New HMDA Data:
Intent, Interpretation, and Implications

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On March 31, 2005, the first round of data reflecting the most recent revisions to the Home Mortgage Disclosure Act (HMDA) became publicly accessible. Containing previously unavailable information on loan pricing, lien status, and loan type, the new statistics have captured the attention of the financial community. Mortgage companies, banks, community development organizations, and consumer groups alike are eager to see what the new data tell us about the workings of the home mortgage market, especially the fast-growing segment of subprime lending. Questions are rapidly surfacing about how to interpret the information and how much it can reveal about equity and efficiency in the market. To address these concerns, the Federal Reserve System, in partnership with other regulatory agencies, is working to increase overall understanding of both the intent behind HMDA and the strengths and limitations of the new data.

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HMDA's Purpose and the Intent of the Most Recent Changes

The Home Mortgage Disclosure Act was enacted by Congress in 1975 to ensure fair and equal access to credit in the housing market. Originally, the law was intended to address concerns that banks and thrifts were "redlining" low- and moderate-income areas, uniformly rejecting all loan applications from these poorer neighborhoods. HMDA sought to end this discriminatory practice by requiring banks to make publicly available data on where their mortgage loans were made. The dataset provided a mechanism to monitor whether financial institutions were adequately supplying housing credit in the geographic areas they served.

Since then, the law has been revised several times to reflect the evolution of the mortgage market. In the late 1970s, concerns surfaced that some lenders were discriminating based on the race and income of a borrower. In response, HMDA was revised in 1980 to require lenders to report each loan applicant's income and race. In 1988, HMDA was expanded to cover mortgage lending subsidiaries of bank holding companies, a move prompted by the growing number of financial institutions moving their mortgage operations into such entities. In 1989, HMDA was further amended to require data collection on loan applications, not simply on loans that were approved and originated. This change was intended to allow for the identification of differing denial rates by race, gender, or income.

The most recent revisions to HMDA have once again updated the law to address emerging trends in the mortgage market. Over the last decade, the development of credit scoring technology and risk-based pricing models has allowed lenders to better determine the risk profile of borrowers. This has led to a proliferation of loan products and prices, the most notable being subprime loans—higher-priced loans associated with higher-risk borrowing. According to the Federal Reserve Bank of St. Louis, subprime loans accounted for 18.7 percent of all mortgages in 2002, up from only 1.4 percent in 1994.

The growth of the subprime market has generally been a positive development, affording mortgage credit to a new population of previously unqualified borrowers and contributing to record levels of homeownership—69 percent of U.S. households were homeowners in 2004, up from 64 percent a decade before. However, subprime lending has led to an increasingly complex mortgage market, prompting concern among consumer groups that borrowers may have difficulty obtaining the best-priced loan for their needs. Concerns center around four broad themes:

First, borrowers in the subprime market are seemingly less likely to comparison shop for mortgages than borrowers in the prime market.

Second, there is a significant amount of aggressive marketing in the subprime market.

Third, some question whether consumers in the subprime market are equipped with enough knowledge to protect themselves from unfair or deceptive lending practices.

Fourth, there is concern that price variation in the subprime market may reflect discrimination against borrowers by race, ethnicity, income, or gender, not legitimate risk-based pricing.

In response to these concerns, HMDA was amended in 2002 to require mortgage lenders to report data related to the pricing of loans. These changes, which went into effect in January of 2004, were intended to enhance the capacity of regulators to monitor subprime lending and continue to ensure equity and efficiency in the mortgage market as a whole.

The New Reporting Requirements

Among the 2002 HMDA changes are four new reporting requirements. Garnering the most attention is a lender's obligation to report "the spread" of each originated high-cost loan. Calculated as the difference between the interest rate on the mortgage loan and that on a U.S. Treasury security of comparable maturity, the spread captures the "price of the loan" vis-à-vis what other borrowers are paying. The relative nature of this measure enables comparisons over time, regardless of changes in the level of interest rates. Because the spread on prime loans is relatively small, this reporting requirement pertains only to "higher-cost mortgage loans." For first-lien mortgage loans, lenders must report the spread if it is 3 percentage points or more. For second mortgages, or subordinate-lien loans, which typically have higher interest rates, the cut off is 5 percentage points. The definition of "higher-cost mortgage loans" is based solely on the interest rate spread and does not take into account points or other fees associated with the loan.

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The remaining new reporting requirements are also focused on understanding price differentials in the mortgage market. For all mortgage loan applications and originations, lenders must now report lien status, a significant determinant of loan price. A lien gives a lender ownership rights to an asset in case of default, and home loans secured by a lien generally have lower interest rates. Moreover, first-lien loans tend to have lower rates than subordinate-lien loans, as the first-lien lender has the initial rights to the asset, while the lender of a subordinate-lien loan has rights only to what is not claimed by the first lien. By requiring lenders to indicate whether a loan is secured by a first- or subordinate-lien, regulators can determine how much price variability is explained by the lien status of a loan.

For similar reasons, lenders must also identify whether a loan application involves a manufactured home. Compared with site-built homes, factory-built homes are perceived to be riskier by financial institutions, in part because they can be owned separately from the land on which they are located. Thus, the market for manufactured homes is characterized by higher interest rates and a greater frequency of denials. In 2002, while the denial rate on all home purchase loan applications was just under 14 percent, an estimated 60 percent of manufactured home applications were rejected. HMDA data will now identify loan applications associated with manufactured homes, allowing regulators to examine this market separately and take into account its unique characteristics.

Finally, financial institutions are now required to flag whether a loan exceeds the price thresholds of the Home Ownership and Equity Protection Act (HOEPA). Part of the Truth in Lending Act, HOEPA seeks to protect consumers from deceptive and unfair practices in home lending. It imposes additional restrictions and requirements on first-lien loans with spreads exceeding 8 percentage points, subordinate-lien loans with spreads exceeding 10 percentage points, and all loans with points or certain fees in excess of the larger of $510 or 8 percent of the loan. Lenders now must clearly label any loans that trigger HOEPA restrictions, permitting more explicit monitoring of these high-priced loans.

What the Data Can and Cannot Reveal

Today, HMDA statistics are collected to assist with three broad goals: (1) Provide an indication of whether or not financial institutions are serving communities' housing needs; (2) Enable public officials to target public-sector dollars in order to attract private investment to areas where it is needed; (3) Identify potential discriminatory lending practices. Of these, the third goal draws the most public attention.

Until recently, differences in denial rates across various groups provided the best available indication of potential discrimination in the mortgage market. However, with the emergence of new loan products, this limited measure has become less relevant as discrimination is increasingly possible in the pricing of credit, not solely in its denial. By providing new information on loan prices, the 2004 HMDA data present the first opportunity to test for potential discrimination via pricing differentials. However, it is crucial to understand precisely what can and cannot be determined about discrimination from the new information.

The new HMDA data may indicate whether discrimination is occurring through price differentiation, but the data cannot offer definitive proof.

In general, the new HMDA information may provide an indication of whether discrimination is occurring through price differentiation, but it cannot offer definitive proof. There are numerous factors that determine the price of a home loan. While HMDA reporting requirements capture some of these factors, such as the lien status of the property, many more are not identified. For example, some of the most pertinent measures of a borrower's credit risk are not reported under HMDA, including a borrower's credit score and debt-to-income ratio. Additionally, many important factors related to the property are omitted—the ratio of the loan amount to the value of the property and whether home prices in the neighborhood are rising or falling. Further, HMDA does not include information about the lender's costs. While it would be helpful for regulators and the public to have access to these and other pricing factors, when the Federal Reserve Board crafted the HMDA changes in 2002, it had to carefully weigh the benefit of such information with the burden its collection would place on lenders.

Without these additional pricing factors, it is impossible to determine from the HMDA data alone whether lenders are engaged in any type of abusive or discriminatory activity. For example, suppose two borrowers want to buy in the same census tract and have the same approximate level of income, but Borrower A is black and Borrower B is white. Borrower A receives a home

Highlights of the New HMDA Reporting Requirements

	Reporting Requirement →	Applies To
Loan Price	Report the difference, or spread, between the interest rate on the loan and that on a U.S. Treasury security of comparable maturity.	• First-lien loans with a spread of 3 percentage points or more. • Subordinate-lien loans with a spread of 5 percentage points or more.
Lien Status	Indicate whether there is a lien on the loan, and if so, whether it is a first- or subordinate-lien.	• All loans
Type of Structure	Indicate whether the home is • a single family home, • a multi-family home, or • a manufactured home.	• All loans
HOEPA Status	Indicate that the loan is subject to the requirements of the Home Ownership and Equity Protection Act.	• First-liens loans with a spread of 8 percentage points or more. • Subordinate-lien loans with a spread of 10 percentage points or more. • Loans with points or certain fees in excess of the larger of $510 or 8 percent of the loan amount.

Other HMDA Changes

In addition to the new disclosure requirements, a number of methodological changes to HMDA reporting will impact year-to-year data comparisons. For example, there are new categories for race and ethnicity, and the definitions for metropolitan and micropolitan areas have been amended to conform with those of the U.S. Office of Management and Budget. For a complete description of the changes that affect the 2004 HMDA data, please visit the Federal Reserve System's web site at **www.federalreserve.gov.**

purchase loan with less favorable terms than Borrower B, that is, the spread reported for Borrower A is larger. Using HMDA data, a comparison of these two borrowers might suggest that racial discrimination is responsible for the difference in the price of their home loans. However, further examination reveals that Borrower A has a lower credit score and a higher debt-to-income ratio than Borrower B and wants to buy a home in a portion of the census tract where prices are falling. With this new information, the lender's decision looks rational, not discriminatory.

Notwithstanding the limitations, the data do provide an initial screening mechanism for the presence of discrimination in the mortgage market. When a particular pattern of pricing differences shows up in the HMDA data for particular lenders, loan products, or geographic regions, regulators can decide if the matter warrants further investigation. If so, they can review actual loan applications, which include many of the pricing factors discussed above, to try to determine the cause of the price differential. More generally, the new data enable regulators to monitor overall trends in loan pricing within the subprime market.

In September, the Federal Reserve Board of Governors will release its first report on the new HMDA data. The report will summarize loan activity for every mortgage lender in each metropolitan area in which the lender does business. Separately, the report will provide an aggregate profile of lending in each metropolitan area. Finally, the data will be totaled by lender, race, and ethnicity for the nation as a whole. The report will provide the first comprehensive picture of mortgage lending in the nation using the new data and will permit comparisons both within and between geographic regions. In addition, the Board plans to undertake an extensive analysis of the new pricing data, intended to raise questions and considerations that may lead to further research, changes in the regulation, or public policy initiatives.

Implications for the Mortgage Industry

Overall, the public disclosure of home loan pricing data has the potential to impact the mortgage industry in the following ways:

1. Improve oversight by regulators.

Regulatory agencies can now more easily detect and analyze patterns of price differentials for different lenders, product types, geographic areas, and racial and ethnic groups. Equipped with this screening mechanism, regulators can rule out discrimination in some instances and efficiently target their resources toward cases of potential discrimination, thereby aiding the overall enforcement of fair-lending laws.

2. Increase accountability for lenders.

Public access to pricing data on subprime loans gives lenders an added incentive to strengthen their internal review process in order to detect any potential price discrimination. Moreover, if an organization's HMDA data suggest potential problems, the institution will want to investigate and correct any problems in order to avoid bad publicity.

3. Enhance understanding of communities' credit needs.

Consumer advocacy groups may confront various lenders about particular pricing patterns revealed in the data, requiring institutions to respond in greater detail about how lending decisions are made. Discussions about particular credit risks associated with a population or geographic area may ensue, helping both consumer groups and lending institutions to better understand the barriers to credit availability in certain neighborhoods.

4. Encourage competition in the subprime market.

By identifying areas with a high concentration of high-cost loans, the new data may entice lenders to enter these markets. Enhanced competition in these areas may increase the availability of credit and weed out overpriced loans.

Responsive Regulation

The 2002 changes to HMDA reflect regulators' latest response to the public's ever evolving concerns about equity and efficiency in the market for housing credit. The new data will enhance understanding of the nation's mortgage lending industry and offer a first look at pricing practices in the subprime market. It will still not be possible to answer all questions about the presence of discrimination in the mortgage market, but the new data will offer a starting point to identify pricing patterns that deserve further scrutiny. In the coming months and years, analysis of the new data will raise questions, invite conversation, inspire research, and shape public policy that will further the goal of fair and equal access to credit for housing.

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