

Racial/Ethnic Disparities in Home Mortgage Lending in Texas

by: Dr. Robert H. Wilson
Lyndon Baines Johnson School of Public Affairs
The University of Texas at Austin

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Texas Low Income Housing Information Service
1100 East 8th Street
Austin, Texas 78702
(512) 477-8910

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1. Introduction

Homeownership is a deeply held value in American society. Major pieces of public policy have been adopted to encourage homeownership, including the creation of the savings and loan system in the 1930's, the federal income tax deduction for interest payments of home-mortgage loans, programs of the VA, FHA, and FMHA, tax-exempt mortgage revenue bonds, and support of secondary mortgage markets through institutions like Fannie Mae. The financing of homeownership occurs almost exclusively through private-sector lending institutions. A healthy financial market for home purchase loans has long been considered an important mechanism for creating wealth through homeownership and for maintaining vibrant and stable neighborhoods.

In light of the deterioration of urban neighborhoods in recent decades, the private home-mortgage lending markets began to be examined in the 1970's. The federal Home Mortgage Disclosure Act (HMDA), passed in 1975, requires depository institutions which originate loans secured by residential property, or home improvement loans, to disclose information concerning their lending practices. In the Community Reinvestment Act of 1977, Congress confirmed that banks and other regulated lending institutions had an affirmative obligation to meet the credit needs in the local communities in which they were chartered. Faced with growing disinvestment in declining communities, CRA recognized that homeownership was vital to healthy neighborhoods and home-mortgage lending was vital to homeownership. If communities do not have access to

home purchase credit, communities will fall into a downward spiral. In addition, families in such communities do not have access to this very important mechanism for wealth accumulation.

Given the segregated housing patterns in the U.S., in which individuals of a similar race or ethnicity frequently live in neighborhoods with people of similar background, community disinvestment is associated with racial/ethnic disparities in lending. Lending institutions are forbidden to use race/ethnicity of applicants as a factor in assessing loan applications under the Equal Credit Opportunity Act. CRA extends the principle of nondiscrimination to communities, especially low-income communities, and prohibits the practice of redlining. Redlining refers to the practice of lending institutions denying loans to individuals because of the neighborhood in which the property is located.

The initial approach of CRA was to encourage lending institutions and communities to enter into dialogue. Through this dialogue new opportunities for potential borrowers in communities and new markets for financial institutions were expected to emerge. Given the slow progress in home mortgage lending practices in low-income communities in the 1980's, Congress amended the CRA legislation in the early 1990's and the performance of banks is now more thoroughly analyzed.

Amendments to HMDA in the early 1990's increased the disclosure requirements for depository institutions. Information on all completed loan applications, not just on loans originated, now has to be disclosed. Characteristics of loan applicants, including income, gender, and race, and the disposition of loan applications, as well as other information, must be reported for various types of loans.

The data used in this study were obtained from the Federal Financial Institutions Examination Council (FFIEC), Board of Governors of the Federal Reserve System in Washington, D.C. The FFIEC is the agency responsible for collecting and compiling the data required under HMDA (for details of the data and methodology, see Appendix 1). This analysis examines applications for home purchase loans in the state of Texas during 1992. The FFIEC data include only lending in the state's Metropolitan Statistical Areas (MSAs), which excludes the @ areas of the state.

This analysis was performed at the request of the Texas Community Reinvestment Coalition and concentrates principally on the racial/ethnic composition of the applicant pool and of those denied home-mortgage loans. This study adopts the methodology used by the *Wall Street Journal* (December 21, 1993) in an analysis of home mortgage lending for the entire nation (see Appendix III). Further studies of the lending practices are anticipated in which the spatial incidence of lending, particularly in low-income communities, will be examined.

These preliminary results show quite substantial and disturbing disparities in home mortgage lending by race/ethnicity. Blacks and Hispanics apply for home purchase loans in relatively small numbers. The Blacks and Hispanics that apply for loans are much more likely to be denied loans than white applicants. The total share of private home mortgage lending in the state received by minority borrowers is quite low.

In 1992, 165,303 applications for home-purchase loans (for one- to four- unit dwellings) were made in Texas in MSAs that were subject to the HMDA reporting requirements (see appendix for the types of lending institutions included). Of this total, complete information on family income, Race/ethnicity and gender of applicant, loan amount and final disposition of loan application was available for 155,348 applications, which constitutes the population for this analysis.

The first table provides basic information on the state's households and home-purchase loan demand. The analysis then turns to rejection ratios for the various racial/ethnic groups. Rejection ratios

are calculated for the state as a whole (recall only data from MSAs in the state are available), for various income classes, for selected counties, and for the 50 lending institutions with the greatest number of home-purchase loan originations in the state.

The state of Texas has a substantial minority population. According to the 1990 U.S. Census of Population, almost 12 percent of the state population was Black and almost 26 percent of Hispanic heritage. The White population constituted around 61 percent of the population in the state. The racial/ethnic composition of heads of households, which provides a rough indication of the composition for the potential demand for home purchase loans, is indicated in Table 1. Of the 6,070,932 heads of households in the state, 11.1 percent were Black and 19.1 percent were I-Hispanic and 68.0 percent were white according to the 1990 Census of Population.

Table 1 - Texas Racial Household Populations and Home Mortgage Lending

Race/Ethnicity	Heads of Households	Loan Applications	Loan Rejections	Loan Approvals	\$ Amount Loaned
Am. Indian	0.3%	0.5%	0.6%	0.5%	0.5%
Asian	1.4%	2.9%	2.5%	3.1%	3.4%
Black	11.1%	5.2%	9.7%	4.2%	4.2%
Hispanic	19.1%	13.8%	22.3%	11.8%	8.4%
White	68.0%	77.6%	64.911/.	80.5%	83.5%
Total	6,070,932	155,348	29,274	120,813	\$14,311,682,000

Source for all tables in this report: Federal Financial Institution Examination Council, Board of Governors of the Federal Reserve System in Washington, D.C., extracted from computer tape; 1990 Census of Population & Housing, Summary T Tape File 1A.

Of all loan applicants in the state in 1992, around seventy-eight percent were White, fourteen percent Hispanic and five percent Black (see Table 1). The shares of the actual demand for home-purchase loans for Blacks and Hispanics are substantially below their corresponding shares of heads of household, indicating that minorities are seeking loans in numbers well below what would be expected given the size of their populations. This difference is presumably compensated by other types of homeownership finance, such as self-financed and owner-financed, or housing rentals. In any event, the relatively small share of minority loan applicants is troubling and suggests aggressive marketing by financial institutions and others may be order.

Not all applications for home purchase loans were approved. Table I indicates that among those applicants rejected, 22 percent were Hispanic and 9.7 percent Black. The shares for these two groups were larger than their corresponding shares, 14 percent and 5 percent respectively, of total loan applications. Among those approved for loans, 81 percent were White and 83 percent of the total dollar amount loaned went to white borrowers. Blacks received 4.2 percent of the loans approved and received a similar percentage of the total dollar amount loaned. Hispanics represented 11.8 percent of those receiving loans but only 8.4 percent of the total dollar amount loaned. These patterns suggest a significant racial/ethnic disparity in lending.

In order to explore further possible racial/ethnic disparities in lending, an indicator utilized by the *Wall Street Journal*, called the rejection ratio, is applied to the Texas data. Rejection ratios are calculated for each racial/ethnic group. This ratio represents the rejection rate for a particular group (number of applications denied divided by total number of applications) divided by the rejection rate for the White group. If there were no disparities among the various racial/ethnic groups in terms of the likelihood of

being rejected for a home purchase loan, the rejection ratio for each group would be approximately to 1.0.

Rejection ratios are presented in Table 2 for various racial/ethnic groups (note that the ratio for Whites is always equal to 1.0). For Blacks, the rejection ratio of 2.23 indicates that Black applicants are denied loans at more than two times the rate of denials for Whites. In the WSJ study, the rejection ratio for blacks nationwide was 2.06. For Hispanics, the rate of denial is a little less than two times (1.9) the rate for Whites. These results provide further evidence of racial/ethnic disparities in home mortgage lending. (Appendix B includes the raw numbers from which the rejection ratios were calculated.)

Table 2 - Home Mortgage Loan Rejection Ratios' by Income and Race

<u>Income Category</u>	<u>American Indian</u>	<u>Asian</u>	<u>Black</u>	<u>Hispanic</u>	<u>White</u>
Total	1.44	1.02	2.23	1.93	1.00
\$1 to <25,000	1.38	0.89	1.52	1.23	1.00
\$25,000 to <50,000	1.15	0.88	1.91	1.56	1.00
\$50,000 to <75,000	1.61	1.25	2.51	1.79	1.00
\$75,000 to < 1 00,000	1.44	1.17	2.41	1.76	1.00
>= \$1 00,000	2.01	1.74	2.38	1.50	1.00

' - The rejection ratio is the rejection rate for one group divided by the rejection rate for Whites. The rejection rate is the number of applications denied divided by the total number of applications. See Appendix 1 for further details.

The review of a home purchase loan application by a lending institution involves the consideration of a range of factors, including the income and wealth of the borrower, the employment and credit history of the borrower, the size of the loan requested and the value of the house, among other factors. This study is exploratory in nature and will not investigate all potential explanations for the racial/ethnic disparities. However, the HMDA data provides the income of borrowers, and the effect of income on explaining disparities can be assessed in a preliminary fashion. That is to say the potential effect of systematic variation in borrower income on the rejection ratio for racial/ethnicity groups can be examined with the data available.

In Table 2, the rejection ratios for various income groupings are provided. To make this calculation, all applicants were separated into income categories based on the borrower's family income. The rejection rate for a specific racial/ethnic group in a specific income category is divided by the corresponding rejection rate for the group of Whites to calculate the rejection ratio. If the overall pattern of disparities in lending were the result of income differentials, one would find lower rejection ratios for the minority groups at higher income levels. This does not occur. In fact, the rejection ratio for Blacks and Hispanics increases until the \$75,000 category is reached and declines only modestly at higher incomes. The results in Table 2 indicate that even when family income is taken into consideration, the rejection ratio of minority groups is much higher than would be expected if no disparity existed. In other words, differences in family income levels cannot explain the overall racial/ethnic disparities in rejection rates. The puzzling result found here, with the rejection ratio for Blacks actually increasing with income levels until higher incomes are reached, was also reported in the *WSJ* article for the country as a whole and also found in *Mortgage Lending in Boston: Interpreting HMDA Data*, a report written by the Federal Reserve Bank of Boston in October, 1992.

Table 3 - Racial Home Mortgage Loan Rejection Ratios for Major Texas Counties

American

County	Indian	Asian	Hispanic	White
Bexar	2.23	1.04	1.78	1.00
Cameron	0.00	0.88	3.32	1.00
Dallas	1.14	1.20	2.26	1.00
El Paso	1.47	1.17	2.14	1.00
Harris	1.58	1.26	2.58	1.00
Hidalgo	2.16	0.91	2.88	1.00
Jefferson	0.86	1.59	2.18	1.00
Lubbock	0.00	1.83	5.43	1.00
Travis	1.37	1.10	2.75	1.00
Webb	1.85	0.74	1.54	1.00

The state of Texas is quite diverse in the racial/ethnic composition of the population in the various subregions of the state. In Table 3, the racial/ethnic rejection ratio is calculated for various counties, including the very large urban areas. The racial/ethnic disparities in lending identified above for the state as a whole are found in virtually all counties in Table 3. Although the rejection ratio varies significantly, from very high levels in Lubbock and Hidalgo to lower levels in Webb, the overall pattern of racial/ethnic disparities appears widespread.

The racial ethnic rejection ratios are calculated for the fifty depository institutions with the largest number of home-purchase loans originated in the state. In the FFIEC data, there are 802 lending institutions with loan applications in the state. The 50 institutions included in Table 4 comprise 76 percent of all loans originated and 78 percent of the dollar amount loaned in the state. The rejection ratio varies substantially among these institutions, but high disparities in the rejection ratios for Blacks and Hispanic are found in most.

III. Conclusions

These preliminary results raise concern about home-purchase lending practices in Texas with respect to the race and ethnicity of borrowers. In 1992 Black borrowers received only 4.2 percent of home purchase loans and a similar share of the total dollar volume of loans even though their share of all households was 11.1 percent. Hispanic borrowers received only 1 1.8 percent of all home purchase loans and 8.4 percent of the dollar value of all loans even though they represent 19.1 percent of all households. Blacks and Hispanics are not applying for home purchase loans in numbers that would be expected based on their share of households. Among Blacks and Hispanic that apply for home purchase loans, they are denied loans in numbers much larger than expected. Blacks are rejected at just over twice the rate of rejection for Whites. Hispanics are rejected at just less than twice the rate for whites.

The existence of a significant disparity in the rejection ratio of Blacks and Hispanics is without question. One potential explanatory factor for the disparity, family income of the applicant, was found not to be the source of the disparity. The examination of the rejection ratios by counties and by lending institution found substantial disparities were widespread although significant variation in lending performance exists. The overall pattern is quite troubling and community organizations, lending institutions, and relevant governmental entities must help identify the source of these disparities and attempt to remedy them.

Appendix I-Methodology and Data Sources

The data for this study are derived from the Federal Financial Institutions Examination Council of the Federal Reserve System, the agency responsible for collecting

and disseminating the I-HMDA data. The data set includes all loan applications from depository institutions subject to regulation by:

Comptroller of the Currency
Federal Reserve System
Federal Deposit Insurance Corporation
Office of Thrift Supervision
National Credit Union Administration Board
U.S. Department of Housing and Urban Development

Excluded by current federal legislation are lending institutions with less than \$10 million in assets and institutions that have neither a home office or branch in a MSA.

The data for the entire country was obtained from the FFIEC on computer tape and an extract of loan applications for properties in Texas was made. Various types of lending are available (home purchase, home improvement, refinance, and multifamily dwelling) in the data set, but the study examines only home-purchase loan applications.

The number of applications for home purchase loans in Texas was 165,303. Applications without a valid variable on race/ethnicity, gender, family income, loan amount and final disposition of application were eliminated from further considerations. The number of applications with complete information was 155,348. The variable race/ethnicity is self-reported by the loan applicant. On approximately 500 applications, the variable race/ethnicity was reported as "other", and these were excluded from the analysis. This study considers only the race/ethnicity of the applicant, and not that of the co-applicant.

To examine potential disparities in lending practices in various racial/ethnic groups, *this* study adopts the methodology utilized by The *Wall Street Journal* in its analysis of the HMDA data for the country (Tuesday, December 21, 1993). The *WSJ* uses a rejection ratio which is defined as the rejection rate for a particular group divided by the rejection rate for the comparable white group. The rejection rate of a group is the number of loan applications denied divided by the total number of applications. The total number of applications is the sum of the number of loans originated plus the number of loan applications approved but rejected by borrower, plus the number of applications denied. The rejection ratio can be calculated for various groupings of loan applicants, such as by race/ethnicity, by family income, by county or by financial institution. The rejection ratio for Whites in this study is always 1.0.