

**Fair Lending Indications of the
2005 Home Mortgage Disclosure Act Data**

Derived from the 2005 Data of Ten Leading National Mortgage Lenders

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Purpose of Study

For the second consecutive year, lenders subject to the federal Home Mortgage Disclosure Act (HMDA) have been required to disclose pricing information on loans with annual percentage rates (APR) that exceed certain thresholds (Rate Spread Loans).¹ Like last year's data, the 2005 numbers have prompted public debate. Regulators have hypothesized that a flattening yield curve may account, at least in part, for an increase in the number of Rate Spread Loans,² and some advocacy groups interpret the 2005 data as evidence of discriminatory lending practices.³

Our analysis suggests that the 2005 data are not an indicator of lending discrimination, and that factors other than the yield curve may also be fueling the rise in Rate Spread Loans. Our conclusions are based on a comparison of 2004 and 2005 loans made to homebuyers by ten leading national mortgage lenders⁴ in three key areas: (1) volume of Rate Spread Loans; (2) average spreads on Rate Spread Loans; and (3) distribution of loan originations and applications.

Summary Conclusions

- (1) **Greater credit risk contributed to a near three-fold rise in the proportion of Rate Spread Loans.** Significant growth in the volume of junior lien home purchase loans and an increase in the median loan-to-income ratio for Rate Spread Loans indicate that 2005 homebuyers had less equity in their homes and were more financially stretched than their 2004 counterparts.
- (2) **Average rate spreads were consistent.** As in 2004, there were only minor differences in the pricing of loans with reported rate spreads to homebuyers of different race and ethnicity.
- (3) **Lenders increased their service to minorities.** The number and proportion of loans originated to African American and Hispanic homebuyers increased significantly in 2005, as did the number and proportion of applications received.

¹ Effective for mortgage loans originated in 2004, HMDA requires lenders to report the spread between a loan's APR and the comparable U.S. Treasury yield, where the spread is at least three percentage points for first lien loans and five percentage points for junior lien loans. 12 CFR §203.4(b)(12).

² "Agencies Announce Updated Answers to Frequently Asked Questions About HMDA Price Data," Joint Press Release of the Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision, April 3, 2006 (Joint Press Release).

³ See, e.g., National Community Reinvestment Coalition, "The 2005 Fair Lending Disparities: Stubborn and Persistent II," May 2006.

⁴ The lenders selected for inclusion in this study were identified as the "Leading Residential Originators in the First Half of 2005" in the *American Banker* of October 21, 2005. See the Appendix below for a detailed list of lenders included in this study.

Discussion

(1) **Greater credit risk contributed to a near three-fold rise in the proportion of Rate Spread Loans.**

The proportion of loans with rate spreads increased 172 percent from 2004 to 2005.

- Proportion of 1st Lien Owner-Occupied Home Purchase Loans with Rate Spreads -

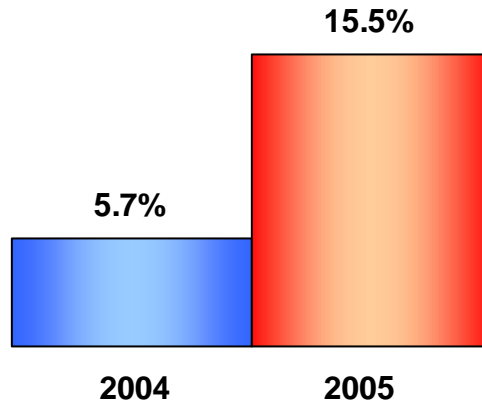


Figure 1

This finding is consistent with recent statements of the Federal Reserve and other regulators who noted “preliminary indications are that the data will show that the proportion of mortgage loans with prices above the HMDA price reporting thresholds increased from 2004 to 2005.”⁵ The regulators stated that a flattening yield curve contributed to this higher proportion, and that “changes in other factors, such as the business practices of lenders or the risk profiles or borrowing practices of borrowers, also could have affected the proportion of loans reported as higher-priced loans.”⁶

Our analysis indicates that changes in risk profiles and borrowing practices were important contributing factors to the higher proportion of Rate Spread Loans. Although HMDA data does not contain information on credit risk factors like borrower credit score or loan-to-value ratio, it does provide information on two other factors which can be used to gauge lender risk: (1) the volume of junior lien loans; and (2) loan-to-income ratio, *i.e.*, the amount of mortgage debt incurred relative to borrower income.

⁵ Joint Press Release, *supra*.

⁶ *Id.* See also, “Flattening of Interest Rate Yield Curve to Result in More ‘High-Priced’ HMDA Loans,” *BNA’s Banking Report*, May 1, 2006, p. 796.

- Junior Lien Loans to Homebuyers

First lien loans without private mortgage insurance (PMI) are often capped at 80 percent of a home’s value. Consequently, homebuyers typically use junior lien loans to finance a greater portion of their purchase price than permitted by the lender or secondary market for first lien loans.⁷ The popularity of junior liens surged from 2004 to 2005, growing 57 percent in number and 72 percent in dollar volume. Both increases were significantly more than the corresponding 15 and 30 percent growth in first lien loans to homebuyers.

**- Increase in Number of
1st and Junior Lien Owner-Occupied Home Purchase Loans
from 2004 to 2005 -**

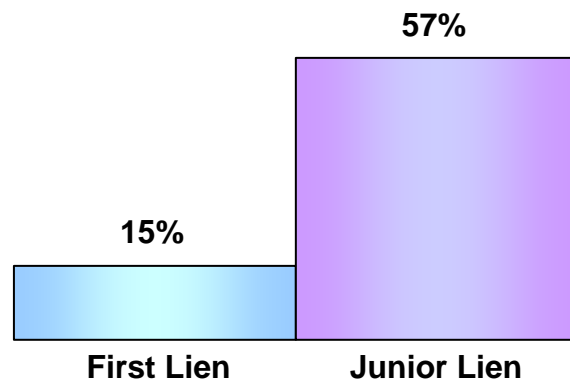


Figure 2

Junior lien home purchase loans reduce homeowner equity⁸ and, as noted by the Federal Reserve, “experience has shown that homeowners with little equity are substantially more likely to default on their mortgage.”⁹ Assuming prudent lenders price their loans according to credit risk, a greater likelihood of default usually results in a higher APR, and higher APRs will be reflected in an increase in Rate Spread Loans.

⁷ The Federal Reserve indicates that junior liens “allow homebuyers to avoid the requirement to purchase PMI for first lien loans with high loan-to-value ratios. In other cases, borrowers take out junior-lien loans to keep the amounts borrowed on their first lien loans within the loan-size limits used by Fannie Mae and Freddie Mac.” Avery, Canner, and Cook, “New Information Reported Under HMDA And Its Application in Fair Lending Enforcement,” 91 Fed. Res. Bull. No. 344, 354, Summer 2005 (Fed HMDA Study).

⁸ The finding that borrower equity diminished from 2004 to 2005 is also a conclusion of Christopher L. Cagan’s study for First American Real Estate Solutions. That study indicates that the proportion of borrowers with home equity of less than 20 percent grew from about half in 2004 to 65 percent in 2005, and that the proportion of borrowers with no home equity increased almost three-fold from 10.6 to 29 percent.

http://www.firstamres.com/pdf/MPR_White_Paper_FINAL.pdf.

⁹ Fed HMDA Study at 394, fn. 24.

- Loan-to-Income Ratio

The median loan-to-income ratio for Rate Spread Loans was 15 percent higher in 2005 than in 2004.

**- Median Loan-to-Income Ratio for
1st Lien Owner-Occupied Home Purchase Rate Spread Loans -**

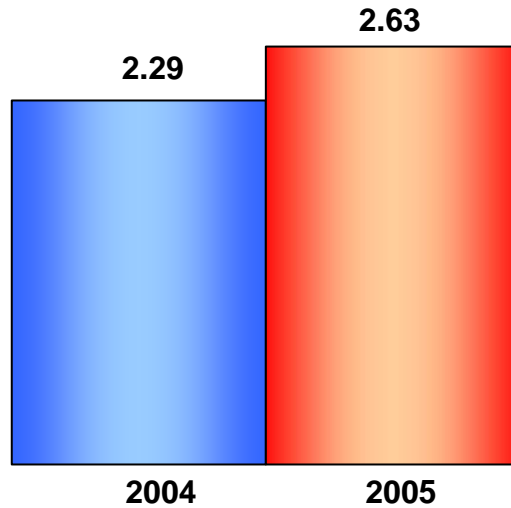


Figure 3

A higher loan-to-income ratio signifies that loan amount increased at a greater pace than borrower income. This suggests that a greater portion of borrower income was devoted to repaying debt,¹⁰ which increases lender risk.

The increase in median loan-to-income ratio also indicates that the risk profile for Rate Spread Loans changed in 2005, and that lenders approved applicants who may have been denied in 2004. This could also help account for the increased volume and proportion of Rate Spread Loans and the higher median rate spreads illustrated in Figures 4 and 5 below.

¹⁰ The NAR's monthly housing affordability index, which uses data on income and housing costs to determine whether a family qualifies for a mortgage loan, confirms that housing was less affordable in 2005. The index fell approximately 12.6 percent from January to December 2005.
[http://www.realtor.org/research.nsf/files/Affordability.pdf/\\$FILE/Affordability.pdf](http://www.realtor.org/research.nsf/files/Affordability.pdf/$FILE/Affordability.pdf)

(2) Average rate spreads were consistent.

The only detailed pricing information reported under HMDA is the spread between the APR and comparable U.S. Treasury yield for each loan with a spread exceeding a certain threshold. Our study found that although the volume of Rate Spread Loans increased in 2005, the median rate spreads for homebuyers of different race and ethnicity were not meaningfully different. This finding is consistent with that of our study of 2004 HMDA data.¹¹

**- 1st Lien Owner-Occupied Home Purchase Rate Spread Loans -
(ranked according to 2005 median)**

Borrower Category	Median Rate Spread		Number of Rate Spread Loans	
	2005	2004	2005	2004
Hawaiian/Other Pacific Islander	4.20	3.68	1,374	252
Asian	4.26	3.59	8,772	1,565
Hispanic	4.31	3.63	57,418	12,813
Non-Hispanic White	4.41	3.78	119,337	42,849
American Indian/Alaska Native	4.44	3.96	991	397
African American	4.62	3.84	38,832	13,849

Figure 4

**- Junior Lien Owner-Occupied Home Purchase Rate Spread Loans -
(ranked according to 2005 median)**

Borrower Category	Median Rate Spread		Number of Rate Spread Loans	
	2005	2004	2005	2004
Asian	6.11	6.09	5,059	2,184
Hispanic	6.13	6.04	36,991	14,966
Non-Hispanic White	6.26	6.28	53,767	28,060
American Indian/Alaska Native	6.31	6.34	470	290
Hawaiian/Other Pacific Islander	6.34	6.16	832	397
African American	6.53	6.37	18,653	8,184

Figure 5

¹¹ Traiger & Hinckley LLP, "A Study of Reported Rate Spreads by Borrower Race and Sex, Derived from the 2004 Home Mortgage Disclosure Act Data of Ten Leading National Mortgage Lenders," May 31, 2005.

Our earlier study hypothesized that if discrimination were widespread, an analysis of the detailed pricing data available for the most vulnerable borrowers, *i.e.*, those with rate spreads, should show meaningfully higher spreads for minorities. The 2004 study found that among rate spread borrowers, lenders were treating minority homebuyers fairly. We concluded that if lenders were treating the most vulnerable borrowers equitably, it seemed unlikely that they were otherwise engaged in illegal discrimination. The 2005 HMDA data supports a similar conclusion.

(3) Lenders increased their service to minorities.

- Loan Originations

In 2005, the ten leading lenders originated 17,333 more first lien loans to African American homebuyers than in 2004, and 33,950 more to Hispanic homebuyers.

- Number of 1st Lien Owner-Occupied Home Purchase Originations -

	Non-Hispanic White	African American	Hispanic
2005	1,055,801	101,421	188,270
2004	942,549	84,088	154,320

Figure 6

African Americans and Hispanics also comprised a greater share of borrowers in 2005.

- Distribution of 1st Lien Owner-Occupied Home Purchase Originations -

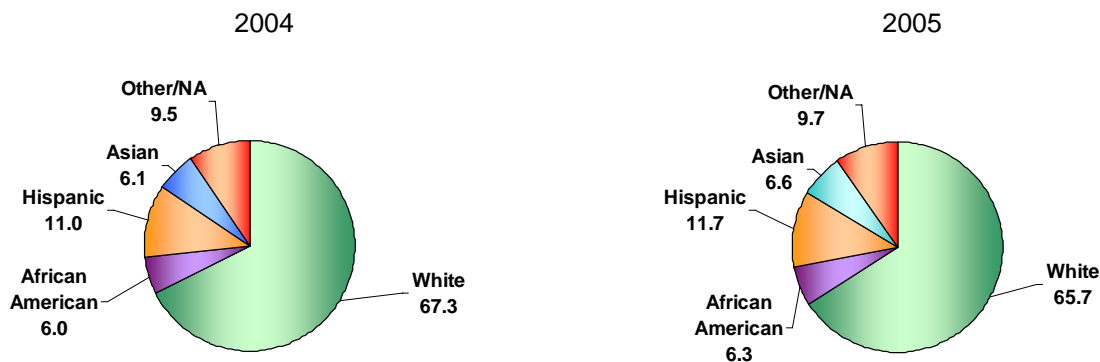


Figure 7

The proportion of first lien loans originated to African American and Hispanic homebuyers grew from 2004 to 2005, while the proportion of loans originated to white homebuyers fell.

- Change in Proportion of Originated 1st Lien Owner-Occupied Home Purchase Loans from 2004 to 2005 -

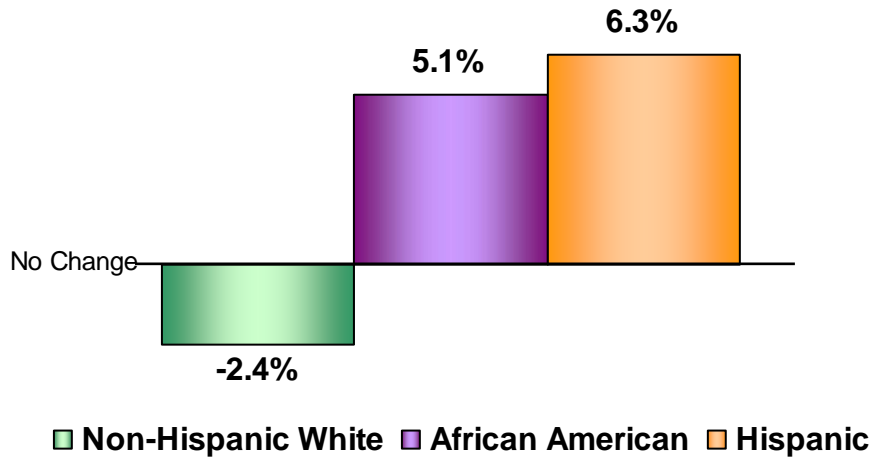


Figure 8

- Loan Applications

Hispanics and African Americans accounted for a greater share of applications to the ten leading lenders in 2005.

- Distribution of 1st Lien Owner-Occupied Home Purchase Loan Applications -

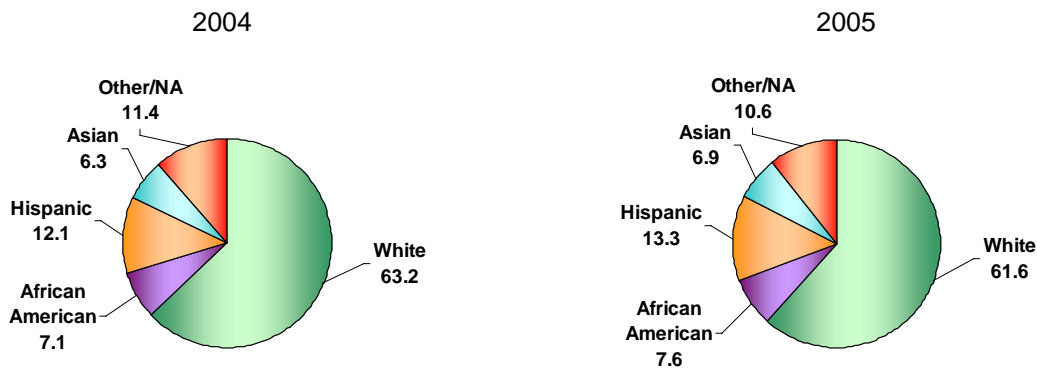


Figure 9

The proportion of first lien loan applications from African American and Hispanic homebuyers grew in 2005, while the proportion of applications from white homebuyers fell.

- Change in Proportion of 1st Lien Owner-Occupied Home Purchase Loan Applications Received from 2004 to 2005 -

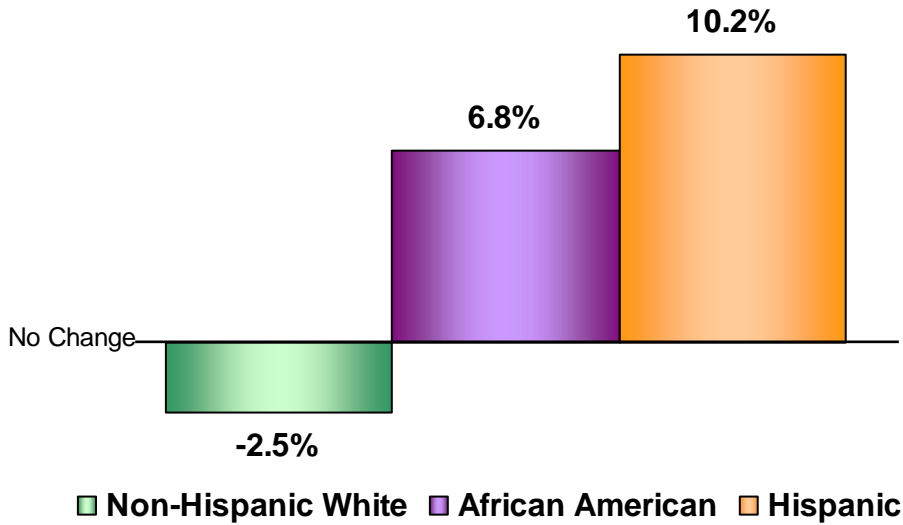


Figure 10

Conclusion

Although the growth in Rate Spread Loans from 2004 to 2005 is likely the result of several factors, our review of the HMDA reports of ten leading national mortgage originators strongly suggests a link between greater credit risk and more rate spread loans.

We stress that data derived from HMDA reports alone can never conclusively prove or disprove lending discrimination. The reports do not include important information on borrower credit quality, such as credit scores, or loan characteristics, such as sale price. However, in the available data we found significant growth in the volume of junior lien loans to homebuyers and an increase in the median loan-to-income ratio for Rate Spread Loans. These factors indicate that in 2005, homebuyers had less equity in their property and were more financially stretched than in 2004. Therefore, we interpret the increase in Rate Spread Loans as an attempt by lenders to manage the increased credit risk without dashing the American dream of home ownership.

The increase in Rate Spread Loans has not adversely impacted minority groups. On the contrary, the number and share of loans made to African American and Hispanic homebuyers increased significantly in 2005. Moreover, the only pricing data available in HMDA reports—the difference between APR and Treasury yield on each Rate Spread Loan—once again shows no meaningful discrepancies in the pricing of these loans to homebuyers of different race or ethnicity.

Methodology

Home purchase mortgages to owner-occupants were selected for the study, because we believe they comprise the most important category of HMDA data. An owner-occupied home purchase loan is made for the purchase of a new home, while other HMDA loans are made on previously-purchased properties, second homes, or investment properties.

Moreover, the most vulnerable Americans are highly represented among home purchase borrowers. Surveys indicate that first-time homebuyers account for 40 percent of all home purchases,¹² that 25 percent of all first time homebuyers are minorities,¹³ and that 21 percent of home purchasers are single women.¹⁴

Conventions

- An application's race and ethnicity were classified according to the primary applicant's data.
- The first race reported for the primary applicant determined the race of the application.
- The study refers to the HMDA race and ethnicity categories of "Black or African American," "Hispanic or Latino," and "Native Hawaiian or Other Pacific Islander" as, respectively, "African American," "Hispanic," and "Hawaiian/Other Pacific Islander."
- "Non-Hispanic white" refers to primary applicants who classified their race as "white" and did not classify their ethnicity as "Hispanic or Latino."
- In order to avoid double-counting, applicants who indicated their ethnicity was Hispanic were classified as Hispanic regardless of the race they selected.
- All ratios and percentages are rounded, which might result in slight computational discrepancies.
- All loan-to-income figures exclude loans with an income of "NA."
- Application figures exclude purchased loans, since they do not involve an application submission from the applicant to the purchaser.
- In figures 7 and 9, the category "Other/NA" refers to primary applicants whose racial classification was "Native Hawaiian or Other Pacific Islander," "American Indian or Alaska Native," "information not provided," or "not applicable," and whose ethnicity classification was not "Hispanic or Latino."

¹² "Home Buyer & Seller Survey Shows Rising Use of Internet, Reliance on Agent," National Association of Realtors Press Release, January 17, 2006.

¹³ "The Changing Face of Homeownership," Realtor Magazine Online, June 1, 2004.

¹⁴ "Home Buyer & Seller Survey Shows Rising Use of Internet, Reliance on Agent," *supra*.

APPENDIX
Lender Data Used in Study

NOTE: No lender commissioned or was otherwise involved in conducting the study.

1 Countrywide Financial Corp.	8 National City Mortgage (Con't.)	9 Wachovia
Countrywide Bank	Ameritrust Home Mortgage, LP	Wachovia Bank
Countrywide Real Estate Finance	Cape Henry Mortgage, LLC	Wachovia Mortgage Corporation
Countrywide LLC	Capstone Mortgage Funding, LLC	Wachovia Bank of Delaware
	Classic First Mortgage, LLC	SouthTrust Mtg Corp dba EquiBanc
2 Wells Fargo Home Mortgage	County CORP Mortgage, LLC	American Mortgage Network
Wells Fargo Home Mortgage	Covenant Mortgage, LLC	
Wells Fargo Funding	Delmarva Mortgage, LLC	10 ABN AMRO
Wells Fargo Financial	Dominion Trust Mortgage, LLC	ABN AMRO Mortgage Group Inc.
Wells Fargo Ventures, LLC	Enter Mortgage, LLC	LaSalle Bank
	Executive Home Mortgage	Standard Federal Bank
3 Washington Mutual	FCB Mortgage, LLC	
Washington Mutual Bank	First Capital Home Mortgage, LLC	
Washington Mutual Bank, FSB	First Flight Mortgage, LLC	
Long Beach Mortgage Company	First Independent Mortgage, LLC	
	First Patriot Mortgage, LLC	
4 Chase Home Finance	First Washington Mortgage, LLC	
JPMorgan Chase Bank, NA	Gateway First Mortgage, LLC	
Chase USA, NA	Global Home Mortgage	
	Heartland Security Mortgage, LLC	
5 Bank of America	Heritage Home Mortgage, LLC	
Bank of America, N.A.	Home Financing, LLC	
	Home Mortgage Centre, LLC	
6 CitiMortgage Inc.	Homeland First Mortgage	
Citibank, FSB	Homesource Mortgage Services	
Citibank, N.A.	Homesync Financial Services	
Citibank Texas, N.A.	Hometown Mortgage, LLC	
Citibank (West)	Intercoastal Mortgage, LLC	
Citicorp Trust Bank	Liberty West Mortgage, LLC	
Citifinancial	Lincoln First Mortgage, LLC	
Citifinancial Mortgage Company	Lower Bucks Mortgage, LLC	
	Mid Atlantic Mortgage, LLC	
7 GMAC Residential Holdings	Millstone Mortgage, LLC	
Ditech.com, Inc.	MNC Mortgage, LP	
GHS Mortgage	Mortgage Construction Finance	
GMAC Bank	Mortgage One, LP	
GMAC Mortgage Corp.	National American Mortgage, LLC	
	NCS First Mortgage, LP	
8 National City Mortgage	Oak Street Capital, LP	
National City Bank of Kentucky	Peninsula Mortgage, LLC	
National City Bank of the Midwest	Platinum First Mortgage, LP	
National City Bank of Pennsylvania	Premier Lending Services, LP	
Provident Community Development	Regent Financial Services, LLC	
Red Mortgage Capital Inc.	Regional First Mortgage, LLC	
National City Bank	Reliable Mortgage Investors, LLC	
National City Bank of Indiana	REO Mortgage Services, LLC	
1st Choice Mortgage, LLC	Summit First Financial, LLC	
1st Premier Mortgage, LLC	Supreme Capital Mortgage, LLC	
1st Residential Mortgage, LLC	The First Mortgage Group, LLC	
Acculend Mortgage, LP	Tidewater First Mortgage, LLC	
Action Home Mortgage, LLC	Tower Mortgage, LLC	
Affirmative Mortgage, LLC	Town and Country Lending, LLC	
All American First Mortgage	Town Square Mortgage, LLC	
American Best Mortgage, LLC	Valley Mortgage Services, LLC	
Americorp First Mortgage, LLC	Virginia First Mortgage, LLC	
Amerimax Mortgage, LLC	Virginia Home Mortgage, LLC	

Source: "Leading Residential Originators in the first half of 2005" *American Banker*, October 21, 2005