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Feature Article
Predatory Lending: What's Race Got To Do With It

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The year is 2003 and you are an African American living on the Southside of Chicago. After years of saving and building your credit, you are finally able to buy your own home. And as you sit at your kitchen table with your mortgage broker, you sign off on the closing documents to seal the deal.[1] You think you're ensuring your slice of the American dream, but little do you know that your mortgage broker preyed on you. Little do you know that you were just a means to an end. Little do you know that your mortgage was carefully designed to default.

Scenarios like this occurred across the United States during the housing bubble of the early 2000s. Financial institutions purposefully issued mortgages that were made to default in order to ensure profitability for their collateralized debt obligations (CDOs).[2] By using this fraudulent tactic, financial institutions were able to obtain big, short-term gain at the expense of American homeowners.[3] This was an exploitation of the most disempowered communities of the United States by the most powerful companies in American finance. Despite the financial collapse of 2008, minority communities can still feel the expense of such exploitation today.[4]

MORTGAGE-BACKED SECURITIES, SUBPRIME MORTGAGES, AND PREDATORY LENDING

A mortgage-backed security (MBS) is an asset-backed security whose value derives from a pool of mortgages.[5] Traditionally, a government-sponsored entity (GSE) or a "private label" company will purchase a pool of loans and sell

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1 Interview with Douglas M. Matton, Attorney, Matton Law Offices (Oct. 16, 2014).

2 Steven A. Ramirez, *The Real Subprime and Predatory Fraud (Fannie and Freddie Acquitted Again and Again II)*, The Corporate Justice Blog (Nov. 6, 2011). *Available at*: http://www.corporatejustceblog.blogspot.com/2011/11/real-subprime-and-predatory-fraud.html.

3 The Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, Chapter 7: The Mortgage Machine, 103, 104- 117 (2011).

4 Interview with Sumi Cho, Professor of Law, DePaul University School of Law (Oct. 15, 2014); Simone Pathe. In Bank of America settlement, who's feeling the pain?, PBS Newshour, Aug. 22, 2014. *Available at*: http://www.pbs.org/newshour/making-sense/in-bank-of-america-settlement-whos-feeling-the-pain/.

5 SEC Facts on Mortgage-Backed Securities. *Available at*: http://www.sec.gov/answers/mortgagesecurities.htm

the bundle to investors.[6] When mortgage payments are made on time by homeowners, investors in a pool of mortgages receive a cut.[7] In this way, MBSs proved to be very profitable.[8]

In order to expand homeownership in the United States, the Clinton and Bush administrations encouraged the investment of MBSs backed by subprime mortgages.[9] Subprime lending compensated high credit risk with higher interest rates and required less of a down payment than a traditional prime loan.[10] Thus, subprime mortgages benefited communities that were historically alienated from the benefits of homeownership.[11] The initial profitability of this market encouraged private investment banks to compete with government-sponsored entities.[12] And as a result, subprime lending increased fivefold between 2001 and 2005.[13] By 2006, 40 percent of all MBSs included at least some subprime loans.[14]

Competition for profitability was an unfortunate consequence, however, since it magnified a common industry practice in subprime lending.[15] The Federal Crisis Inquiry Commission (FCIC) found that hedge funds not only sponsored pools of subprime loans, but also simultaneously engaged in non-transparent transactions (such as credit default swaps).[16] Thus, they were guar-

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6 *Id*.

7 *Id*.

8 Frank J. Fabozzi et al., Mortgage-Backed Securities: Products, Structuring, and Analytical Techniques, xi (2007).

9 Steven A. Ramirez, Lawless Capitalism: The Subprime Crisis and the Case for an Economic Rule of Law, 79 (2013).

10 HUD Facts on FHEO-Subprime Lending. *Available at*: http://webcache.googleusercontent.com/search?q=cache:4cxkYFAXGRoJ:www.hud.gov/offices/fheo/lending/subprime.cfm+&cd=11&hl=en&ct=clnk&gl=us.

11 *Id*.

12 Christopher L. Peterson, Fannie Mae, Freddie Mac, and the Home Mortgage Foreclosure Crisis, 10 Loyola J. Pub. Int. L. 149, 157, 160 (2009). Stating that, "Like the GSEs, purely private institutions saw the potential benefits of pooling home mortgages into mortgage-backed securities and soon began attempting to channel capital into home age lending in similar ways;" The Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, Chapter 5: Subprime Lending, 68-70 (2011); The Financial Crisis Commission, *supra* note 3 at 102, 122; Mortgage Lending: Subprime Subsidence, The Economist (Dec. 16, 2006). *Available at:* http://www.economist.com/node/8424086.

13 Mortgage Lending: Subprime Subsidence, *supra* note 12.

14 *Id*.

15 The Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, Chapter 10: The Madness, 192 (2011); Peterson, *supra* note 12 at 160; The Financial Crisis, *supra* note 3 at 102

16 The Financial Crisis Inquiry Commission, *supra* note 15 at 189, 191.

anteed bigger profits when loans defaulted than when loans were paid on time.[17]

In addition, the same hedge funds that sponsored pools of subprime loans were usually in charge of selecting the loans that entered it.[18] In order to maximize profits, financial institutions utilized predatory lending techniques to ensure a supply of loans defaults.[19] They targeted vulnerable communities and purposely pursued loans that had a greater chance of defaulting (i.e. risky and unpayable loans).[20] By 2006, this practice was evidenced in 50 percent of all collateralized debt obligations issued.[21]

BUT WHAT'S RACE GOT TO DO WITH IT?

A common predatory technique used by financial institutions was steering, i.e. issuing subprime loans to homeowners who qualified for conventional, prime loans.[22] According to a Wall Street Journal study, 61 percent of borrowers who were issued subprime loans actually qualified for prime loans.[23] Borrowers who were steered into subprime loans had interest rates that were on average 3.5 percent higher than what they would have been with prime loans.[24] And with higher than necessary interest rates, these borrowers were saddled with thousands of dollars in unnecessary payments.[25] This exacerbated the economic plight that many families faced, causing some families to eventu-

17 *Id* at 191-194

18 *Id*. at 189,192-193; The Financial Crisis Inquiry Commission, *supra* note 12 at 68.

19 Ramirez, *supra* note 2; *Supra* note 4.

20 *Supra* note 4.

21 The Financial Crisis Inquiry Commission, *supra* note 15 at 192, 194; Ramirez, *supra* note 2.

22 Amaad Rivera et al., Foreclosed: State of the Dream, 2008, at 8, 11. Available at: http://www.faireconomy.org/files/pdf/StateOfDream_01_16_08_Web.pdf. This explains how loans can be predatory if there is steering, i.e. "Mortgage brokers and other financial institutions deliberately targeted asset poor communities whose members were eager to acquire homes. This practice was coupled with giving subprime loans to middle and lower income families and households (typically people of color) that qualified for conventional (market rate) loans but were given higher cost loans instead."

23 Rick Brooks and Ruth Simon, Subprime Debacle Traps Even Very Credit-Worthy, The Wall Street Journal (Dec. 3, 2007). *Available at:* http://www.online.wsj.com/articles/SB119662974358911035.

24 Ramirez, *supra* note 9 at 148.

25 Brooks and Simon, *supra* note 22.

ally lose their homes to foreclosure.[26] In fact, when compared to prime loan defaults, subprime loans defaulted eight times more.[27]

Although financial institutions preyed on low income, elderly, and minority communities, their efforts were particularly concentrated in communities of color.[28] Studies show that minorities were subjected to predatory loans more so than whites. Lenders issued high cost loans to 58 percent of low-income blacks and to 37 percent of low-income Latinos, as compared to only 28 percent of low-income whites.[29] When level of income is taken into account, 54 percent of high-income blacks and 49 percent of high-income Latinos were issued high cost loans, compared to only 16 percent of high-income whites.[30] Thus, even high-income blacks and Latinos were issued more high cost loans than low-income whites.[31] Even when credit risk is controlled, Blacks were 3.9 times more likely than whites to receive subprime loans, while Latinos were 2.6 times more likely.[32] In fact, when regulatory authority, credit risk, and other variables (which lenders use to determine issuance) are controlled, race is still found to play a major role.[33]

In addition, the subprime industry blossomed in areas of the United States where marginalized and vulnerable minority communities lived.[34] Even after controlling for credit risks, subprime lending was plentiful in the region where the U.S. borders Mexico, in the urban areas of the Midwest, and within the Black Belt of the old Confederacy.[35]

THE AFTERMATH

According to Douglas Matton, a Chicago based attorney who works on foreclosure cases, foreclosures have had a "disruptive and traumatic effect" on

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26 *Supra* note 4.

27 Claudia Colton et al., Pathways to Foreclosure, June 2008, at 26. Available at: http://www.blog.case.edu.msass/2008/06/23/Pathways_to_foreclosures_6_23.pdf.

28 Ramirez, *supra* note 9 at 8.

29 Rivera, *supra* note 22 at 14.

30 *Id*.

31 *Id.*

32 Elvin K. Wyly, The Subprime State of Race, Oct. 2008, at 1, 41-42. *Available at*: http://ibis.geog.ubc.ca/~ewyly/research/race.pdf.

33 Debbie Gruenstein Bocian et al., Race, Ethnicity and Subprime Home Loan Pricing, 60 J. Econ. Bus. 110, 121-123 (2008).

34 *Supra* note 4; Elvin K. Wyly et al., Cartographies of Race and Class: Mapping the Class-Monopoly Rents of American Subprime Mortgage Capital, 33 Int'l J. Urban Reg. Res. 332, 339 & 350 (2009).

35 Ramirez, *supra* note 9 at 150.

families and communities.[36] Unfortunately, this traumatic effect does not end once the bank seizes the house.[37] Not only does an ex-homeowner have to pack up and move his family elsewhere, the location of "elsewhere" becomes a hurdle as well.[38] With a foreclosure on record, an ex-homeowner is rendered vulnerable in terms of immediate housing, and it becomes increasingly hard to find an apartment with poor credit.[39]

Furthermore, banks can continue to go after an individual even after a house is foreclosed on.[40] Mr. Matton notes that if a bank cannot sell the property for the same value before foreclosure, it will try to obtain the remaining balance from an already struggling individual.[41] This can be done by taking the ex-homeowner to court, garnishing his wages, and forcing him to sell off assets.[42] For a struggling and vulnerable minority family in the United States, this creates financial trauma that can only be solved by filing for bankruptcy.[43]

When the housing bubble popped and the market experienced huge losses, minorities were affected most by the downturn.[44] Black borrowers suffered $72 billion to $93 billion in loss, while Latinos suffered losses between $76 billion and $98 billion.[45] Mike Calhoun of the Center for Responsible Lending stated that the crisis "stands to likely be the largest loss of African-American wealth that [the United States] has seen, wiping out a generation of home wealth building."[46]

"Foreclosures can hurt an entire family and this hurt extends to the community with the consequence of deteriorating neighborhoods," states Sumi Cho, a professor of Economic Justice at DePaul University School of Law.[47] A city can experience a loss of tax revenue when banks and local governments shirk away from the responsibility of maintaining vacant properties (either purposefully or, in the case of some local governments, because they cannot afford

36 *Supra* note 1.
37 *Id.*
38 *Id.*
39 *Id.*
40 *Id.*
41 *Id.*
42 *Id.*
43 *Id.*
44 Ira Goldstein, Subprime Lending, Mortgage Foreclosures and Race: How far have we come and how far have we to go?, 1, 14 (2008). *Available at*: http://www.prrac.org/projects/fair_housing_commission/atlanta/SubprimeMortgageForeclosure_and_Race_1014.pdf.
45 Rivera, *supra* note 22 at 17.
46 *Id*. at 18.
47 *Supra* note 4.

to).[48] And entire communities can witness a decline in investment and in jobs.[49] "A recent study by the Association of Community Organizations for Reform Now (ACORN) concluded that foreclosures increase violent crime in neighborhoods, decrease property values, and 'reduce city tax revenue, making it harder to provide good schools, police protection, code enforcement, and other services.'"[50] This leaves many, including Ms. Cho, to conclude that urban blight has "devastating, long-term communal and intergenerational effects."[51]

GOVERNMENT RESPONSE

After the collapse, federal and state governments scrambled to hold financial institutions accountable for their actions. Illinois Attorney General Lisa Madigan led a multi-state action against Countrywide, the largest mortgage lender in the United States.[52] As a result, Countrywide paid a total of $8.7 billion for claims of predatory lending in 400,000 loans nationwide.[53] In August of 2014, Bank of America reached a $17 billion dollar settlement, the largest of its kind, with the Department of Justice (DOJ).[54] The settlement was offered after the DOJ charged Bank of America for the "faulty sale in mortgage securities" which enabled predatory lending to thrive.[55] The two-pronged settlement included $9.65 billion to serve as a cash penalty, and $7 billion to serve as a form of relief for, "homeowners struggling with unrealistic mortgages and demolishing 'urban blight.'"[56]

Local governments have also filed suits against major financial institutions. Pending lawsuits from the City of Memphis and the City of Baltimore have utilized statements from former employees explaining how they were en-

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48 *Id.*

49 *Id.*

50 Rivera, *supra* note 22 at 21.

51 *Supra* note 4.

52 Ramirez, *supra* note 2.

53 *Id.*

54 Danielle Douglas, Bank of America and DOJ reach $17 billion settlement over mortgage securities, The Washington Post (Aug. 21, 2014). *Available at:* http://www.washingtonpost.com/business/economy/bank-of-america-and-doj-reach-17-billion-settlement-over-mortgage-securities/2014/08/21/800ba0e8-2936-11e4-958c-268a320a60ce_story.html.

55 *Id.*

56 Pathe, *supra* note 4.

couraged to target black neighborhoods for high cost loans.[57] Los Angeles has filed four suits against banks for "flooding minority neighborhoods with sub-prime mortgages even when residents qualified for better terms."[58] The City has also "explored legal means to hold banks accountable for urban blight," which has racked the city since the collapse of 2008.[59] Similarly, Cook County has filed suit against HSBC Holdings Plc for "targeting Chicago-area minority borrowers for high cost home loans."[60] The County also plans to hold HSBC liable for Chicago's urban blight.[61]

NOW WHAT?

In order to prevent predatory lending, Ms. Cho believes that legal assistance programs should continue to aid prospective homebuyers in their pursuit of homeownership.[62] Financial education can benefit individuals with a lack of homeownership history as well as those who are experienced in the process.[63] However, Ms. Cho is quick to note that any assistance or educational program will only serve as a "band aid" on a bad wound.[64] After all, the problem will never be solved if the source of the problem still exists.[65]

Legislation must be created to prevent financial institutions from engaging in fraudulent tactics, and those that violate the law should be held accountable. Unfortunately, there's a long way to go. As Mr. Matton pointed out, Illinois does not have an anti-predatory statute on its books and the government does not pursue criminal prosecution of those engaged in fraudulent financial practices.[66]

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57 Michael Powell, Memphis Accuses Wells Fargo of Discriminating Against Blacks, The New York Times (Dec. 30, 2009). *Available at*: http://www.nytimes.com/2009/12/31/us/31 wells.html.

58 Karen Gullo, JPMorgan Wins Dismissal of Los Angeles Bias Lending Case, Bloomberg News (Aug. 6, 2014). *Available at:* http://www.bloomberg.com/news/2014-08-06/jpmorgan-wins-dismissal-of-los-angeles-bias-lending-case.html.

59 Edvard Pettersson, Wells Fargo Can't Shake L.A. Lawsuit Over Predatory Loans, Bloomberg News (May 28, 2014). *Available at:* http://www.bloomberg.com/news/2014-05-28/wells-fargo-can-t-shake-l-a-lawsuit-over-predatory-loans.html.

60 Edvard Pettersson and Andrew Harris, HSBC Sued by Illinois' Cook County Over Minority Lending, Bloomberg News (Mar. 26, 2014). *Available at:* http://www.bloomberg.com/news/2014-03-25/hsbc-sued-by-illinois-cook-county-over-minority-lending.html.

61 *Id.*

62 *Supra* note 4.

63 *Id.*

64 *Id*.

65 *Id*.; *supra* note 1.

66 *Supra* note 1.

Despite how bleak the future may look, Mr. Matton offers one golden rule of advice for those seeking to purchase a home: "Never enter into a transaction of such magnitude without first obtaining a lawyer. A lawyer is there to help read through the 30 plus pages of mortgage paperwork and to help you understand the ramifications of your signature."[67] Had individuals utilized lawyers when purchasing a home, perhaps there would not have been so many predatory loans signed.[68] And, perhaps, there would not still be 60,000 foreclosures pending in Cook County alone.[69]

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67 *Id.*

68 Books and Simon, *supra* note 22. "A study done in 2004 and 2005 by the Federal Trade Commission found that many borrowers were confused by current mortgage cost disclosures and 'did not understand important costs and terms of their own recently obtained mortgages. Many had loans that were significantly more costly than they believed, or contained significant restrictions, such as prepayment penalties, of which they were unaware.'"

69 *Supra* note 1.