# Unequal Burden In Chicago:

## Income and Racial Disparities in Subprime Lending

## May 2000

U.S. Department of Housing and Urban Development
Office of Policy Development and Research

# UNEQUAL BURDEN IN CHICAGO: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING

This study of subprime lending in Chicago is part of a series that is constructing a national look at the growth in subprime lending.[1] Over the last decade, the amount of money available for home mortgages to borrowers with blemished or insufficient credit histories has grown at a tremendous rate. From 1993 to 1998, the number of subprime refinance loans reported under HMDA increased ten-fold – from 80,000 subprime refinance loans in 1993 to 790,000 in 1998. In 1994, the $35 billion in subprime mortgages represented less than 5 percent of all mortgage originations. By 1999, subprime lending had increased to $160 billion, almost 13 percent of the mortgage origination market.

In November 1999, the Woodstock Institute released a report, "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," that analyzed the growth of subprime lending in Chicago's minority and low-income neighborhoods. The Woodstock Institute found that prime lenders active in white and upper-income neighborhoods tend to be much less active in lower-income and minority neighborhoods – effectively leaving these neighborhoods to unregulated subprime lenders. The Woodstock Institute concluded that segmentation of the mortgage market by neighborhood racial composition provides a fertile ground for predatory lending since these practices are generally found among subprime lenders.[2]

HUD's analysis of home refinance lending in different metropolitan areas across the nation reveals the same troubling trend. Minority neighborhoods are underserved by prime lenders in the refinance market and disproportionately rely upon subprime lenders to refinance their mortgages. In October 1999, a HUD analysis of mortgage trends reported that the subprime share of the home refinance market in neighborhoods where minorities comprised at least 30 percent of the population had increased from 3 percent in 1993 to 23 percent in 1998 compared to an increase from one percent in 1993 to 12 percent in 1998 for the nation overall.[3]

---

[1] For a national analysis, see the HUD report Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000. For similar analyses of the Atlanta, Los Angeles, New York, and Baltimore metropolitan areas, see the HUD reports: Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending, April 2000; Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending, May 2000; Unequal Burden in New York: Income and Racial Disparities in Subprime Lending, May 2000; and Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending, May 2000.

[2] "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," Woodstock Institute. Chicago, IL, November 1999.

[3] See Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

The growth in subprime lending over the last several years has been a beneficial development for borrowers with impaired or limited credit histories. Subprime lenders have allowed such borrowers to access credit that they could not otherwise obtain in the prime credit market. However, there is a growing body of anecdotal evidence that a subset of these subprime lenders, who generally operate outside the federal regulatory structure, engage in abusive lending practices that strip borrowers' home equity and place them at increased risk of foreclosure. For this reason, this report examines patterns in subprime lending to understand where the risk and impact of predatory practices may be highest.

## AN OVERVIEW

This study presents a preliminary analysis of mortgage originations in the Chicago metropolitan area in 1998 using data reported under the Home Mortgage Disclosure Act (HMDA). Nationwide, the HMDA data demonstrate the rapid growth of subprime refinance lending during the 1990s and further, the disproportionate concentration of such lending in the nation's low-income and minority neighborhoods.[4] These same conclusions hold in the Chicago metropolitan area.

By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending can and does serve a critical role in urban areas such as Chicago. Some borrowers may have blemishes in their credit record, insufficient credit history, or non-traditional credit sources. The subprime loan market offers these borrowers opportunities to obtain loans that they would be unable to realize in the prime loan market.

But there are two sides to this story. Since subprime lending often operates outside of the federal regulatory structure, it may be a fertile ground for predatory lending activities. Anecdotal evidence suggests that these practices may include imposing and financing excessive fees, bundling high-cost loans with lump-sum credit life insurance, and requiring prepayment penalties. Predatory lending can have disastrous consequences for less financially savvy borrowers. Equity may be stripped from their homes, and in more egregious cases, they may lose their homes altogether.

Some prime lenders have made significant progress in reaching underserved communities. A recent report for the Treasury Department showed that banks and thrifts increased the share of their mortgage originations to low-income borrowers and borrowers in low-income communities from 25 percent in 1993 to 28 percent in 1998.[5]

---

[4] See the HUD report Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000.

[5] Robert E. Litan, Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag, The Community Reinvestment Act After Financial Modernization: A Baseline Report, U.S. Department of Treasury, April 2000.

However, as the evidence in this report suggests, there are many Chicago neighborhoods that could benefit from increased competition from prime lenders in the home refinancing market. Such increased competition would give borrowers in these communities alternative options to lenders that may engage in abusive lending practices.

The first step to ensuring that subprime lending enhances the economic health of the borrowers' families without exposing them to predatory practices is to learn more about how and where it operates in America. To further understand geographic disparities, HUD has analyzed the problem nationwide and has now taken a look at the data on subprime lending in Chicago.[6]

## THE FINDINGS FOR CHICAGO

In general, the analysis shows that subprime lending is more prevalent in lower-income and minority neighborhoods than in higher-income and white neighborhoods. This likely indicates that because of their lower incomes, lenders may consider these borrowers to be a higher credit risk, and these borrowers may therefore be less likely to qualify for prime loans. However, a lack of competition from prime lenders in these markets to find creditworthy borrowers may increase the chances that borrowers are exposed to the predatory practices of a subset of subprime lenders. There is also evidence suggesting that after controlling for income, predominantly black neighborhoods may be comparatively underserved by prime lenders.

The importance of subprime lending to minorities and low-income Americans, which is documented in what follows, demonstrates how important it is to these communities that subprime lending not include any lenders engaging in predatory practices.

1. **As reported in HMDA, the number of subprime refinance loans originated in Chicago increased over 1,600 percent between 1993 and 1998.** The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the Chicago metropolitan area increased from 1,582 loans in 1993 to 27,470 in 1998.

2. **Subprime loans are six times more likely in low-income neighborhoods in Chicago than in upper-income neighborhoods.** In low-income neighborhoods, subprime loans accounted for 31 percent of all refinance loans

---

[6] HUD identifies subprime loans in HMDA using a list of lenders that primarily originate subprime loans. For the list of lenders and a discussion of the methodology, see Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

originated during 1998 – compared with 5 percent in upper-income neighborhoods.[7]

3. **Subprime loans are over eight times more likely in predominantly black neighborhoods in Chicago than in white neighborhoods.[8]** In predominantly black neighborhoods in Chicago, subprime lending accounted for 52 percent of home refinance loans originated during 1998 - compared with only 6 percent in predominantly white neighborhoods.

4. **Homeowners in middle-income predominantly black neighborhoods in Chicago are six times as likely as homeowners in middle-income white neighborhoods to have subprime loans.** In 1998, only 8 percent of borrowers in middle-income white neighborhoods obtained subprime refinance loans while 48 percent of borrowers in middle-income black neighborhoods refinanced in the subprime market.[9]

5. **The findings are similar when borrowers (rather than neighborhoods) throughout the Chicago metropolitan area are examined.** In 1998, 53 percent of the refinance loans for low-income black borrowers throughout the Chicago metropolitan area were subprime loans, compared with only 10 percent of loans for low-income white borrowers.

In addition, a recent study by the National Training and Information Center (NTIC) of foreclosures in Chicago found that foreclosures of mortgages originated by subprime lenders have substantially increased since 1993.[10] Subprime lenders in the Chicago area were responsible for 36 percent of foreclosures in 1998, compared with only 1 percent in 1993. This study of foreclosures in Chicago is consistent with studies of

---

[7] The census tract income categories are as follows: low-income tracts have median incomes that are less than 80 percent of the metropolitan area median income (AMI); middle-income tracts, between 80 percent and 120 percent AMI, and upper-income tracts, greater than 120 percent AMI. These income categories are also used for analyses of borrower incomes relative to the area median income.

[8] This paper adopts the classification of tracts in the Woodstock Institute report, "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," Chicago, IL, November 1999. That is, predominantly white neighborhoods are tracts where the minority percentage is less than 15 percent; and predominantly black neighborhoods are tracts where blacks comprise at least 75 percent of the population. The racial composition of neighborhoods is based on 1990 census data; there may have been some changes in racial composition by 1998.

[9] Of the predominantly black tracts in the Chicago area, there were 287 low-income tracts and 44 middle-income tracts, but only 4 upper-income tracts. Thus, this analysis of the Chicago market is restricted to low-income and middle-income, predominantly black tracts. See HUD's Unequal Burden: Income and Racial Disparities in Subprime Lending in America (April 2000) for a separate analysis of upper-income predominantly black tracts at the national level.

[10] NTIC, Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures, September 1999.

foreclosure in Atlanta and Baltimore, which found that, like originations, the subprime share of foreclosures is highest in lower-income and minority neighborhoods. The NTIC study is reviewed below.

## THE ANALYSIS

Subprime mortgage lending provides credit to borrowers with past credit problems, often at a higher cost or less favorable terms than loans available in the conventional prime market. In most cases, these lenders offer credit to borrowers who would not qualify for a loan in the prime market, thus expanding access to credit and helping more families to own their own homes. The higher costs of these loans may serve to offset the increased risk that these lenders assume in lending to these borrowers.[11]

In some cases, however, subprime lenders engage in abusive lending practices known as "predatory lending", which hits homeowners with excessive mortgage fees, interest rates, penalties and insurance charges that raise the cost of refinancing by thousands of dollars for individual families.

HUD's study of subprime lending focuses mainly on subprime refinance lending, which accounts for nearly 80 percent of total (home purchase and refinance loans combined) subprime mortgage lending nationwide and for 84 percent of subprime lending in Chicago.[12] HUD's study of subprime loans in the Chicago metropolitan area found that:

1. **As reported in HMDA, the number of subprime refinance loans originated in Chicago increased by 1,600 percent between 1993 and 1998.**

The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the Chicago metropolitan area increased from 1,582 loans in 1993 to 27,470 loans in 1998. (See Figure 1.)

The magnitude and speed of the increase in subprime lending creates a critical need for greater scrutiny. The rapid growth of subprime lending may help expand credit access for more borrowers; however, some portion of subprime lending may be occurring with borrowers whose credit would qualify them for conventional loans. Subprime lending may expose borrowers to higher up-front fees and interest rates than they would bear if they had obtained prime loans.

---

[11] However, there is evidence that the higher interest rates charged by subprime lenders cannot be fully explained solely as a function of the additional risks they bear. See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000.

[12] Subprime lenders are also active in the home improvement market. Home improvement loans of subprime lenders were excluded from these comparisons.

2. **Subprime loans are six times more likely in low-income neighborhoods in Chicago than in upper-income neighborhoods.**

HUD's analysis reveals that subprime lending is being provided increasingly to low- and very low-income families and their communities. In Chicago, 11 percent of all refinance mortgages in 1998 were subprime, but in low-income neighborhoods, the percentage of refinances in the subprime market was almost three times as large -- 31 percent. (See Figure 2). In the poorest communities, where families make 50 percent or less of the area median income, subprime refinances accounted for 42 percent of all refinance loans. In middle-income neighborhoods, 11 percent of refinancing families relied on a subprime loan, as did only 5 percent in upper-income neighborhoods. According to HMDA data for 1993, only 3 percent of refinance mortgages in low-income neighborhoods and 1 percent in upper-income neighborhoods were subprime.

3. **Subprime loans are over eight times more likely in black neighborhoods in Chicago than in white neighborhoods.**

In predominantly black neighborhoods in Chicago, subprime lending accounted for 52 percent of home refinance loans in 1998 - compared with only 6 percent in predominantly white areas. Thus, while subprime refinance mortgages accounted for only one in sixteen refinance loans originated in predominantly white neighborhoods, they accounted for one half the refinance loans originated in predominantly black neighborhoods. (See Figure 3.) Comparable 1993 figures reported by HMDA were 5 percent in predominantly black neighborhoods and 1 percent in predominantly white neighborhoods.

4. **Homeowners in middle-income black neighborhoods in Chicago are six times as likely as homeowners in middle-income white neighborhoods to have subprime loans.**

Notably, even after controlling for differences in neighborhood income, homeowners in black communities are more likely than homeowners in white communities to refinance in the subprime market. (See Figure 4.) Among homeowners living in low-income black neighborhoods, 54 percent turned to subprime lenders, compared with 8 percent of homeowners living in low-income white neighborhoods. This disparity also existed in higher income neighborhoods. Among homeowners living in middle-income black neighborhoods, 48 percent turned to subprime lenders, compared with 8 percent of homeowners living in middle-income white neighborhoods. In fact, the subprime share (48 percent) for middle-income black neighborhoods is six times larger than the subprime share (8 percent) for lower-income white neighborhoods.[13]

[13] It should be noted that there are only 10 low-income predominantly white tracts. Subprime mortgages accounted for 72 of the 873 refinance originations in these neighborhoods.

The map of the Chicago metropolitan area summarizes the neighborhood concentration of subprime refinance loans. (See Figure 5.) In 1998, subprime mortgages accounted for at least 25 percent of all refinance mortgages in 438 (or 25 percent) of the 1,767 census tracts in the Chicago metropolitan area refinance market. Census tracts where blacks comprised more than 30 percent of the population (black neighborhoods) accounted for 367 of these 438 census tracts. On a market share basis, black neighborhoods accounted for 10 percent of all refinances in the Chicago metropolitan area but for 41 percent of all subprime refinances.

**5. The findings are similar when borrowers (rather than neighborhoods) throughout the Chicago metropolitan area are examined. In 1998, 53 percent of low-income black borrowers in the Chicago metropolitan area relied upon subprime loans.**

This section analyzes the Chicago data by individual borrowers instead of entire neighborhoods; the impacts are similar. Subprime refinances accounted for 22 percent of all refinancing by low-income borrowers throughout the Chicago metropolitan area; only 6 percent of upper income borrowers relied upon subprime refinancing. (See Figure 6.) The borrower data show that blacks in the Chicago metropolitan area are also carrying a large proportion of subprime: in 1998, 39 percent of refinance mortgages for black borrowers were subprime, compared with only 5 percent for white borrowers.[14]

Combining data on the income and racial characteristics of the borrower shows large disparities between black and white borrowers with similar incomes. Subprime loans accounted for 53 percent of refinance loans originated for low-income black borrowers, compared with only 10 percent for low-income white borrowers. (See Figure 7.) Similarly, subprime loans accounted for 38 percent of refinance loans for middle-income black borrowers, compared with only 6 percent for middle-income white borrowers. In fact, upper-income black borrowers were over four times more likely as middle-income white borrowers to rely on the subprime market (27 percent of upper-income blacks versus 6 percent of middle-income whites); and were also almost three times as likely as low-income white borrowers to rely upon the subprime market (27 percent for upper-income blacks versus 10 percent for low-income white borrowers).

[14] It should be noted that borrower race and ethnicity data was not provided for 24,435 (10 percent) of the 258,469 refinance originations and for 6,857 (25 percent) of the 27,470 subprime refinance originations. Since the "not provided" data was a higher percentage of the subprime totals than of the market totals, and given that black borrowers account for a large percentage of subprime loans, any method of reallocating this "not provided" data would increase the presence of the subprime market among black borrowers.

## FORECLOSURES IN CHICAGO

Recent studies have found that there has been a rapid increase in mortgage foreclosures paralleling the trend of rapidly increasing subprime lending. The first study to document the link between subprime loans and foreclosures in urban areas was conducted in 1999 by the National Training and Information Center (NTIC).[15] The NTIC study focused on completed foreclosures between 1993 and 1998 in the Chicago area, including the City of Chicago, suburban Cook County, and DuPage and Will counties.[16] Specific findings from the NTIC study about the link between foreclosures and the subprime market are as follows:

- Completed foreclosures in the Chicago area doubled over the five-year period, rising from 2,074 in 1993 to 3,964 in 1998. The increase in foreclosures corresponded to the increase in originations by subprime lenders, which rose from 3,137 in 1991 to 50,953 in 1997. The subprime share of the mortgage origination market had risen from 3 percent in 1991 to 24 percent in 1997.

- Subprime lenders and servicers were responsible for 1,417 foreclosures in 1998, compared with only 30 foreclosures in 1993. Their share of total foreclosures increased from 1 percent in 1993 to 36 percent in 1998.

- Foreclosures on loans originated after 1994 had higher average interest rates than foreclosures on loans originated before 1994. Between 1993 and 1998, the greatest growth in foreclosures was on loans with interest rates 4-8 percentage points above the 30-year Treasury rate. The NTIC study notes that this increase in high-interest-rate foreclosures coincides with the growth in subprime lending in the Chicago area.

- Fast foreclosures in the Chicago area have grown rapidly and are linked to subprime lenders. The NTIC found that the vast majority of foreclosures on home loans less than two years old were foreclosed by subprime lenders.

---

[15] NTIC, Preying on Neighborhoods: Subprime Mortgage Lenders and Chicagoland Foreclosures, September 1999.

[16] NTIC obtained foreclosure data from the Foreclosure Report of Chicago, a private, for-profit company that collects foreclosure court filings. Unlike the studies of foreclosures by Abt Associates and HUD (discussed below) which focused on foreclosures initiated, the NTIC study focused on “foreclosures completed” where the property was sold at an auction.

In addition to the NTIC study, Abt Associates has conducted a foreclosure study of the Atlanta market and HUD has conducted a similar study of the Baltimore market.[17] These studies reach similar conclusions to those discussed above for the NTIC study. They found that foreclosures on loans initiated by subprime lenders accounted for a large portion of all mortgage foreclosures in the Atlanta and Baltimore markets, that they occur much more quickly than foreclosures on prime loans, and that they are concentrated in low-income and black neighborhoods. For example, HUD's study of Baltimore found that subprime loans accounted for 57 percent of foreclosures initiated in predominantly black neighborhoods – a figure larger than the subprime share (42 percent) of mortgage originations in these neighborhoods. The HUD, Abt and NTIC studies raise serious questions and concerns about the impact of subprime lending on low-income and minority neighborhoods in our major urban areas.

## CONCLUSIONS

HUD's analysis of refinance mortgages originated in the Chicago metropolitan area during 1998 clearly demonstrates the exponential growth in subprime lending and its growth for lower-income and, particularly, minority homeowners and communities. The NTIC analysis of foreclosures in Chicago shows that increased levels of foreclosures have accompanied this increase in subprime lending. While the growth in subprime lending has expanded access to credit for many borrowers with impaired or limited credit histories, these borrowers may also be vulnerable to predatory lending practices and possible loss of their homes.

Despite the progress made by prime lenders in reaching these markets, the growth of subprime lending in both lower-income and minority communities strongly suggests that much more can be done by both primary and secondary market participants to expand access to the prime lending market.

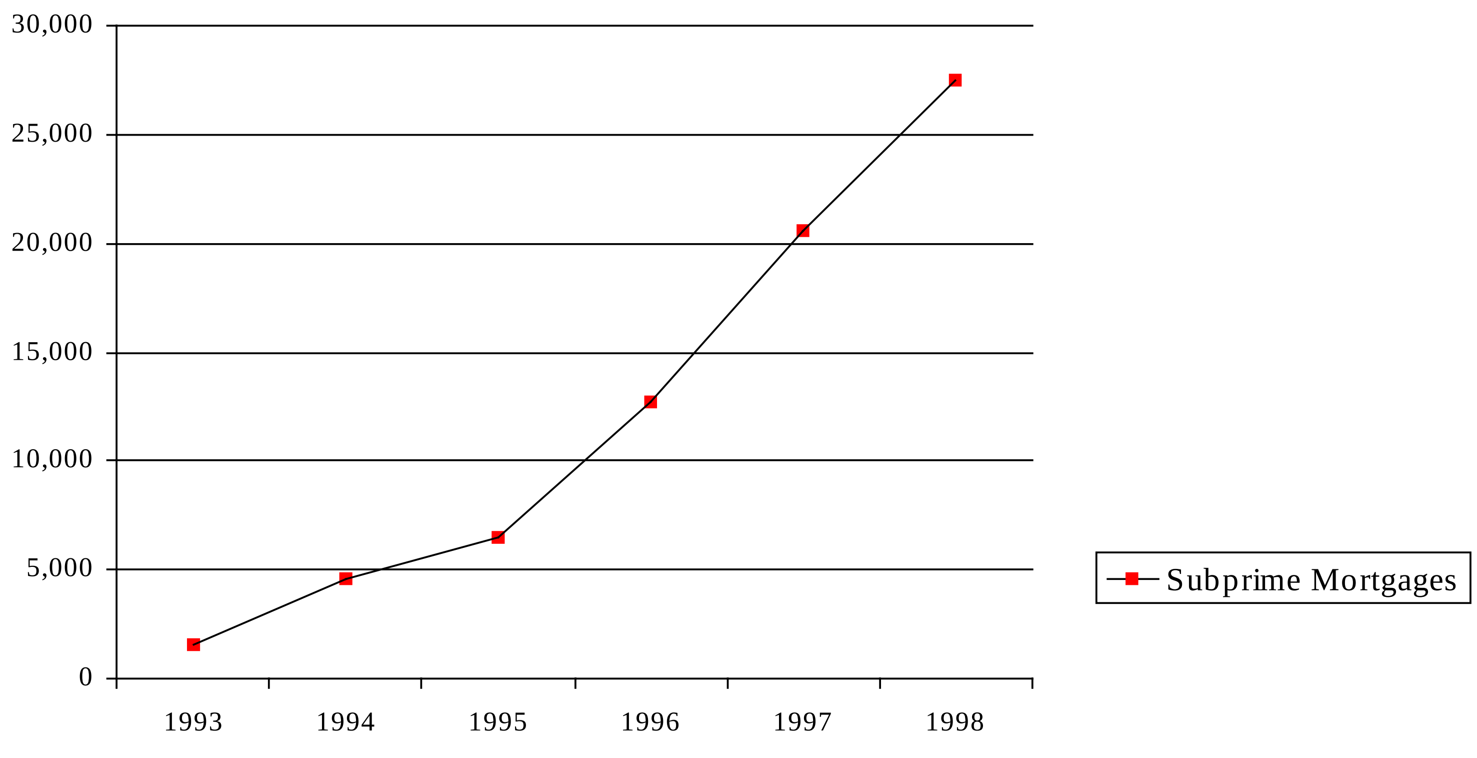
[17] See Abt Associates Inc., Analyzing Trends in Subprime Originations and Foreclosures: A Case Study of the Atlanta Metro Area, February 2000; and the HUD study, Unequal Burden in Baltimore: Income and Racial Disparities in Subprime Lending, May 2000.

**Figure 1**

# Growth in Subprime Refinance Lending

## (Chicago Metropolitan Area)

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|
| Subprime Mortgages | 1,582 | 4,582 | 6,512 | 12,726 | 20,537 | 27,470 |




Source: 1993-1998 HMDA Data

**Figure 2**

# Subprime Share of Refinance Mortgages by Neighborhood Income

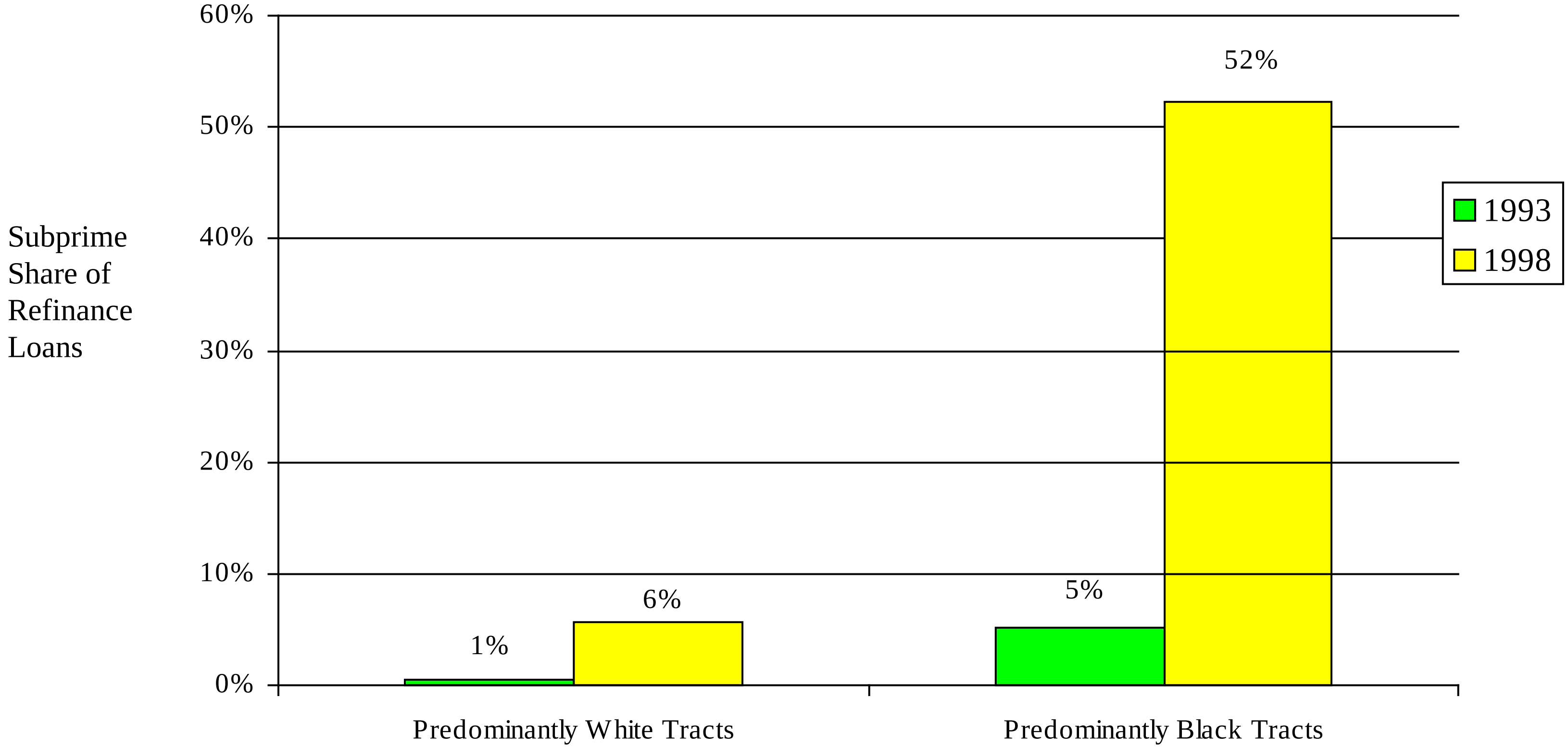
## (Chicago Metropolitan Area)


Note: Low-Income Tracts: Not More than 80% AMI; Middle-Income Tracts: 80-120% AMI; Upper-Income Tracts: More than 120% AMI.

**Figure 3**

# Subprime Share of Refinance Mortgages by Neighborhood Race

## (Chicago Metropolitan Area)

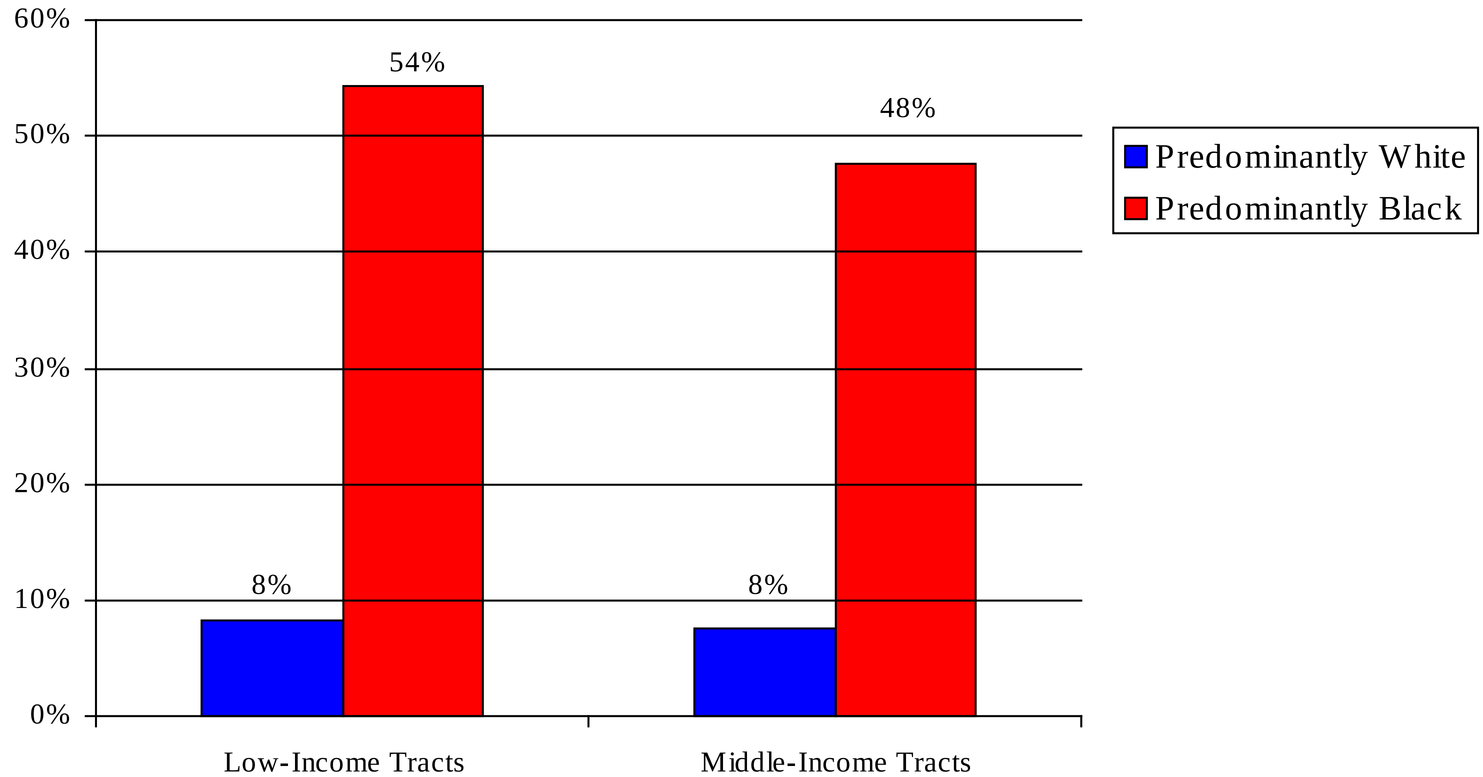



Note: Predominantly White Tracts: At least 85% White; Predominantly Black Tracts: At least 75% Black.

**Figure 4**

# Subprime Share of 1998 Refinance Mortgages by Neighborhood Race and Income

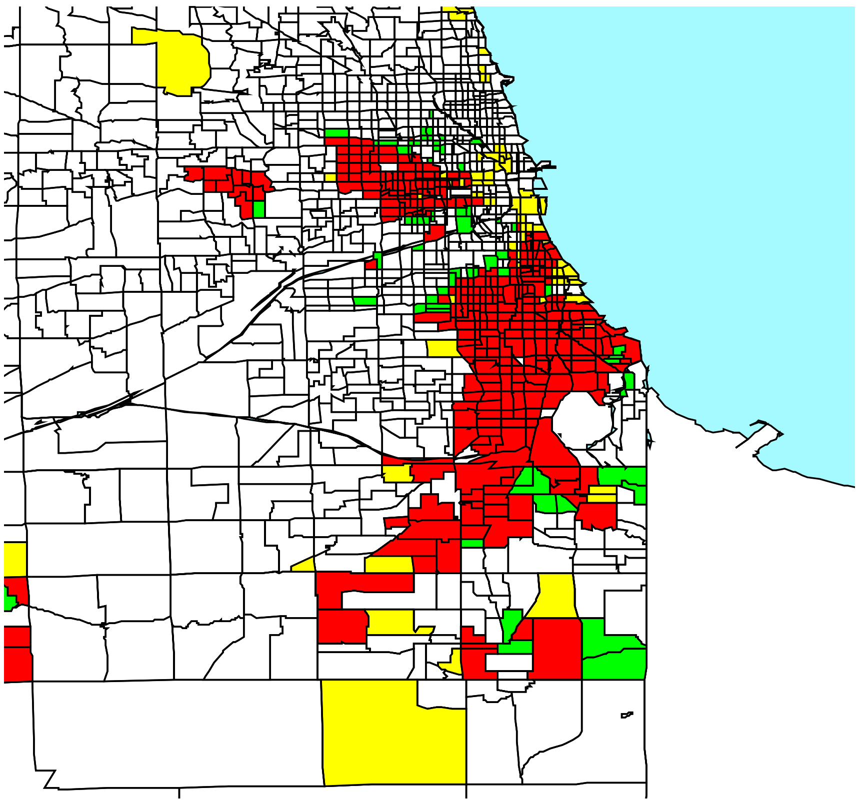
## (Chicago Metropolitan Area)




Note: Predominantly White Tract: At least 85% White; Predominantly Black Tract: At least 75% Black.
Low-Income Tract: Not More than 80% AMI; Middle-Income Tract: 80-120% AMI.

**Figure 5**

# Chicago Metropolitan Area
# Refinance Market



Subprime mortgages accounted for at least 25 percent of all refinance mortgages in 438 (or 25 percent) of the 1,767 census tracts in the Chicago metropolitan area refinance market.

Census tracts where Blacks comprised at least 30 percent of the population (Black neighborhoods) accounted for 367 of these 438 subprime census tracts.

Black neighborhoods accounted for 10 percent of all refinances in the Chicago metropolitan area but 41 percent of all subprime refinances.

- Subprime and Black Neighborhoods (red)
- Other Subprime Neighborhoods (green)
- Other Black Neighborhoods (yellow)

Source: 1998 HMDA Data

**Figure 6**

# Subprime Share of 1998 Refinance Mortgages by Income and Race of Borrower
## (Chicago Metropolitan Area)

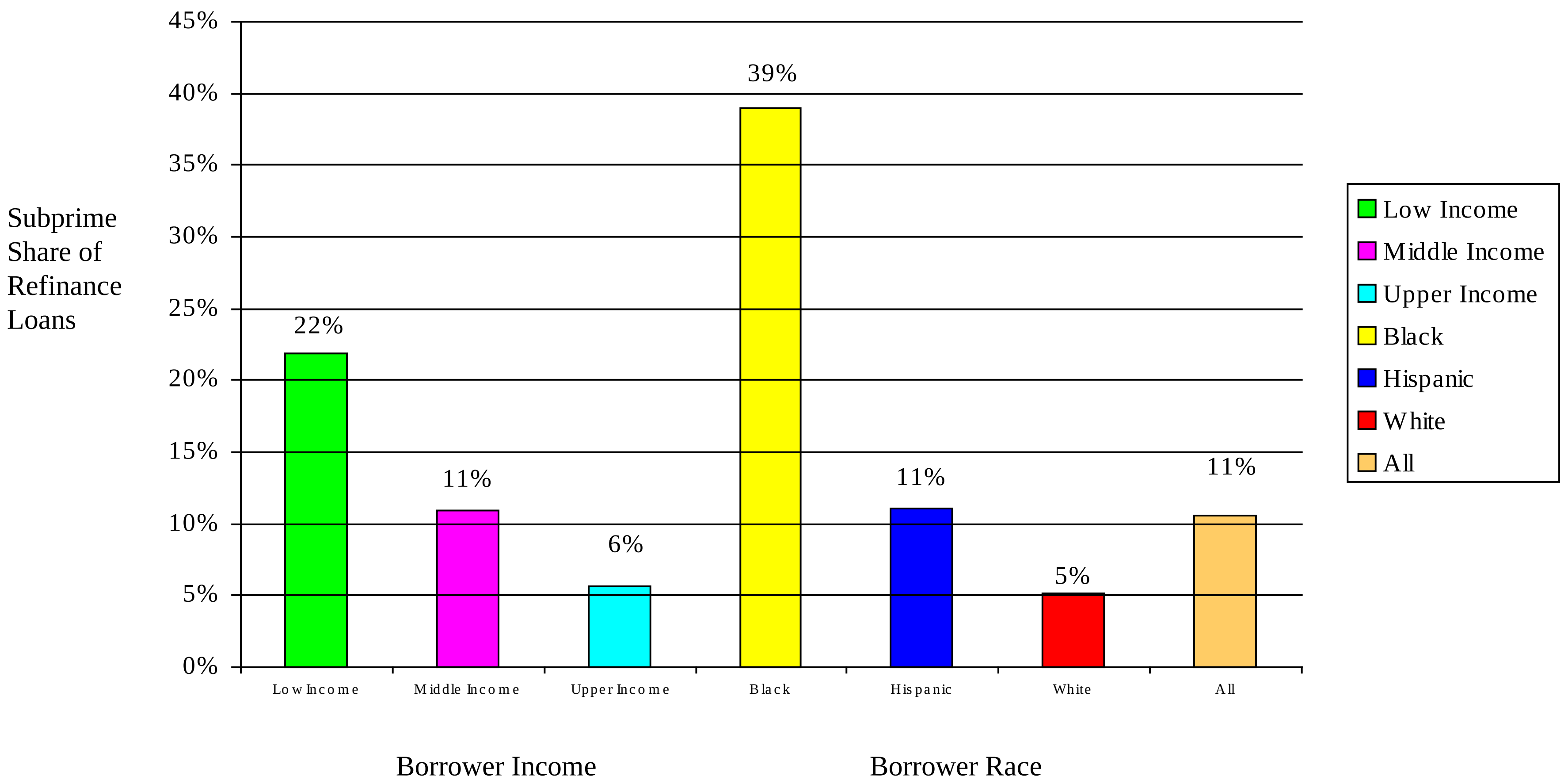
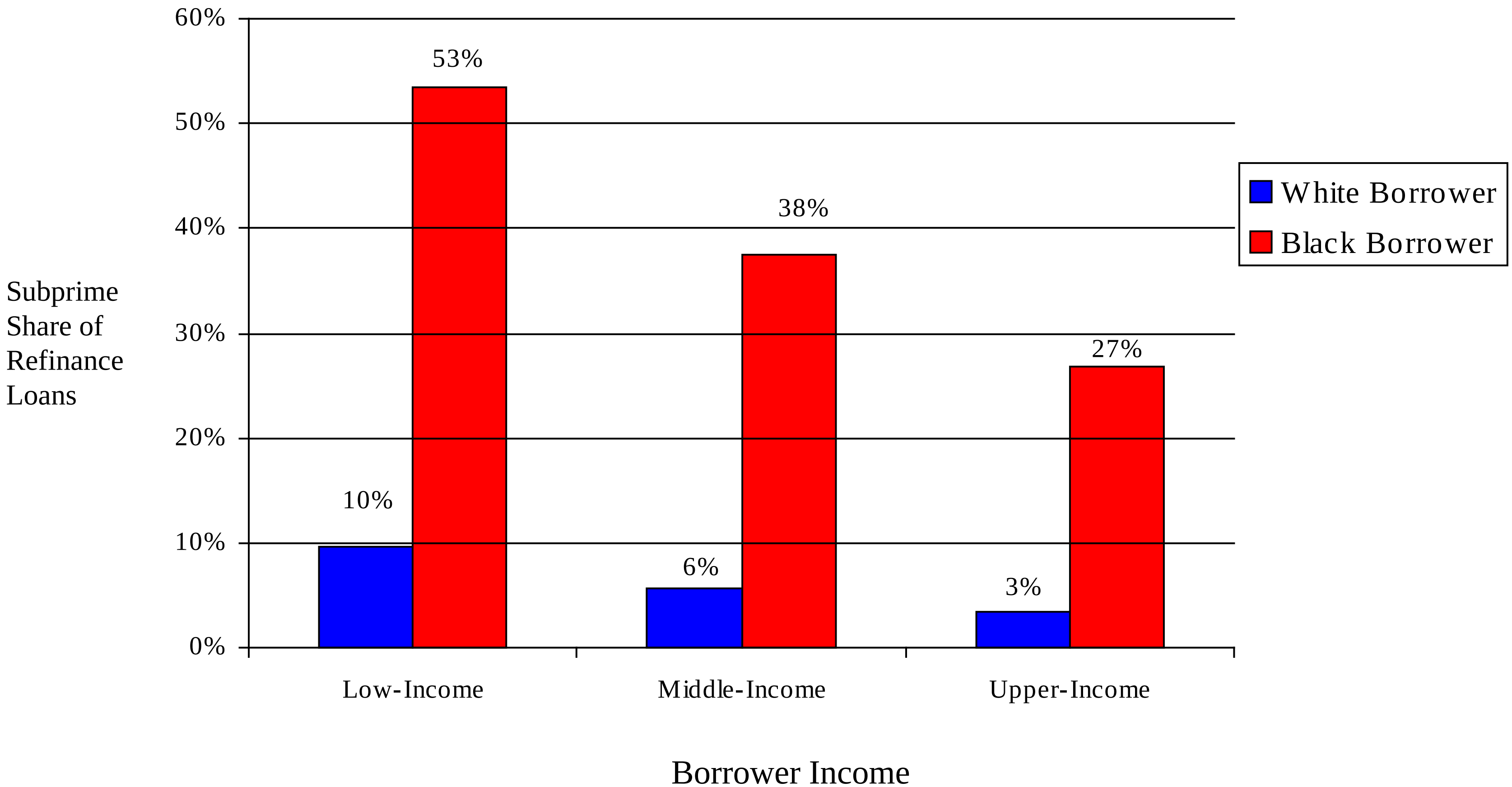


**Figure 7**

# Subprime Share of 1998 Refinance Mortgages by Borrower Race and Income (Chicago Metropolitan Area)




Note: Low-Income Borrower: Not More than 80% AMI; Middle-Income Borrower: 80-120% AMI; Upper-Income Borrower: 120% AMI.