Analyzing Trends in Subprime Originations and Foreclosures: A Case Study of the Atlanta Metro Area

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Executive Summary

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NEIGHBORHOOD REINVESTMENT CORPORATION, THE NEIGHBORWORKS® NETWORK AND THE NEIGHBORWORKS® CAMPAIGN FOR HOME OWNERSHIP 2002

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Neighborhood Reinvestment Corporation was established by an act of Congress in 1978 (Public Law 95-557). A primary objective of the Corporation is to increase the capacity of local community-based organizations to revitalize their communities, particularly by expanding and improving housing opportunities. These local organizations, known as NeighborWorks® organizations, are independent, resident-led, nonprofit partnerships that include business leaders and government officials. All together they make up the NeighborWorks® network.

The NeighborWorks® Campaign for Home Ownership 2002 is the largest national initiative of its kind: a joint effort by private industry and government working with community-based NeighborWorks® organizations to bring more families into home ownership. NeighborWorks® organizations participating in the campaign use the NeighborWorks® Full-Cycle Lending℠ system. Under this system, prepurchase education, innovative loan products and early-intervention delinquency counseling are combined into a system that helps create successful homebuyers who take charge of their neighborhoods as well as their homes.

Executive Summary

Subprime lending for home mortgages has grown rapidly during the 1990s, with recent estimates indicating that this market segment accounted for about $200 billion in new loans by the end of the decade. On the positive side, the growth in subprime lending expands borrowing opportunities for those with impaired credit, and may increase homeownership opportunities for those who might otherwise not qualify for a conventional—or perhaps any—mortgage. However, subprime loans carry higher interest rates and therefore create a greater payment burden for the borrower. And the rise in subprime lending has also been associated with a growth in predatory lending practices, in which lenders use misleading or fraudulent means to lure borrowers into loans with high interest rates and high fees that rob owners of their equity and threaten their ability to maintain ownership. Subprime lending is also much more prevalent in low-income and minority communities, threatening the stability of these communities. However, while awareness of predatory lending practices has grown, there is little systematic data available to evaluate the magnitude and trends in the origination of these loans and resulting foreclosures. This study uses available data to examine the growth of subprime lending and foreclosures in the Atlanta metro area.

Analyzing Trends in Originations by Subprime Lenders

Data reported under the Home Mortgage Disclosure Act (HMDA) can be used to analyze trends in home loan origination at the local level. Unfortunately, the HMDA data do not include direct information for identifying subprime loans. But the Department of Housing and Urban Development has identified the lenders in HMDA that are primarily originating subprime loans, using industry sources and other data. Unfortunately, the HMDA data excludes a not-insignificant portion of the subprime market since lenders are not required to report second mortgages or home equity credit lines other than those used expressly for home improvement. Despite this flaw, HMDA can provide valuable information on subprime lending trends at the neighborhood level.

Analysis of HMDA data for the Atlanta area for the period 1994 to 1998 finds that:

- Loan originations by subprime lenders grew by 150 percent between 1994 and 1998, compared to a growth in all loan originations of 111 percent.
- The share of all originations accounted for by subprime lenders reached 12 percent in 1997. While the number of subprime loans continued to increase in 1998, the market share declined to 9 percent due to the conventional refinancing boom.
- The growth in subprime lending was much more significant for properties in low-income and minority neighborhoods than other kinds of neighborhoods. Between 1994 and 1998, subprime lending grew by 440 percent in very low-income neighborhoods (where the median household income is less than 50 percent of the metro area median). In the same period, subprime lending grew by 317 percent in majority minority neighborhoods (where more than half the residents are minority group members).
- In very low-income neighborhoods, subprime lenders accounted for 37 percent of all originations in 1997 – 3 times the subprime market share in the Atlanta area overall. In majority minority areas, subprime lenders accounted for 30 percent of all originations in 1997 – 2.5 times the share for the entire metropolitan area.

Analyzing Trends in Foreclosures by Subprime Lenders

Data on home loan foreclosures from June 1996 through December 1999 were obtained from the Atlanta Foreclosure Report, a local company that publishes monthly listings of properties to be sold at foreclosure auctions. The database includes the name of the lender pursuing each foreclosure, and we matched these names to the list of HMDA reporters to identify subprime lenders.

Aside from the name of the lender, subprime loans among the foreclosures can be identified using information on the interest rate the loans carry. Specifically, we compared the interest rates on the loans in foreclosure to the 30-year Treasury bill rate at the time the loans were made, to identify loans with high interest rate premiums or spreads (defined as those 4 percentage points or more above the Treasury bill rate). Unfortunately, only one-quarter of the sample includes interest rate information. An examination of foreclosures of high interest rate loans found the following:

- Only a small share (8 percent) of loans attributable to non-subprime lenders have high interest rates, while among subprime lenders 44 percent of loans bear high interest rates.
- The share of high interest rate loans in foreclosure grew rapidly for all lender types over the period 1996 to 1999. Among HMDA reporters that are *not* primarily subprime lenders, the share of foreclosures with high interest rates grew from 2 to 22 percent, while among subprime lenders the share increased from 26 to 57 percent, and among non-HMDA reporters the share went from 9 to 38 percent.
- While subprime lenders have the highest share of high interest rate loans, almost half of high interest rate foreclosures were by other kinds of lenders. In fact, the three lenders with the largest numbers of high interest rate foreclosures were depository institutions. This finding may reflect the fact that some conventional lenders service subprime loans originated by other lenders, but it may also reflect a growing involvement by conventional lenders in this market segment.

An analysis of Atlanta area foreclosures started by subprime lenders reveals:

- The overall volume of foreclosures declined by 7 percent between 1996 and 1999, but the volume of foreclosures started by subprime lenders grew by 232 percent.
- Among lenders reporting under HMDA, the share of foreclosures attributed to subprime lenders now exceeds their share of originations. Originations by subprime lenders peaked at 12 percent of all originations in 1997, while foreclosures by these lenders accounted for 16 percent of all foreclosures in 1999. And while the share of originations by subprime lenders declined in 1998, the share of foreclosures by these lenders continued to rise.
- The share of foreclosures by subprime lenders grew rapidly in Atlanta neighborhoods of all income levels. But like their originations, foreclosures by subprime lenders were highest in very low-income neighborhoods.
- Foreclosures by subprime lenders were also most common in majority minority neighborhoods. In 1999, the share of foreclosures in these areas attributable to subprime lenders was 16 percent, about twice as high as the share in all other areas.
- By 1999, the share of foreclosures by subprime lenders in majority minority areas had exceeded these lenders' share of originations. Unlike the subprime share of originations, which had declined in 1998, the share of foreclosures by subprime lenders was still rising as of 1999.