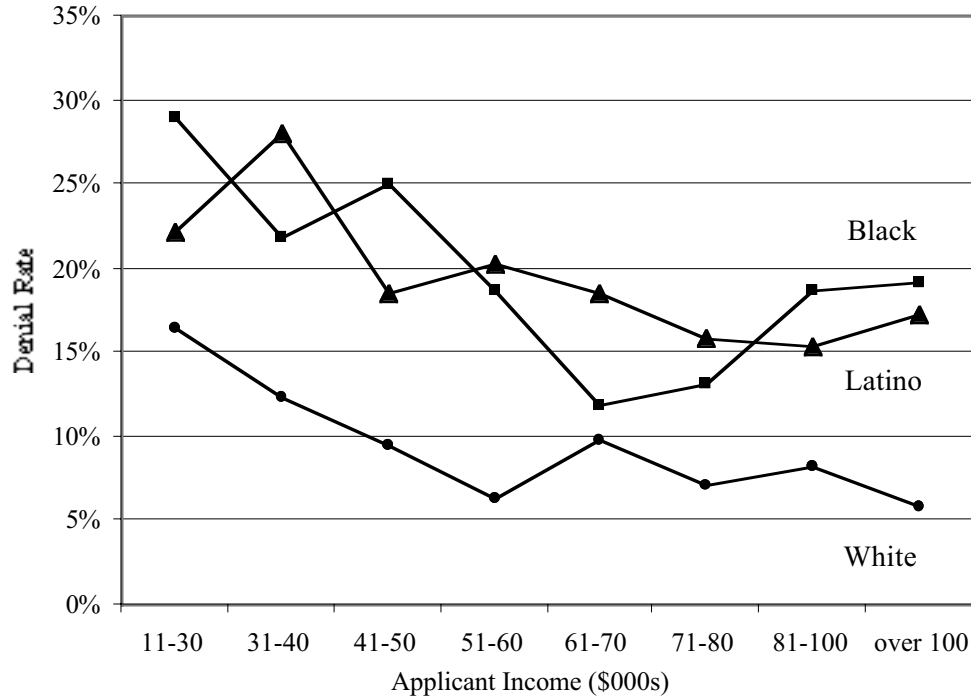
The continuing high rates of minority denials and disparity ratios are particularly troubling. In the city of Boston, the denial rate for black homebuyers in 2002 was 18.6 percent, as compared to a denial rate for white homebuyers of 7.7 percent. As a result, the denial rate for blacks, which has usually been about twice the white denial rate, was 2.42 times the white rate in 2002. The Latino denial rate, typically 1.5 times the white denial rate, was 2.25 times the white rate in 2002 (see chart below from *Changing Patterns X*). In the Metropolitan Area Planning Council (MAPC) Region, which includes 100 municipalities in addition to Boston, the black/white and Latino/white ratios were even higher: 2.58 and 2.27, respectively.

MINORITY/WHITE DENIAL RATIOS, BY RACE
BOSTON HOME-PURCHASE LOANS, 1990-2002



Within the same income categories, the 2002 denial rates for blacks and Latinos were in every case well above the denial rates for white applicants. For example, for applicants in Boston with incomes above \$100,000, blacks experienced a denial rate of 19.2 percent, more than triple the 5.8 percent rate experienced by their white counterparts; the 17.2 percent denial rate for Latinos in this income category was almost triple the denial rate for whites (chart below from *Changing Patterns X*).

**DENIAL RATES BY RACE AND INCOME
BOSTON HOME-PURCHASE LOANS, 2002**



Changes in the Mortgage Lending Market

MCBC recognizes that, since the issue of minority mortgage loan denials was raised in the early 1990s, there have been significant changes in the mortgage lending market. In 2002, mortgage companies and out-of-state banks made 73.6 percent of all Boston home purchase loans, a substantial jump from less than one-quarter of all loans in the early 1990s. The biggest Boston banks, together with their affiliated mortgage companies, made 10.9 percent of all loans in the city of Boston in 2002, down significantly from the approximately 40 percent share these banks maintained between 1992 and 1995. The market share of all other Massachusetts banks fell to 15.6 percent from 16.1 percent in 2001, their lowest share ever. Subprime lenders made 7.6 percent of total home purchase loans in 2002. At the same time, Massachusetts banks and credit unions (whose local lending is covered by the Community Reinvestment Act – CRA) directed a substantially greater share of their total Boston loans in 2002 to every one of the categories of traditionally underserved borrowers and neighborhoods than did mortgage companies and out-of-state banks not covered by CRA.

Other changes in the market include a significant increase in housing costs in Boston and the metropolitan area; increases in the number of mortgage products; increased use of automated underwriting; increased reliance on credit scoring and increased marketing and lending activity by subprime lenders.

Despite these changes, MCBC and its member organizations remain committed to playing a central role in identifying barriers to expanded homeownership and, specifically, to addressing the issue of minority denials. MCBC's Roundtable Discussion and this report are intended to help promote and expand dialogue and collaboration among banks, community organizations and others to help expand opportunities for homeownership for all residents.

ROUNDTABLE SUMMARY

Banks, other mortgage lenders, community-based home counseling agencies and other participants in the mortgage process all play an important role in helping homeowners qualify for mortgages.

Banks

Since 1990, many banks have established second look procedures to review mortgage loan denials to ensure that all loan applicants receive equitable treatment. Specific internal procedures vary depending on the size of the banks but can include:

- Targeted review, e.g. all low- and moderate-income denials, all denials in low- and moderate-income census tracts
- Multi-level review, e.g. by multiple underwriters, plus senior underwriter; by the underwriting manager, plus CRA Officer and/or established review committee
- Tracking of loan denials by race (sometimes as part of fair lending procedures)
- Tracking of loan denials by bank staff
- Internal goal-setting

While second look procedures can help to ensure equitable treatment, flexible application of underwriting standards and, in some cases, other options for individual homebuyers (e.g. alternative loan products), the procedures do not change bank standards for approval. Most banks report that poor credit and high debt-to-income ratios remain the principal reasons for denial.

All banks provide training on fair lending and compliance to mortgage originators, underwriters and processors. Some banks also offer staff financial incentives for loans to low- and moderate-income households. At the same time, banks cannot discourage

mortgage applicants, even those who are not qualified, and many banks believe that they are limited in the nature and degree of counseling that they can provide.

Homebuyer Counseling Agencies

In Massachusetts, most community-based homebuyer counseling agencies are part of the Massachusetts Homeownership Collaborative. Formed in 1996 by Citizens' Housing and Planning Association (CHAPA), the Collaborative serves as the mechanism for professionalizing, improving and bringing standards and consistency to the quality of homebuyer education services across the state. In 2000, the Collaborative established a Collaborative Seal of Approval to recognize homebuyer counseling agencies that meet or exceed a minimum standard in providing effective pre-purchase, group homebuyer counseling and education to low- and moderate-income, first-time homebuyers.

To earn a Collaborative Seal of Approval, counseling agencies must meet or exceed the following criteria:

- Provide homebuyer education targeted to low- and moderate-income, first-time homebuyers
- Provide group, pre-purchase homebuyer education workshops that offer at least eight hours of instruction over a minimum of two classes
- Cover all of the “core” material in the Collaborative’s Homebuyer Counseling Curriculum
- Distribute the Collaborative’s “core” hand-out materials
- Utilize the Collaborative’s subject review worksheets
- Provide, or have counseling staff participate in, on-going training
- Keep accurate records on workshop attendees
- Offer individual counseling, if needed, for group workshop graduates
- Adhere to the Collaborative’s Code of Ethics
- Provide appropriate disclosures to workshop participants
- Agree to on-site monitoring by the Collaborative.

To date, 58 homebuyer counseling agencies have received the Collaborative’s Seal of Approval. All of the agencies with a Seal of Approval cover material designated as “core” in the Collaborative Curriculum. Core material includes information on the entire homeownership process, including budgeting and credit, obtaining a mortgage and maintaining the home after purchase. Information on pre-purchase homebuyer counseling workshops is available on CHAPA’s website at www.chapa.org.

While all certified counseling agencies must meet the Collaborative’s criteria, there are acknowledged differences between agencies, both in the scope of their programs (e.g. not all agencies pull credit reports and/or provide financial fitness classes) and the level of instruction. Agency capacity – to provide one-on-one counseling, long-term credit repair, financial fitness education and other programs – is directly related to available funding.

Financial Education

Many banks and non-profit organizations offer financial education classes for local residents on bank products and services, managing bank accounts, budgeting, savings and/or credit. Some homebuyer counseling agencies utilize the programs listed below to expand their homebuyer curriculum.

In Massachusetts, the Federal Deposit Insurance Corporation (FDIC) provides train-the-trainer instruction to organizations and individuals on *Money Smart*, the FDIC's adult education program. In 2001, the FDIC held 19 training sessions for over 350 participants. The FDIC curriculum, including a comprehensive guide for instructors and a take-home booklet for class participants, is available free of charge. *Money Smart* is available on a CD in English, Spanish, Chinese, Korean and Vietnamese. Information about the *Money Smart* program is available through the regional FDIC office at (781) 794-5632 or at the FDIC's website at www.fdic.gov/consumers/consumer/moneysmart/index.html.

Consumer Credit Counseling Service (CCCS) of Southern New England provides group instruction and individual credit counseling to local residents. Many homebuyer counseling agencies include CCCS staff instruction as part of their homebuyer classes. Banks and counseling agencies can also refer homebuyers with credit problems to CCCS or other counseling agencies such as ESAC. More information on CCCS programs is available by calling CCCS at (617) 960-8136. Information on ESAC assistance is available (insert phone number, website).

Other financial education programs and materials are available through Freddie Mac and Fannie Mae. The City of Boston is currently providing Freddie Mac's CreditSmart program through The Boston Home Center. Information on Freddie Mac's CreditSmart program is available at www.freddiemac.com/creditsmart. Information on Fannie Mae publications is available at www.homebuyingguide.org.

RECOMMENDATIONS

Banks, mortgage companies, homebuyer counseling agencies and others can all take steps to help homebuyers qualify for home mortgage loans. Not all of the strategies listed below will be appropriate for all financial institutions or all organizations and agencies. Some have already adopted action steps similar to those proposed here. Some may not be feasible due to an organization's size or capacity. Several strategies represent long-term commitments, some are short-term projects. However, it is hoped that all mortgage lenders, homebuyer counseling agencies and others who play a role in assisting homebuyers will use the strategies as a guide to identify ways in which they, individually and in partnership with others, can help to better qualify prospective homebuyers and to reduce the number of minority denials.

For Mortgage Lenders

- **Reinforce management’s commitment to fair lending.** Senior management determines company culture. Senior managers should be explicit in their commitment to oversight and review, staff training, customer service and product flexibility.
- **Establish and improve second look procedures to ensure that all mortgage loan applicants receive equitable treatment.** Specific procedures may vary depending, among other things, on the size of the company. Whatever the process, senior managers should regularly track denials (e.g. by applicant income, by loan production staff) to ensure that the process is effective and to identify potential problem areas.
- **Provide appropriate fair lending, compliance and diversity training to all mortgage originators, underwriters and processors.** Diversity training should include awareness of cultural and/or linguistic barriers and sensitivity to the special needs of first-time (and, in many cases, unsophisticated) homebuyers.
- **Review company compensation structures to ensure that loan production staff are not discouraged from working with lower-income or financially unsophisticated applicants.** Compensation that is based solely on commission (number and size of loans closed) may discourage staff from working with applicants that require more time. Some companies have adjusted their compensation programs for staff working primarily in inner-city markets.
- **Help prospective homebuyers better understand the mortgage application and approval process.**
- **Request clarification from regulators on the nature and extent of counseling that may be provided to individual homebuyers.** Many banks are reluctant to provide counseling because of their concern about lender liability and compliance with the Fair Credit Reporting Act. Regulators should provide banks with clear guidance on what constitutes credit counseling.
- **Refer homebuyers to homebuyer and/or credit counseling agencies prior to application.** Bank branch staff and mortgage brokers should be provided with information on local home buyer counseling programs and credit counseling agencies for distribution to all customers seeking information on mortgage loans.
- **Provide denied applicants with information on counseling options.** Some banks include CCCS brochures to customers who are being denied because of credit history issues. Mortgage lenders should assemble information on counseling options for distribution to denied applicants.

- **Continue to provide financial support for homebuyer education programs.**
- **Track referrals from homebuyer counseling agencies.** Banks should keep records of referrals from homebuyer counseling agencies. Agencies that continue to refer unqualified applicants should be reported to the Massachusetts Homeownership Collaborative.
- **Provide financial education classes in collaboration with local community-based organizations.** Financial education programs are an important first step in educating local residents on the basics of money management and the importance of a sound credit history. Identify organizations that serve moderate and upper income residents to reach those unlikely to attend homebuyer education classes.

For Homebuyer Counseling Agencies

- **Improve screening of prospective homebuyers.** Some banks report that agency graduates do not meet basic credit standards. Homebuyer counseling agencies should ensure that all program graduates know whether or not they meet bank credit and other underwriting standards.
- **Require review of credit reports by all prospective homebuyers prior to graduation.** Some homebuyer counseling agencies have expressed concern that pulling a homebuyer's credit report will be counted as an inquiry on that report. Prospective homebuyers should be instructed on how to access their own credit report. Residents of Massachusetts are entitled to receive free copies of their credit annually and those requests are counted as self-inquiries. Agencies should anticipate that many prospective homebuyers fear looking at their credit reports. However, all program graduates should have a copy of their credit reports and know what they mean.
- **Provide on-going training to counseling staff on bank credit requirements and lending programs.**
- **Provide training or refer homebuyers to workshops on financial fitness.** Some prospective homebuyers may need additional help in money management, savings and/or budgeting. Budgeting assistance is available through CCCS. Homebuyers who need help in saving for a down payment can also be referred to local Individual Development Account (IDA) programs.
- **Work with credit counseling agencies to assist homebuyers with credit problems.** Homebuyer counseling agencies and credit counseling organizations should work together more effectively to assist prospective homebuyers with credit repair. Including credit counselors as part of the agency's homebuyer program can serve to introduce students to staff members and increase the comfort level for those who may need additional assistance. Agencies should

educate prospective homebuyers that the principal reasons for denial are credit history and debt-to-income ratios (excessive debt).

- **Provide on-going assistance and support to homebuyers not ready to buy.** Prospective homebuyers who have a poor credit history or are otherwise not qualified to purchase a home can be overwhelmed by the effort and time required to correct their problems. Homebuyer counseling agencies should consider ways to provide on-going assistance and support to help make that process manageable. Some organizations have established peer programs to help provide motivation and support.
- **Track program graduates.** Many homebuyer counseling agencies lose touch with homebuyers after graduation from the program. However, tracking can be an effective way to evaluate program outcomes and to develop new and/or expanded assistance.

For Others

MCBC's Roundtable Discussion was intended to focus attention to the issue of minority mortgage loan denials and to serve as the basis of on-going discussion on this important issue. While many of the recommendations listed above are intended to reduce the number of denials among minority homebuyers, it is unclear whether these steps alone will reduce the disparity between white and minority loan denials. MCBC believes it is important to address both issues – reducing the number of minority loan denials and reducing the disparity between the percentage of white and minority denials.

This is not a job for MCBC or its member banks and community organizations alone. Mortgage companies, which have an increasingly larger share of the mortgage market; regulators; industry organizations; neighborhood groups; local governments and homebuyers themselves all have a stake in the home mortgage process and a role to play in ensuring fair and equitable treatment for all homebuyers.

- **Increase public awareness of the importance of sound credit practices.** Most mortgage loan denials are due to poor credit history or high debt-to-income ratios. The highest disparity ratios between blacks and whites are in the highest income categories. How can we reach families before they apply for a mortgage loan so that they can be better prepared for borrowing? How can we better reach middle- and upper-income minorities?

Community-based organizations, mortgage companies and real estate brokers can also play important roles in helping to ensure that prospective homebuyers are qualified for mortgage loans. Some community-based organizations and churches have established financial education programs to educate local residents. In Boston, the Earned Income Tax Credit (EITC) Coalition is planning to add financial education to its tax preparation assistance. The Organization for a New

Equality (O.N.E.) has re-launched its Campaign for Economic Literacy in programs in Boston, Springfield and Worcester. Other non-profit organizations are establishing financial education programs as a way of expanding services to local residents and supporting self-sufficiency. Organizations such as these can be effective partners in increasing public awareness of the importance of financial management skills and the responsible use of credit.

Real estate brokers and private mortgage lenders also can help prospective homebuyers understand the standards required for loan approval. Industry groups can help to ensure that real estate and mortgage sales staffs are prepared to provide information and assistance to homebuyers on mortgage lending standards and counseling options.

- **Expand discussion on mortgage procedures.** In the last decade, the increased use of automated underwriting, increased reliance on credit scoring and a growing number of mortgage products have all had an impact on the mortgage market. What impact do they have on expanding home ownership opportunities and on mortgage loan denials? Are there systemic biases at work?

MCBC's Mortgage Lending Committee will continue to produce its annual report on mortgage lending patterns which includes tracking of loan denials and disparity ratios. Committee meetings will also continue to include discussion of those trends and of mortgage procedures and other factors which may play a role in the denial of mortgage applications. MCBC encourages industry organizations and the secondary market to address these issues as well.

- **Revisit Mass Bankers' Fair Lending Initiative.** The Fair Lending Initiative, active from 1994-1997, was intended to help banks increase mortgage lending to low- and moderate-income and minority homebuyers and to improve and expand internal fair lending procedures. What lessons were learned? Can we identify effective strategies and/or best practices to address denial disparities? Is it time for a new/revised initiative?

The awareness gained in the development and implementation of the Fair Lending Initiative may have faded with time. MCBC is pleased that the Massachusetts Bankers Association, the Massachusetts Mortgage Association and the Massachusetts Mortgage Bankers Association will convene a Fair Lending Summit in June 2004 to revisit this initiative and to consider next steps.

Appendix A

Massachusetts Community & Banking Council 2004 Board of Directors

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Hyde Park Savings Bank

Kathleen Tullberg, Manager

Appendix B

Massachusetts Community & Banking Council Mortgage Lending Committee

Thomas Callahan*, Massachusetts Affordable Housing Alliance
Jim Campen, Gaston Institute, UMass/Boston
Helena Chaikin, H.O.M.E.
Julie Connelly, Citizens Bank
William Cotter, Boston Department of Neighborhood Development
Joseph Courtney, Boston Department of Neighborhood Development
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Gary Klein, Grant & Roddy
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Janna Peckham, Citizens' Housing & Planning Association
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Richard Thompson, Hyde Park Savings Bank
Heather Hennessey Whelehan, Massachusetts Housing Partnership
Anitt Wilkinson, Federal Reserve Bank of Boston
Odette Williamson, National Consumer Law Center, Inc.
* Committee Co-Chairs

Appendix C

Roundtable Discussion: A Look at Minority Mortgage Loan Denials

March 16, 2004
8:30-11:30 a.m.
Federal Reserve Bank of Boston

Welcome/Introductory Presentations by:

David Harris, Fair Housing Center of Greater Boston, Moderator
Jim Campen, Gaston Institute, UMass Boston
Esther Schlorholtz, Boston Private Bank & Trust Company
Janna Peckham, CHAPA
Tim DeLessio, FDIC

Issues for Discussion:

- HMDA Denial Rates
- Internal Bank Strategies
 - Second look procedures
 - Training/incentives for mortgage originators and underwriters
- Credit problems
 - What bankers see
 - What homebuyer counselors can do
- Homebuyer education
 - Student needs
 - Adequacy of financial education
 - Capacity for credit repair
- Middle/upper income minority homebuyers
- Early intervention
 - Public awareness
 - Financial literacy/credit repair – what’s available, how to find it
- Opportunities for collaboration