Racial segregation key factor in subprime lending

November 6 2009

(PhysOrg.com) -- New study examines impact of segregation on the prevalence of high-cost loans in U.S. metro areas. Subprime loans disproportionately located in segregated areas.

When the housing market collapsed under the weight of unsustainable subprime loans, it destabilized the U.S. financial system, sent shock waves through the global economy, and created chaos for homeowners across the country. A report released today by the Economic Policy Institute shows that the subprime crisis reached its highest concentration in the nation's most racially segregated metropolitan areas. Segregation and the Subprime Lending Crisis, by Gregory D. Squires, Derek S. Hyra, and Robert N. Renner, reveals the role of racial segregation in the current economic crisis, a problem yet to be addressed in the aftermath of the subprime meltdown.

The authors examined the incidence of subprime lending in metropolitan areas nationwide. To illustrate their point, the percentage of high-cost loans in the nation's 10 metropolitan areas where African Americans and whites were most segregated were compared to the share of high-cost loans in the 10 least segregated areas. The most segregated areas, as measured by how separated the races are within a metro area, were Detroit, MI; Milwaukee, WI; Chicago, IL; Cleveland, OH; Flint, MI; Muskegon, MI; Buffalo, NY; Niles/Benton Harbor, MI; St. Louis, MO; and Cincinnati, OH where 31% of loans were high cost compared to an average of 20% in the least segregated areas of Coeur d'Alene, ID; Hinesville-Fort Steward, GA; Santa Fe, NM; Prescott, AZ; Bellingham,

WA; Boulder, CO; Jacksonville, NC; Blacksburg-Christiansburg-Radford, VA; Santa Cruz-Watsonville, CA; and Missoula, MT. Even after accounting for metro-level income and credit scores, the authors found highly segregated metropolitan areas were much more likely than less segregated areas to have greater shares of subprime loans.

“In a nutshell, the more racially segregated a residential area is, the more subprime loans the area is likely to have,” said co-author Gregory Squires. “Unless discriminatory lending practices that specifically take advantage of racially segregated metropolitan areas are addressed, these practices will undermine other policies attacking lax underwriting or tightening regulations.”

African American segregation has a stronger effect compared to Hispanic segregation. In communities where African Americans are highly segregated from whites, segregation accounts for approximately 7% of the increase in subprime loans. In areas where Hispanics are highly segregated from whites, segregation accounts for 4.2% of the increase. In general, for every 10% increase in African American segregation, there is a 1.4% increase in high-cost lending. Each 10% increase in Hispanic segregation is associated with an increase of 0.6% in high-cost lending.

Under the once-rampant but now outlawed practice of redlining, banks and other lending institutions denied home loans to predominately African American communities. A number of laws were enacted in the ’60s and ’70s to outlaw the practice and require equal opportunity in mortgage markets. Subprime loans made their debut after The Depository Institutions Deregulation and Monetary Control Act of 1980 allowed lenders to charge a variety of higher fees and rates for mortgages, depending on the rate of risk and default. Vulnerable segregated communities went from virtually no loans, to unscrupulous loans for mortgages with jacked-up fees. This new form of

discrimination is often referred to as “reverse redlining.”

Despite massive government bailouts, progress in restoring health to the nation’s credit markets remains unclear. “When the credit markets do come back, there should be policies in place to increase affordable housing and decrease racial segregation, address housing discrimination, improve education—specifically financial literacy—and to better regulate the lending industry,” said Squires.

Provided by George Washington University

Citation: Racial segregation key factor in subprime lending (2009, November 6) retrieved 25 April 2024 from https://phys.org/news/2009-11-racial-segregation-key-factor-subprime.html

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.