
By Samantha Nelums

Summary

This paper analyzes mortgage loans granted under less than optimal conditions, known as subprime mortgage loans. The author explores this as a phenomenon that has affected in particular minorities, and low-income Americans. In recent years, people eager to enter the housing market—many of them first time buyers—borrowed from reckless lenders sums of money, and purchased property, well beyond their means. Borrowers were often unaware—or had limited understanding—of the implications of the terms of their mortgages. Substantial increments in interest rates after an initial grace period and the plummeting of the housing market cause thousands and thousands of borrowers to default in their payments in what has been portrayed as the worst housing market crisis on record.

Introduction:

The taking of unbelievably reachable subprime mortgage loans has occurred all over America, and global investors have jumped in on the bandwagon too. Eventually an overheated economy and a wildly unregulated market has resulted in levels of delinquent accounts of historical proportions. The consequences of not paying off a high mortgage loan can be heartbreaking, and all stakeholders involved suffer if the loans are not paid. The payoff however for receiving a loan, selling a loan, and buying a loan can attract all stakeholders who want to profit for various reasons.

This purpose of these pages is to explore this phenomenon that can be referred to as the melting of the subprime mortgage market, hoping that the reflections here included may help people in the future not to fall victim of reckless lending practices. Some people affected by the crisis were less fortunate than others: there seems to be enough evidence to support the contention that minorities were particularly targeted for subprime mortgage loans. This reflection will hopefully shed light on the issues surrounding subprime mortgage loans.

Buying new home can be exciting, nerve wracking, and complicated all at the same time. A potential homebuyer generally
weighs in the timing of when they want to buy a home, they weigh in how much money they will need to buy a house, and they also consider who they want to buy a home mortgage from. These considerations for buying a house are important factors, but what if someone took care of all of these factors at an initially low price? Low prices for costly investments, such as buying a home, sound like a dream come true for potential homebuyers. The creation of subprime mortgage loans would eventually lead to potential homebuyers owning their own home, and even better, they would own these homes at a low initial buy in rate. After a homeowner completes the process of taking out a large loan for the home, they then would complete the mortgage process; the next step is to move in, and thus, start paying the mortgage for the new home. Suddenly though, homebuyers realize that their new home costs a lot of money, and having to work extra hard just to make the payments becomes grueling. This realization is currently plaguing homeowners who took out subprime mortgage loans, and unfortunately, the cost of owning their homes now starts to be overbearing.

The American Economy Before Subprime Mortgage Loans

In the late sixties and early seventies, America was fresh off of the Civil-Rights movement era. Minorities however were still being denied homes, and lenders themselves were denying minority’s credit and loans. This practice, known as “redlining,” was addressed by the Federal Government with a “Fair Housing Act of 1968, when private lenders did not suddenly end redlining and minority neighborhoods across the nation endured increasing distress as persistent discrimination compounded the efforts of structural urban economic transformation.” (Halloway, 2002, p. 131)

This issue would be addressed in the 1980s, when the American economy was in a period of stagflation (a period of inflation, high unemployment, and low economic production rate in Case and Fair, 1999, p. 405), the Reagan administration responded to the American economy by using ‘supply-side’ policies. This macroeconomic concept was used to give the American economy an incentive to, “work, save, and invest by lowering tax rates.” (Case and Fair, 1999, p. 405) President Reagan also strongly supported anti-inflationary policies such as reducing tax-rates so that capital gain could get routed to the savers, the administration also claimed that cutting tax rates would give people with little income a chance to save. The Reagan Administration’s policies provided an open door to excessive claims and ‘easy money’, yet the poor, including minorities would still remain in the same financial and housing state.” (Hendershott, 2004, p. 282) Minorities and low-income families would not contribute to the housing market, and not necessarily by choice, until the 1990s.

The Reagan Administration’s ‘supply-side’ policies would however increase capital gain for future entrepreneurs, and before America knew it, the ‘dot com bubble’ would arrive. “Between 1995 and 2000, Internet stock prices soared and thousands of newly founded companies raised tens of billions of dollars from venture capitalists and others to pursue internet-related opportunities.” (Hendershott, 2004, p.282) This venture capital can be comparable to subprime mortgage loans in terms of the intents that such venture capitalists were aiming at during the ‘dot com bubble.’ With Wall Street doing well during the boom, along with the local economy, Wall Street’s thoughts soon led to maximizing profits on a global scale. (Neo-classical assumption) As a result, subprime mortgage loans were created.
The act of creating excessive and easily accessible loans would not only maximize profit for lenders and large banking institutions, but it would increase a larger investment relationship with the global economy. The interest rates that come with subprime mortgage loans would be considered “pooled mortgages.” Mortgage institutions would accumulate these debt interest rate gains (attained from borrowers) and sell them as investments to global investors (Hendershott, 2004, p. 282). [Also known as Collaterized Debt Obligations]. Global investors, in turn, would ‘goose’ the investments by investing in Wall Street. Global investors were essentially investing in debt that was not even paid off yet by subprime mortgage borrowers.” (Leonhardt, 2008, pp. 1-2)

Subprime Mortgage Loans:

“Subprime” in mortgage lending refers to loans that do not meet certain credit scales that larger credit or loan companies require. Subprime mortgage loans are sold in the secondary market, this term describes the sale of loans at wholesale price, usually in bulk, to subprime mortgage lenders from smaller lenders in the securitization market (separating mortgage loans from original lender, this takes away the risk associated with the original lender and selling the mortgage loans to a third party, aka: the secondary market and subprime mortgage lending companies). These mortgage loans became accessible to those who had bad credit and could not borrow on the primary market. The primary loan market consisted of borrowers who could borrow large mortgage loans from large banking institutions based on a good credit scale and income rate. Subprime mortgage loans were attractive for borrowers because they were disguised with low initial rates, and anyone who had low-income, bad credit, or little experience in accessing mortgage loans would benefit because they could soon buy a home with little money. (Renuart, 2004, pp. 475-478) As mentioned above, the practice of redlining had historically occurred, but after the creation of subprime mortgage loans, reverse redlining became prevalent, and lenders were looking for anyone and everyone to do business with, so that they too, could maximize their profits.

Dilemmas With Subprime Mortgage Lending

Increased tax rates in 2000, along with an unforeseen housing market crash would lead to numerous dilemmas in the subprime mortgage market. To begin with borrowers, these were the people who initially took out a subprime mortgage loan at a low buy in rate, and a low interest rate, but by the ending of the ‘dot com bubble’ came borrowers inability to pay such high interest rates on their subprime mortgage loans. The borrowers had to foreclose their houses. Studies have shown that, “the rate at which loans go into foreclosure is significantly higher in the subprime market.”1 A micro study (Immergluck, and Wiles, 2001) that I found in author Elizabeth Renuart’s article, “An Overview of Predatory Mortgage Lending Process,” found that, “in Chicago, subprime loans lead to foreclosure at 20 or more times the rate then prime loans, aka loans given to those who had better credit with a less risky loan process involved, done through large firms like Fannie Mae.”(Renuart, 2004, pp. 457-478)

Assumptions:

The eagerness for subprime mortgage lenders to sell mortgages would drive them to hasty loan practices. These practices would
Subprime Mortgage Loans

in turn be targeted towards borrowers who were eager as well to attain a loan, and not surprisingly, minorities and low-income families would serve as much of my research findings. In finding micro and macro research from pre-existing data, I could see that everyone involved in the subprime mortgage lending industry, including global investors, had intents of maximizing their profits at any cost, therefore by creating low buy-in and interest rates, borrower’s demand for such loans became high. The lenders on the other hand were not only maximizing their profits by reverse redlining, but they were also selling these debts to global investors. Subprime mortgage loans sound like a beneficiary for everyone, but research studies have shown that borrowers ultimately are the ones that lose out.

Lenders

The subprime mortgage lenders are considered a “holder, trustee, or lender.” These stakeholders work for smaller capital based mortgage companies that take out a line of credit from larger banking institutions. The subprime mortgage lender, holder, or trustee act as middlemen for the small mortgage based companies. The subprime mortgage lender buys loans at a wholesale price from smaller originating loaners (securization). The secondary market, in which the small mortgage company, along with their lenders, buy wholesale mortgage loans from smaller lenders, and these smaller lenders are then completely out of the picture. Subprime mortgage lenders want to maximize their profit, and in doing so, they would target people who would sign loans with out knowing that hidden costs would included, and the lenders, along with their companies, could make even more profit off of these costs, not to mention the high interest rates that were to come for the victimized subprime mortgage borrowers. (Canner and Passmore, 1999, pp. 709-724).

Predatory Market Lending

Lenders wanted to find people who traditionally have been denied mortgage loans; “Predatory mortgage lending” consisted of subprime mortgage lenders targeting specific borrowers. Such characteristics of borrowers targeted would be low-income families, people of color, (as my findings show mostly African Americans and Hispanics), and borrowers who did not understand or fully read the loan terms that were created by the lender. Two different micro studies in urban, metropolitan cities found that:

“In Philadelphia, 21 percent of loans was predatory. (The predatory lending consisted of manipulating property data, saying that there is more property value then there really is...thus making up property size). In Montgomery County Ohio, a random sample of mortgage loans associated with foreclosure revealed that 21 percent were predatory mortgage loans. (Consisted of fluctuating interest rates, fixed verse adjustable rates).” (Canner and Passmore, 1999, pp. 709-724)

Marketing and the sale of loans is also a manipulation that predatory mortgage lenders have partaken in. In one finding, the predatory Market is a push market targeting homeowners who are not generally seeking home loans. Within this Market, brokers and lenders are searching for soliciting borrowers. The marketing practices include aggressive solicitations in targeted neighborhoods that often include older and minority homeowners, steering of borrowers to higher-rate lenders, door-to-door solicitation of business by home improvement contractors who arrange financing, and mobile home dealers acting as conduits for lenders.(Canner and Passmore, 1999, pp. 709-724) In four cities in California (on a more local basis), the authors reported that, “25 percent of the sur-
veyed homeowners took out loans from a subsidiary or affiliate of a financial institution, yet none were referred to the prime lender for lower-cost loans. It is interesting to note that 60 percent of all surveyed homeowners believed that they had good or excellent credit.” (Stein and Libby, 2001)

Another interesting aspect when analyzing predatory loan practices are the loan terms and application process. In predatory mortgage lending, subprime lenders would falsify the borrower’s information, such as skewing their income level, inflating the value of a home through a partnership with an unscrupulous appraiser, and even worse, forging necessary signatures. (Renuart, 2004, pp. 479-481) Loan terms are the other means in which predatory lenders can manipulate a borrower. In association to subprime mortgage loans, high interest rates, high fees, high appraisal costs, back-dating of documents, charges for duplicative of services, and mandatory credit services, (Renuart, 2004, pp. 479-481) all serve as devices that lenders use to gain profit.

Borrowers

After reviewing predatory mortgage lending, it is easy to say that borrowers are victimized by predatory subprime mortgage lending practices. In multiple findings, borrower characteristics showed that women and elderly attributed for some sort of inequality in data findings. When authors and researchers addressed minority subprime mortgage lending, African Americans and Hispanics were the main victims. (At least that is what pre-existing data shows) These characteristics are not representing the full range of American mortgage loan borrowers. The following data shows enough empirical data to prove that subprime mortgage loans have strategically been given to certain borrowers.

Women, Elderly, Low-Income Families:

This paper’s first findings showed that low and moderate-income families, women, and older homeowners may be overrepresented in the subprime and predatory markets. According to 1998 Home Mortgage Disclosure Act (HMDA) data, about 50 percent of the subprime refinancing market consisted of loans to low and moderate-income borrowers, whereas this percentage was just about 34 percent in the prime market. Women accounted for 29 percent of subprime refinancing mortgages, compared with 43 percent of all subprime refinancing mortgages.” (U.S. Department of Treasury and U.S. Department of Housing and Urban Development, 2008) When refinancing happens, an already made subprime mortgage loan gets adjusted and renewed with new terms, perhaps a fixed interest rate, but even so, there is a large fee tacked on just for conducting a subprime mortgage refinancing loan. Interestingly enough, age seemed to play a factor in subprime refinance loans, “those who were 45 and older represent 56 percent of all subprime refinancing borrowers, compared with a 43 percent of prime borrowers. Borrowers 55 and older make up 35 percent of subprime borrowers alone.” (U.S. Department of Treasury and U.S. Department of Housing and Urban Development, 2008)

When examining the general borrower characteristics of subprime mortgage loans, low-income families located in metropolitan areas seemed to be targeted heavily. When thinking about low-income families in need of a home, it is about housing wealth equity. Housing wealth and equity, in the case of low-income families, is based on educational attainment, physical and cognitive functioning, occupation of employment, and horizon planning.” (Flippen, 2001, pp. 134-136) This kind of data would explain the reasoning for targeted characteristics of borrowers, especially low-income families where, contributing to the fact that they are low-income, generally human capital is hard
to attain due to the lack of resources needed to move up in the work and educational force.

To further explain the case of low-income families as victims of predatory mortgage lending and subprime mortgage loan processes, low-income parents who support their families work at jobs where there hourly wage, or wages in general are low. For example, in labor unions across America, labor strategies by employees are being taken to the next level such as unionization occurring. (Offner, 2003, pp. 203-217) This process, if completed successfully, could increase the income of a low-income family, but in general terms, such processes that form resistance to American corporations fail due to American corporation’s power to simply hire other employees. This form of resistance however, is important to point out, because if low-income immigrant workers in the unionization process, form resistance to predatory mortgage lending, and subprime mortgage lending practices, maybe more recognition of such practices will be seen.

**African Americans:**

The discussion of income plays a role in my research findings for African Americans and subprime mortgage loans. The issue of targeting race for subprime mortgage loans as opposed to “credit risk” characteristics for borrowers is shown in a national study conducted by Paul Calem, Kevin Gillen, and Susan Wachter in 2002. The researchers found that African Americans are represented disproportionately in the subprime market, even at upper income levels. They continued to find that, “Lower-income blacks receive 2.4 times as many subprime loans as lower-income whites. However, the upper-income blacks receive 3 times as many subprime loans as whites with comparable income.” (Calem, Gillen, and Wachter, 2002, p. 14)

These facts alone are alarming, because regardless of income, African Americans are still more likely to be targeted for subprime mortgage loans. These researchers found a “statistically significant relationship such that African American borrowers, regardless of the neighborhood where they are located, have relatively high likelihood of obtaining a subprime loan compared to a prime loan.” In 2002, a micro study conducted by Ken Zimmerman found, “New Jersey Blacks are 2.5 times more likely to be provided subprime loans than whites.” (Zimmerman, 2002) These findings tend to highlight the metropolitan cities, but “high concentrations of subprime lending and racial disparities in subprime lending exist in all regions throughout the United States and in metropolitan areas of all sizes.” (Bradford, 2002)

**Hispanics**

Researchers had similar findings with Hispanics in comparison to African Americans. In the same report by, Paul Calem, Kevin Gillen, and Susan Wachter in 2002, their findings also concluded that, “Lower income Hispanics receive 1.4 times as many subprime loans as lower income-whites, while the upper-income Hispanics receive 2.2 times as many subprime loans as upper-income whites.” (Calem, Gillen, and Wachter, 2002, p. 14) Income level for Hispanics played a little role in the deciding factor for subprime mortgage lending as well. Another micro study conducted by Ira Goldstein showed that, areas within Philadelphia with a higher potential vulnerability to predatory lending tended to have greater concentrations of foreclosure sales; areas that are predominantly African American and/or Hispanic also tended to have higher concentrations of foreclosure sales and were more vulnerable to predatory lend-
This micro study can support this paper claims that the effect of region on housing is also markedly different across groups. This claim is also true for regions such as in the Northeast and West relative to the South, is significantly stronger among blacks and Hispanics than it is among whites. This too, suggests the role of discrimination in undermining minority housing wealth. “In housing markets characterized by high entry costs, where average debt-to-income ratios are higher and loans more risky, blacks and Hispanics are more adversely affected then whites.”(Flippen, 2001, p. 136)

Interest Rates (APR’s) and Minorities:

An interesting study conducted by Chenoa A Flippen in the Spring of 2004 comprised of an aggregate table that displays interest rates and minorities compared to Whites. In the realm of predatory mortgage lenders in the subprime mortgage lending process, they can create loan terms with interest rates that are not fixed. These interest rates fluctuate based on mortgage payments made each month, and some interest rates will fluctuate just based off of whatever terms that the lender creates.

### 2004-2005 Aggregate Count of Subprime Mortgage Representing APR Rates for African Americans, Hispanics and Whites

<table>
<thead>
<tr>
<th>Year</th>
<th>Borrower/Race Ethnicity</th>
<th>Mean APR</th>
<th>Mean Subprime APR</th>
<th>Mean Prime APR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>African American</td>
<td>7.22</td>
<td>8.48</td>
<td>6.25</td>
</tr>
<tr>
<td>2004</td>
<td>Hispanic</td>
<td>6.58</td>
<td>7.86</td>
<td>5.94</td>
</tr>
<tr>
<td></td>
<td>White Non-Hispanic</td>
<td>6.03</td>
<td>7.83</td>
<td>5.65</td>
</tr>
<tr>
<td></td>
<td>African American Minus White Non-Hispanic</td>
<td>1.2</td>
<td>0.65</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td>Hispanic Minus White Non-Hispanic</td>
<td>0.56</td>
<td>0.03</td>
<td>0.29</td>
</tr>
<tr>
<td></td>
<td>African American</td>
<td>7.99</td>
<td>9.57</td>
<td>6.72</td>
</tr>
<tr>
<td></td>
<td>Hispanic</td>
<td>7.45</td>
<td>9.24</td>
<td>6.5</td>
</tr>
<tr>
<td></td>
<td>White Non-Hispanic</td>
<td>6.71</td>
<td>9.07</td>
<td>6.25</td>
</tr>
<tr>
<td></td>
<td>African American Minus White Non-Hispanic</td>
<td>1.28</td>
<td>0.5</td>
<td>0.47</td>
</tr>
<tr>
<td>2005</td>
<td>Hispanic</td>
<td>1.28</td>
<td>0.5</td>
<td>0.47</td>
</tr>
<tr>
<td></td>
<td>Hispanic Minus White Non-Hispanic</td>
<td>0.74</td>
<td>0.17</td>
<td>0.25</td>
</tr>
</tbody>
</table>

Source:

This table includes mean, or average, percentage rates that minorities APR comparisons, and it clearly shows that minority borrowers pay higher APRs than non-minority borrowers. In 2004, the mean APR of African American borrowers is 120 basis points above White non-Hispanic borrowers and the mean APR of Hispanic borrowers is 56 basis points above White non-Hispanic borrowers. In 2005, these differences grow to 128 basis points above White non-Hispanic borrowers for African American borrowers, and 74 basis points above White non-Hispanic borrowers for Hispanic borrowers. (Flippen, 2001, p. 136) These points show a disparity between all three ethnicities, and just for the 2004-05 year, Whites had at least one percent lower APR’s compared to both African Americans and Hispanics.
Consistency of Data, Suggestions, Conclusion

The consistency of this paper’s findings from study to study raises the real question of whether discrimination and steering account more for placement in the subprime market. Sociological explanations as to why African Americans, Hispanics, women, and low-income families choose subprime mortgage loan could be related to home owning equity and wealth. Factors such as education, employment, preference, location of neighborhoods, and human capital access all contend with my notion that minorities, women, and low-income families are victims of subprime predatory mortgage lending practices. The practices alone act as the mechanism, and the subprime loan itself essentially created the dilemma of hasty loan practices from the beginning. Lenders who want to maximize their profits by ruthlessly targeting people who are not capable of paying off a mortgage loan, needs to come to an end.

The secondary market, and subprime mortgage lenders are middle men to mortgage companies that also want to maximize their profits. Borrowers are unable to make payments to the lenders, and lenders are selling mortgage debt to global investors. Global investors are investing money that does not even exist. These investors are incapable of controlling the American economy; including the American economy’s interest rates and housing market. Subprime mortgage loans should be defeated altogether. If a specific borrower has low-income, or they lack resources to make payments, loaning them a large amount of money would not be a good idea in the first place. Lenders are putting themselves at risk due to their eagerness for profiteering.

The federal government does have regulations to protect unlawful predatory mortgage lending, but low-income families do not have the money to pay a lawyer to defend their case. Many subprime mortgage borrowers are unaware that they were even victims of predatory mortgage lending practices. The only awareness that is brought to the federal government’s attention are court cases, which is not occurring enough compared to the amount of subprime mortgage borrowers’ homes going into foreclosure. This issue of victimizing borrowers can only be stopped through awareness, and third parties who watch over the loan process should not be affiliated with the subprime mortgage lender, or their company. This third party could act as the mediator, and they should be required for all loan practices as it is.

Bibliography


Flippen, C. (Spring, 2001). “Racial and Ethnic Inequality In Homeownership and


