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Predatory Lending
Attempts to Plug the Money Drain

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THIS ISSUE:

Predatory Lending
Attempts to Plug the Money Drain

By Stephen O'Sullivan, Federal Reserve Bank of Boston

Predatory lending continues to capture attention nationwide. Since it entered the spotlight in the 1990s, advocates, legislators, regulators, lawyers, and lenders have intensified their activities around the issue. Over the past year, the Board of Governors of the Federal Reserve System initiated amendments to the Home Mortgage Disclosure Act (HMDA); community groups, city councilors, and other lawmakers proposed additional protections to curb abusive lending practices; Georgia's predatory lending law came under scrutiny; and Household International and Citigroup settled lawsuits (worth $700 million in total) that alleged abusive lending practices.[1]

Why is predatory lending so heatedly debated? Besides the sometimes devastating consequences of predatory lending, the practice itself has evaded simple definition and detection, allowing for a lot of debate about solutions. This article reviews some of the issues involved in isolating predatory lending and describes efforts under way to curb the practice.

Predatory versus Subprime

Establishing an agreed-upon, standard definition for the term "predatory lending" has not been easy. State and federal regulators, financial institutions, mortgage industry associations, and community groups all have different views on what types of loan terms and activities they consider to be traits of abusive lending. This lack of a standard definition has made it almost impossible for regulators or legislators to determine what loans are, or are not, predatory. As former U.S. Senator Phil Gramm has commented on the issue, it is impossible to regulate something that cannot be defined. The box on page 4 describes some loan terms and practices often associated with predatory lending.

Part of the difficulty in defining predatory lending is that many people mistakenly equate it with subprime lending. In actuality, predatory lending is the rogue component of subprime lending. Regulatory guidelines describe subprime lending as the extension of credit to "borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers." To compensate for these higher risks, lenders charge higher rates and fees. Borrowers benefit by qualifying for credit they otherwise wouldn't obtain, and lenders gain access to a new and potentially profitable market.

Subprime lending started proliferating in the 1990s. Home Mortgage Disclosure Act (HMDA) data show that from 1993 to 2000, the number of subprime loans for home purchases shot up by a factor of 19, from 16,000 to 306,000. The rise in subprime loans that are home-equity loans has been less steep, increasing from 66,000


TUESDAY, MAY 13, 2003 9

Predator Spotlight Now Swinging to Loan Servicing

NEW YORK — The movement to curb predatory mortgage practices has created another risk to the $284 billion market for securities

the ratings agencies look at the front end of the transaction, "they will also review the back end." Apparently "the entire process is in

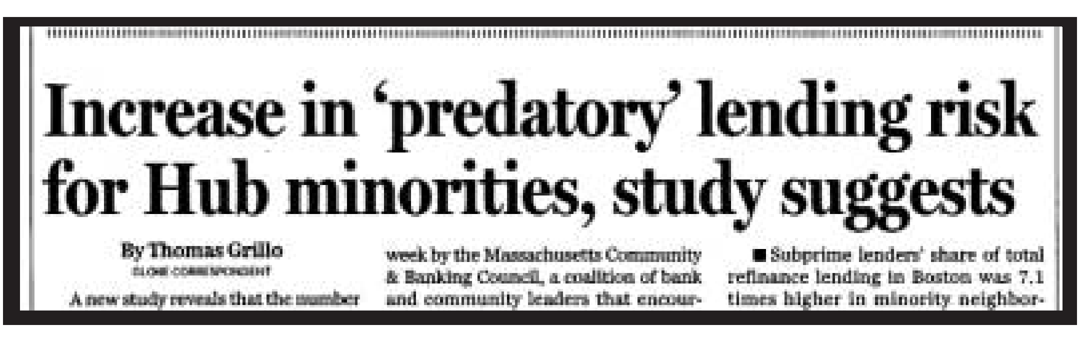

THE WALL STREET JOURNAL

POLITICS & POLICY

Subprime Bill Aims to Mute State Laws

Republican's Proposal to Police Predatory Lending Would Set Weaker National Standards

A Helping Hand?


Increase in 'predatory' lending risk for Hub minorities, study suggests

By Thomas Grillo

GLOBE CORRESPONDENT

A new study reveals that the number

week by the Massachusetts Community & Banking Council, a coalition of bank and community leaders that encour-

■ Subprime lenders' share of total refinance lending in Boston was 7.1 times higher in minority neighborto 658,000, but these loans represent a much larger segment of the market. The subprime market continues to expand; its value in 2002 was estimated at $175 billion, or about 10 percent of the total dollar amount of the residential mortgage market, according to the *Mortgage Industry Directory*.

Federal Reserve Board Governor Edward Gramlich has suggested that the subprime market helped make it possible for low-income and minority consumers, groups that traditionally have had difficulty obtaining mortgage credit, to obtain housing loans at record levels. During the rise in subprime lending from 1993 to 2000, the number of conventional home-purchase mortgage loans going to lower-income borrowers nearly doubled, while those to upper-income borrowers increased at a slower pace of two-thirds. Further, conventional home mortgage loans increased 122 percent to African-American borrowers and 147 percent to Hispanic borrowers. Other factors, such as low interest rates, advances in technology, and greater competition also worked to broaden access.[2]

HUD Subprime Lender Tally

Year	Number
1993	49
1994	68
1995	100
1996	140
1997	205
1998	246
1999	252
2000	190
2001	178

The dark side of subprime lending is that it acts as the umbrella under which predatory lending finds cover. Subprime lenders have been found to target people in particular communities and groups, regardless of their ability to qualify for better loans. Fannie Mae and Freddie Mac have pointed out that between 30 and 50 percent of those who get subprime loans could qualify for prime rate loans, or at least loans with lower interest rates. In a study of the subprime market in Boston from 1999 to 2001, "Borrowing Trouble? III," Jim Campen of the University of Massachusetts – Boston finds the subprime loan share to upper-income blacks is 7.5 times greater than the subprime loan share going to upper-income whites, and three times greater than the share going to lower-income whites.

Both consumer advocates and lenders look to mortgage delinquency and foreclosure data for validation about whether loan costs and fees are warranted or excessive. For example, U.S. foreclosure data released by the Mortgage Bankers Association of America show that 0.86 percent for all conventional loans were foreclosed on during the fourth quarter of 2002. Further analysis reveals that only 0.54 percent of conventional prime loans were in foreclosure, whereas 7.79 percent of conventional subprime loans were. Consumer advocates point to this information and charge that subprime lenders are saddling borrowers with loans they cannot afford. Lenders assert these data provide evidence of the higher risks associated with subprime lending.

Detecting Predatory Lenders

Presumably, financial institutions try to avoid being linked with the word "predatory." Such a stigma would be hard to erase, and the institution would be intensely scrutinized by regulators and others, potentially resulting in consumer lawsuits that might force the company to shutter its mortgage-lending operation.

Despite the risks of running such an operation, predatory lending continues. In part, this is because a majority of total residential mortgage originations occur outside the realm of federal- and state-regulated financial institutions. Mortgage brokers, for instance, are typically licensed and examined by state agencies, but the degree of monitoring varies from state to state. At the federal level, the Federal Trade Commission, an entity charged with enforcing numerous federal antitrust and consumer protection laws, has oversight responsibility for mortgage brokers and other nonbank lenders.

Much of the information about and awareness of subprime lenders, therefore, comes from annual reports produced by the U.S. Department of Housing and Urban Development (HUD). Since 1993, HUD has identi-

Defining Predatory Lending

In general, predatory lending refers to the actions of unscrupulous mortgage lenders and brokers in taking advantage of poor, elderly, and unsophisticated borrowers. Here are some lending terms and practices typically considered predatory:

Excessive or unnecessary interest rates, points and fees, or insurance
Asset-based lending or equity stripping: lending without regard for the borrower's ability to repay the loan
"Packing" a loan with concealed or unwarranted products and fees
Financing fees, charges, or insurance as part of the loan
"Flipping" a loan by repeatedly refinancing it, charging further fees
Balloon payments
Negative amortization
Increased interest rate after default
Certain prepayment penalties; modification fees; mandatory arbitration clauses
Deceptive or overly aggressive marketing tactics; engaging in fraud
Broker fees tied to interest rates

fied lenders who appear to specialize in subprime lending. The list is primarily compiled from industry trade publications and HMDA data analyses.[3] HUD cautions against assuming that these lenders carry out predatory activities, and adds that its selection process is not systematic, leaving room for error and omissions. Regardless, many groups use the list as a starting point when attempting to uncover lenders in the predatory market. The table on the facing page shows HUD's count of subprime lenders for the past nine years.

> Subprime lenders have been found to target people in particular communities and groups, regardless of their ability to qualify for better loans.

Attempts to Rein in Predatory Lending

Given the infrastructure of mortgage lending today, local legislatures and regulators have been making their own attempts at limiting predatory practices. They strive for a delicate balance. If the scales are tipped too heavily in one direction with rigid regulations, legitimate subprime products could be eliminated. Some lenders might move out of particular geographic areas, crimping the availability of subprime credit. But if the scales are tipped too much in the other direction, the most vulnerable borrowers could become victims of lending scams and abuses.

Across the country, various legislatures and regulatory groups have taken different stances on the issue, resulting in a patchwork of rules and regulations. Financial institutions and mortgage lenders have criticized this hodgepodge of regulations, claiming the rules hurt the borrowers they intend to assist. So far, about a dozen states and 10 cities have laws and regulations (some pending) against predatory lending.

States have generally attempted to limit predatory lending by expanding the requirements of the federal Home Ownership and Equity Protection Act (HOEPA). HOEPA, along with HMDA, the other relevant federal regulation, have recently been revised to allow for better tracking of subprime lending activity, among other aims. (For summaries of HOEPA and HMDA, see the sidebar "Federal Regulations" on page 6.) States make HOEPA more stringent either by lowering the terms that trigger a high-cost loan , thereby requiring additional disclosures, or by classifying additional practices as predatory.

The effects of these laws vary by state, and have been interpreted differently. The Center for Responsible Lending estimates that North Carolina's anti-predatory law saved borrowers $100 million in total abusive lending costs in its first year of operation (the law was passed in 1999). It reports that the new law did not result in a mass exodus of subprime lenders from the state. It claims North Carolina ranked sixth highest among the 50 states for subprime activity by the end of 2000. Other sources, however, such as the Mortgage Bankers Association, attribute a major lender's 2001 exit from the subprime market to stricter state anti-predatory lending laws, including North Carolina's.

The Georgia Fair Lending Act (GFLA), as first issued, seemed likely to be an example of the mortgage industry's claim that firmer regulation would restrict credit overall. But the law was recently amended, and outcomes of the revised law remain to be seen. When the GFLA became effective in October 2002, it was the strictest anti-predatory law in the nation. Two specific provisions of the GFLA were especially tough. The first provision was "pass-through liability." This meant that liability for violations of the law moved with ownership of the loan, from mortgage lenders to loan servicers to investors in mortgage-backed securities. The second provision concerned penalties for violations of the law. These provisions had unintended consequences. Numerous mortgage lenders either restricted their lending activities in Georgia or withdrew outright from the state. Many of those that continued lending increased rates and fees to compensate for greater risks. In addition, lack of competition within the state may have led to increased mortgage costs.

Credit-market tightening spread outside the state as well. Standard & Poors stopped assigning credit ratings to asset-backed securitizations that included conforming mortgages originated in Georgia because it said it was unable to assess the risks. Fannie Mae and Freddie Mac stopped purchasing high-cost loans originated in Georgia. Fortunately, the growing liquidity drought was halted in March 2003, when Georgia's governor signed an amendment to the law, eliminating the detrimental provisions.

In addition to action at the state level, cities from Oakland to New York City have passed local ordinances intended to curtail predatory lending. The scope of these ordinances varies, but many take the approach used in New York City. The city establishes what it considers to be a predatory loan and then prohibits the city from doing business with lenders who originate those loans nor with the investment firms with which they are associated.

What's Next

Industry and consumer advocates are currently squaring off on federal legislation called the "Responsible Lending Act of 2003," introduced in February by Representatives Robert Ney, R-Ohio, and Ken Lucas, D-Kentucky. Consumer groups argue the legislation intends to preempt all local action against predatory lending without taking significant steps to end the practice. Industry groups argue that they cannot continue operating with different sets of rules in different places, and cite Georgia as a case study. Cities are not waiting to express their concerns. City Councils in Boston and Bridgeport, among a few others, have passed resolutions opposing federal preemption.

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1. Household settled a suit alleging predatory lending practices brought by a group of attorneys general and regulators from more than two dozen states on October 11, 2002. Citigroup settled a case brought by the Federal Trade Commission (FTC) that alleged predatory lending practices by the Associates, a lender purchased by Citigroup in November 2000 and merged into the CitiFinancial unit. Household and Citigroup settled their cases without admitting any wrongdoing in the amounts of $484 million and $215 million, respectively. The $215 million settlement is the largest in FTC history.
2. Information in this paragraph (and HMDA statistics in the prior one) are from a speech on predatory lending made by Federal Reserve Governor Gramlich before the Housing Bureau for Seniors Conference on January 18, 2002. The speech is available at www.federalreserve.gov/boarddocs/speeches/2002.
3. This information was collected from the website, www.huduser.org/datasets/manu.html. HUD used a number of HMDA analyses to screen potential subprime lenders. First, HUD assumed subprime lenders typically have higher denial rates and lower origination rates than prime lenders. Second, HUD assumed that home refinance loans generally account for higher shares of subprime lenders' total originations than prime lenders' originations. To verify this belief, HUD then called the lenders or reviewed their web pages to determine if they specialized in subprime lending. A large number of lenders told HUD they offer subprime loans, but that these loans do not constitute a large percentage of their overall conventional mortgage originations. In cases where lenders offered both prime and subprime loans, HUD identified lenders as subprime lenders if they reported at least half of their conventional originations as subprime loans. This criteria eliminated some lenders who have very large (but not chiefly) subprime businesses. Most lenders identified themselves as primarily a subprime or a prime lender.

Federal Regulations

Home Ownership and Equity Protection Act (HOEPA)

In 1994, Congress passed the Home Ownership and Equity Protection Act (HOEPA) in an attempt to curtail loan abuses stemming from excessive costs. When the law passed, one of the biggest misconceptions was that HOEPA abolished high-cost loans. HOEPA does not eliminate high-cost loans or make them illegal. HOEPA was implemented as part of Regulation Z, Truth in Lending, which establishes four requirements for these types of loans:
* First, HOEPA establishes two separate thresholds for determining what type of loan is considered a high-cost loan. One trigger is the annual percentage rate (APR), and the other is the amount of points and fees.
* Second, if a loan is determined to be high cost, the lender must provide written notice informing the borrower of a mortgage on his home, and of the possibility that the borrower could lose his house.
* Third, if high-cost provisions are triggered, certain loan terms are not permitted. These include balloon payments, negative amortization, prepayment penalties, increased interest rate after default, and rebates made by a method less favorable than the actuarial method.
* Fourth, three practices are not permitted with these types of loans: (1) making asset-based loans, (2) directly paying loan proceeds to home-improvement contractors, and (3) selling or assigning the loan without providing a notice informing the purchaser or assignee that the loan is subject to "special rules under the Truth in Lending Act."

In 2001, the Federal Reserve Board amended Regulation Z to broaden the scope of loans subject to HOEPA's regulatory protections. The Board adjusted the two triggers that define high-cost loans: APR and points and fees. It lowered the APR threshold for first-lien loans from 10 percentage points over the rate of a Treasury bond of comparable maturity to 8 percentage points. (The trigger for subordinate lien loans remained at 10 percentage points.) In addition, the Board amended the method of calculating points and fees. The new regulation classifies optional single-premium credit insurance as a fee that must be included in the calculation of total points and fees. The amendments, which became effective on October 1, 2002, also prohibit these loans from being refinanced within a one year period.

Home Mortgage Disclosure Act (HMDA)

The Federal Reserve Board also amended Regulation C, which implements the federal Home Mortgage Disclosure Act (HMDA). The focus of the amendments (effective January 1, 2004) is to allow for more effective collection and monitoring of subprime and potential predatory lending trends. The changes require lenders to collect additional data for potential high-cost loans. The amendments:
* set thresholds for determining the loans for which financial institutions must report loan pricing data. Institutions must report loan-pricing data if the rate spread (the difference between the APR on a loan and the yield on comparable Treasury securities) equals or exceeds 3 percentage points for first-lien loans or 5 percentage points for subordinate-lien loans.
* require lenders to report the lien status of applications and originated loans.
* require lenders to ask applicants their ethnicity, race, and sex in applications taken by telephone. (This became effective January 1, 2003.)

Factoring Child Care into the Welfare to Work Equation: Lessons from Massachusetts and Rhode Island

by Ashley Maurier and Rebecca Russell
Federal Reserve Bank of San Francisco and Wellesley College

Perhaps the largest barrier to moving welfare recipients off cash assistance and into work and economic self-sufficiency is the lack of adequate and affordable child care. Reauthorization of federal welfare law is currently under way, and new requirements passed in February 2003 as part of House Republican Welfare Bill HR4, call for states to increase work activity among parents who receive cash assistance. The bill aims to have 70 percent of parents participate in work activity by 2008 and raises work hour requirements to 40 hours per week. With a freeze on federal welfare funding, an uptick in caseloads across the nation, and state budgets under severe fiscal strain, these new standards may force states to shift funds away from already strapped support programs — including child-care programs and services — that facilitate the welfare to work transition for many families.

To provide a New England context for the current reauthorization, we look at how welfare reform has progressed in Massachusetts and Rhode Island since the 1996 reforms. Rhode Island has one of the most generous versions of welfare reform, while Massachusetts has one of the most restrictive.

Child-care provisions under welfare programs in these two states are very different, yet each program helps us see how important child care is in enabling women to work. Studying each of these different approaches provides useful information about child care and work — especially as states everywhere cut spending.

In Massachusetts, studies show that the cost, quality, and availability of child care play a major role in a mother's decision to choose work over welfare. In Rhode Island, studies suggest that child-care subsidy reforms are important in encouraging mothers to use child-care benefits and make the transition to work.

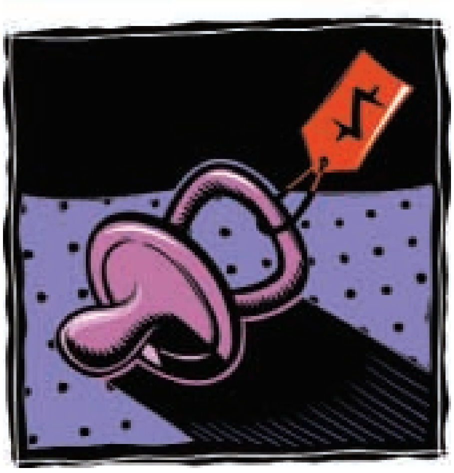
Numerous studies show that the **cost** of child care is a significant factor in the decision of a low-income mother to move from welfare to work.

Yet these studies typically do not consider the **quality** and **availability** of child care.

Welfare Reform

By many measures, welfare reform — the Personal Work and Responsibility Act of 1996 — has been a remarkable success. The overall goal was to end recipients' dependence on government benefits by promoting job preparation, work, and the raising of children in two-parent families. Welfare reform devolved power from the federal government to the states. Aid to Families with Dependent Children (AFDC) was replaced by Temporary Assistance to Needy Families (TANF), which allows states to construct their own welfare programs within federally mandated parameters. This freedom for states to construct their own programs explains why, despite their geographic proximity, Massachusetts and Rhode Island have adopted markedly different policies for child care and welfare reform.

In Massachusetts, welfare recipients with children over two years of age have a maximum of 24 months of assistance in any consecutive 60-month period. Time limits on assistance start ticking as soon as the youngest child turns two years old, but the mother remains exempt from work requirements until the child turns six years old. Welfare recipients with children over six years of age must work at least 20 hours per week two months after benefits begin. Failing to find a job, they must fulfill 20 hours of community service per week to remain eligible for assistance.



Rhode Island enforces a 60-month time limit on benefits — two and a half times longer than the 24 months allowed in Massachusetts (and the maximum allowable under federal law). In addition, Rhode Island recipients have the option of completing up to 24 months of either post-secondary education or job training that counts toward the work requirement. These 24 months allow for a gradual transition to work and the possibility of learning skills that might lead to a better paying job.

Lessons from Massachusetts

Numerous studies show that the cost of child care is a significant factor in the decision of a low-income mother to move from welfare to work. Yet these studies typically do not consider the quality and availability of child care. Armed with comprehensive data from Massachusetts, economists Lemke, Queralt, Witt, and Witte designed a study to measure how child-care cost, quality, and availability (referred to as the "child-care trilogy") affect the probability that a mother on cash assistance will work.

The results of this study provide important insights. The authors found that if the weekly cost of child care were to double, a mother would be five percent less likely to work. Enhancing the quality of providers, as measured by the number with national accreditation, had a positive, but small, effect on whether a mother would choose to work. The availability of full-day kindergarten also encouraged work, as women living in towns offering this type of care showed a three percent higher work probability. However, increasing the stability of child care, by raising the number of years a provider has been in operation, was found to have even larger effects. Increasing the stability of child-care providers may have the most dramatic impact on moving low-income mothers from welfare to work.

Lessons from Rhode Island

In contrast to Massachusetts, which has waiting lists for child-care subsidies, Rhode Island guarantees vouchers to all eligible families to help them pay for child care. In 1997, Rhode Island enacted major reforms to encourage welfare recipients to use those subsidies and make the transition to work.

Among the reforms, Rhode Island decided to raise the rate at which it reimburses child-care providers. Subsidies are now pegged to the 75th percentile of market prices; this compares with Massachusetts, where the subsidy is set at or below the median (50th percentile). Rhode Island's relatively high reimbursement rates have resulted in 90 percent of child-care providers accepting vouchers, while only 60 percent of providers in Massachusetts take them. Rhode Island also increased the income cap at which a family, and the age range at which a child, could qualify for a subsidy. In addition, the state offers subsidized health insurance to family child-care providers and to employees of centers that serve subsidized children. This has led to significant increases in the availability of child care, especially in cities such as Providence, Pawtucket, and Central Falls.

In April 2003, Witte and Queralt completed a study of the impact of Rhode Island's subsidized child-care reforms. They found that the reforms increased by 11 percent to 13 percent the likelihood that a working welfare family would use a child-care subsidy. Further, the reforms increased by 5 percent the probability that a single-parent family would leave welfare and work more than 20 hours per week. Because of information lags, welfare recipients only slowly became aware of increased benefits as a result of Rhode Island's reform – making it likely that the full and final impact of the reform is even greater than these estimates, which were calculated halfway through year 2000.

Rhode Island's numerous reforms also show that raising provider reimbursement rates indirectly affects the work decisions of low-income women, ultimately increasing the probability of work and the number of hours worked. Rhode Island's policy made it more attractive for providers to care for subsidized children. In turn, these providers found it beneficial to disseminate information about the subsidy program to low-income women – facilitating recruitment of children to their centers. It is likely that these mothers were not aware of the full extent of state support, but when provided with sufficient information, could be lured off cash assistance by the relative benefits of work.

Rhode Island's policy made it more attractive for providers to care for subsidized children.

In turn, these providers found it beneficial to disseminate information about the subsidy program to low-income women.

Beyond the States

Last year, the Congressional Budget Office predicted that the cost to states of enforcing the 40-hour work requirement and meeting the increased participation rates could reach as high as $11 billion over five years. With more welfare recipients working and putting in more time on the job, the costs of child-care supports will increase. The Congressional Budget Office estimates that $5 billion in child-care funding will be needed to ensure that TANF funds devoted to child care keep pace with inflation. The new bill provides only $1 billion over the next five years in additional child care.

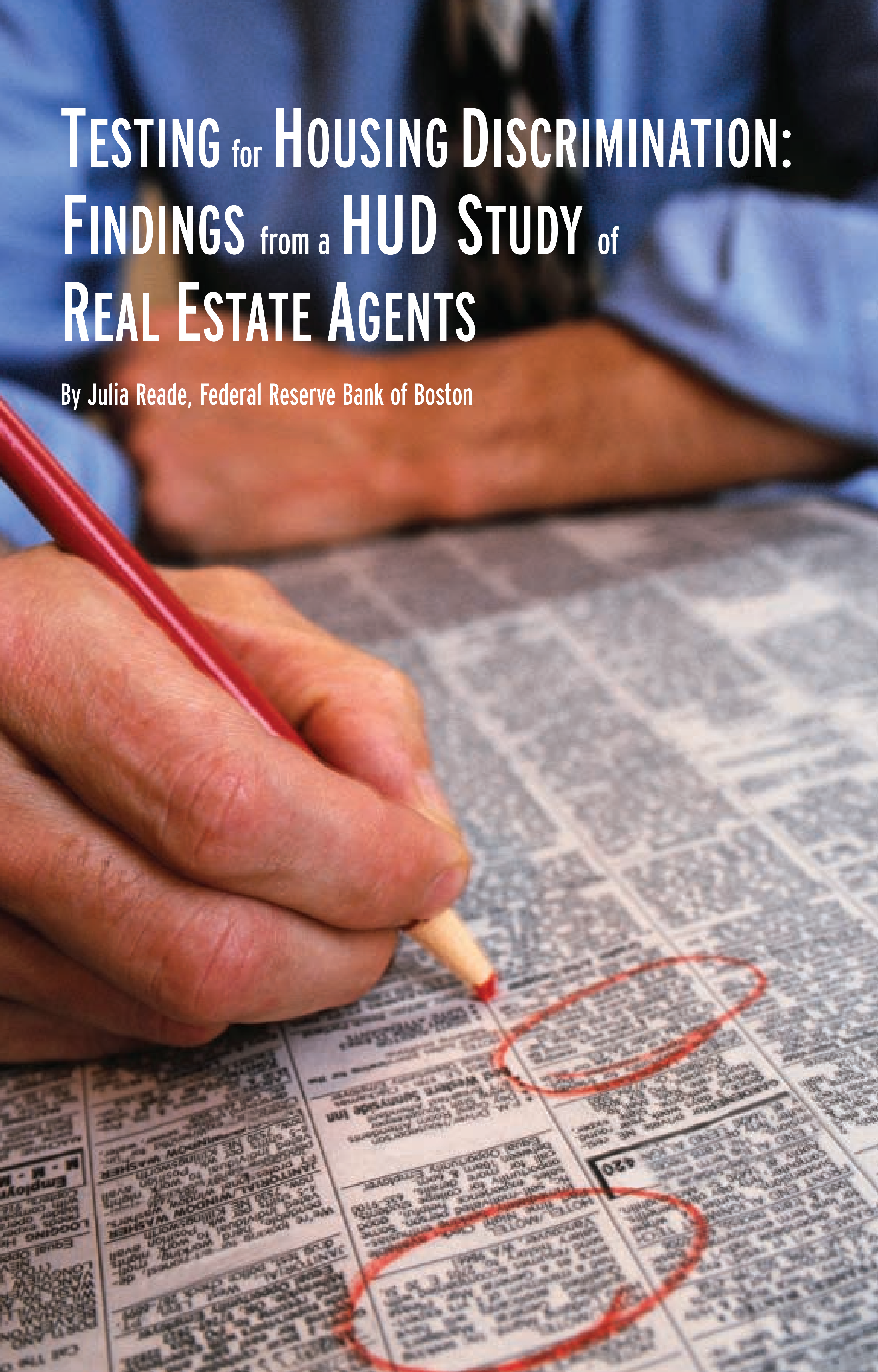
States have already had to make substantial cuts in child-care programs. Compliance with the new bill will likely require detrimental additional cuts, particularly in light of the dire fiscal situation in most states and because the federal government will not be supplying additional funds. Across-the-board cuts in federal spending for child care and other children's services will result in 30,000 children being dropped from child care in fiscal year 2003. The Bush Administration's budget acknowledges that, in addition to these 30,000 children, over the course of the next five years at least 200,000 more children will be dropped from child care.

Evidence from Massachusetts and Rhode Island shows that as availability of child care wanes and support for child-care programs disappears, parents may decide to stay at home and work less. This will hinder efforts to move families to self-sufficiency and threaten to counter the progress made by welfare reform.

Ashley Maurier and Rebecca Russell both worked as research assistants to Ann Witte at Wellesley College. Ashley Maurier is currently employed by the Federal Reserve Bank of San Francisco and Rebecca Russell is working toward her economics degree at Wellesley College. Ann Witte is director of Wellesley College's Child Care Research Partnership; she provided oversight for the article.

Testing for Housing Discrimination: Findings from a HUD Study of Real Estate Agents

By Julia Reade, Federal Reserve Bank of Boston



Housing discrimination against blacks and Hispanics is declining but still remains a significant national problem. The U.S. Department of Housing and Urban Development (HUD) reached this conclusion using results of the national Housing Discrimination Study, conducted by the Urban Institute and released this past November.

The study focused on one of the earliest steps in the process of finding housing – working with a real estate agent. The researchers examined whether renters and homebuyers get different treatment from real estate agents and rental management companies depending on their race or ethnicity. The research did not assess credit issues, such as whether people of certain races and ethnicities are disproportionately denied mortgages, but did look at the extent to which agents provide assistance with financing. Describing the importance of this research, the authors wrote, "Housing discrimination raises the costs of the search for housing, creates barriers to homeownership and housing choice, and contributes to the perpetuation of racial and ethnic segregation."

The study found that blacks and Hispanics faced discrimination whether they were renters or homebuyers. However, this study, conducted in 2000, found significant improvements over an earlier study conducted in 1989. Most of the gains occurred because bias against black and Hispanic *homebuyers* fell dramatically. Bias among *renters* did not show such improvement. Discrimination against black renters fell only moderately, while Hispanic renters saw no improvement.

Testing with Pairs

In both 1989 and 2000, the Housing Discrimination Study used "paired testing" to measure discrimination. Researchers bought the local newspapers in nearly two dozen metropolitan areas and selected a random set of advertised units for investigation. Then "testers" were sent to inquire at real estate offices about these properties. On paper, the two testers were identical – same family type, kind of job, education level, and financial standing. The only difference was that one tester was white while the other was black or Hispanic. (Throughout this article, "white" refers to a "non-Hispanic white.")

Because researchers wanted to detect even indirect discrimination, they employed many measures of how each tester was treated. Despite the subtle issues addressed by the tests, most questions were easily answered. Simple questions like, "how many rental units did the agent indicate were available to you?" can illuminate patterns of discrimination if systematic differences occur by race and ethnicity. The questions addressed issues of availability, inspections (going to see a home or apartment), costs, encouragement, and, for homebuyers, geographic steering. The box on page 12 details the particular measures examined in the study.

In their visits to real estate offices, testers inquired about an advertised unit and then let the sales or rental agent guide the next steps in the interaction. If units were available, testers asked to see the units. Afterward, they recorded their experience on a survey form. (This setup helped prevent real estate agents from realizing they were being studied.) After all the tests were completed, researchers compared the information. For each measure, three outcomes were possible: the white tester was favored, the minority tester was favored, or both were treated equally.

Hispanic renters experienced more discrimination than blacks in measures of availability and inspections. Rental comparisons between Hispanics and whites showed some of the highest levels of bias in the whole study.

It's All in Interpretation

Paired-test studies leave a lot of room for interpretation. For example, in comparing the number of units shown to Hispanic renters versus the number shown to whites, the white tester received favorable treatment 21 percent of the time. However, the Hispanic tester received favorable treatment 14 percent of the time. There are a couple of ways to interpret these results.

One interpretation focuses on a single measure of preferential treatment: the fact that whites are favored in 21 percent of cases. This reflects the highest level of favoritism towards whites that may have occurred. Another interpretation focuses on the net difference in favoritism between whites and Hispanics, which was 7 percentage points. This reflects the lowest level of favoritism towards whites that may have occurred.

So how much bias was there? The researchers stress that the underlying level is somewhere between 7 and 21 percent. Although this is a wide range, it indicates likelihood of some white-favored bias. The lower-bound estimate (7 percent) can be tested for statistical significance. If it is found to be significant, which it is in this case, we can expect white-favored bias exists.

How Discrimination Was Measured

Many of the same measures were used to determine discrimination for renters and buyers. The categories in common include availability, inspections, cost, and encouragement. For buyers, steering was also studied.

Renters

Availability
Advertised unit available?
Similar units available?
Number of units recommended?
Overall availability

Inspections
Advertised unit inspected?
Similar units inspected?
Number of units inspected?
Overall inspection

Cost
Rent for advertised unit?
Rental incentives offered?
Amount of security deposit?
Application fee required?
Overall cost

Encouragement
Follow-up contact from agent?
Asked to complete application?
Arrangements for future?
Told qualified to rent?
Overall encouragement

Buyers

Availability
Advertised unit available?
Similar units available?
Number of units recommended
Overall availability

Inspections
Advertised unit inspected?
Similar units inspected?
Number of units inspected?
Overall inspection

Cost/Financing
Help with financing offered?
Lenders recommended?
Down payment discussed?
Overall financing

Encouragement
Follow-up contact from agent?
Arrangements for future?
Told qualified?
Overall encouragement

Steering
Homes recommended?
Homes inspected?
Editorializing?

Discrimination among Renters

Black and White Renters

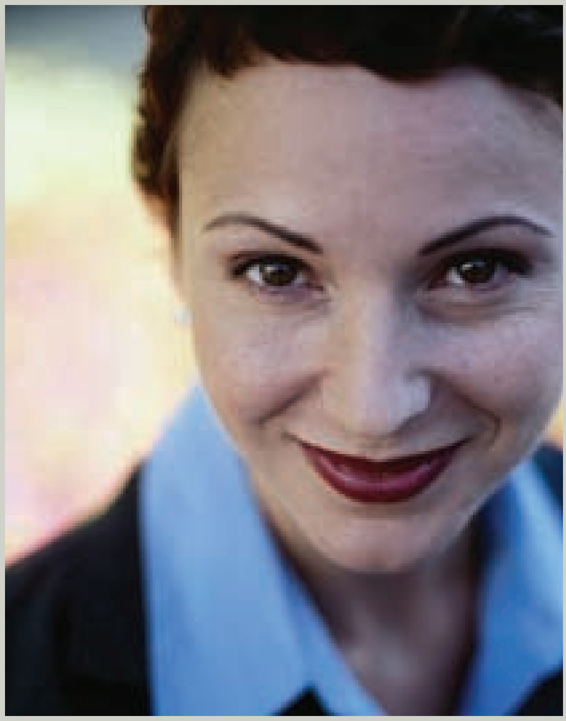
Black and white renters in the study were treated differently. White applicants were more likely than blacks to find better availability of apartments (32 percent versus 28 percent), mainly because agents more often told whites the advertised unit was available and recommended more units to them. The disparity in treatment, a 4-percentage-point difference, was weakly significant. White applicants were also more likely (by 8 percentage points, 28 percent versus 19 percent, taking rounding into account) to have preferential inspection experience, again because they more frequently inspected the advertised unit and saw a higher number of comparable units.

These gaps were significantly less than those found in the 1989 study. The earlier gaps, 13 and 15 percentage points, fell to 4 and 8 point differences. Bias fell primarily because preferential treatment of whites declined.

Hispanic and White Renters

Hispanic renters experienced more discrimination than blacks in the same measures — availability and inspections. Rental comparisons between Hispanics and whites showed some of the highest levels of bias in the whole study. Whites were 12 percentage points more likely to

Have Same Background, Looking for Home (fictional example)



Marital Status: Married
Family Size: Three
Occupation: Teacher
Joint Income: $75,000
Credit Standing: Excellent

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find better availability (34 percent versus 22 percent) and 7 percentage points more likely to have better experience with inspections (24 percent versus 17 percent); both gaps were statistically significant and were little changed from 1989 because preference for both groups fell at about the same rate.

Discrimination among Buyers

Black and White Buyers

White preference was found more broadly in the case of buyers. In all but one of the areas measured, preferential treatment for white buyers was statistically significant. At 9 percentage points the largest gap (43 percent versus 34 percent), was for overall inspections. This gap was driven mainly by differences in the average number of units inspected. Weaker, but still statistically significant, bias was found for treatment related to financing assistance (such as when agents recommend lenders) and overall encouragement. The only area in which blacks and whites received comparable treatment was availability. This gap was just 3 percentage points — down from 17 in 1989 and one of the greatest improvements since then.

Hispanic and White Buyers

Bias against Hispanic homebuyers was confined principally to one area: financing. (This pattern contrasted with that of black homebuyers, who experienced low to moderate levels of bias across most measures.) Whites were more likely to receive better financing assistance (39 percent versus 24 percent), leading Hispanics by 14 percentage points. This was the only major discriminatory gap to widen since 1989. All other gaps shrank by 11 to 15 points over the years since 1989, leaving them too small to be statistically significant.

Geographic Steering Exists, but at Low Levels

Geographic steering is another important but subtle form of disparate treatment. It occurs when a renter or buyer is given more information about homes in neighborhoods whose occupants share the applicant's race or ethnicity. For example, a Hispanic homebuyer may be shown a higher number of homes in neighborhoods with more Hispanics than a white homebuyer would be shown. In this study, the researchers focused on geographic steering solely with respect to homebuyers.

Three types of agent behavior were considered indicators of steering: homes recommended, homes shown, and editorializing. Editorializing is agent commentary, both positive and negative, on home locations. Even little comments, such as "great schools" or "that restaurant can get noisy," can influence homebuyers. After testers turned in their surveys, researchers noted the address of each recommended and shown home. Using data on each home's census tract, municipality, and school district, they could determine whether agents were more likely to recommend or show homes to blacks and Hispanics in areas with higher

Specific Metros Studied

Bias varied considerably across metropolitan areas according to the Housing Discrimination Study. Compared with the average level of discrimination nationwide, high levels of pro-white bias were found in some metros, while low levels were found in others. Still others had more of a mix. Comments below summarize the researchers' findings of discriminatory behavior in some of these areas. Unfortunately, insufficient data often kept researchers from being able to say that the differences they found were statistically significant.

Highest Pro-White Bias

Birmingham, Alabama

Of all the metros, bias against black homebuyers was highest in Birmingham. According to every availability measure, whites were favored with percentage point gaps ranging from 14 percent to 26 percent. Inspections were even more biased, with gaps over 22 percentage points. Whites inspected more homes than their black partners in 62 percent of tests, while blacks inspected more in only 18 percent of tests, leaving a wide 44 percentage point gap. Black renters in Birmingham also faced higher levels of unfavorable treatment. (Data were not collected in Birmingham for Hispanics.)

Austin, Texas

Bias against both black and Hispanic homebuyers was higher in Austin than nationally. Both groups were more likely to have unfavorable treatment regarding inspections. They also experienced disparities related to availability and financing. Bias against black and Hispanic renters was weaker.

Lowest Pro-White Bias

Denver, Colorado

Black and Hispanic renters in Denver were treated comparably to whites according to almost all measures. Actually, the only two manifestations of bias among renters showed that minorities received significantly *favorable* treatment. (Real estate agents were more likely to make future arrangements with black renters; Hispanic renters were less likely to be told an application fee was required.) Hispanic homebuyers were treated with little bias. Black homebuyers, however, faced bias at rates significantly higher than the national average, particularly regarding availability, inspection, and encouragement.

Chicago, Illinois

Tests in Chicago found that black and Hispanic renters received virtually the same treatment as white renters according to all but one measure (Hispanics were 15 percent less likely to be offered rental incentives). Black homebuyers were also treated comparably to whites according to all but one measure (blacks were 16 percent less likely to be told they qualified for financing). Hispanic homebuyers, however, faced strong bias in all financing measures as well as most availability and inspection measures.

Detroit, Michigan

Few measures for either renters or homebuyers showed statistically significant net bias between whites and blacks, making overall bias lower than average. (Data were not collected in Detroit for Hispanics.)

Mixed Bias

Atlanta, Georgia

Atlanta's black renters faced bias at rates much higher than the national average, but the city's black buyers faced bias at rates much lower than nationally. White renters were far more likely to be quoted a lower rent for each unit (28 percent versus 6 percent) and also more likely to be offered rental incentives (16 percent versus 5 percent). Most other rental measures were weakly biased against blacks. For homebuyers, pro-black bias was strong according to many encouragement and finance measures. (Data were not collected in Atlanta for Hispanics.)

Los Angeles, California

Black and Hispanic renters were treated comparably to whites in all but one measure (blacks were recommended significantly fewer units). Black homebuyers faced bias in only two measures (whether agents discussed down payment requirements and whether agents told them they were qualified to rent), but the gaps were high, 19 percentage points and a remarkable 56 percentage points, respectively. Hispanic homebuyers were treated with pro-Hispanic bias in availability and inspection measures, but faced pro-white bias in financing.

concentrations of blacks and Hispanics, respectively. Did agents editorialize on neighborhoods, steering testers toward purchasing in areas where their race or ethnicity was common?

In black/white and Hispanic/white tests, whites were more likely than both blacks and Hispanics to be shown homes in census tracts with higher concentrations of whites. Whites were also more likely than blacks to be recommended such homes. (These differences tended to be weakly significant, and no differences were found by municipality or school district.) Bias in editorializing was substantial; it was significant for blacks and weakly significant for Hispanics. Whites were 15 percentage points more likely than blacks and 6 percentage points more likely than Hispanics to hear more positive comments about homes in census tracts with higher concentrations of whites.

The study also sought to determine if agents steered along class lines, directing minorities to areas of lower socioeconomic status.

The study also sought to determine if agents steered along class lines, directing minorities to areas of lower socioeconomic status. To investigate this possibility, researchers used numerous measures of the socioeconomic status of a geographic area, such as the percent of owner-occupied homes, median home price, per capita income, and percent of households below the poverty threshold.

Evidence of class steering between blacks and whites existed only in editorializing, with no differences in recommendations or inspections. White testers were about 12 percentage points more likely to hear positive comments about areas where fewer were poor. There was no evidence of socioeconomic steering between Hispanics and whites.

Agents and Agencies

Having established that bias clearly exists when blacks and Hispanics work with real estate agents, researchers then tried to determine if certain characteristics of agents or firms were associated with a pro-white bias. The most consistent finding was that older agents were more likely to show bias against the two minority groups, particularly blacks. Also, both blacks and Hispanics had less favorable inspection experiences with female agents. Hispanic agents were more likely to give Hispanic testers favorable treatment, but also more likely to give black testers less favorable treatment. In addition, larger firms tended to exhibit higher levels of pro-white bias.

What about Testers' Other Characteristics?

The paired-test method is often criticized because it measures the effect of only one characteristic: in this case, race/ethnicity. There is no way to know the effects of other tester characteristics. Is discrimination worse for people with less education? For immigrants? The authors ran some other analyses to examine the role of these other characteristics. They mainly found that female minority testers tended to face lower levels of bias than male minority testers. The roles of other characteristics were unclear.

Future phases of the Housing Discrimination Study will attempt to unravel these questions. Instead of using paired testing, the researchers will send triads of people. This way, with either two whites and a minority or two minorities and a white, it will be easier to tease out the effect of race and ethnicity. Future reports will also show the level of housing discrimination faced by Asians, Native Americans, and persons with disabilities.

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Testing for Housing Discrimination among Real Estate Agents

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