

REINVESTMENT ALERT

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REFINANCING BOOM BENEFITS SOME, NOT OTHERS

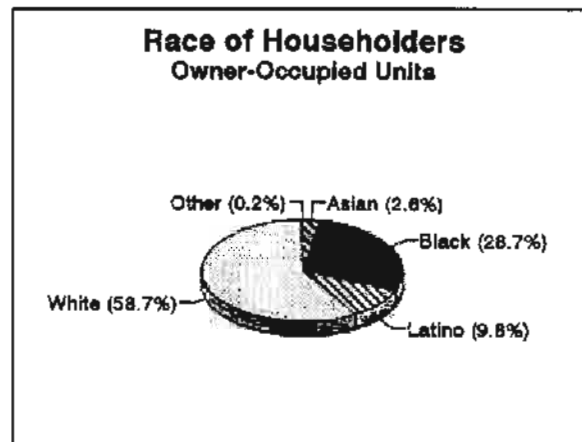
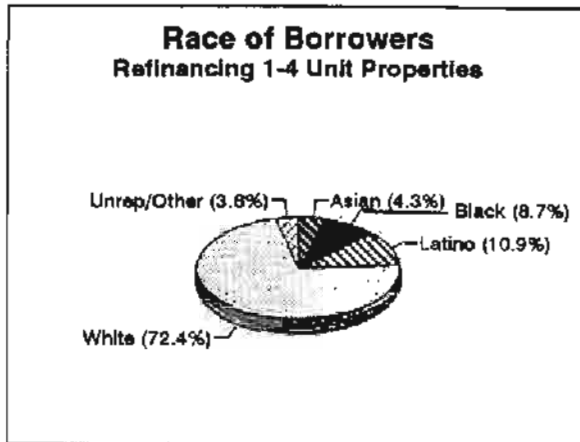
Introduction

The most recently available Home Mortgage Disclosure Act (HMDA) data for Chicago show that refinancing loans were not uniformly accessible to all residents. Woodstock has found that during 1992, African-American residents of Chicago had lower than expected application and approval rates for refinancing. This lack of access has denied minorities, particularly African-Americans, the ability to profit from the refinancing boom of the 1990s.

In September 1992, interest rates on 30-year fixed-rate mortgages dropped to an average of 7.92 percent--a rate that had not been seen since 1973--and more people than ever before were trying to refinance their home mortgages. In 1992, the number of refinancing loans in Chicago outnumbered those for home purchase loans by almost 40 percent (23,811 to 17,282).

Why refinance? The savings to a homeowner who chooses to refinance can be substantial. For example, a homeowner with a balance of \$60,000 on a 30-year mortgage, paying an interest rate of 11.5 percent might have refinanced to an 8.5 percent interest rate. This 3 percent interest rate reduction would save the homeowner more than \$130 per month in mortgage payments. Assuming this homeowner had 25 years left on the mortgage, this savings would amount to almost \$40,000 over the life of the loan. Homeowners often use refinancing as a means of addressing other credit needs (e.g., home improvements) by taking out loans large enough to cover those needs.

Unfortunately, not everyone benefitted from the refinancing boom. Given the number of homes they own, African-Americans obtained substantially fewer refinancing loans than whites, Latinos or Asians. While African-Americans own 28.7 percent of the total number of owner-occupied housing units in the city of Chicago, they obtained only 8.8 percent of the refinancing loans. The figure below illustrates this disparity.



Where Does Discrimination Occur?

Often, people only think of lending discrimination in terms of denial rates--lenders displaying a pattern of denying loans to applicants of a certain race or ethnic origin for no justifiable reason. But the decision to originate or deny a loan is only one step in the lending process; there are other mechanisms through which effective discrimination may take place. The lending process can be described by the following diagram.

Lending Process



This alert will examine these three steps, revealing possible sources of disparities in refinancing home mortgages from marketing through actual origination.

Marketing

Marketing plays a key role in refinancing, and may be a considerably more important factor in attracting refinancing applicants than in attracting home purchase applicants. When ready to purchase a home, prospective buyers go to a financial institution for a loan. Interest rates do have some impact on whether or

not people purchase homes, but other factors may often dominate the decision. However, the decision to refinance depends almost entirely on interest rates, and is not constrained by many other factors. When interest rates drop, homeowners aware of the potential savings are likely to pursue refinancing. Since interest rates had been considerably higher for nearly two decades, reaching rates over 16 percent in 1980, 1981, and 1982, the low rates of 1992 provided an excellent opportunity for many homeowners to realize significant savings.

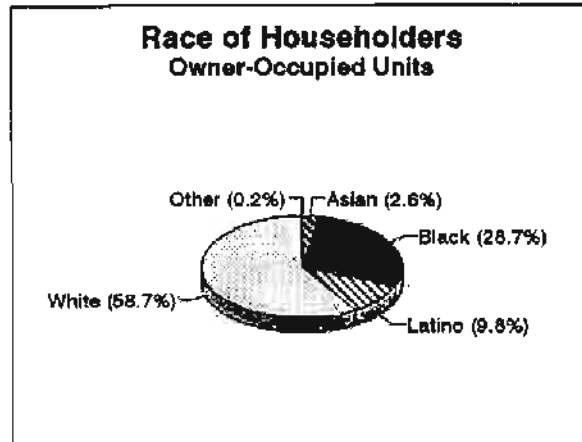
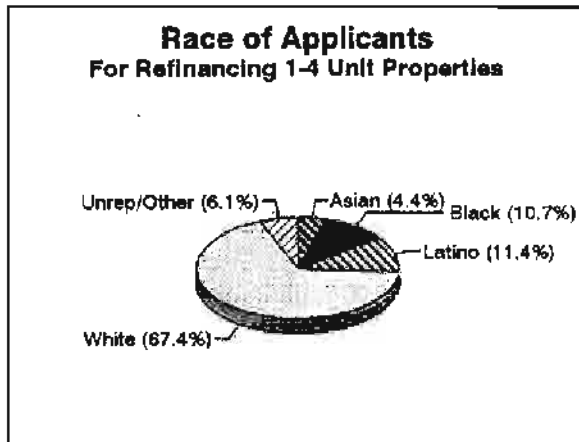
But marketing may not reach the entire population who would potentially be eligible to refinance. Lack of advertising in community newsletters and African-American newspapers and radio stations can generate less demand from African-Americans.

Prescreening

The second stage in the lending process where disparities can be found is in prescreening. Prescreening occurs during interactions between a borrower and a lender before a formal application is completed. During this time the lender may informally encourage or discourage the potential borrower. Unfortunately, this is very difficult to track due to lack of data. When prescreening is used to discourage minority applications, it can lead to a significantly lower number of minority applications. People who were interested in applying, and possibly qualified, are discouraged. While lenders are required to report certain prescreening activities as an actual application, in practice they may not. This results in lower denial rates for formal applications and lending practices which appear less discriminatory.

Implications of Poor Information and Prescreening

When considering the number of homeowners who could benefit from refinancing a home mortgage loan, the difference in who tried to take advantage of the opportunity suggests that marketing and prescreening may be working against African-American homeowners. In looking at refinancing applications filed by whites and African-Americans in Chicago, Woodstock found that African-Americans filed only 10.7 percent of the applications. Yet, 28.7 percent of homes in the city are owned by African-Americans. Far fewer African-Americans have applied for refinancing home mortgage loans than whites or other minorities. In a recent report, James Carr and Isaac Megbolugbe of Fannie Mae address this issue by explaining, "If whites are the primary targets of marketing efforts, they receive the superior information, which translates into higher mortgage demand." Either lack of marketing or screening out of African-American applicants could clearly lead to the low application rate among African-American applicants. The figure below illustrates the differences between the racial and ethnic breakdown of refinancing applications, compared to the racial and ethnic breakdown of owner-occupied units.

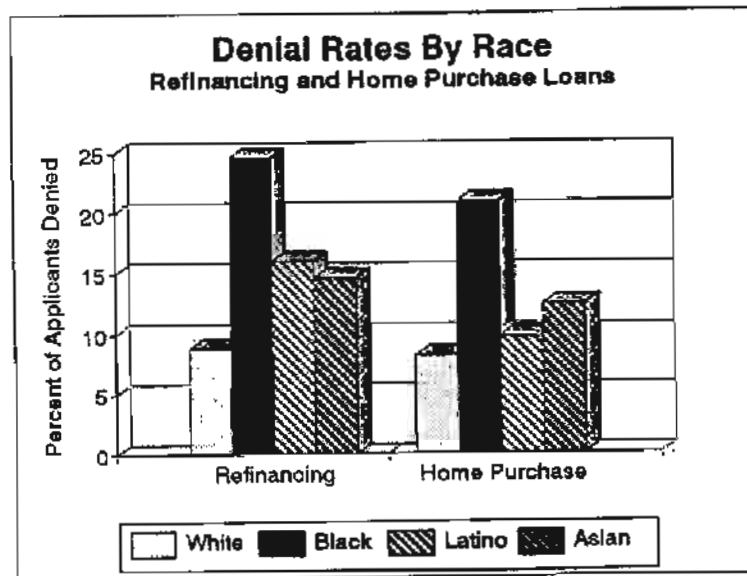


Whites, Latinos, and Asians are over-represented for refinancing applications, African-Americans are extremely under-represented. While just over twice as many whites as African-Americans own homes in Chicago, whites filed applications for refinancing home mortgage loans more than six times as frequently as African-Americans.

Application Processing: Denial Rates

African-American homeowners not only applied for refinancing at lower rates than whites, when they did apply for refinancing, their applications were denied at higher rates. Denial rates for refinancing applications for African-Americans are higher at all levels of income than whites, although for both they decrease as income increases. In fact, the denial rate for African-Americans in the highest income category (\$84,000 and over) is still more than one and one-half times that for whites in the lowest income category (\$1,000 - \$33,000). Since denial rates typically decrease as income increases, the disparities between denial rates are even greater within comparable income categories. Overall, compared to whites, African-Americans are denied refinancing loans 2.8 times more often, Latinos 1.8 times more often, and Asians 1.7 times more often.

The disparity in refinancing home mortgage loans experienced between all minority groups and whites is greater than that experienced for home purchase loans. For home purchase loans African-American applicants are turned down 2.5 times more often than whites, Asians 1.5 times more often, and for Latinos the disparity is sharply reduced to only 1.2 times more often. The figure below illustrates the differences in denial rates by race for both refinancing and home purchase loans.



Access Across Communities

Refinancing can be an important source of household income. If communities are unable to tap this income source, they will not see economic gains that other communities enjoy. Woodstock examined refinancing in the thirty-one moderate-income Chicago community areas--those with median household incomes ranging from 80 to 120 percent of the Chicago median of \$26,301 (from \$21,041 to \$31,561). The ratio of the number of refinanced loans for 1-4 unit properties to the total number of 1-4 unit properties (including condominiums) was calculated for each neighborhood. Of these moderate-income neighborhoods, white communities typically saw a much higher rate of refinancing than African-American communities.

The chart below displays the ten moderate-income communities with the highest and lowest levels of refinancing, measured by the number of refinancing loans obtained per 100 mortgageable properties (1-4 unit buildings, condominiums and coops). Of the ten moderate-income neighborhoods with the lowest levels of refinancing, all but the South Lawndale and Chicago Lawn are more than 50 percent African-American. Of the ten with the highest levels of refinancing, only one, Kenwood, is predominantly African-American. However, even in Kenwood, more whites obtained refinancing than African-Americans.

Refinancing Rates in Moderate-Income Community Areas

Ten Lowest Rates

Community	1989 Median Household Income	Refinancings per 100 Mortgageable Properties
Burnside	25,946	0.24
West Englewood	22,112	0.42
Roseland	28,601	0.91
Pullman	25,413	0.95
Auburn Gresham	27,547	1.03
South Chicago	22,840	1.19
South Deering	28,553	1.21
Chatham	24,008	1.41
South Lawndale	22,260	2.13
Chicago Lawn	25,757	2.27
Chicago	26,301	4.59

Ten Highest Rates

Community	1989 Median Household Income	Refinancings per 100 Mortgageable Properties
Rogers Park	23,902	8.18
North Center	28,941	7.77
Lincoln Square	26,344	6.87
Albany Park	27,285	6.80
Hyde Park	27,692	6.75
West Ridge	31,408	6.55
Irving Park	28,816	6.50
Edgewater	25,042	6.24
Kenwood	22,808	5.76
Bridgeport	25,057	4.89

Implications for Individuals and Communities

The impact of the lack of access to mortgage refinancing, either through marketing, prescreening, or denial, is two-fold. Individuals are evidently harmed, by being denied the opportunity to increase their disposable income. However, entire communities can also suffer. The money saved by individuals through refinancing their home mortgage loans can be used to improve their homes, thus raising the value of individual homes and creating a positive impact on their neighborhoods. In addition, some of the additional income held by the borrowers will be spent in their local communities. As that money circulates through communities, areas with substantial numbers of refinancing will benefit.

African-Americans obtained only a very small portion of home mortgage refinancing loans. While African-Americans own 28.7 percent of the total number of owner-occupied housing units, they obtained only 8.8 percent of the total number of refinancing loans. Refinancing is a critical credit need and provides an important source of income to communities. Community Reinvestment Act activity has focused primarily on home purchase and multifamily lending. But monthly

surveys by Freddie Mac show that over the last five years refinancing has accounted for 20 to 70 percent of total mortgage activity. Refinancing constituted a significant amount of mortgage activity even when interest rates were not particularly low. CRA must begin to consider refinancing as an important issue in access to credit.

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