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Introduction

Cesario Gonzalez said he was encouraged to go for his first home last year by a mortgage broker handing out business cards in front of Pancho Villa Farmers Market on El Cajon Boulevard. Gonzalez said through a translator that he still is uncertain what kind of loans he signed up for on the \$565,000 duplex he purchased in May 2007. With monthly mortgage payments of \$4,200 and monthly income of \$3,200, the purchase appeared dubious...He could see his neighbors being owners of houses. He trusted the Realtor and the loan officer. He wanted a home. (Crabtree 2008)

Colvin Grannum, an African American who grew up in a black neighborhood in Brooklyn, explained that his father bought several properties in the 1950s and '60s, often without turning to banks. "I don't want to say it's in the cultural DNA, but a lot of us who are older than 30 have some memory of disappointment or humiliation related to banks," Mr. Grannum said. "The white guy in the suit with the same income gets a loan and you don't? So you turn to local brokers, even if they don't offer the best rates." (Powell and Roberts 2009)

These two anecdotes, taken from the *San Diego Union Tribune* and *The New York Times* respectively, provide uncommon insight into the social processes governing the mortgage borrowing decision. Mr. Gonzalez was approached by a mortgage broker, working the streets in front of a Latino grocery store, a person he trusted, and he was swayed by his neighbors who were also buying homes. For Mr. Grannum, going to a local broker, "even if they don't offer the best rates," was a conscious choice for a borrower who had historically been excluded from the financial mainstream, a choice shaped by the intergenerational knowledge passed down from his father's home-buying experiences. Both anecdotes suggest that mortgage lending is as much a social process as it is an economic decision, and highlight the importance of local context in shaping what has been construed predominantly as an economic transaction.

The anecdotes also provide insight into why so many borrowers ended up in loans that they could not afford over the long term, and why borrowers with prime credit scores—particularly among Hispanic and Black borrowers—received a subprime loan. Did borrowers actively "seek" out subprime loans, or were they "sold" loans by unscrupulous brokers and lenders? In this paper, I explore this question by exploring the local context and social relations that guided borrowers' decisions within the

¹ The views in this paper are solely those of the author and do not necessarily reflect the views of the Federal Reserve Bank of San Francisco or the Federal Reserve System.

mortgage market. Building on Granovetter's concept of social embeddedness, I seek to understand how mortgage market institutions interacted with localized social networks to shape loan choices for minority borrowers. What types of institutions and marketing practices were prevalent in minority communities during the "subprime boom"? How did borrowers decide on their choice of lender? What loan products were they offered, and how knowledgeable were they about their loan terms? Were loans in lower-income and minority communities "sold or sought"? What other social networks and local institutions (e.g. governments, churches, nonprofits) shaped mortgage market outcomes? To answer these questions, the paper draws on in-depth interviews, local data on mortgage lending and foreclosures, and analysis of the institutions and marketing practices in two communities that represent the two faces of the mortgage crisis in California: an older, predominantly minority neighborhood with an older housing stock (Oakland), and a fast growing suburban area characterized by new construction (Stockton).

Understanding how local context influences mortgage market outcomes is critical, particularly as policy-makers and regulators revisit issues related to consumer protection and access to credit. The Community Reinvestment Act of 1977 (CRA) was premised specifically on a construction of "local" responsibility. Banks with a branch in a specific neighborhood had an affirmative obligation to lend to residents of that neighborhood, consistent with safe and sound lending operations. Local context was also critical to the lending decision: banks relied on "relationship lending" to determine whether or not to approve or deny the loan, gleaned insights into a borrower's character from interactions at the local church or grocery store and community gossip (Holmes et al. 2007; Immergluck 2004).

The landscape of financial services has changed considerably since then, and as Chairman Bernanke (2007) has said, "for some institutions, the concept of 'community' is no longer as clear as it was when the CRA was enacted." Bank deregulation and consolidation, the emergence of statistically-based credit models, and the growth of the secondary market have all led to the demise of the Main Street banking model. In 1977, fully 54 percent of the nation's 18,834 banks were unit institutions—that is, they had a single location, with a single office, and no branches—and predominantly took deposits from individuals and businesses located within the neighborhood. By 2007, however, this share had fallen to 24 percent, and the number of banks had dropped to just 8,605 (Avery, Courchane and Zorn 2009). Concomitant with this trend of consolidation, banks increasingly shifted their lending activities away from the neighborhoods in which they have branches—also known as their "assessment areas", the geographic areas in which their loans receive the greatest scrutiny under the CRA. In addition, other types of financial institutions with no local connection—most notably independent mortgage companies—emerged, and garnered an increasing share of the mortgage market during the subprime boom years.

Yet, while financial services have gone global, I argue that obtaining a mortgage is still a very local process, embedded in local context and social relations. Particularly in communities that have traditionally been denied credit, social networks and local presence may be a vital component of responsible lending. Indeed, a 1998 HUD report stressed the important role of social networks in linking underserved borrowers to homeownership opportunities.

“Applying for a mortgage is only the final state of a series of contacts between a potential applicant and various individuals and institutions. These contacts are embedded in social networks within local communities and influence every aspect of the pre-application phase of mortgage lending...The decision to apply for a mortgage is as much social as it is economic; thus **successful strategies must identify and develop the social and community networks that encourage minority-LMI borrowers to try to become homeowners and apply for a mortgage**” (HUD 1998, ii).

Despite this affirmative statement, however, we actually know quite very little about how social and community networks influence the mortgage lending process, especially from the perspective of the borrower. It is this gap in the literature that this paper seeks to address. The paper proceeds as follows. First, I review the literature on social embeddedness that informs the theoretical framing of this research. Then, I turn to an analysis of quantitative data on lending in California during the subprime boom. The analysis focuses on two pieces of the mortgage origination channel: a) whether or not a loan was originated by a mortgage broker, and b) whether or not the loan was funded by a federally regulated depository or by an independent mortgage company. In the third section, I present the findings from 100 interviews conducted with residents in Stockton and Oakland, California. In the final section, I discuss the policy implications of this research.

Literature Review

Numerous studies have sought to understand disparities in mortgage market outcomes, with great attention being placed on mortgage lending patterns among low-income and minority borrowers and communities. Early research in this area focused on understanding differences in loan denial rates among different groups of borrowers (Ross and Yinger 2003). A seminal study published by the Federal Reserve Bank of Boston found that even after controlling for financial, employment, and neighborhood characteristics, black and Hispanic applicants were significantly more likely to be turned down for a mortgage than were comparable whites (Munnell et al. 1996). Subsequent studies have either critiqued the Boston Fed’s study (Liebowitz 1993; Horne 1994; Yezer et al. 1994), or have concluded that it effectively demonstrated the existence of discrimination (Carr and Megbolugbe 1993). A rigorous review of the Boston Fed data conducted by Ross and Yinger (2003) concluded that while many of the critiques did raise important issues with the original study’s methods, the minority-white disparities in denial rates could not be entirely explained away.

As the share of the subprime market began to grow in the mid-1990s, however, researchers increasingly focused attention away from disparities in “access to credit” towards disparities in “the cost of credit.” Facilitated by automated credit scoring and the growth of the secondary market for mortgage-backed securities, “risk based” pricing provided lenders with the ability to expand access to credit for borrowers with lower credit scores, fewer assets, and less stable incomes (Pennington-Cross, 2002; Nichols, Pennington-Cross and Yezer, 2005; Courchane, Surette, and Zorn, 2004). The risks associated with lending to these “subprime” borrowers were offset by charging a higher interest rate for the loan. In the

words of former Federal Reserve Chairman Alan Greenspan (2005), “where once marginal applicants would have simply been denied credit, lenders are now able to quite efficiently judge the risk posed by individuals and price that risk appropriately.” This shift towards risk based pricing was accompanied by the rise of subprime mortgage lenders that specialized in subprime products. Subprime lenders—which were not subject to the same federal regulations as are banks—accounted for a large portion of the growth in home purchase financing for low-income and minority borrowers during the mid-1990s (Canner, Passmore, and Laderman 1999). However, as house prices began to take a steep climb upwards at the start of this decade, subprime increasingly became a moniker for a much wider range of nontraditional or alternative mortgage products, including interest-only loans, option ARMs, and loans that coupled extended amortization with balloon-payment requirements. In 2004, these exotic mortgage products accounted for 12.5 percent of loan originations; by 2006, this segment had increased to 32.1 percent (Chambers et al. 2008).

Research on the subprime market, as it’s related to disparities in lending outcomes, has pretty consistently found that the use of subprime loan products varies significantly by race, with Blacks and Hispanics more likely and Asians less likely to hold a subprime loan (Nichols, Pennington-Cross, and Yezer 2005; Avery et al. 2006; Bocian, Ernst and Li 2008; Courchane 2007); that subprime loans and loans with features such as prepayment penalties, adjustable interest rates, and payment options are much more likely to go into foreclosure (Ding et al. 2008; Ambrose, LaCour-Little, and Huszar 2005; Pennington-Cross and Ho 2010; Quercia et al. 2007; Danis and Pennington-Cross 2005); and that subprime lending is more frequent in low-income neighborhoods than in upper income neighborhoods, and more frequent in predominately Black neighborhoods than white neighborhoods (Calem, Gillen and Wachter 2002; Immergluck and Wiles, 1999; Hershaff, Wachter and Russo, 2005; Calem, Hershaff and Wachter 2004; Scheessele 2002; Ding et al. 2008). As with the early Boston Fed HMDA report, many of these studies are limited due to data constraints and do not control for all of the factors that likely influence mortgage choice, pricing and outcomes, yet on balance these findings have stood up to significant academic and real life scrutiny.

Understanding why these differences in mortgage market outcomes persist is much more difficult, however. Some researchers have argued that neighborhoods with a legacy of urban decline are strategic targets within the subprime business model, as they offer concentrations of these borrowers along with low levels of competition from other lenders (Immergluck and Wiles 1999; Immergluck and Smith 2004). In areas of lower competition, borrowers have fewer options to bargain, and the terms of credit may therefore be less advantageous (Ashton 2008). Other researchers have focused on mortgage origination channel in helping to explain disparities in subprime lending. For example, research has shown that mortgage brokers charged less financially sophisticated borrowers more for their services, and that they were more likely to steer borrowers into more risky loan products (Jackson and Burlingame 2007, Ernst, Bocian and Li 2008). Regulations governing mortgage lending institutions also seem to matter. Loans originated by federally regulated depository agencies (and subject to laws such as the CRA) were significantly less likely to end up in foreclosure (Laderman and Reid 2009), and state anti-predatory lending laws have a strong and positive effect on reducing both the likelihood of predatory lending and default (Quercia et al 2010). Still others have focused on information

asymmetries. In a detailed survey, Courchane and her colleagues found that subprime borrowers were less knowledgeable about the mortgage process and were less likely to search “a lot” for the best rates. “Borrowers who do not search for the best interest rates or who do not have the opportunity to make choices about their mortgage options disproportionately end up with subprime loans, as do borrowers whose search emphasized affordable monthly payments.” (Courchane et al. 2004, p. 373)

In the majority of these studies, the process by which consumers choose mortgage products is viewed as a standard economic transaction in which borrowers try to maximize the amount of the loan, lenders try to maximize profits and limit risks, and the prevalence of subprime lending in lower-income and minority communities has to do with local credit supply and demand. Yet in many communities, subprime lenders and federally regulated depositories operated side by side, and mortgage brokers served as intermediaries for many different types of borrowers and lenders. Why is it that some borrowers were more likely to receive a loan from an independent mortgage company than from a federally-regulated depository, particularly when it appears that doing so did work against their economic self-interest?

Mark Granovetter’s theory of social embeddedness, which argues that people are social beings whose attributes and actions are conditioned by their location within networks of “concrete, ongoing personal relations” (Granovetter 1985, p. 490), suggests a different way of viewing the mortgage transaction. Granovetter’s work posits that social networks shape economic actions in three key ways: first, they shape the information that people receive and act upon; second, they shape the motives that drive people’s actions; and third, they influence perceptions of trust and provide economic actors with the confidence that others will do the “right” thing (Granovetter 2005). Through various case studies, Granovetter demonstrates that through these mechanisms social relations can lead consumers to depart from the instrumentally rational and opportunistic forms of economic action, for good or bad.

One of Granovetter’s primary theoretical contributions is his formulation of the “strength of weak ties,” which suggests that new and more diverse information flows through weak social networks—e.g. acquaintances—than through strong social networks—e.g. family members and close friends. Weak ties are critical in connecting people to information outside of what’s known in an immediate social circle. Granovetter (1973) argues that weak ties have a special role in a person’s opportunity for mobility. Strong ties, in contrast, are likely to have access to the same information as oneself, and are less likely to be able to connect one to new ideas or contacts. Building on this idea, Burt (1992) contends that focusing on the strength of tie is not as important as focusing on whether not a social tie helps to bridge a “hole” between networks and their information. Once a hole is bridged, information flows and opportunities increase. Within communities that have historically been denied access to credit, bridging ties—be they weak or strong—may help borrowers overcome knowledge gaps by connecting them to sources of information on the mortgage origination process, such as other homeowners, nonprofits, homebuyer education courses, or professional services such as brokers or lenders.

Recently, researchers have begun to draw on these ideas to consider how social relations influence lending decisions, and how social networks can actually shape “who gets capital and at what cost.” Brian

Uzzi's work, for example, shows that Chicago firms that have strong relationships with local banks pay lower interest rates on loans than those without, and that banks cultivate those relationships to help reduce the credit risk associated with lending to unknown clients (Uzzi 1999). In a detailed book written before the mortgage crisis, Guy Stuart (2003) situates the concept of "risk-based pricing" within a social context. Through a detailed investigation into the mortgage lending industry, he explores how a seemingly neutral tool such as risk-based pricing is actually deeply influenced by rules, social networks, and the production of space, and how these processes in turn lead to unequal outcomes for minority borrowers. He shows, for example, that the loan application process is strongly influenced by personal relationships as well as storytelling not only in the construction of the loan application file, but also how the underwriters 'read' and perceived the information within the file. He also shows significant segmentation in mortgage market institutions across neighborhoods: black brokers in Chicago largely served the black neighborhoods of Chicago, and that black borrowers were served by a narrow slice of mortgage banks compared to the overall market.

Two more recent studies also inform how localized social networks might lead to different mortgage choices and outcomes. Stephanie Moulton (2008), in a paper that looks at how lender marketing strategies related to pre-purchase homebuyer education and market influences loan performance, identifies four locally embedded social mechanisms that could influence the mortgage origination process: linking disconnected actors, providing information about exchange, creating reputational controls, and shaping preferences. She shows that borrowers who received loans from lenders that worked through housing counselors and provided face-to-face financial education were less likely to be delinquent than borrowers who were not as "connected" to lending institutions. Pittman (2008) conducts in-depth interviews with 32 borrowers in Atlanta and finds that not only were borrowers' product choices shaped by the informal and formal advice they received, but that borrowers who consulted the most diverse sources of information had loans with lower interest rates. In addition, borrowers who received advice from credit counselors fared better than those who relied on advice from friends and family members.

In this paper, I build on these insights to explore how concepts of "social embeddedness" can help us to explain how borrowers made decisions about obtaining a mortgage. However, unlike previous studies which have focused on the social embeddedness of institutional actors (e.g. real estate agents, lenders, brokers and the mortgage industry), I look specifically at the experiences of borrowers and explore how local social relations shaped their mortgage decision. As Essene and Apgar (2007) have pointed out, consumers lack perfect information on mortgage market products, and their preferences are malleable and subject to influence such as marketing and the framing of choices. In this paper, I explore how social relations shaped borrower's preferences and behavior in the mortgage market. How did their local social networks influence the information they received about mortgage product options? How did local social networks and social relations shape norms and expectations about the home buying process? And how did issues of trust influence the choice of a mortgage lender and product? Understanding the answers to these questions is a critical component of being able to design better consumer protection regulations going forward.

Research Design

To understand the social processes that govern the mortgage origination decision, I interviewed 80 homeowners that live and work in Oakland and Stockton, California. These two communities represent the two faces of the foreclosure crisis in California, thus providing two very different contextual settings for this research. Oakland's subprime crisis was heavily concentrated in older, predominantly minority parts of the city, with older housing stock and evidence of community disinvestment well before the foreclosure crisis. Stockton, in contrast, was characterized by very rapid housing construction during the housing boom, and subprime loans were concentrated in new suburban subdivisions and marketed as "affordability" products for families trying to purchase their first home. Despite these differences, however, both Oakland and Stockton saw extremely high rates of subprime lending between 2004 and 2006, and subsequent high levels of foreclosures. (Figure 1) In addition, a significantly larger share of loans in these communities was originated by mortgage brokers and by independent mortgage companies than in California as a whole. More troubling is the extent to which originations facilitated by mortgage brokers were concentrated in low- and moderate-income neighborhoods, especially in Oakland. (Figure 2) For California as a whole, the matched data show that about 56 percent of borrowers used a mortgage broker to originate their mortgage, so areas in orange and red in the map represent areas where a disproportionate share of borrowers used a mortgage broker. Understanding why consumers in these Oakland and Stockton were served by a different mix of products and by different types of lenders, especially those which operated outside of the existing federal regulatory framework, than commonly serve higher-income markets can provide insights into the workings of the dual mortgage market system (Apgar and Calder 2005).

To identify borrowers for the interviews, a two stage recruitment strategy was used. First, borrowers were recruited at foreclosure prevention events in both Oakland and Stockton: these events draw borrowers who are delinquent on their mortgages and who are seeking to speak to a servicer to modify their loan. As borrowers left the fair, they were given a postcard asking if they wanted to participate in an interview for a research project that "seeks to understand how homeowners in [Oakland/Stockton] obtained their mortgage." The postcard asked for volunteers willing to discuss their own experiences in buying a home, and provided a contact phone number to call if they were interested. These initial interviews formed the set of "core" respondents, and included 14 distressed borrowers in Oakland and 9 distressed borrowers in Stockton.

During the interview, respondents were asked to provide the address of their most recent home (the distressed property). After the interview, a postcard describing the study was sent to all of the houses on the same block as the distressed property, with the goal of interviewing the neighbors of the original distressed borrowers. A variation on snowball or chain-referral sampling, the purpose of this recruitment strategy was to explore how the mortgage origination decision is embedded within a very "local" context: that of the neighborhood block and the social networks that shape the social environment in that community. Only homeowners were eligible to participate: renters living in the neighborhood were not interviewed. Although respondents were told that the goal was to interview "as many people in the neighborhood as possible," the name or address of the original distressed property owner was never revealed, nor were any of the respondents' names or responses shared with

others in the neighborhood. All interviews were conducted in the neighborhood, either at the respondent's home or at a nearby coffee shop, library or restaurant. Respondents were provided with a \$40 honorarium at the start of the interview. The interview format was open-ended, although each respondent was also asked to fill out a worksheet with a series of standard questions about their loan, their household balance sheet, and their household composition. Interview tapes were transcribed and coded into segments, assigning codes to each segment according to its thematic content. As of March 2010, 80 total interviews had been conducted, with 47 in Oakland and 33 in Stockton. These interviews form the basis for this paper.

Table 1 provides descriptive statistics for the respondents within each of the case study cities. As the table demonstrates, the sample of interview respondents included not only homeowners in distress or in the foreclosure process, but also those who were still in their homes and current on their mortgage. The sample also includes respondents from diverse racial and ethnic backgrounds, although the Oakland interviews included a greater range of backgrounds, including several Ethiopian families. Interestingly, there was quite a bit of racial and ethnic segmentation across blocks, with some blocks serving as immigrant enclaves in that every interview was with a family from the same racial and/or ethnic background. Most of the interview households had incomes between \$60,000 and \$120,000, around the local area median. Most of the respondents had either purchased their home or refinanced during California's housing boom, and a majority used a mortgage broker to facilitate the mortgage transaction; very few reported having gone into a bank branch to obtain their mortgage. In addition, only 4 respondents in Oakland had worked with a nonprofit pre-purchase, although 11 respondents in Oakland and 9 in Stockton were working with a nonprofit housing agency post-purchase to assist with foreclosure mediation.

In addition, the paper supplements the qualitative analysis with a unique dataset that merges loan-level data submitted by financial institutions under the Home Mortgage Disclosure Act (HMDA) of 1975 with a proprietary dataset on loan performance. The loan performance data include both prime and subprime loans, and include information on borrower risk characteristics (e.g. FICO score), loan characteristics (e.g. LTV, ARM v. FRM, prepayment penalty), as well as loan performance (e.g. delinquency and foreclosure). The merged dataset is limited to conventional, first-lien, owner-occupied loans originated in metropolitan areas in California between January of 2004 and December of 2006, and loan performance outcomes are observed through December of 2008. Variables from other datasets, including the U.S. Census, the HMDA Lender file compiled by the Federal Reserve Board, the Federal Housing Finance Agency, and the Bureau of Labor Statistics are also attached to each loan record. Observations with missing data or obvious data-coding errors were excluded from the analysis.

Social Embeddedness and Consumer Decisions in the Mortgage Market

In the interviews, three key themes related to social embeddedness emerged. First, the networks through which borrowers received information about mortgage transactions tended to be quite insular, and few respondents had access to "weak" or "bridging" ties that could provide them with detailed and

independent information about loan products and pricing. Second, borrowers relied significantly on social networks to help them identify mortgage brokers and lenders, and particularly for the immigrant and African-American respondents, revealed a strong preference for brokers who were part of the local community. This preference was driven by perceptions that outsiders would not treat them fairly, and that a broker who “understood” their situation would be more likely to result in a positive outcome. The shared identity that borrowers felt with their brokers, coupled with the broker’s perceived expertise about the mortgage process, led borrowers to trust their advice and not seek external validation of the information provided. As I show using the quantitative data, this led to mortgage outcomes that were not necessarily in their best economic interest. Finally, the interviews also pointed to the importance of the overall context of the housing market bubble in California for creating social norms and expectations about homeownership and its financial benefits. Below, I consider each of these themes in turn.

Social Networks as Sources of Information

The first theme to emerge from the interviews was that networks through which borrowers received information about mortgage transactions tended to be quite insular (the exception being advice obtained through a mortgage broker, which is discussed in more detail below). The interviews in both Oakland and Stockton revealed that very little concrete information about mortgage products was shared across weak ties; instead, respondents tended to rely on the information and advice provided by close friends and family members. Figure 3 summarizes the results from the question, “Who did you talk to for advice about obtaining a mortgage?,” in which respondents were encouraged and prompted to think about all the people they turned to for advice. Overwhelmingly, respondents said they had talked primarily to family members, with a much smaller percentage saying that they got advice from even close friends, and even less so from colleagues at work or acquaintances. Almost nobody said that they discussed specific mortgage terms with anyone other than those who were going to be co-signers on the documents or responsible for part of the mortgage payments. Even so, many respondents acknowledged that they didn’t get very useful advice from their family.

My parents had only ever owned a home in Mexico, and the systems there are so different. But we included them since they were helping us with the purchase and wanted to know the monthly payments...They said buy a house for less than \$300,000. But of course we couldn’t find a house for that.

My brother bought a house a few months earlier, but he had relied on the agent and broker to help him get the mortgage. He told me no one actually reads the mortgage contract completely.

Overall, the main reluctance with seeking advice from weaker ties was the sentiment that mortgage details were too personal to discuss with anyone outside the family.

Everyone at work knew I was buying a house, but it wouldn’t have been right to talk about the mortgage or the payments.

Interviewer: Did you try and find out whether or not you were paying a fair price for the loan, for example, compared to your friends at work?

I didn't. I don't think you can. It's all based on your own income and credit score and stuff like that, so there's no way to compare without getting into your finances and hers. And that's my business.

Even if privacy concerns had not kept borrowers from seeking out more detailed information on mortgage terms, respondents in the sample would have had a hard time finding a neighbor who received a prime, 30-year conventional fixed rate loan for comparison. Out of the 80 interviews conducted, only 6 respondents reported that their loan was a 30-year fixed. While the interview data proved to be less robust when it came to gathering concrete information about things like the respondent's FICO score or their actual loan terms (only about 60 percent of respondents had their loan documents with them at the interview), the vast majority of respondents said that their loan had at least one of the following features: an adjustable interest rate, limited documentation, less than 20 percent downpayment, and/or a low teaser interest rate. One Stockton respondent who wanted a 30-year fixed said that he was talked out of it by the lender, and that his attempts to verify this product choice merely confirmed the prevalence of the product.

The lender said an ARM was better, since I'd likely want to trade up to a larger house in a couple of years and he could give me a better rate on an ARM so I'd pay less in interest... I asked around a bit and everyone I talked to had an ARM.

Information on mortgage products from other local sources—including newspaper advertisements, local flyers, and local billboards or posters—also tended to emphasize “affordability” products and products for consumers with poor credit history than more traditional mortgage products. A survey of the real estate sections of *The Oakland Tribune* and *The Stockton Recorder* between 2004 and 2006 revealed that approximately three-quarters of the mortgage-related advertisements featured products other than a 30-year fixed rate conventional mortgage. Instead, the majority emphasized low monthly payments and low or no downpayment requirements. Additionally, many respondents reported having received loan offers in the mail. One homeowner, who had lived in her house in Oakland for over 10 years, said she was struck by the amount of marketing around credit she received during the boom.

For a while, it seemed like there was a new offer every day. Sometimes they were in the forms of official letters...I got a lot of letters telling me I could refinance my house...sometimes it was flyers....And it just wasn't loans either, it was credit cards and store offers.

Interviewer: Did you follow up on any of these advertisements?

I got two new credit cards. We almost refinanced but [we ran into some other troubles] so it didn't work.

Ten respondents said that they had done additional research on mortgage rates over the internet, but that it was difficult to sift through the information and compare the very different products being offered. All ten of these respondents ultimately relied on a mortgage broker to help them obtain their mortgage.

Mortgage Brokers as “Trusted Advisors”

Indeed, nearly three-quarters of the respondents sought out the services of a mortgage broker to help them navigate the mortgage origination process. The use of a mortgage broker was more prevalent for respondents who had bought their home in 2004 or later, and out of the 9 interviews with households who refinanced their mortgage, all were initiated by a mortgage broker.

One of the strong themes that emerged from the interviews was the extent to which respondents of color expressed their desire to work with a broker from their own community or background, and that they turned to friends and family members to identify a broker or lender that had a history of serving other families in the community. In this sense, the interviews support Granovetter's hypothesis that individuals are "less interested in *general* reputations than in whether a particular other may be expected to deal honestly with *them*—mainly a function of whether they or their own contacts have had satisfactory past dealings with the other." (Granovetter 1985, p. 491) In numerous interviews, borrowers said that they turned to their social networks and relations in the neighborhood to identify a local mortgage broker who would be willing to "work with someone like me." Part of this was driven by a lack of trust in traditional lenders, and several respondents in Oakland noted a historical distrust of banks in the community. One interviewee, who had owned his home for 20 years before refinancing in 2006 noted:

You got all those shiny new banks over in Fruitvale. But where were they when we were trying to have a go at things, you know, trying to start up a little business or buy a house? They were nowhere to be found. And as a black man there was no way you'd be welcome in that door...they don't provide for me, I'm not giving my money to them.

More frequently, however, respondents noted that they didn't think they could obtain or qualify for a loan without help from someone who was 'like them' but who knew the system.

[Translated from Spanish] I didn't think I'd be able to afford a house, maybe a condo. I had a pretty good salary in construction, but no downpayment. But my friends at the site said that [their broker] could help me. I went to him, and he explained that he's got this relationship with lenders who want to help first-time homebuyers like me. I have to pay a little more, he said, but I can buy a house.

When I first got married eight years ago, we tried to buy a house, but the bank denied us the loan. Said we had too much debt and bad credit. Then when I got divorced, I gave up all chances of buying a house. But my sister bought a house, and she doesn't have any more money than me, so I went to her broker to see if I could get a loan.

Interviewer: *Why do you think you got a loan this time? Did you pay off your debts?*
No, I think I might have more debts now, just living off of one income. I'm not sure what changed. I think [the broker] wanted to help me, saw that it wasn't fair that I couldn't buy a house when everyone else can.

You experience subtle discrimination, the color of your skin, your accent. I remember when I opened my first bank account and the manager seemed impatient while I translated everything into Tamil for my parents. When it came to buying a home, I wanted to use a broker who was from Madras—Chennai now—like us.

Respondents listed a wide array of ways that they received recommendations for both real estate agents and mortgage brokers: family, neighbors on the block, the local church, their jobs, the park, and parents at their kids' school. On one block in Oakland, five of the eight houses that were part of the interview sample all used the same mortgage broker.

He came recommended, he did well by [my neighbor across the street], and she told me he'd treat me the same. After I got this house, I told my Auntie to talk to him too.

The desire to be served by someone from the community was not lost on mortgage brokers, who during this time period actively created the impression that they were part of the community to help promote their business. Strategies ranged from relying on customer referrals to generate new business, to frequenting local churches, social gatherings, and businesses and by adopting local social conventions.

For example, in Stockton, more than half of respondents said that they found their lender/broker through the recommendation of the real estate agent or developer selling the house. Unlike in Oakland, where more of the connections were based on recommendations from family members and friends, in Stockton about half of the respondents found their broker through the open house process. Yet the importance of creating the impression that the broker was sympathetic to the borrower came through just as strongly. The interviews pointed to how the respondents felt immediately connected to these brokers, "he understood my situation", "he told me that he understands how difficult the paperwork is, especially when you have lots of jobs," "I liked his ideas for how to brighten the kitchen," "she seemed to understand why we wanted to move from SF, buy a house, provide for a yard for the kids, a good school."

I picked up a brochure at the open house. The agent said he recommends this guy, always gets people into a house, a real "can do" guy.

[Translated from Spanish] We looked at the house, and you know, there was a nice guy there who spoke Spanish. Friendly. He said he's helped a lot of Latinos buy houses in the neighborhood. It was nice having someone there who spoke Spanish who could answer our questions. Made it feel like a place we'd like to live.

One respondent from Stockton, who decided to become a broker during the boom to supplement her family's income, explained the strategy this way:

I heard that the way to get a steady stream of clients was to develop a relationship with one of the developers, because they'd let you spend time at the home during open houses. It was really fun; the message was really positive, there were these beautiful, brand new houses and it was a

joy to tell folks coming through that it could be theirs. And it was really gratifying to help make it happen...they'd hug me and we'd all cry.

She indicated that it was important that the borrowers see her as a friend throughout the process, and still maintains contact with many of the families she helped to buy homes, including a few of her clients who have been foreclosed upon.

Interviewer: In retrospect, do you wish you had done anything differently with the borrowers?
No. I don't think so. I helped a lot of families buy beautiful homes, where they could raise their families. Some of them couldn't afford it. [That's life.]

In theory, mortgage brokers are well-placed to serve as a “bridging tie” and “trusted advisor”, since they have both experience with the lending process and access to information about mortgage products and prices. Empirical research studies, however, have revealed that during the subprime boom, yield spread premiums coupled with a push for a greater volume of loan originations provided a financial incentive for brokers to work against the interests of the borrower (e.g. Ernst, Bocia and Li 2008). In addition, since there was no statutory employer-employee relationship between lending institutions and brokers, there were few legal protections to ensure that brokers provide borrowers with fair and balanced information. This aligns with the “trust” that social relations engender. According to Granovetter, the link between social relations and trust can provide important reputational controls, and can keep opportunistic behavior in check. Yet he also admits that it can “provide occasion and means for malfeasance.”

In both Stockton and Oakland, respondents did not seem to be aware of the potential for perverse incentives on the part of brokers, and instead trusted them fully to act in their best interests. Figure 4 presents a summary of responses from those who used a broker to obtain their mortgage. For example, among respondents who used mortgage brokers, only a few reported that they had done any research on their own in regards to mortgage products and pricing, or that they had “shopped around” for a mortgage. Instead, most said that they took the mortgage broker’s information at face value, even when it conflicted with other advice received from family or friends.

He's the expert, right? I figured if he found me a loan that worked, that was the loan I should take.

I liked the fact he spoke Spanish, so I could understand what he was saying. He seemed very knowledgeable and committed to getting us a loan.

I was so relieved when she told me I qualified for the loan. I wasn't about to try again somewhere else. What if the terms changed while I was shopping around?

I didn't realize the implications of the loan terms. We were so focused on whether or not we could afford the monthly payments, and once that seemed to be worked out, I was ready to sign on the dotted line.

In addition, few borrowers reported having read the disclosures or mortgage documents at closing. This held true for borrowers who were delinquent on their mortgage as well as those who were comfortable with their choice of a home and their loan. A few interviewees said they “looked over the figures” or checked to see if the details were right, such as the address of the property and the spelling of the lien holder. But very few took the time to read them in detail, or to ask questions as they were signing the various forms. One common theme was that respondents did not feel comfortable reading the documents at closing, because “it felt like there was too much pressure to finish quickly,” “it’s too late,” and “I didn’t want to show how slow I read.”

I didn’t read them carefully. I just pretended to look over them and then asked for the pen.

Interviewer: Why didn’t you feel like you need to read the documents?

They were going to give me my keys. I wasn’t going to raise any kind of concern at that point.

The lack of attention to official documents held true for borrowers who used a mortgage broker and those who didn’t, although those who didn’t were more likely to report paying attention to at least the basics in the loan documents. These data support previous research which has shown that borrowers make decisions based on their trust in the loan originators and the recommendations of friends, rather than carefully reading and understanding their loan disclosures themselves (Lacko and Pappalardo 2007).

The quantitative data, however, shows that the decision to “trust” a broker often worked against the best financial interests of the borrower, especially for minority borrowers. Research has shown that regardless of their FICO score, Blacks and Hispanics were much more likely to receive a high-cost loan, especially when that loan was facilitated by a mortgage broker. This holds true even when we control for other factors, such as local housing and mortgage market conditions, fico score, and loan to value and debt to income ratio. Indeed, in a multivariate model that controls for the majority of underwriting variables, we find that origination by a mortgage broker has a large statistically significant effect on the likelihood of getting a high cost loan for certain borrowers, and that this effect is greater for Hispanics and Blacks. (Figure 5) The marginal effect of using a broker is 22 percent for Hispanics, and 18 percent for Blacks. While it may not seem like an extremely large effect, it is approximately equivalent to a 200 point decrease in a borrower’s FICO score. In contrast, white borrowers who used the services of a mortgage broker were 4 percent less likely to get a high cost loan, suggesting that in their case, on average, brokers helped them to navigate a better mortgage product based on their risk characteristics.

So, were these loans “sold” or “sought”? While certainly not conclusive, the interviews suggest both are true. First, mortgage brokers in Oakland and Stockton were specifically targeting their services to borrowers with lower FICO scores, and much of the marketing focused on reaching borrowers with poor credit records. (Figure 6) Second, borrowers with lower credit scores actively sought out mortgage brokers who they had heard would help them wade through the paperwork and get a mortgage approved. What was less clear from the interviews was whether or not brokers had intentionally duped borrowers into taking on irresponsible loan products. Out of the 80 interviews, 4 were with respondents—all persons of color—who had worked as a mortgage broker at some point during the

past five years. These interviews revealed that in general, the sentiment during the housing boom was that getting into a house—by any means necessary—was pervasive, and there wasn't much thought to the possible risks. For example, one respondent said he didn't think the yield spread premiums worked to the disadvantage of his clients, since they expected him to make money off the deal, and they were happy that he was in a position to help them buy a home.

I was making it possible for them to buy a home. I wasn't doing anything wrong. The bank told me what they would [accept in a loan application], and I saw my job as helping my clients access credit and achieve their goals.

In addition, very few of the respondents were willing to openly criticize their mortgage broker, even when they were in the process of renegotiating loan terms with their lenders. "The broker just sold me what the bank was offering. He couldn't change the terms."

The Housing Market Bubble: Shaping Social Norms

The third theme that emerges from the interviews is the role that the housing market bubble—and the prevailing sentiment that the goal was to buy a house at any cost—played in shaping borrowers' decisions. It is important not to discount the context of the housing boom in California between 2004 and 2006, and the extent to which the housing market became a local celebrity on par with the Giants and the Warriors. Everyone wanted to talk about their home-buying experience: how many times they had lost out on a house, how much they had to overbid to win, and wasn't it remarkable that a 2 bedroom, 1 bath bungalow sold for \$820,000. As one respondent shared, "It became a game; who could get the biggest house for the least upfront money." In Stockton and Oakland during the subprime boom, the conventional wisdom wasn't "live within your means" but rather "buy a house by any means." One couple in Oakland, who did end up going against the advice of their real estate agent and dropped out of a price war on a house, said "It was hard not to wonder if we were making a mistake, since so many of our friends were buying houses with little money down and at crazy terms. It was hard not to feel jealous, and just throw caution to the wind."

Over and over again, borrowers indicated that they felt pressure from their friends, family, brokers, and the media to purchase a house "now", or else they might miss the opportunity to become a homeowner in the future. "Everyone was telling me prices don't go down in California," "I just kept thinking that if I had bought in 2003, I would have doubled my money. My neighbor did. I didn't want to miss out," "the broker showed me how much it would cost if I waited six months to build some savings. I'd never be able to save as much as the house prices were going up."

A friend told me that it's a good idea to research different mortgage interest rates, but the broker said that if I didn't decide right away, I'd probably lose my chance...other friends had lost out in the market, and I really really loved this house.

It was so hard to know what to do. We needed to come up with an extra \$20,000 to cover our expenses while my husband was out of work, and we were getting calls on our credit card bills. So you've got the other credit card at 18 percent interest, and then there's this broker telling you that you can refinance and pay yourself back, plus the interest is just 5 or 6 percent, and it just sounded like a good idea...with house prices going up the way they were, we felt pretty confident we'd be in better financial shape in a couple of years.

In interviews with Latino and African American respondents, this theme was also closely tied to responses that brought up past barriers to homeownership and the link between identity and becoming a homeowner. Past research has documented that homeownership conveys high social status in American society and owning a home serves as a symbol of status and success (Cooper, 1976; Hubbard and Davis, 2002; Saunders, 1978, 1990; Rohe and Stegman 1994). For many of the respondents who had immigrated to America, becoming a homeowner was also tied to settling down in their adopted country.

It's hard for me to put this in words. [long pause] But I saw my family struggle, and we never owned anything before. I was being given a chance to change that, to achieve something that's always been out of reach. The idea that I'm going to lose this now...I really hope I can find a way to keep my home.

We bought three houses, one for us to live in, two to rent. I figured that when I got older I wouldn't have to work construction anymore. I could be the boss, and the income from the properties would be mine. We could live comfortably, pay for college for the kids. But once the market dropped and I lost my job...it's a big step back.

While it is easy in hindsight to see the mistakes that borrowers made in these situations, and to assume that better financial knowledge or tightened credit standards could have avoided the large number of borrowers who ended up in loans they couldn't afford. But it is hard to correctly value a financial decision when the majority of social cues are pointing in one direction. As Granovetter has argued, what looks like non-rational behavior may be more reasonable when the social context of the decision is fully appreciated, including how that behavior not only aims at economic goals, but also at social status or acceptance (Granovetter 1985, p. 506).

Conclusion

Through interviews with homeowners in two cities in California—Oakland and Stockton—this paper has revealed the importance of local contextual factors in shaping the mortgage origination decision. Many consumers—especially those that have historically not had access to credit—were not well equipped to navigate all the information and institutions that are associated with the mortgage market.

If our goal is to continue to provide access to credit to underserved borrowers, multiple interventions are necessary to ensure that this credit helps to build assets rather than strip them. At the borrower level, there is certainly more room for financial education and counseling that can improve mortgage

outcomes. While some of this should include standard homeownership counseling curricula, it seems that consumers might also be well served by a better understanding of the political economy of the mortgage market. In most aspects of the home-buying transaction, incentives are not aligned in the interest of the borrower. The borrower's real estate agent earns more if the house sells for more rather than less; the mortgage broker earns more if the loan is priced above par. Being aware of incentive structures can help borrowers be more aware of the context of the advice they are receiving, and may encourage them to do their own research on mortgage products and prices. The lack of borrower attention to disclosures—coupled with the fact that very few borrowers shopped around for different rates or products—also suggest that the current practice of consumer protection through complicated disclosures deserves to be rethought.

Certainly, leveling the regulatory playing field is also critical: had it not been for poor and uneven regulation of independent mortgage companies and federally regulated lenders, mortgage brokers would not have been allowed to sell such unsustainable mortgage products, nor get away with such poorly underwritten loans. Consumer protection will also entail developing a better understanding of anti-predatory lending laws (to ensure broad protections without unduly limiting or raising the cost of credit), and ensuring that those laws are enforced at both the state and federal level. While the research here shows that mortgage brokers played an important role in shaping consumer decisions about their mortgage, more research is needed to understand the links between regulations and licensing requirements, mortgage broker originations, and loan performance.

While protecting consumers from predatory lending may be an important first step, what is less clear is how to ensure equal and fair access to affordable credit, especially when local context so fundamentally shapes how borrowers learn about and obtain a mortgage. In other words, rather than just protecting consumers from “bad loans”, how do we help consumers—especially those who have historically been denied credit—access “good loans.” One option could be to “best the brokers at their own game,” and develop a better system of third-party intermediaries that can operate at a larger scale than most nonprofits, and that can help to bridge individuals and communities with financial markets. Community development financial institutions (CDFIs), for example, already serve that function in some neighborhoods; the combination of responsible loan products and financial education have led to very positive outcomes, even among borrowers with subprime credit profiles (Ding et al. 2008). Providing CDFIs with additional capital to play an expanded role in mortgage lending and reach more borrowers could be one way to create a network of local intermediaries who could respond to local conditions and social processes (e.g., developing different interventions in communities comprised largely of immigrants than in communities with historically African American residents). Alternatively, it might entail expanding and strengthening the CRA in a way that encourages banks and other financial services institutions to reach out to underserved areas in new ways, and that emphasizes the community aspect of lending even as the officially defined assessment area becomes obsolete. While of these options would entail public costs, these costs seem to be justified when weighed against the very real price we are paying as a result of the existing dual mortgage market.

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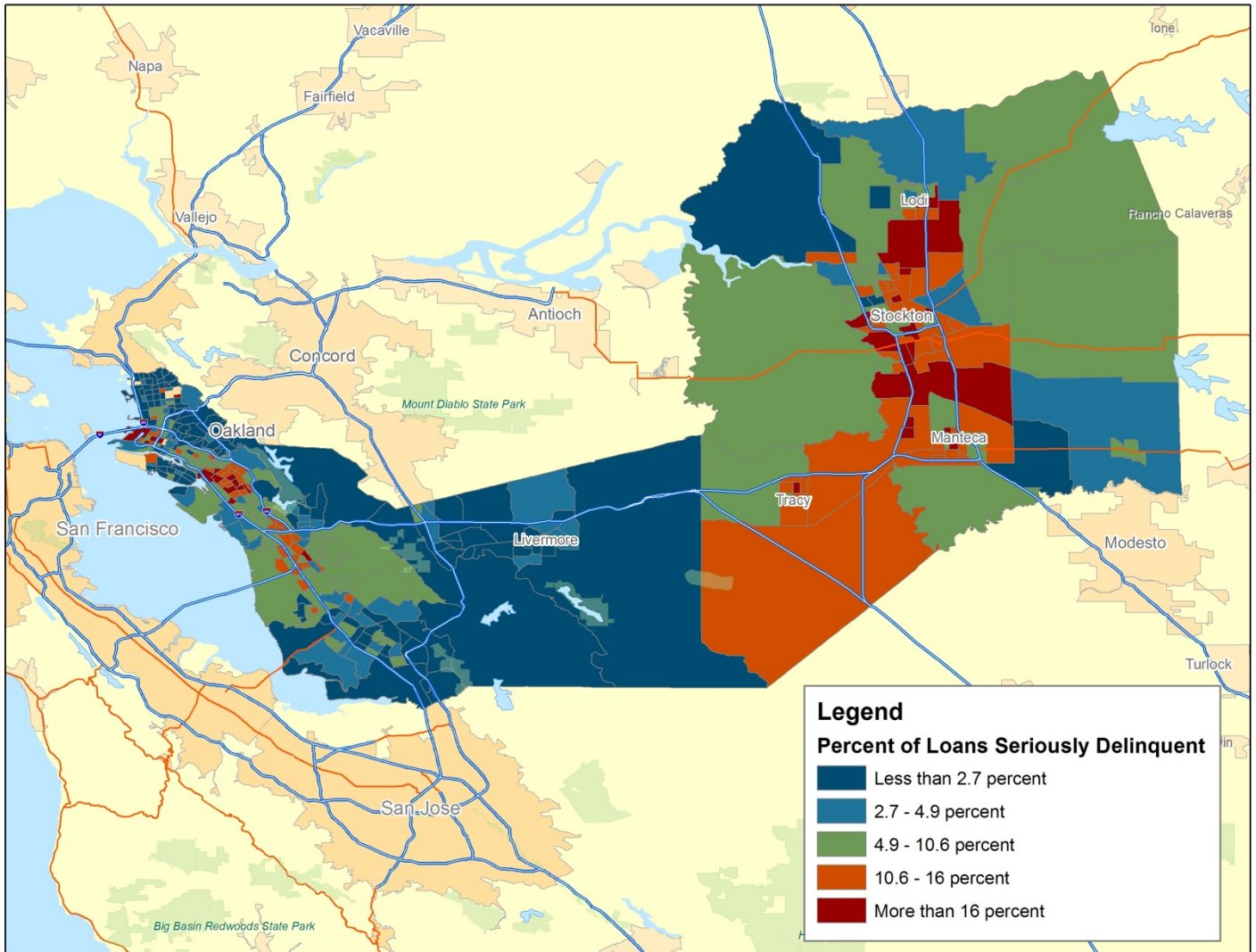


Figure 1: Distribution of Foreclosures in Oakland and in Stockton

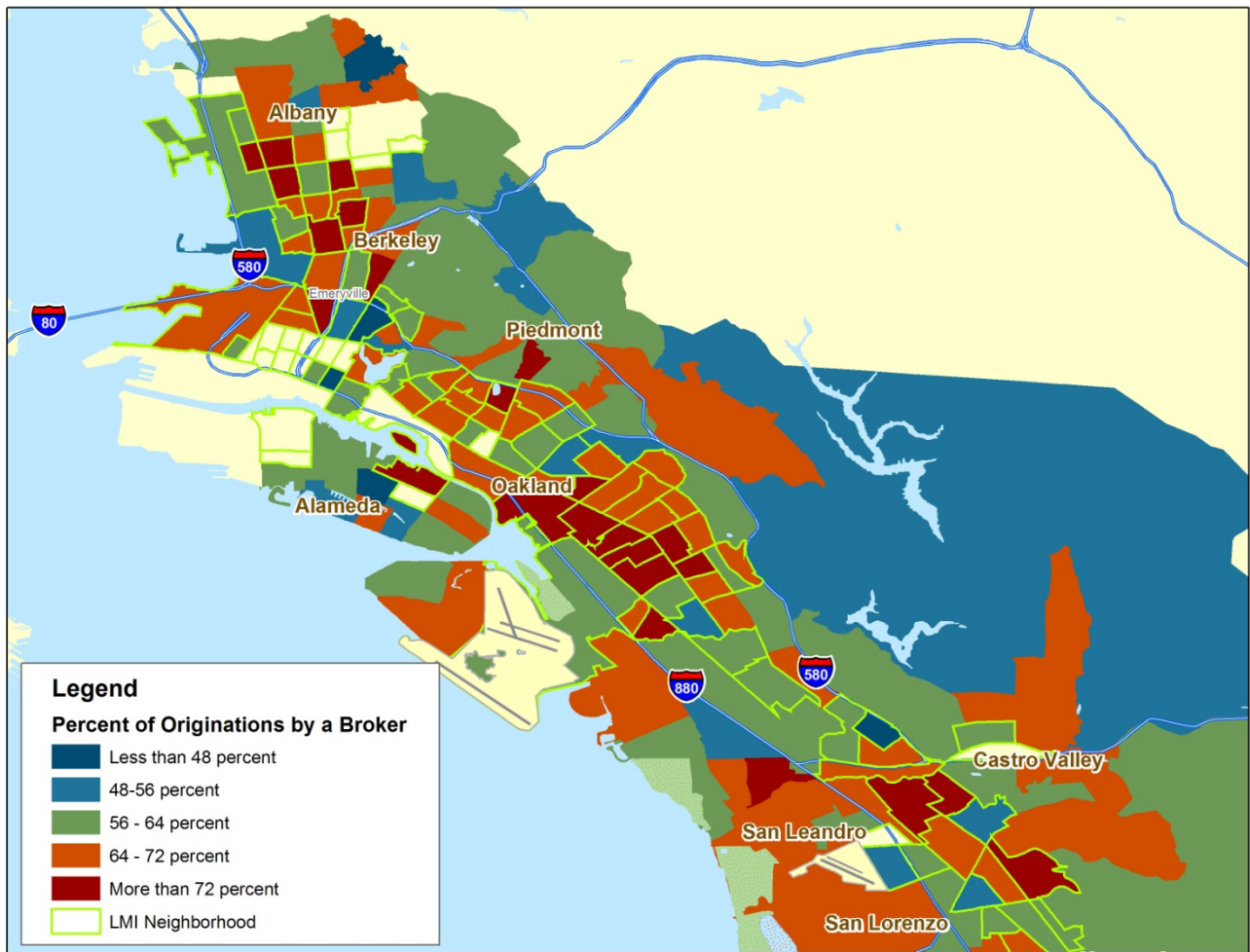


Figure 2: Mortgage Broker Originations in Oakland, CA during Subprime Boom

Table 1: Descriptive Statistics for Interview Sample

	Oakland	Stockton
Number of Interviews	47	33
Number of Neighborhood Blocks	14	9
Maximum Number of Interviews per Block	8	7
Minimum Number of Interviews per Block	2	1
Non-Hispanic White	5	9
Hispanic/Latino	15	12
African American	17	5
Asian		
Filipino	2	0
Vietnamese/Hmong	2	0
Indian	0	5
Other	2	2
African	4	0
Household Income Below \$60,000	14	2
Household Income Between \$60,000 and \$120,000	27	24
Household Income Above \$120,000	6	7
Bought House Before 2003	5	2
Bought House in 2004 or later	31	23
Refinanced House in 2004 or later	11	8
Used a Mortgage Broker	33	24
Went into a "bank branch" to apply for their mortgage	6	3
Worked with a nonprofit		
Pre-purchase	4	0
Post-purchase (e.g. foreclosure mitigation)	11	9
In Distress (Missed 1 or more mortgage payments)	13	3
In Foreclosure Process	16	13

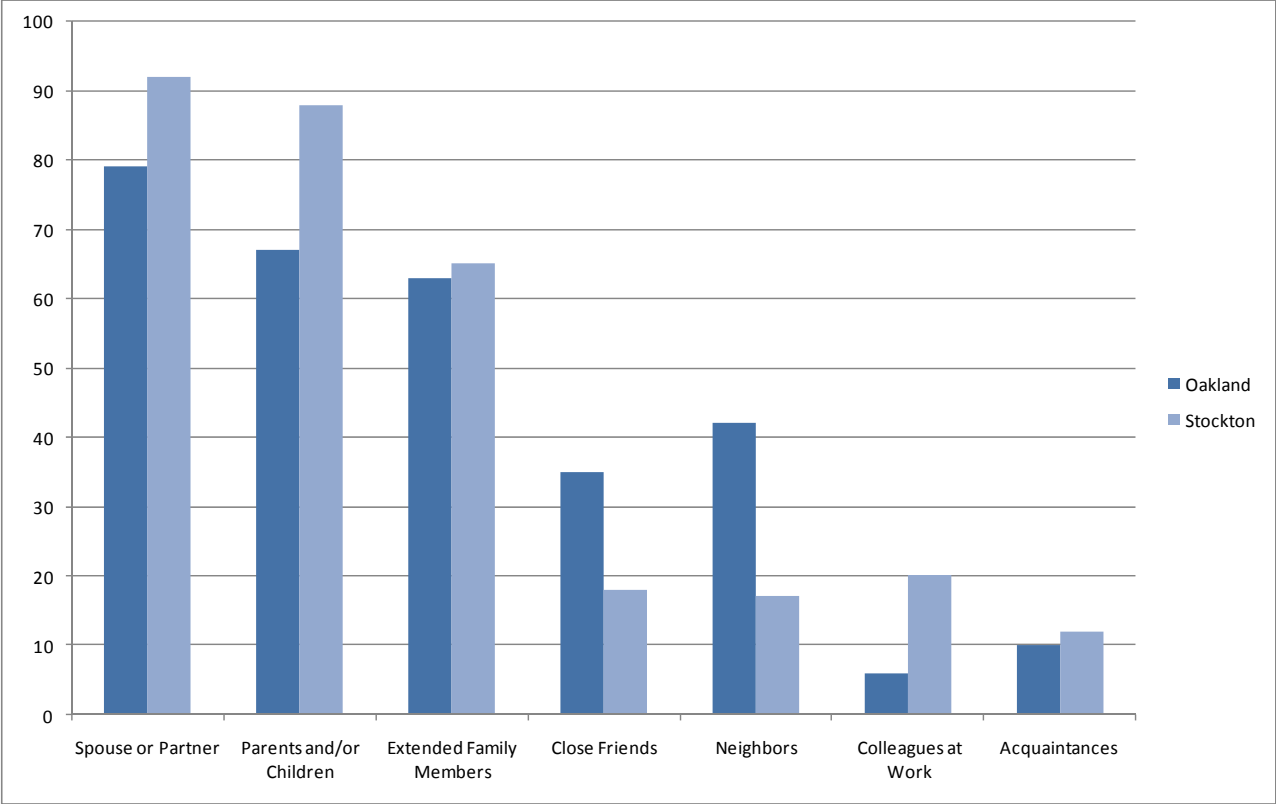


Figure 3: Sources of Information about the Mortgage Process

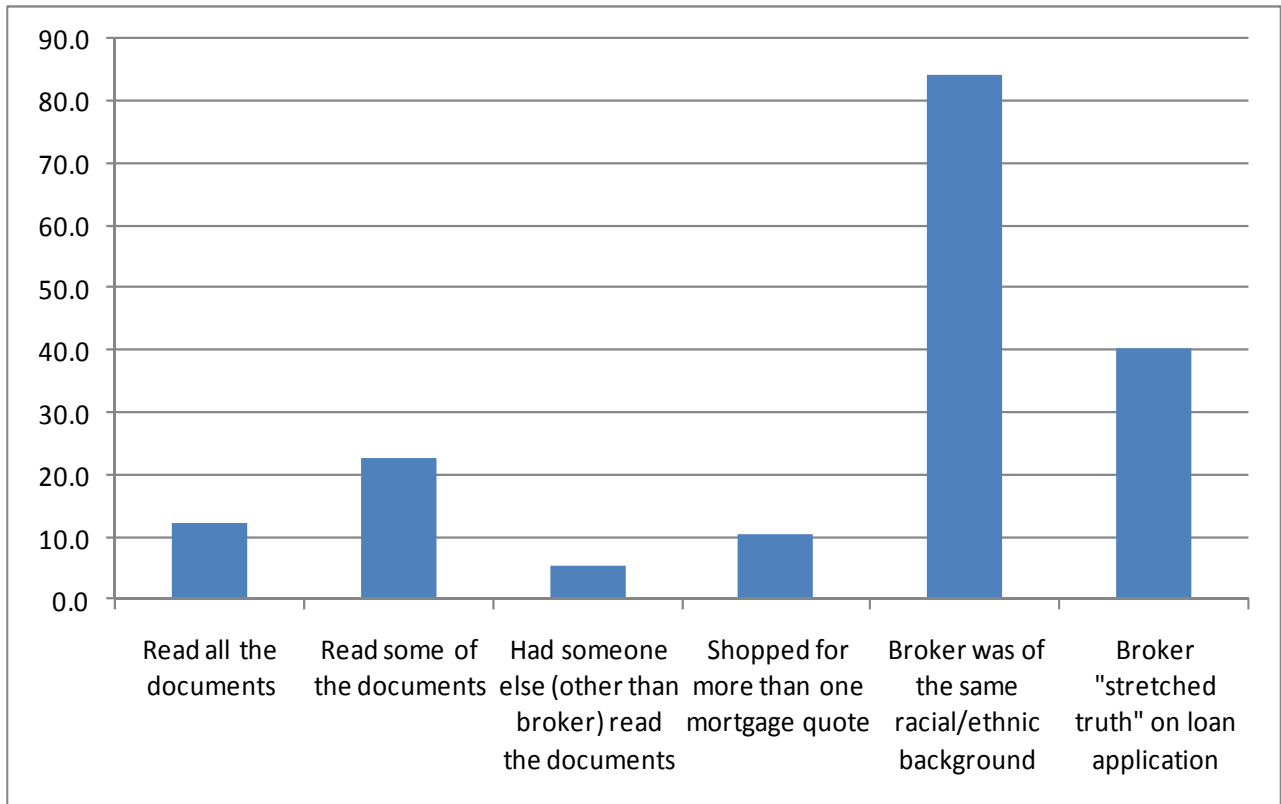


Figure 4: Mortgage Choices of Borrowers who Used a Broker to Originate their Mortgage

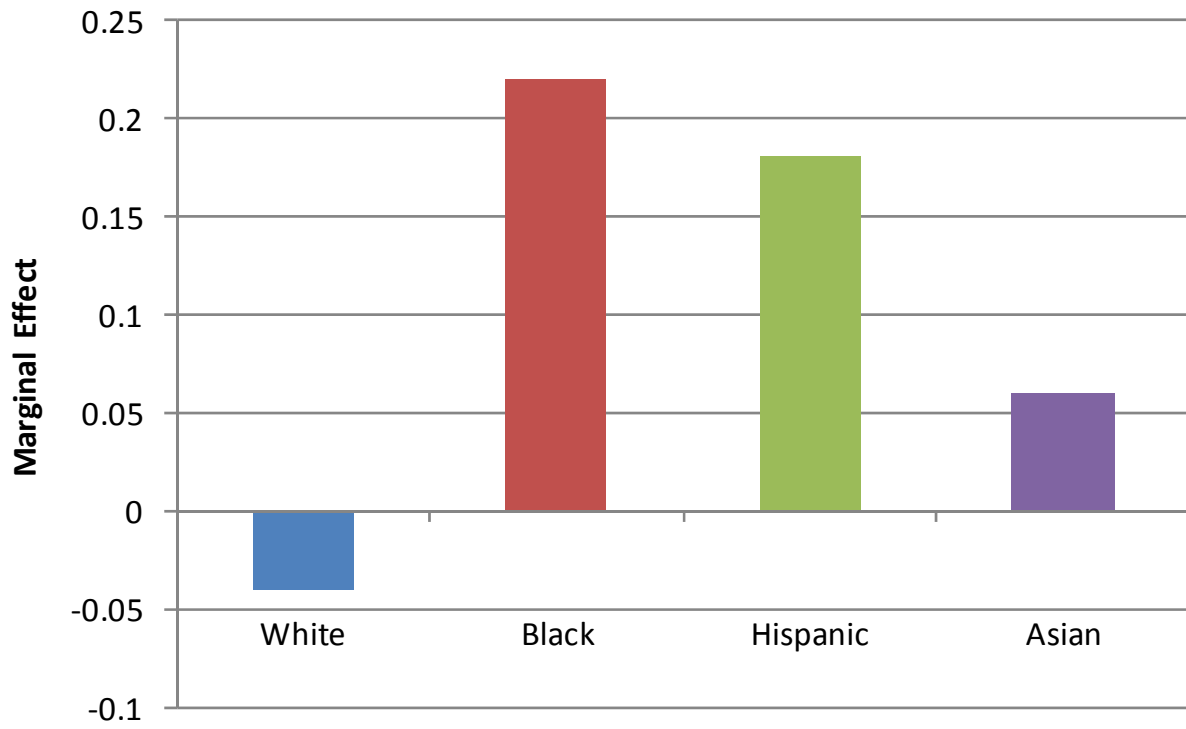
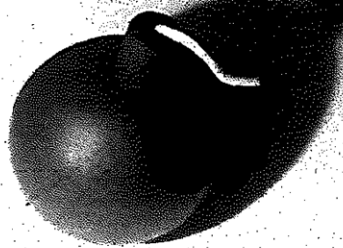


Figure 5: Marginal Effect of Using a Mortgage Broker on the Likelihood of Receiving a Subprime Loan



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Figure 6: Examples of Advertising from the Oakland Tribute and Stockton Record