Racial and Ethnic Disparities in Home Loan Application Outcomes: A 2019 Snapshot of Lending Discrimination in North Carolina

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Introduction

Homeownership is one of the most fundamental ways to build wealth – both by increasing equity in the home and market value appreciation over time – but not everyone has had the equal opportunity to generate such wealth (Lerner). Housing policies like redlining and restrictive covenants prevented Black families from buying homes in or around white neighborhoods for much of the twentieth century (Mikhitarian, 2018; Rothstein, 2017).[1] More recent practices such as steering Black house hunters to or away from certain neighborhoods (Choi et al., 2019), and racial disparities in subprime lending (Bocian et al., 2006), property tax assessments (Van Dam, 2020), and home appraisals (Brown, 2012; Kamin, 2020), while more subtle than the overtly racist policies of the past, contribute to lower rates of Black homeownership and wealth acquisition.

Access to home loans is another example of a formally race-neutral process that continues to produce racially disparate outcomes. In order to examine lending patterns by race and ethnicity, we analyzed data from the Home Mortgage Disclosure Act's (HMDA) 2019 report. We looked at over 300,000 home loan applications, including loans for purchase, home improvement and refinancing, for single-family homes in North Carolina.

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[1] The Federal Housing Administration's Underwriting Manual from 1938, which served as a guide for mortgage lenders, recommended the construction of physical barriers between white and Black neighborhoods: "[n]atural or artificially established barriers will prove effective in protecting a neighborhood from… adverse influences… [including] the prevention of the infiltration of… inharmonious racial groups," (Underwriting Manual).

Home Loan Denial Rates by Race and Ethnicity

Our analysis shows that minority loan applicants have much higher denial rates than White applicants. Home loan applications for applicants who are non-Hispanic Black, Asian, American Indian and Two or More Minority Races are rejected at twice the rate of White applicants.[2]

Figure 1 shows the mortgage application denial rate for applicants who were identified as not Hispanic or Latino (n = 328,064), by race. Applicants who were identified as being of Two or More Minority Races suffered the highest denial rate of 39.6%, followed by American Indians or Alaska Natives (38.6%), Asians (33.3%), Blacks or African Americans (33%), Joint (25.1%) and Native Hawaiians or Pacific Islanders (18.9%). White applicants had the lowest denial rate of 17.8%. (See Table 1 in the Appendix for a full data summary.)

Figure 1: Denial Rate by Race (Not Hispanic or Latino Ethnicity)


Source: Home Mortgage Disclosure Act
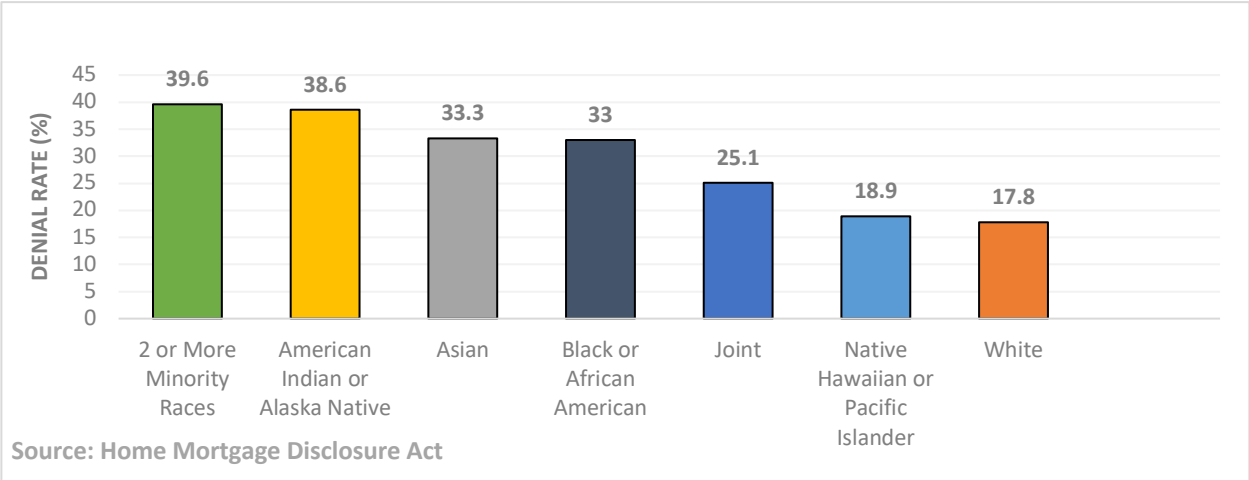
Figure 2 illustrates that Hispanic or Latino loan applicants are over seven percentage points more likely to be denied a mortgage than applicants who are identified as non-Hispanic. **Figure 3** breaks this down further by looking at the application denial rate across racial groups within the group of applicants who were identified as Hispanic or Latino. Hispanic/Latino applicants who identified as being Two or More Minority Races again endured the highest denial rate of 49.4%, while White Hispanic or Latino applicants enjoyed the lowest denial rate of 23.4%.

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[2] The racial and ethnic categories used here are the ones used by HMDA.

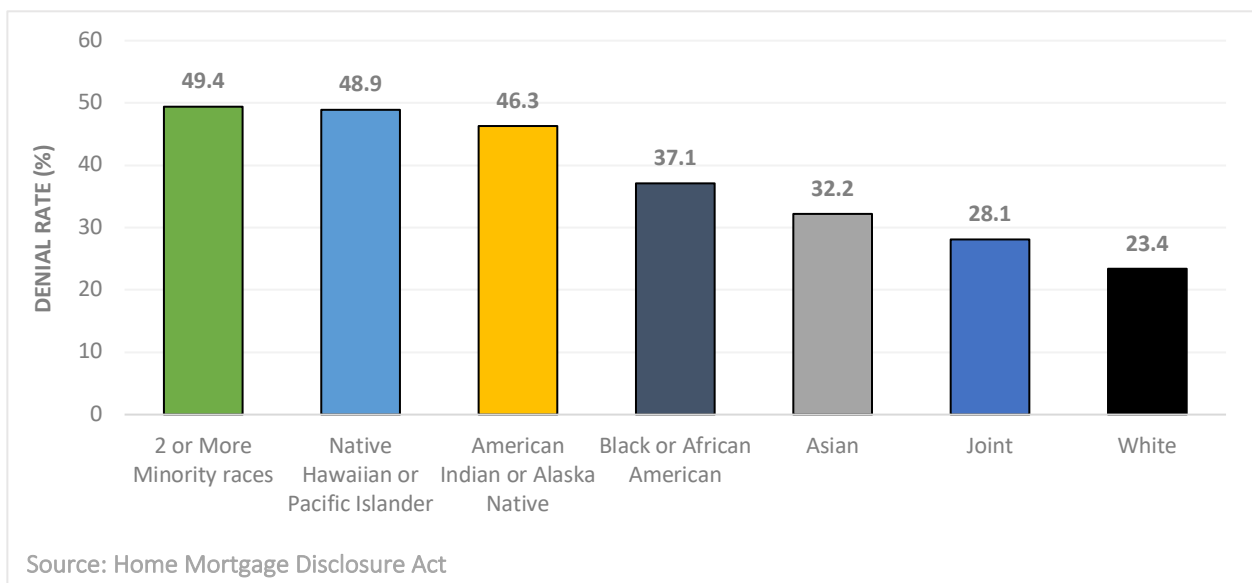**Racial and Ethnic Disparities in Home Loan Application Outcomes**

Figure 2: Denial Rate by Ethnicity

Source: Home Mortgage Disclosure Act
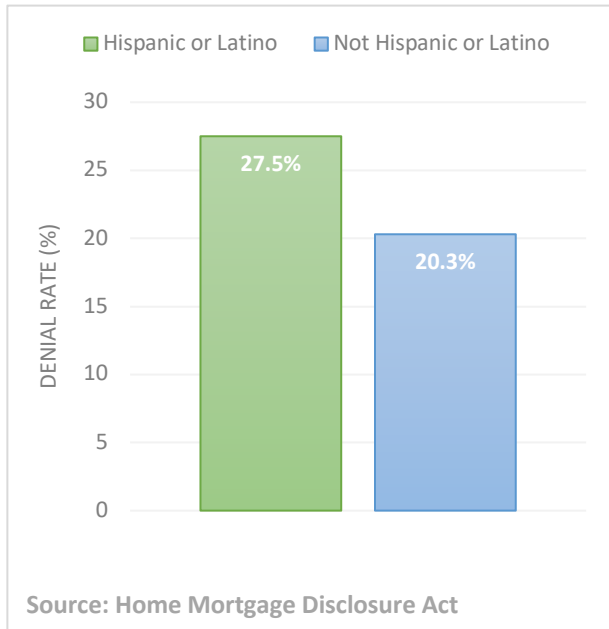
As **Figure 3** shows, within the category of Hispanic or Latino ethnicity (n = 19,075), home loan application outcomes vary tremendously by race. Comparing Hispanic/Latino racial groups to non-Hispanic/Latino racial groups (i.e., Hispanic White versus non-Hispanic White) demonstrates that for most races, the denial rate for those who are Hispanic or Latino is higher. The racial category with the largest difference (Two or More Minority Races) reveals a difference of nearly 10 percentage points, and even White applicants are more likely to be denied if they are identified as Hispanic or Latino. Still, within the Hispanic/Latino group, a number of minority racial groups have much higher denial rates than Hispanic or Latino Whites. In this sense, the Hispanic/Latino group reflects the same trends in race as the non-Hispanic group.

Figure 3: Denial Rate by Race (Hispanic or Latino Ethnicity)

Source: Home Mortgage Disclosure Act

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These two analyses combined show that Hispanic or Latino applicants experience a compounded difficulty in obtaining loans. It also shows that regardless of their ethnic identification, minority racial groups experience much higher rates of home loan application denials than White applicants.

> **The bottom line is that about one in three minority applicants in North Carolina is thwarted in their attempts to obtain a home loan, blocking their ability to purchase, improve, or refinance a home.** As a result, they are denied access to many advantages of homeownership and wealth-building. This finding is typical of studies conducted elsewhere (Anderson, 2020; Kapfidze, 2020).

Racial and ethnic disparities in the denial rate largely lie in historical inequalities, structural racism and ongoing differences in wealth and income. Black applicants are more likely to have more debt, specifically student loan debt (Katz, 2020). Additionally, Black and Latinx consumers are more likely to be "credit invisible" (National Consumer Law Center, 2019) or have lower credit scores (Katz, 2020; Mui, 2012). The calculation of the FICO credit score, a facially race-neutral process, has been shown to have a disparate impact on Black and Latinx consumers (National Consumer Law Center, 2016). According to Rice and Swesnik (2013), factors that are used to determine the FICO credit score reflect racial inequalities. For example, one of the factors that FICO uses to calculate a credit score is *Amounts Owed.* It accounts for 30% of the FICO score and considers the "amount of credit available to a borrower for certain types of revolving and installment loan accounts" (Rice & Swesnik, 954). Communities of color are less likely to have relationships with mainstream lending institutions, leaving approximately half of African Americans and Latinos "unbanked" or "underbanked" (Board of Governors of the Federal Reserve System, 2020). Limited access to mainstream lenders hinders the ability of these consumers to open these lines of credit. This is just one example of how Black and Latinx consumers' credit scores are penalized for factors other than their actual creditworthiness.

Lastly, racial discrepancies in the home loan denial rate might well reflect lender discrimination. Housing discrimination remains alive and well in the United States (Bartlett et al., 2019; Nance-Nash, 2020; National Fair Housing Alliance, 2018) and lender discretion leaves the process vulnerable to bias (Glantz & Martinez, 2018; Katz, 2020). An Urban Institute report on homeownership found that while differences in income, marital status, FICO scores and age could

explain some of the gap between Black and White homeownership, about 17% of the gap was unexplained (Choi et al., 2019).

Credit scores – a key factor in the mortgage underwriting process – are absent from the publicly available data on home loan applications. Though the data highlight racially disparate outcomes in applications, not much is known about the opaque loan underwriting process. More transparency in that process would require that credit score data (and credit score source) be published and included in the HMDA's annual reports. This would allow for more accurate assessment of mortgage lending trends by race and ethnicity.

Methods

Denial Rate. In determining how to calculate the mortgage application denial rate, we looked at the Consumer Financial Protection Bureau's (CFPB) methodology: "Denial rates are calculated as the number of denied loan applications divided by the total number of applications, excluding withdrawn applications and application files closed for incompleteness," (Dietrich, 2019). Reveal, from The Center for Investigative Reporting, uses a similar methodology to calculate a denial rate, "[including] only applications for which the lending institution either made the loan to the applicant or denied it, excluding withdrawn applications and other loan outcomes," (Glantz, 2018). Similarly, the denial rates in this analysis are calculated using loan outcomes of either "Loan Originated" or "Application Denied" with the latter being the numerator and both constituting the denominator, excluding all other loan outcomes provided by the Federal Financial Institutions Examination Council's (FFIEC) 2019 Home Mortgage Disclosure Act (HMDA).

An Urban Institute publication on denial rate calculation suggests that the aforementioned conventional methods lack consideration of the creditworthiness of applicants, resulting in a distorted denial rate (Bai, 2018). HMDA does not publicly report the creditworthiness of applicants; thus, we cannot control for this important factor.

These findings are exclusive to loan applicants in North Carolina for the year of 2019. The denial data include conventional and non-conventional loan types for Single Family (1-4 unit) Site-built and Manufactured homes. The majority of applicant race and ethnicity is identified based on the underwriter's assessment of either visual observation or surname, though some applicants self-identify their race and ethnicity. Applications categorized as "Joint" race have one applicant

reporting a racial designation as "White" and another applicant reporting as one or more racial minorities.

Appendix

Table 1: HMDA Data Summary

	NATIVE HAWAIIAN OR PACIFIC ISLANDER	2 OR MORE MINORITY RACES	AMERICAN INDIAN OR ALASKA NATIVE	WHITE	BLACK OR AFRICAN AMERICAN	JOINT	ASIAN
TOTAL APPLICATIONS DENIED	2463	253	875	49206	15768	2282	250
TOTAL LOANS ORIGINATED	10334	364	1334	221624	31418	5110	395
TOTAL	12797	617	2209	270830	47186	7392	645
TOTAL DENIAL RATE (%)	19.246	41.004	39.61	18.168	33.416	30.871	38.759
HISPANIC OR LATINO APPLICATIONS DENIED	113	43	133	3329	300	36	102
HISPANIC OR LATINO LOANS ORIGINATED	118	44	154	10883	508	92	214
TOTAL HISPANIC OR LATINO	231	87	287	14212	808	128	316
HISPANIC OR LATINO DENIAL RATE (%)	48.917	49.425	46.341	23.423	37.128	28.125	32.278
NOT HISPANIC OR LATINO APPLICATIONS DENIED	2361	210	742	45877	137	1117	15468
NOT HISPANIC OR LATINO LOANS ORIGINATED	10120	320	1180	210741	277	3317	30910
TOTAL NOT HISPANIC OR LATINO	12481	530	1922	256618	414	4434	46378
NOT HISPANIC OR LATINO DENIAL RATE (%)	18.916	39.622	38.605	17.877	33.091%	25.191	33.352
PERCENTAGE POINT DIFFERENCE BETWEEN DENIAL RATE FOR "HISPANIC OR LATINO" AND "NOT HISPANIC OR LATINO"	30.001	9.803	7.736	5.546	4.037	2.934	-1.074

Table 1 displays the variables used in previous figures. In comparing "Hispanic or Latino" and "Not Hispanic or Latino" observations, it should be noted that the former ethnicity (n = 19,075) contains much fewer observations than the latter (n = 328,064). This difference could reflect either a non-response bias or a real lower prevalence of Hispanic or Latino applicants. Given that the number of observations for the Hispanic or Latino category is relatively low, especially once broken down by race, it is unclear whether the data points provided are reliable estimates upon which a definitive conclusion can be drawn, though the discrepancies between White and other categories remains consistent. Most research into the racial disparities in home loan application outcomes focus on the difference in White, Black and Hispanic communities. More should be

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done to focus on the other racial categories who experience high denial rates compared to White applicants.

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