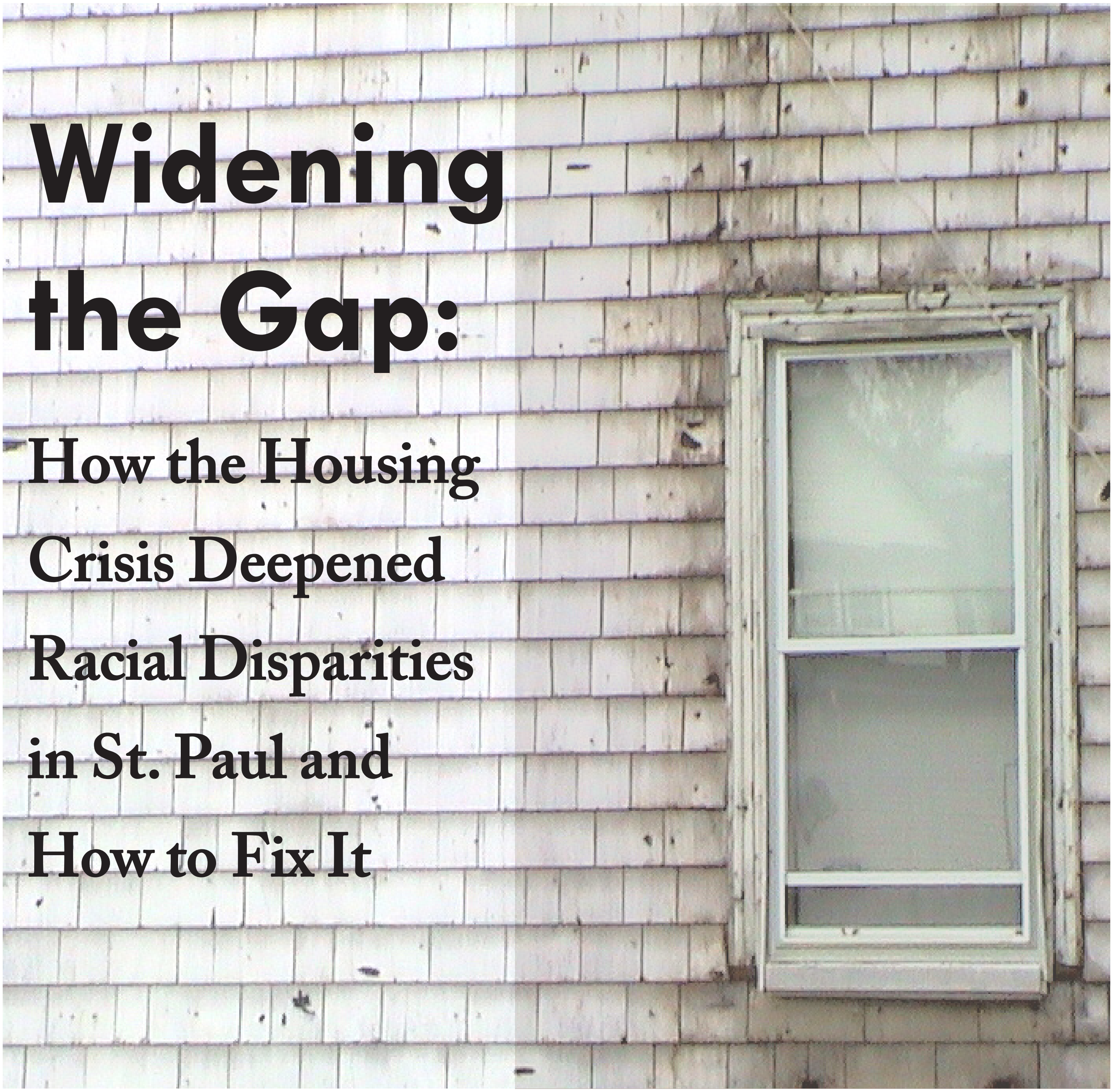
Widening the Gap:

How the Housing Crisis Deepened Racial Disparities in St. Paul and How to Fix It



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INTRODUCTION AND SUMMARY OF FINDINGS

The subprime mortgage meltdown has resulted in a record number of foreclosures and plunged the United States into the worst financial crisis since the Great Depression. St. Paul has not been immune from this crisis. Although the housing crisis has affected individual homeowners of all races and ethnicities, minority neighborhoods have suffered from an extreme concentration of housing problems.[1]

- Predatory subprime lenders targeted people of color for high cost loans. In some cases, the subprime lenders, whose loans were more likely to be made in minority neighborhoods, were owned or bankrolled by mainstream financial institutions such as Wells Fargo and US Bank, whose loans were more likely to be in predominantly white neighborhoods.
    - Twenty-eight percent of the loans made in St. Paul by Wells Fargo Financial were in minority neighborhoods, compared to just 15% of the loans made through Wells Fargo Bank.[2]
    - Subprime loans accounted for 42% of the home refinance loans made by New Century, a subprime lender in which US Bank was a major investor, compared to just 14% o the refinance loans made by US Bank[3]
- Predatory subprime loans stripped homeowners of their wealth and lead to an epidemic of foreclosures.
    - The number of foreclosures in Ramsey County skyrocketed from 632 in 2005 to a peak of over 3,000 in 2008. Although the number of foreclosures has passed its peak, it appears that there will be thousands more in the next few years.[4]
    - Lower-income families and households of color have been hit the hardest, resulting in clusters of foreclosures in the Thomas-Dale and East Side neighborhoods of St. Paul, with some blocks having six to eight vacant buildings.[5]
- Foreclosures ravaged neighborhoods and left behind a trail of vacant homes.
    - There are over 1,300 vacant residential buildings in St. Paul[6] and 90% of them are in low and moderate income neighborhoods.
    - Almost half of the city's vacant housing is located in a minority neighborhood, although minority neighborhoods contain just 20% of the housing units in the city.[7]
- The unprecedented numbers of foreclosures and vacant homes caused a steep and continuing decline in home values throughout the city, but especially in lower income and minority neighborhoods.
    - Homes in the Dayton's Bluff, Payne-Phalen, and Thomas-Dale neighborhoods experienced the greatest loss of value since 2006, whereas homes in the Mac-Groveland, Highland, and St. Anthony Park neighborhoods lost the lowest percentage of their value.[8]

SUBPRIME MORTGAGE LENDING

Low-income and minority communities have long been excluded from traditional banking services. A study by economists found that the number of banking offices in low- and moderate income areas decreased 21% over a two decade period, while the number of total banking offices in all areas rose 29% during this same time. This is significant because studies have documented that the proximity of a bank's branches to low and moderate income neighborhoods is directly related to the level of lending made by the bank in those neighborhoods.[9]

African-American and Latino loan applicants have regularly been turned down more often than white applicants. A report from the Urban Institute, prepared for HUD, corroborated this statistical analysis, concluding that minority homebuyers face discrimination from mortgage lenders. The report cited "paired testing" which showed that minorities were less likely to receive information about loan products, received less time and information from loan officers, and were quoted higher interest rates.[10]

This history of racial exclusion created an environment that was fertile for predatory lenders to market high-rate loan products. These unscrupulous actors aggressively targeted underserved communities with a bombardment of mailings, phone calls, and door-to-door solicitations.

A number of reports have documented the startling racial and economic disparities in mortgage lending. Residents of low income and minority neighborhoods have been much more likely than residents in upper income and predominantly white neighborhoods to receive a high-cost subprime loan.

While not all subprime lenders were predatory, the overwhelming majority of predatory loans were subprime, and the subprime industry was a fertile breeding ground for predatory practices. Subprime loans were said to be for people who were unable to obtain a conventional prime loan, and the higher interest rates on subprime loans were supposedly to compensate for the potentially greater risk that the borrowers represent. However, predatory lending occurred when loan terms or conditions became abusive or when borrowers who would have qualified for credit on better terms were targeted instead for these higher cost loans.

Too often higher rate subprime loans were also loaded with abusive features – such as high fees, large and extended prepayment penalties, financed single premium credit insurance – which cost borrowers even more money, and kept them trapped into the higher interest rates.

While predatory lenders sometimes appeared to be small-time storefront operators, the masters of behind predatory lending could be found among some of the world's largest financial institutions. In fact, many of the same institutions which first created the situation by their failure to serve certain communities later seized the opportunity to reap enormous profits.

Sometimes these institutions had direct ownership of subprime lending subsidiaries, such as Wells Fargo and Wells Fargo Financial. In other cases, these institutions bankrolled predators by investing in them directly, such as US Bank and New Century Financial, or by serving as the trustee for securitized pools of subprime mortgages, which both US Bank and Wells Fargo did.

The loans made through the parent bank had greater concentrations in predominantly white neighborhoods, while the loans made through the subprime subsidiary were more concentrated in minority neighborhoods. This created a shameful pattern of profiteering; preying on the most vulnerable among us, and creating a devastating impact on already-struggling neighborhoods.

A. Subprime Refinance Lending

The vast majority of subprime loans were for refinances, rather than home purchases. For instance, from 2004 to 2007, Wells Fargo Financial made a total of just three home purchase loans in St. Paul.

Subprime loans were promoted as a way to consolidate debt, provide money for home improvements, or for household or personal needs, rather than being sought by borrowers as a way to lower their interest rates or lock in a fixed rate.

There are circumstances where refinancing to use some of the equity in one's home makes sense, but cash-out refinances were rife with potential for abuse by predatory lenders. Too often homeowners with significant amounts of equity were convinced to refinance under conditions that left them considerably worse off than they were before.

In some cases, homeowners were sold refinance loans which produced just a few thousand dollars in cash at closing, but which refinanced their existing mortgages at higher rates, high fees, and often with abusive loan terms.

B. Wells Fargo

In July 2011, the Federal Reserve Board assessed an $85-million civil penalty against Wells Fargo, the largest fine the Federal Reserve has ever imposed in a consumer case.[12] The Federal Reserve charged that between 2004-2008 Wells Fargo Financial steered customers into more expensive subprime loans even though they qualified for better rates. As part of its settlement with the Federal Reserve, Wells Fargo will have to repay up to $200 million to customers that it overcharged.[13]

> *"Wells Fargo drained wealth from families and neighborhoods and added to the stockpile of boarded-up homes . . ."*

Previously, the Illinois Attorney General sued Wells Fargo for steering African-American and Latino homeowners to higher cost subprime mortgages while giving white borrowers who had similar incomes lower cost loans. The suit charged that "Wells Fargo drained wealth from families and neighborhoods and added to the stockpile of boarded-up homes . . ."[14]

There is evidence that Wells Fargo has engaged in the same pattern of practices in the Twin Cities. Wells Fargo has served upper income and pre-

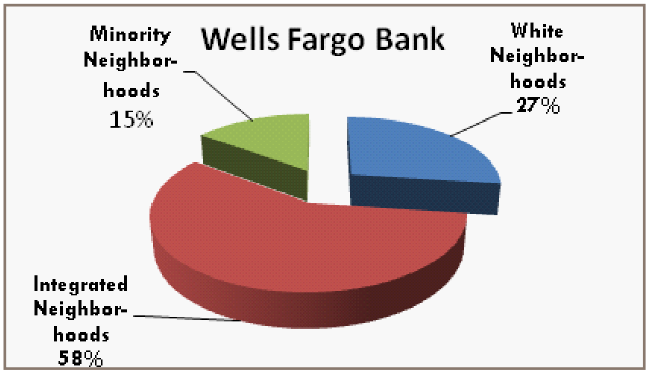
Mortgages in St. Paul[11]

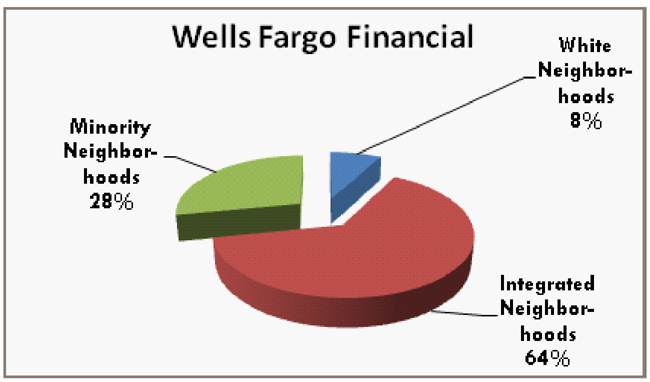
	Wells Fargo Bank	Wells Fargo Financial	US Bank	New Century
% in Minority Neighborhoods	14.9%	28.2%	14.1%	42.4%
% in White Neighborhoods	27.4%	7.9%	31.2%	7.8%

-dominantly white neighborhoods through its bank, providing prime loans with good terms and low rates. In contrast, Wells Fargo has served low-to-moderate income and minority neighborhoods disproportionately through its finance company, Wells Fargo Financial, which makes higher rate subprime loans.

C. US Bank

Refinance Loans in St. Paul[15]





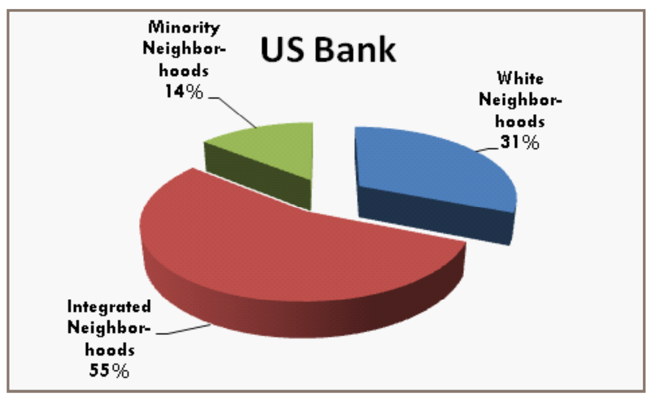
US Bank was a major investor in New Century Financial, the poster child for bad practices in the mortgage industry. By 2007, when the company filed for bankruptcy, New Century was the second largest subprime mortgage lender in the country.[16]

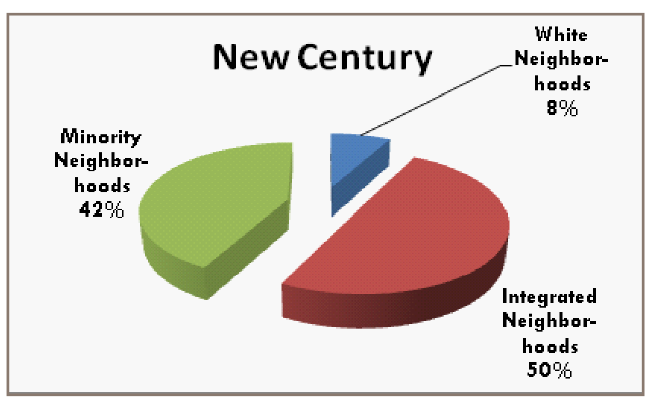
In 1998 and 1999 when it was difficult for subprime lenders to raise capital, US Bank came to New Century's rescue and invested $40 million in the company. US Bank reaped a profit of nearly $18 million from this investment within just a few years.[17]

In contrast to US Bank, New Century, which made loans with high rates and enormous fees, made a large percentage of its loans to minority neighborhoods. From 2004 to 2006, New Century's last year of business, almost half of the refinances New Century made in St. Paul were in minority neighborhoods. Whereas just 14% of US Bank's refinances in St. Paul were in minority neighborhoods.

The investments in New Century were just a small part of US Bank's involvement with subprime lenders. Throughout the last decade, US Bank served as a trustee for billions of dollars in securitized pools of home mortgages made by New Century and others. The list of lenders whose loans US Bank served as a trustee for reads like a who's who of the subprime industry: Aames, Ameriquest, BNC, Citifinancial, Conseco, Countrywide, Downey, Equicredit, First Franklin, First Plus, Fremont, Greenpoint, Household, and New Century.[18] As the Trustee, US Bank was responsible for distributing the cash flow from the mortgage pools to all the different investors, after US Bank took its cut first. Trustees take a percentage each month of the overall pool balance.[19]

Refinance Loans in St. Paul





FORECLOSURES

The number of foreclosures in Ramsey County skyrocketed from 632 in 2005 to a peak of over 3,000 in 2008. Although the number of foreclosures has passed its peak, Ramsey County still experienced over four times more foreclosures in 2010 than in 2005, and it appears that there will be thousands more in the next few years.

Lower-income families and households of color have been hit the hardest, resulting in clusters of foreclosures in the Thomas-Dale and East Side neighborhoods of St. Paul, with some blocks having six to eight vacant buildings.[20]

According to the Center for Responsible Lending approximately 8 percent of African-American and Latino families have lost their homes to foreclosure compared to 4.5 percent of white families.[21]

Many of these foreclosures can and should be avoided. A report from state regulators stated:

> ***[T]oo many homeowners experience foreclosure when finding an alternative solution would be in the interest of both the homeowner and the mortgage holder. Preventing these unnecessary foreclosures would help not only the struggling homeowners and mortgage investors, but also the neighborhoods and local governments that bear the indirect costs of foreclosures.***[22]

The regulators found that mortgage servicers were only reaching a minority of delinquent homeowners with their foreclosure prevention efforts.

> ***Nearly three years into the foreclosure crisis, we find that more than 60% of homeowners with seriously delinquent loans are still not involved in any loss mitigation activity.***[23]

There have been almost 120,000 foreclosures in Minnesota since 2006 – over 60,000 since 2009 when the federal Home Affordable Modification Program began. In contrast, there have been less than 12,000 permanent loan modifications in Minnesota under HAMP.[24]

As the foreclosure crisis has exploded, mortgage servicers have failed to adequately meet the number of delinquent homeowners. In a recent GAO survey of non-profit housing counselors, for example, seventy-six percent of the counselors reported that overall their clients had a "negative" or "very negative" experience with the mortgage servicers. The most commonly cited problems were of homeowners receiving inconsistent or confusing information, speaking to a different representative each time they called, of servicers losing their paperwork, and of the decision-making process taking too long.[25]

Even worse, in a rush to foreclose on delinquent homeowners, many mortgage servicers were accused of engaging in negligent and fraudulent practices, where servicer employees admitted to preparing massive numbers of foreclosure documents without appropriate verification and, in some cases, even without the appropriate signatures. Servicers have been foreclosing on homeowners without proof that the lender is the actual holder of the note or that the borrower is even in default. Attorneys General from all 50 states and D.C. have been investigating this practice of robo-signing.

Foreclosures in Ramsey County 2005-2011

Year	2005	2006	2007	2008	2009	2010	2011 (1st 6 mos.)
Foreclosures	632	1498	2346	3023	2519	2608	1128

VACANT HOUSES

Foreclosures not only impact the individual homeowners but also local governments, neighbors, and Foreclosures not only impact the individual homeowners but also local governments, neighbors, and other property owners. Especially when a foreclosure leaves a home vacant and unsecured, it can cost cities and counties tens of thousands of dollars.

Vacant and Boarded Buildings in St. Paul

Year	2004	2008	2011
Buildings	370	2000	1452

Foreclosures result in decreased revenue for cities and counties through lower property values, delayed and uncollected taxes, and unpaid services. At the same time that foreclosures mean less revenue for cities and counties, they also impose additional requirements to those cities and counties for increased policing, building inspection, demolition, property maintenance, and managing the foreclosure process.

After peaking in 2008, the number of vacant houses has started to decline, but there are still four times more properties on St. Paul's vacant building list than there were in 2004.

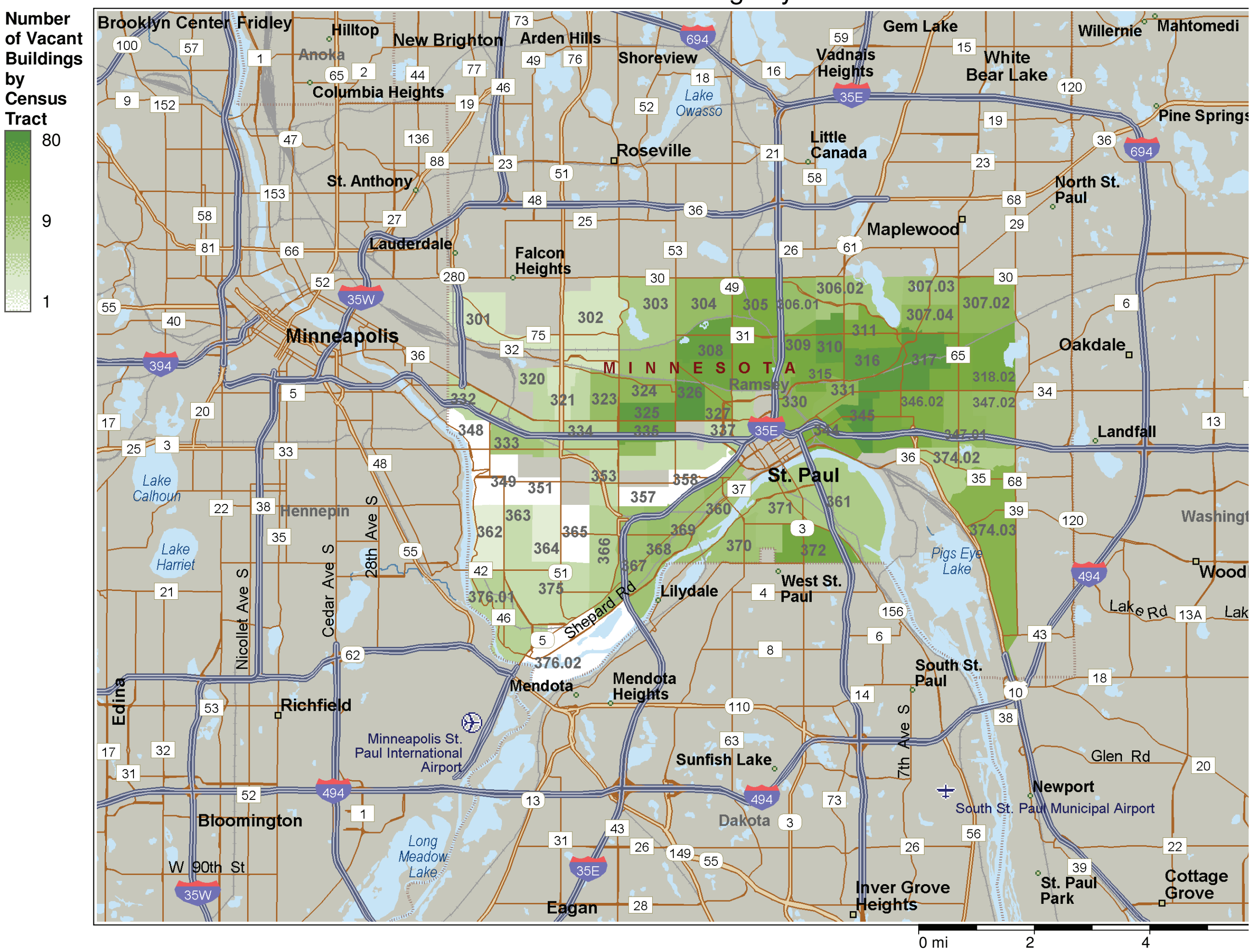
The vacant buildings are disproportionately concentrated in St. Paul's lower income and minority neighborhoods.[26] Ninety percent of the city's vacant housing is in low and moderate income neighborhoods.

Almost one out of every two vacant buildings in St. Paul is in a minority neighborhood, although just one out of five of the city's housing units are in these neighborhoods. In contrast white neighborhoods contain one in five of the city's housing units, but only one in forty vacant homes.

St. Paul Neighborhoods	% of City's Vacant Buildings	% of City's Housing Units
Minority Neighborhoods	45.1%	22.7%
Integrated Neighborhoods	52.4%	56.0%
White Neighborhoods	2.5%	21.3%

St. Paul Neighborhoods	% of City's Vacant Buildings	% of City's Housing Units
Low and Moderate Income	90.6%	61.7%
Middle Income	8.6%	25.2%
Upper Income	0.9%	21.3%

Number of Vacant Buildings by Census Tract

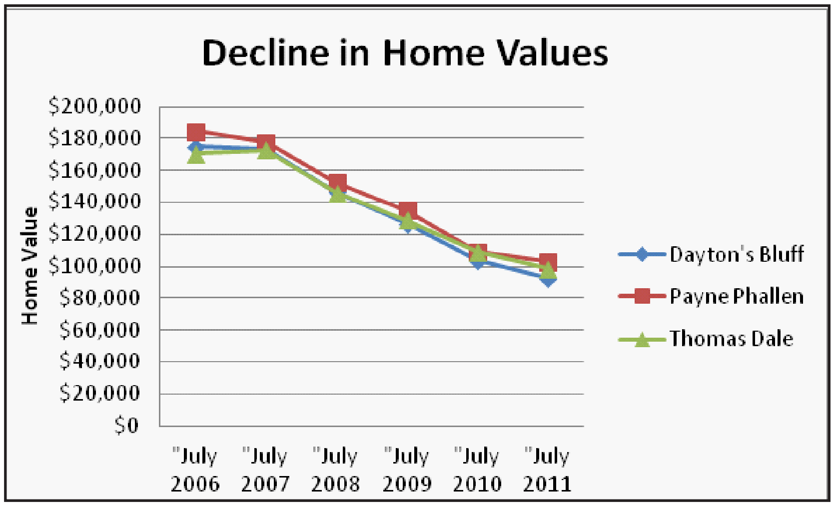


	Properties on City's Vacant Building List[27]			
	2004	2005	2006	Vacant Building Registration Fee
St. Paul	370	2000	1452	$1200
Minneapolis	286	857	802	$6746

In contrast to St. Paul, Minneapolis has many fewer vacant buildings and charges property owners a much higher vacant building fee.

HOME VALUES

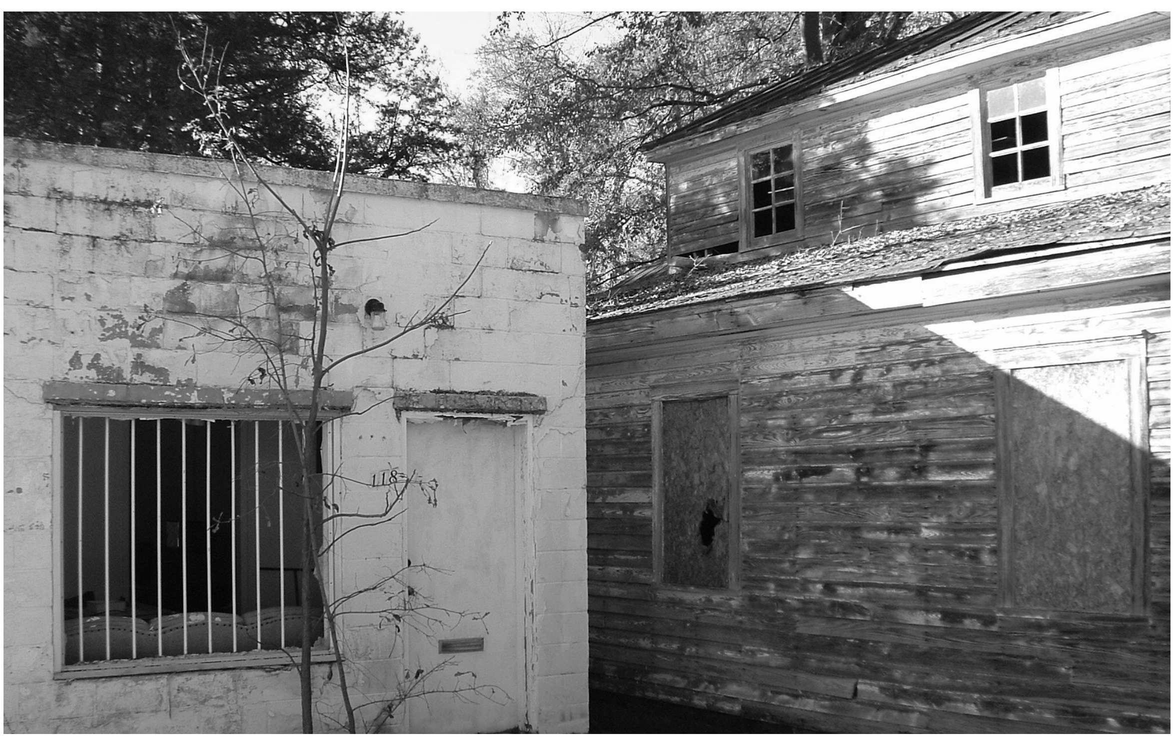
The unprecedented numbers of foreclosures and vacant homes caused a steep and continuing decline in home values throughout the city, but especially in minority neighborhoods. Home equity accounted for nearly two-thirds of the net worth of Latinos in 2005 and 59% of the net worth of African-Americans, but just 44% of the net worth of whites.[28]



A recent report from the Pew Research Center found that the bursting of the housing bubble and the ensuing recession resulted in[29]:

- a 66% decrease in the wealth of Latino households from an average of $18,359 in 2005 to $6,325 in 2009
- a 53% drop in the wealth of African-American households from an average of $12,124 to $5,677 in 2009
- just a 16% decline in the wealth of white households from an average of $134,992 to $113,149

In St. Paul, homes in the Dayton's Bluff, Payne-Phalen, and Thomas-Dale neighborhoods experienced the greatest loss of value, dropping almost 50% since 2006, whereas homes in the Mac-Groveland, Highland, and St. Anthony Park neighborhoods lost the smallest percentage of their value, dropping approximately 25%.[30]



	Single Family Home Prices		Change from 2006 to 2011	
Neighborhood	**July 2006**	**July 2011**	**Dollar**	**Percentage**
Dayton's Bluff	$175,000	$92,300	-$82,700	-47.26%
Payne-Phalen	$184,500	$103,100	-$81,400	-44.12%
Thomas Dale	$170,700	$98,400	-$72,300	-42.36%
Battle Creek	$206,300	$120,700	-$85,600	-41.49%
Greater Eastside	$185,000	$108,700	-$76,300	-41.24%
North End	$180,700	$109,100	-$71,600	-39.62%
Summit-University	$226,000	$139,900	-$86,100	-38.10%
St. Paul City	$207,500	$131,200	-$76,300	-36.77%
West Side	$189,200	$120,800	-$68,400	-36.15%
Summit Hill	$521,800	$349,200	-$172,600	-33.08%
Midway	$200,600	$137,900	-$62,700	-31.26%
Como	$240,800	$167,100	-$73.700	-30.61%
West 7th	$190,500	$132,500	-$58,000	-30.45%
Merriam Park	$308,200	$215,800	-$92,400	-29.98%
St. Anthony	$358,000	$258,800	-$99,200	-27.71%
Highland	$304,900	$228,300	-$76,600	-25.12%
Macalester-Groveland	$304,300	$233,900	-$70,400	-23.14%

RECOMMENDATIONS

1. The state of Minnesota, counties, and cities should adopt a foreclosure mediation program to prevent unnecessary foreclosures.

There is growing recognition of the effectiveness of foreclosure mediation programs in preventing unnecessary foreclosures. The number of states and municipalities that have such programs continues to grow, and there are now jurisdictions in 24 states that have foreclosure mediation.

Foreclosure mediation benefits all of the involved parties:

- Servicers avoid a long and costly foreclosure process since more than 70 percent of mediated cases reach a settlement.[31]
- More than half of homeowners in mediated cases get to keep their homes, while those for whom that is not a sustainable option also benefit by negotiating a "graceful exit" in how and when they move out.
- For government, mediation can reduce the number of vacant homes and stabilizes property values and tax revenue.

In 2009 the Minnesota legislature passed the Homeowner-Lender Mediation Act which would have required lenders to offer homeowners the opportunity to participate in non-binding mediation before the lender could foreclose, however Governor Time Pawlenty vetoed the bill.[32]

Under the Act, lenders would have been required to serve a mediation notice to the homeowner and filed proof of it with the Attorney General's office. Homeowners would have 20 days after this to file a request for mediation. If the homeowner does not request it, then the lender could proceed with the foreclosure.

Although a state level mediation program would be optimal in that it could benefit from an economy of scale and would serve the largest number of homeowners, cities and counties can implement their own mediation programs.

2. Minneapolis charges property owners $6,746 annually to register vacant buildings, while St. Paul charges just $1,200.

The city of St. Paul should increase its vacant building registration fee to offset the significant costs to the city of vacant buildings, but also to reduce the number of vacant buildings by spurring owners to sell or rehab their properties.

3. Local governments, school boards, and public agencies should require that any banks they do business with meet responsible lender criteria that includes using best practices for foreclosure prevention.

4. Local governments, school boards, and public agencies should require that any banks they do business publicly disclose information regarding its foreclosures, including:

a. The number of homeowners eligible for loan modifications

b. The number that received or were denied permanent modifications

c. The principal and/or rate reduction in each modification

d. A breakdown for each of the above categories by the race, ethnicity, and census tract of the homeowners.

5. Mortgage servicers should comply with the following best practices for foreclosure prevention:

a. Stop foreclosure proceedings while they are evaluating a borrower's eligibility for a loan modification or other foreclosure prevention options

b. Respond within 72 hours to requests or inquiries about loan modifications

c. Ensure that the loan modification process takes less than 30 days

d. Modify troubled loans so that they are for no more than the value of the home

e. Allow tenants of foreclosed properties to continue to rent the property until it is sold

f. Take steps to ensure that its loans are not being used for property flipping or foreclosure rescue scams.

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NOTES

[1] Minority neighborhoods are defined as census tracts in which people of color make up more than half of the population.
[2] Based on Home Mortgage Disclosure Act (HMDA) data for first lien conventional refinance loans 2004-2006
[3] Based on Home Mortgage Disclosure Act (HMDA) data for first lien conventional refinance loans 2004-2006
[4] Data from Ramsey County Sheriff's Office
[5] "Equitable Development Toolkit: Reclaiming Foreclosed Properties for Community Benefit," Policy Link, August 26, 2009
[6] Data from city of St. Paul Vacant Building Registration List, 938 single family, 345 duplexes, 48 multi-family
[7] 2000 Census data
[8] Zillow Home Values Index, calculated September 1, 2011
[9] "The Community Reinvestment Act After Financial Modernization: A Baseline Report," U.S. Treasury Department, April 2000.
[10] "What We Know About Mortgage Lending Discrimination," The Urban Institute, September 1999.
[11] Based on Home Mortgage Disclosure Act (HMDA) data for first lien conventional refinance loans 2004-2006
[12] "Wells Fargo, Countrywide Mortgage Settlements Give Homeowners a Bit of Relief," Daily Finance on AOL.com, Catherine New, July 22, 2011
[13] Up to 10,000 customers, up to $20,000 each, equals $200 million
[14] July 31, 2009 Press Release, "Madigan Sues Wells Fargo for Discriminatory and Deceptive Lending Practices"
[15] Based on Home Mortgage Disclosure Act (HMDA) data for first lien conventional refinance loans 2004-2006
[16] "New Century, Biggest Subprime Casualty, Goes Bankrupt", Bloomberg, April 2, 2007, Bradley Keoun and Steven Church.
[17] "U.S. Bancorp Profits Handsomely from Its Investment in New Century," *National Mortgage News*, March 11, 2002, Brad Finkelstein
[18] Information from ABSNet
[19] Information from ABSNet
[20] "Equitable Development Toolkit: Reclaiming Foreclosed Properties for Community Benefit," Policy Link, August 26, 2009
[21] "Speculators, Not CRA, Behind Foreclosures in Black Neighborhoods," September 7, 2011, *American Banker*, John I. Gilderbloom and Gregory D. Squires
[22] "Analysis of Mortgage Servicing Performance", Data Report No. 4, January 2010, State Foreclosure Prevention Working Group
[23] "Redefault Rates Improve for Recent Loan Modifications," State Foreclosure Prevention Working Group Memorandum on Loan Modification Performance, August 2010
[24] "Making Home Affordable: Summary Results, Program Performance Report Through July 2011,"
[25] GAO-11-367R Survey of Housing Counselors about HAMP, May 26, 2011, United States General Accounting Office
[26] Minority neighborhoods are defined as census tracts in which people of color make up a majority of the population. Integrated neighborhoods are defined as census tracts in which people of color make up between 10%-49% of the population. White neighborhoods are defined as census tracts in which people of color make up less than 10% of the population.
[27] "Cities using federal money to address foreclosures," Star Tribune, September 18, 2010, Chris Havens
[28] "Wealth Gap Rise to Record Highs Between Whites, Blacks, Hispanics," Pew Research Center, July 26, 2011
[29] "Wealth Gap Rise to Record Highs Between Whites, Blacks, Hispanics," Pew Research Center, July 26, 2011
[30] Zillow Home Values Index, calculated September 1, 2011
[31] Walk the Talk: Best Practices on the Road to Automatic Foreclosure Mediation," Alon Cohen, Center for American Progress, November 2010
[32] "Minnesota AG to push for Foreclosure Mediation," *Housing Wire,* Jon Prior, January 8, 2010