Increasing homeownership among low-income and minority communities is a major goal of housing policy at national, state, and local levels. In particular, policies intended to open up mortgage markets to underserved populations have helped to increase homeownership in neighborhoods that previously had little access to financial resources. Although policy makers and community leaders applaud gains in homeownership, the high rate of subprime lending in low-income and minority neighborhoods threatens to undo hard-won gains. The high cost of subprime loans may put many families in financial jeopardy and increase the risk of foreclosure. Foreclosures in turn threaten the viability of entire neighborhoods, as the increase in vacant homes lowers property values, encourages crime, and discourages business development.

This article reports on a study to determine the prevalence of subprime lending in Hennepin and Ramsey Counties, and the potential links between subprime lending and foreclosure. The project was supported by grants from CURA’s Faculty Interactive Research Program and the Saint Paul Foundation’s Pan-African Community Endowment Fund. The foreclosure data on which the study is based were collected jointly with the Federal Reserve Bank of Minneapolis.

The first section of this article provides a brief overview of subprime lending, including the economic impacts and geographic distribution patterns associated with subprime loans. The second section describes the data and methodology used for this study of subprime lending in Ramsey and Hennepin Counties. The third section describes the findings of the study, including the relationship between subprime lending and foreclosures. The final section offers public policy recommendations for addressing some of the problems associated with subprime lending.

Subprime Lending and Homeownership: American Dream or Nightmare?

What Is Subprime Lending? To understand subprime lending in Hennepin and Ramsey Counties, an operational definition is needed. The first point is that subprime loans are more expensive than those obtained in the prime market. Subprime loans generally have higher rates of interest, smaller loan amounts, and greater origination costs. The second point is that the subprime lending market is associated with certain “predatory” practices that are not justified by an applicant’s lack of credit-worthiness. According to Deborah Goldstein, author of Understanding Predatory Lending, predatory loans are usually distinguished from subprime loans by the sales practices of the lenders. Predatory lending is characterized by sales practices that mislead borrowers by withholding information or purposefully hiding the costs associated with a loan, and selling loans that the lender knows the borrower will not be able to pay back. Although we know that predatory lending exists, there is little information about how prevalent the practices are.

It is important to recognize that it is not easy to distinguish between a subprime loan and predatory lending. Not all subprime loans are predatory, but some are. What is known is that for borrowers with predatory loans, the financial burdens can be heavy.

The Costs of Subprime Lending.

Subprime lending expanded rapidly during the 1990s, growing from $35 billion in 1994 to $160 billion in...
1999. Subprime lenders often charge high interest rates, and a subset of lenders may practice predatory and unscrupulous business practices such as loan flipping, excessive fees and charges, lending without regard to the borrower’s ability to repay, and various forms of home improvement fraud and abuse. According to a 2001 report published by the Coalition for Responsible Lending titled *Quantifying the Economic Cost of Predatory Lending*, such practices cost American consumers roughly $9.1 billion a year. Because approximately 50% of those borrowing in the subprime market could qualify for a prime loan, the cost to consumers is not easily justified.

The costs of subprime loans can be considerable because the higher interest rates typical of subprime loans add a substantial amount to the price of a home. For example, at an interest rate of 5%, the total interest on a 30-year fixed-rate mortgage would be $153,198. By comparison, if the same loan were obtained at a higher interest rate of 7%, an additional $81,519 in interest would be paid over the course of the 30-year loan for a total of $234,717. (It should be noted that these figures are for the purpose of comparison only.) Furthermore, higher interest rates are only one of the expenses associated with subprime lending. Subprime lenders also charge consumers loan initiation fees, credit insurance premiums, and prepayment penalties.

An example of how these charges can increase the cost of a loan was documented by the Minnesota Attorney General’s Office in the 1998 case *State of Minnesota v. First Alliance Mortgage Company* (Court File No. C9-98-11416). Evidence introduced during the trial indicated that Ramsey County borrowers paid First Alliance Mortgage Company origination fees that were 18% of the total loan amount, and total loan fees that comprised an average of 23.3% of home equity. To put this in concrete terms, for a homeowner with $100,000 in equity, the total loan fees would be $23,300.

**The Geography of Subprime Lending.** A 2000 report by the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury, *Curbing Predatory Home Mortgage Lending*, found that relatively high numbers of subprime loans are found in low-income and minority neighborhoods. Instead of promoting the financial independence symbolized by homeownership, some subprime lenders use sophisticated marketing techniques that may undermine the financial health of many homeowners by stripping them of their home equity. As the report notes, “an unscrupulous subset of... lenders... engage in abusive lending practices that strip borrower’s home equity and place them at increased risk of foreclosures... Predatory lending has contributed to the rapid growth in foreclosures in many inner-city neighborhoods and foreclosures can destabilize families and entire neighborhoods” (p. 13).

From the perspective of lenders, subprime loans play an important role in providing individuals with less-than-perfect credit records with the funds needed to purchase a home. According to the mortgage industry, the costs associated with subprime loans simply reflect the greater risk associated with borrowers with low incomes, high debt loads, or blemished credit records. This explanation might lead one to conclude that the spatial pattern of subprime lending mainly reflects the individual characteristics of borrowers, and is not the result of targeting by subprime firms.

In contrast to the explanations put forth by the subprime mortgage industry, critics argue that subprime lenders target vulnerable low-income and minority communities. From this perspective, subprime lenders target neighborhoods that are historically underserved by conventional lenders; neighborhoods that are populated by minorities who have suffered from systematic discrimination in the mortgage market and who may be reluctant to approach depository banks or savings and loan institutions; and neighborhoods with aging housing stock that is in need of repair (i.e., places where home improvement loans are easily marketed).

**Data and Methodology**

The data used here to describe and analyze the spatial distribution of subprime lending in Hennepin and Ramsey Counties come from publicly available information contained in the Home Mortgage Disclosure Act (HMDA) dataset for the years 1996 to 2002. The HMDA data used include individual and census-tract information on all the loan applications for home purchases, home improvements, and refinancing loans for Hennepin and Ramsey Counties.

Although it is the most comprehensive publicly available data, HMDA data present some real challenges. The most significant concern is that subprime loans are not explicitly identified in the HMDA data. Therefore, to identify which loans are subprime, I used the list of subprime lenders that the U.S. Department of Housing and Urban Development (HUD) issues yearly to categorize each loan in the HMDA data set. An important limitation to this method of identifying subprime loans is that if HUD classifies a lender as subprime, then all loans from that lender were categorized as subprime loans for the purpose of this study. The reverse is true of lenders HUD classifies as prime; all their loans were placed into the prime loans category. Although this is an important limitation of the HMDA data set, this methodology is employed in nearly all studies of subprime lending. To address this limitation, the most recent HMDA data include the interest rate for the loan; unfortunately, these data sets were not available at the time of this study.

A second concern with the HMDA information is the increased incidence of missing data pertaining to the racial and ethnic identity of applicants. A study in the April 2002 issue of the journal *Economic Geography* titled “The Disappearance of Race in Mortgage Lending” found that racial information is most likely to be missing for African American applicants. What this means in practice is that the analysis presented here likely underestimates the prevalence of subprime lending in African American neighborhoods.

To understand the spatial distribution of foreclosures and analyze the relationship between subprime lending and foreclosure, the address, lender, and date of sale for each foreclosure was collected from publicly available sheriff’s records. To the best of my knowledge, all foreclosure sales that occurred in Hennepin and Ramsey Counties in 2002 were included in this analysis. To help accomplish the time-consuming task of gathering these data, I entered into an informal data-sharing agreement with investigators at the Federal Reserve Bank of Minneapolis. Because researchers at the Federal Reserve Bank were collecting foreclosure data for Ramsey County, rather than duplicating their efforts, it was agreed that I would compile the information for Hennepin County and combine it with the Ramsey County data the Federal Reserve Bank researchers collected.
Subprime Lending and Foreclosures in Ramsey and Hennepin Counties, 1996–2002

This section presents an analysis of subprime lending and foreclosures in Ramsey and Hennepin Counties. I analyze subprime lending in these counties from 1996 to 2002, as well as the spatial distribution of subprime loans and foreclosures in these counties. The section concludes with a discussion of the relationship between subprime lending and foreclosure in Ramsey and Hennepin Counties.

Subprime Loan Applications and Originations, 1996–2002. Between 1996 and 2002, housing markets in Hennepin and Ramsey Counties were very active. Of the 1.2 million loan applications made in Hennepin and Ramsey Counties between 1996 and 2002, more than one-fifth (21.4%) were to lenders that HUD classified as subprime.

From 1996 to 2002, there were a total of 587,852 loan originations (Table 1). Subprime loans comprised 7.1% (41,541) of the total. In comparison to the prime mortgage market, a smaller proportion of subprime loans were actually originated (Figure 1). Whereas nearly two-thirds (63.3%) of prime loans were originated, less than one-quarter (22.7%) of subprime loans were actually originated.

Loan denial rates were much greater for subprime applicants. More than one-fourth of subprime applicants were denied loans, compared to 10% of prime applicants. Because the subprime market is said to include many less credit-worthy applicants, it would stand to reason that denials would be higher. One finding that is intriguing is that more than 25% of the subprime loan applications were withdrawn by borrowers themselves, compared to just 4.3% among prime originations. It is possible that education programs currently under way in Hennepin and Ramsey Counties may have convinced some borrowers to withdraw their subprime loan applications. Another potential explanation is that the high cost associated with such loans led to applicants withdrawing their loan applications.

Subprime Lending and Race. Nearly one-half (53.0%) of subprime loan originations went to White borrowers, and subprime loans accounted for 4.9% of all mortgages received by Whites between 1996 and 2002 (Table 1). These figures indicate that although Whites account for the largest absolute number of subprime loan originations, the vast majority of Whites receive prime loans, with their concomitant lower costs.

The relative balance between prime and subprime loans is different for Latinos and African Americans. For example, Latinos receive 1.5% of all prime loans and 2.0% of subprime loans. The results indicate that slightly less than 10% of all home loans originated for Latinos were from subprime lenders.

Table 1. Mortgage Loan Originations in Ramsey and Hennepin Counties by Race/Ethnicity, 1996 to 2002

<table>
<thead>
<tr>
<th>Race/Ethnicity</th>
<th>Percentage of all prime loans originated</th>
<th>Percentage of all subprime loans originated</th>
<th>Percentage of all loans originated</th>
<th>Percentage of loans that are subprime</th>
<th>Likelihood of receiving a subprime loan*</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Indian</td>
<td>0.3% (1,831)</td>
<td>0.8% (332)</td>
<td>0.4% (2,163)</td>
<td>15.3%</td>
<td>22%</td>
</tr>
<tr>
<td>Asian/Pacific Islander</td>
<td>3.1% (16,789)</td>
<td>2.4% (991)</td>
<td>3.0% (17,780)</td>
<td>5.6%</td>
<td>8%</td>
</tr>
<tr>
<td>African American</td>
<td>2.5% (13,498)</td>
<td>11.3% (4,697)</td>
<td>3.1% (18,195)</td>
<td>25.8%</td>
<td>34%</td>
</tr>
<tr>
<td>Latino</td>
<td>1.5% (8,188)</td>
<td>2.0% (842)</td>
<td>1.5% (9,030)</td>
<td>9.3%</td>
<td>13%</td>
</tr>
<tr>
<td>White</td>
<td>78.2% (424,434)</td>
<td>53.0% (22,008)</td>
<td>76.5% (449,442)</td>
<td>4.9%</td>
<td>10%</td>
</tr>
<tr>
<td>Other</td>
<td>1.1% (5,839)</td>
<td>1.1% (464)</td>
<td>1.1% (6,303)</td>
<td>7.4%</td>
<td>—</td>
</tr>
<tr>
<td>Information not provided</td>
<td>12.7% (69,235)</td>
<td>29.2% (12,117)</td>
<td>13.8% (81,352)</td>
<td>14.9%</td>
<td>—</td>
</tr>
<tr>
<td>Not applicable</td>
<td>0.6% (3,497)</td>
<td>0.2% (90)</td>
<td>0.6% (3,587)</td>
<td>2.5%</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>92.9% (543,311)</td>
<td>7.1% (41,541)</td>
<td>100% (587,852)</td>
<td>7.1%</td>
<td>—</td>
</tr>
</tbody>
</table>

Source: Author’s calculations from Home Mortgage Disclosure Act data set, 1997–2003

*The likelihood of receiving a subprime loan was calculated with income held constant.
The highest proportion of subprime loan originations is found among African American borrowers. Between 1996 and 2002, African Americans obtained 2.5% of all prime mortgages. At the same time, they received 11.3% of all subprime loans. Because of the high proportion of subprime loans in the African American community, more than one-fourth (25.8%) of all mortgages originated for African Americans were subprime. The rate of subprime lending among African Americans is 3.6 times the overall rate for Hennepin and Ramsey Counties during the period 1996 to 2002.

To further substantiate these findings, additional statistical analyses were used. In this case, logistic regression analysis was employed to calculate the likelihood that an individual would receive a subprime loan. One advantage of this technique is that it is possible to hold certain factors constant. In this case, I held income constant, meaning the analysis eliminated the effects of income on the likelihood of obtaining a subprime loan. The results of the logistic regression analysis are illuminating. The statistical analysis indicates that African Americans have a 34% likelihood, regardless of income, of receiving a subprime loan (Table 1). This is 3.4 times greater than the likelihood that a White resident of Hennepin or Ramsey County will receive a subprime mortgage.

The Geography of Subprime Lending in Ramsey and Hennepin Counties, 1996–2002. To analyze the geography of subprime lending in Hennepin and Ramsey Counties, maps at the census tract level were compiled for each year from 1996 to 2002. Because there was very little year-to-year variation in the geographic distribution of subprime loans, the distribution map for 2002 (Figure 2) is used here to illustrate the spatial patterns of loans.

Given the foregoing analysis—which shows that a large number of subprime loans are going to African Americans—as well as the segregated nature of housing in Hennepin and Ramsey Counties, it is no surprise that relatively high proportions of subprime loans are found in neighborhoods where significant numbers of African Americans live.

For Hennepin County, which encompasses the city of Minneapolis, subprime loan concentrations are clearly evident in Figure 2. Both north and south Minneapolis have large African American populations. In every census tract in north Minneapolis, more than 10% of all home loans fall into the subprime category. A similar pattern is evident in south Minneapolis.

The association of subprime lending with minority neighborhoods is apparent in St. Paul as well. Here, the predominantly minority Latino West Side, which lies across the Mississippi River from downtown St. Paul, and the ethnically diverse Frogtown neighborhood, which is just northwest of the State Capitol, exhibit relatively large numbers of subprime loans. Clusters

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of subprime loans are also found in predominantly minority census tracts of St. Paul; particularly in the area between University and Lexington Avenues and on the mainly Hispanic west side.

The results of this spatial analysis indicate that subprime loans in Hennepin and Ramsey Counties are concentrated in African American and Latino communities. Therefore, it is reasonable to expect that problems often associated with subprime lending, namely foreclosure, should also be concentrated in these neighborhoods.

Subprime Lending and Foreclosures in Ramsey and Hennepin Counties, 2002. An examination of the spatial pattern of foreclosures in 2002 reveals a striking cluster of foreclosures in north Minneapolis, and a lesser grouping in south Minneapolis (Figure 3). Although patterns in St. Paul are not as obvious, there still appears to be a high correlation between areas in the city with high concentrations of subprime lending and the locations of foreclosures.

Overlaying the locations of foreclosures on the map showing concentrations of subprime lending (Figure 4) bolsters the conclusion that there is a relationship between subprime lending and foreclosure. Foreclosures are found predominantly in minority neighborhoods. In particular, north Minneapolis has a large number of foreclosures. To further examine the link between foreclosure and subprime lending, the HUD list of subprime lenders for the period 1996 to 2002 was compared to the list of mortgage holders on foreclosed properties in Hennepin and Ramsey Counties in 2002. Of the 1,290 foreclosures, 505 of the properties had mortgages held by subprime lenders. Although subprime lenders account for only 7.1% of all home mortgages, borrowers with subprime loans account for 40% of all foreclosures.

Conclusion
This article has presented the results of an analysis of subprime lending and foreclosure in Hennepin and Ramsey Counties. The findings indicate that African Americans, in comparison to other racial groups, are more likely to have a subprime loan. Latinos also have a relatively high level of subprime mortgages. Because race and neighborhood are highly correlated in Hennepin and Ramsey Counties, high proportions of subprime loans are found in Latino and African American neighborhoods.
Lenders, homeowners, public policy makers, and community activists all have a common interest in preventing foreclosure.

It is important that policy makers continue to extend the opportunities associated with homeownership to traditionally underserved communities. To withdraw from efforts intended to promote homeownership among minorities would be a significant step backward, and would only lead to the exacerbation of urban problems such as crime and poverty. Although subprime lending has opened the doors of homeownership to some, predatory abuses associated with subprime lending may ultimately threaten the policy goal of increasing homeownership.

There are two potential solutions to the challenges associated with subprime lending. First, consumers need to be educated about subprime lending. Currently active efforts are under way through the “Don’t Borrow Trouble” campaign to educate home buyers about the risks associated with subprime lending.

Regulation is another way to address the challenges associated with subprime lending. Several states, notably North Carolina, have passed laws that regulate aspects of the home mortgage industry. Nationally respected organizations such as the American Association of Retired Persons (AARP) support consumer protection legislation. However, there is widespread opposition to regulation of the subprime lending industry in some sectors, and the federal government has recently promulgated regulations that override local and state laws.

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