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David Listokin & Elvin K. Wyly

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Making New Mortgage Markets: Case Studies of Institutions, Home Buyers, and Communities

David Listokin and Elvin K. Wyly
Rutgers University

Abstract

America's housing and mortgage markets are undergoing a dramatic transformation, as urban reinvestment and attempts to tap underserved markets of new homeowners alter historical processes of redlining and discrimination. This article synthesizes findings from case studies of private lenders, lender consortia, and nonprofit community organizations that are active in underserved markets and analyzes the strategies these organizations use to attract and qualify mortgage applicants and retain new homeowners.

The case studies reveal a diverse array of strategies designed to address market imperfections related to information, discrimination, and household financial characteristics. Although these strategies expand homeownership opportunities, challenges remain. They reflect inherent tensions between the industry trend toward standardized, efficient business practices and the customized, often expensive programs needed to address the multiple obstacles to homeownership and community development faced by underserved households and communities. They also reflect the historically unequal distribution of risks and rewards in America's central socioeconomic institution—homeownership.

Keywords: Homeownership; Mortgages; Underserved

Introduction

America's housing and mortgage markets are in the midst of a dramatic transformation. After generations of discrimination and disinvestment, low-income and minority borrowers and neighborhoods now represent growth potential for homeownership and mortgage lending. In a movement that seems to reconcile socioeconomic equity with the imperatives of profitability in a competitive and turbulent industry, mortgage lending has emerged as the key to revitalizing the inner city, opening access to suburban housing markets, and promoting the accumulation of household wealth. Housing policy is now a race to tap new markets for homeownership by reaching traditionally underserved populations of racial and ethnic minorities, recent immigrants, American Indians, and low- to moderate-income (LMI) households.

This article, building on a 1998 investigation funded by the U.S. Department of Housing and Urban Development (Listokin et al. 1998), examines illustrative lending and other strategies used by a cross section of leaders to foster homeownership among traditionally underserved populations. The case studies encompass diverse institutions, including private banks and mortgage lenders, lending consortia, and nonprofit community organizations. Lending industry regulators and other sources recognize those institutions as among the leaders in the effort to expand homeownership opportunities.

We use a qualitative approach to synthesize the efforts of case study participants. We thus refrain from terming these strategies *best practices* because our research provides too few cases and has other limitations that inhibit the identification of "best" or "exemplary" actions according to generally accepted social science methodologies. Instead, we term the efforts *illustrative strategies* because they reflect the wide variety of interventions that have evolved in response to changes in America's housing and mortgage markets and in response to the different city, institution, client group, and other contextual factors faced by the different case study institutions.

These illustrative strategies provide useful documentation of the scope and diversity of efforts to expand homeownership opportunities at a critical juncture in the development of the U.S. housing finance system. Numerous, diverse strategies include activities to attract and qualify applicants and to retain successful homeowners. At their core, however, the strategies encompass a broad central notion of how to reach traditionally underserved markets by "developing an intimate knowledge of the target clientele and their housing and lending needs and finding a way to match their needs with services within the agency's resource and legal, financial, and institutional constraints."[1] Efforts to meet the needs of traditionally underserved populations are challenging because they attempt to address a broad range of financial, discriminatory, cultural, and other barriers historically confronting such populations. Adding to that challenge is the tension between a contemporary lending industry that emphasizes efficient, standardized procedures and the labor-intensive, customized interventions required to reach the underserved.

The analysis and findings are presented in seven sections. We begin with a brief history of the current movement to tap new markets for homeownership, followed by a discussion of the theoretical framework used to organize the results of the case studies. We then turn to the illustrative strategies used by the case study institutions, with separate sections on (1) institutional management, (2) attracting applicants, (3) qualifying applicants, and (4) retaining new homeowners. In the concluding section, we discuss the accomplishments, potential, and limitations of housing finance as a policy instrument for promoting household opportunity and community development.

[1] We are indebted to George McCarthy for his insightful depiction of this theme in an unpublished letter.

Background: A generation of change in housing finance

From "redlining" to "reinvestment" to "underserved markets"[2]

America's housing finance system has undergone a sweeping transformation over the past generation. Economic restructuring, community activism, and policy measures have intersected in complex but distinct ways in each of the past three decades. In the 1970s, the dislocations of deindustrialization and "stagflation" devastated housing market activity, while discrimination against minority and low-income urban neighborhoods remained widespread, severe, and often blatant. A diverse and vibrant community reinvestment movement with roots in the civil rights and community-organizing movements responded with aggressive efforts to document and challenge blockbusting, disinvestment, and redlining (Squires 1992). Local and regional activism broadened to a national movement, culminating in the passage of the Home Mortgage Disclosure Act (HMDA) of 1975 and the Community Reinvestment Act (CRA) of 1977.

By the 1980s, housing markets had experienced some revival, but several problems as well.[3] For instance, the overall homeownership rate slipped from 64.6 percent in 1983 to 63.9 percent in 1985. Also, evidence from HMDA and other sources continued to show lingering racial and geographic disparities in mortgage lending. Research and community activism surrounding Dedman's (1988) Pulitzer Prize–winning "Color of Money" study of redlining in Atlanta led to provisions strengthening HMDA as part of the S&L legislation of 1989 (see Vartanian et al. 1995). Those provisions generated new loan-level data on characteristics of mortgage applicants and the disposition of their applications, which in turn initiated a new wave of research.

The 1990s ushered in an era of growing complexity that has continued into 2000. The nation is enjoying its longest-running expansion in the context of extremely low inflation and low unemployment, and an expanding secondary mortgage market has reduced borrowing costs while allowing greater flexibility in underwriting. The nation has realized significant gains in homeownership since the mid-1990s and recently posted the highest homeownership rate ever recorded—66.8 percent in 1999 (table 1). Further, a subtle but widespread shift has become apparent among lenders, regulators, and scholars: In many quarters, talk of fair lending requirements has given way to discussions of reaching underserved markets of minorities, LMI borrowers, and formerly redlined city neighborhoods.

[2] We extend our apologies to Squires (1992) for paraphrasing his title.

[3] As an example of this revival, the value of newly constructed housing units rose from $57 billion in 1982 to almost $140 billion toward the end of the 1980s.

Table 1. **Homeownership Rates for the United States, 1994 and 1999**

	1994 (%)	1999 (%)	1994–1999 Change in %	1994–1999 % Change
Nation overall	64.0	66.8	+2.8	+4.4
By group				
White (non-Hispanic)	70.0	73.2	+3.2	+4.6
African American (non-Hispanic)	42.5	46.7	+4.2	+9.9
Hispanic	41.2	45.5	+4.3	+10.4
Other (non-Hispanic)*	50.8	54.1	+3.3	+6.5

Sources: U.S. Bureau of the Census 1994, 1999.
* Includes Asian Americans, American Indians, and Pacific Islanders.

These shifts, as well as extremely favorable employment and interest rate environments, have yielded dramatic progress in lending to borrowers and neighborhoods that were traditionally excluded from homeownership. Between 1993 and 1997, the number of conventional home-purchase loans to African-American and Hispanic borrowers increased by 72 percent and 45 percent, respectively, compared with an increase of only 22 percent for non-Hispanic whites. From 1994 to 1999, both the absolute and relative percentage increases in minority households achieving homeownership outstripped those of their majority counterparts, as is evident in table 1. Lending increases have also been apparent when underserved markets are defined geographically: Between 1993 and 1997, mortgage loan originations increased by 40 percent in predominantly minority neighborhoods and by 31 percent in low-income neighborhoods, compared with an overall increase of 20 percent across the nation's metropolitan areas (Can, Bogdon, and Tong 1999).[4] Many lenders have committed capital to lending initiatives explicitly targeted to underserved borrowers or neighborhoods. Schwartz (1998) cites evidence that since the passage of the CRA in 1977, community-based organizations have negotiated with lenders to secure more than 300 reinvestment agreements valued at more than $353 billion. Nevertheless, substantial challenges and barriers remain.

Persistent challenges and barriers

First, expanded lending to underserved markets is precariously balanced on the long-running economic expansion of the 1990s. Fair lending initiatives have benefited greatly from the combination of low interest

[4] These figures include both conventional and government-backed products. *Minority neighborhoods* are defined as tracts in which racial minorities composed more than 80 percent of the total population in 1990; *low-income neighborhoods* are defined as tracts with median household income at or below 80 percent of the metropolitan median in 1990.

rates, sustained economic growth, and tight labor markets; but questions about the sustainability of those efforts remain, particularly among first-time low-income borrowers shouldering high debt ratios on properties that might not reap the appreciation windfall characterizing the postwar period. Thus, the 1990s run-up in homeownership attainment by the traditionally underserved may, like the stock market, be due for a correction when the economic cycle turns.

Second, it is also important to recognize that alternative statistics tell different stories about the nation's booming housing market, and rapid growth rates have not yet eliminated long-standing inequalities. Even though African-American and Hispanic homeownership grew at six times the net rate of increase for non-Hispanic whites between 1995 and 1999, minority ownership still stands at only about 63 percent of the level for whites. The differences are stark: In 1999, 73.2 percent of non-Hispanic whites owned their homes, compared with 46.7 percent for non-Hispanic African Americans and 45.5 percent for Hispanics (table 1). There are also marked geographic disparities, such as a central-city homeownership rate of just over 50 percent, compared with a rate of almost 75 percent in suburban areas. Similarly, CRA lending during the past 20 years appears striking at $353 billion until one considers the total magnitude of mortgage credit flows: In the first half of the 1990s alone, mortgage loans on one- to four-family homes exceeded $4.3 trillion (Simmons 1997).

National data indicating enhanced mortgage lending to, and homeownership gains achieved by, the traditionally underserved also mask many pockets of stark need. Through 1994, not a single conventional mortgage had been closed on the Navajo Nation, an Indian reservation with a land area larger than that of nine states (27,000 square miles, 17 million acres). The Little Haiti neighborhood in Miami, with a population of about 65,000, has only one bank, and its residents must often turn to pawnshops for their credit needs.

Third, racial discrimination remains a problem that cannot be regarded as only a historical legacy. The most comprehensive, rigorous study of mortgage-lending discrimination ever undertaken revealed that African Americans are 60 percent more likely to be denied a mortgage loan than identically qualified whites (Munnell et al. 1992, 1996). This finding has withstood repeated attempts to dismiss racial disparities in terms of unmeasured applicant characteristics, econometric flaws, and data coding errors (Browne and Tootell 1995). Discrimination in mortgage lending persists and still demands scholarly attention, regulatory scrutiny, and legal action (Yinger 1998).

Fourth, racial disparities in mortgage markets cannot be divorced from processes that take place before the underwriting stage. Because of the widespread availability of HMDA data on mortgage-applicant race and ethnicity, most research has focused narrowly on the decision to approve or reject a loan. It is widely recognized, however, that race permeates many aspects of housing markets in American cities from the search process onward (Turner 1992, 1993; Turner and Mikelsons 1992; Turner and Wienk 1993) and that discrimination in one market may reinforce and multiply discriminatory effects in others (Yinger 1995). These effects are by no means trivial. Yinger (1997) estimates that racial inequalities in housing search processes impose a discrimination "tax" of nearly $4,000 on African-American and Hispanic households every time they search for a home to purchase. And the search process is just the beginning of a racial gauntlet. A 1993 Cleveland (Ohio) Residential Housing and Mortgage Credit Project identified many areas of the home-buying process in which discriminatory acts were most likely to occur (see table 2).

Table 2. **Discriminatory Acts in the Home-Buying Process**

Potential Trouble Area	Examples of Discriminatory Barriers
Home purchaser's contact with the real estate agent	Steering; disparate treatment, as in provision of information (e.g., a real estate agent informing only certain home seekers about a particular affordable loan program)
Home purchaser's contact with the lender	Disparate treatment, as in provision of information; redlining
Appraisal process	Inaccurate appraisals for LMI- or minority-concentrated neighborhoods
Property insurance	Poor service to LMI and minority markets by insurance companies and agents
Interaction with the credit bureaus	Slow correction of errors on credit reports; inappropriate use of credit scoring

Source: Federal Reserve Bank of Cleveland 1994.

Fifth, even without the "American dilemma" of racial divide and discrimination, the limited assets of minorities would severely limit their ability to secure homeownership. According to the 1995 *Survey of Income and Program Participation,* white (non-Hispanic) renters had an average household income of $30,196 and an average of $11,368 in assets. By contrast, African-American and Hispanic renters had average household incomes of $20,917 and $23,026, respectively; their average assets were a paltry $1,601 and $2,000, respectively. Such constrained resources severely limit minority renters' economic capacity to realize the American dream.

Finally, discriminatory and economic barriers confronting the underserved are sometimes worsened by language and cultural differences.

This problem is exemplified by the hurdles to homeownership confronted by immigrants, most of whom are members of racial or ethnic minorities. In revealing ethnographic research, Ratner (1996) documented that immigrants wishing to become homeowners were often challenged because of their minority status, limited resources, communication problems, and culturally based misinformation on how the homeownership financing system operates in the United States.

Understanding underserved markets

All of these factors—the transformation of housing finance and the many remaining barriers—demand increased attention to the complexities of lending to traditionally underserved markets. While it is still essential to document the existence and severity of discrimination (Yinger 1998), it is also crucial to understand how affordable lending initiatives have evolved from the intricate interplay of macroeconomic forces, regulatory intervention, community activism, and lending institution profitability. Indeed, some experts place less emphasis on the need to document inequalities in access to mortgage credit and more emphasis on the mortgage credit terms offered and the material benefits actually delivered by homeownership. Unfortunately, with few exceptions (Rohe et al. 1998; Schwartz 1998), relatively little is known about the role of mortgage lending in sustainable homeownership and community development in traditionally underserved markets. Evidence suggests that such initiatives have expanded dramatically in the past decade, but we often have only a superficial knowledge of how they evolved, what they comprise, and what they have accomplished. Answering those questions requires detailed case studies of current efforts to expand mortgage credit and homeownership opportunities.

Research approach

This article describes the lending and other strategies used by a cross section of organizations recognized as leaders in the effort to foster homeownership among traditionally underserved populations. Our focus is, therefore, in stark contrast to the literature documenting the limitations on access to credit and homeownership; our purpose is to document emerging efforts to reduce discrimination in, and more generally to open access to, underserved markets.

We adopt an inclusive definition of such markets. In light of wide variations in industry practices and local contextual factors, our definition includes all attempts to increase lending to (1) LMI or minority *borrowers* or (2) LMI or minority *neighborhoods* (minority is defined as all racial and ethnic groups except non-Hispanic whites, but in practice most efforts are directed toward African Americans and Hispanics).

Clearly, this broad definition encompasses an exceedingly wide range of lending industry efforts under the banner of "underserved markets." As we hope to show, however, the market for homeownership among groups traditionally excluded from the mainstream mortgage market has grown considerably in size and complexity in recent years, yielding a dizzying array of alternative submarkets, guidelines, and practices.

Leaders in efforts to reach underserved markets were identified mainly through reputation. Reputation is stressed because of limitations in HMDA data and because we believe that financial industry and nonprofit groups have a good working knowledge of the leaders and innovators in expanding markets to minority, LMI, immigrant, and similar populations. To that end, in a prior investigation for HUD (Listokin et al. 1998), we sought reputational nominations from financial institution *regulators* (e.g., Federal Reserve Banks and the U. S. Comptroller of the Currency); secondary market *funders* (Fannie Mae and Freddie Mac); industry groups (e.g., the American Bankers Association and the Mortgage Bankers Association of America); and *advocacy and community groups and activists* (e.g., Woodstock Institute and fair housing councils). In that investigation, we contacted a total of 25 such entities and asked them to identify institutions with the foremost reputations in expanding homeownership opportunities to traditionally underserved populations.

As a supplement to the procedure just noted, we further identified candidate institutions by consulting the growing body of literature[5] on efforts to expand home mortgage opportunities. (That review also gave us a better understanding of the so-called best practices.) In addition, we used other means to identify candidates, such as personal knowledge of lenders and nonprofits acting to further opportunities. While we used various approaches to identify institutions for study, reputation was the most heavily weighted.

In considering candidates, we excluded from our analysis those entities focusing on subprime lending. We did include several lenders specializing in Federal Housing Administration (FHA)–insured products, while recognizing that debate persists on the program's contributions and drawbacks (e.g., Bradford 1998). Our central focus, however, was on attempts to expand access to conventional credit.

[5] Prominent contributions to the literature include America's Community Bankers 1997; Federal Deposit Insurance Corporation 1994; Federal Financial Institutions Examination Council 1992; Federal Reserve Bank of Boston 1993; HUD 1996; Interagency Regulatory Task Force 1994; Mortgage Bankers Association of America 1994; National Community Reinvestment Coalition 1997; Neighborhood Reinvestment Corporation 1997; Savings and Community Bankers of America 1993; Social Compact between Financial Services Institutions and America's Neighborhoods 1995; U.S. Comptroller of the Currency 1997; and Vartanian et al. 1995.

We ultimately identified over 200 potential case study candidates. From this pool, we selected 16 case studies, or roughly 8 percent.[6] We winnowed the field on the basis of available study resources, the willingness of those nominated to cooperate with the research team, our desire to study diverse organizations serving varying populations in different areas of the country, and our prior contact with and knowledge of many of the candidates in the HUD-funded study (Listokin et al. 1998).

The case studies are a cross section of highly regarded institutions rather than a representative sample of those nominated. The cross section comprises four national and regional lenders; four community lenders, including two minority-owned banks; two metropolitanwide lender consortia; and six nonprofit enterprises as follows:

For-Profit Institutions
- National/Regional Lenders
  - Bank of America (BofA)
  - Countrywide Home Loans, Inc. (Countrywide)
  - Norwest Mortgage, Inc. (Norwest)
  - People's Bank (People's)
- Community Lenders
  - Berean Federal Savings Bank (Berean)
  - First National Bank of Farmington (FNBF)
  - Industrial Bank (Industrial)
  - Trent Financial (Trent)
- Lender Consortia
  - Atlanta Mortgage Consortium (AMC)
  - Delaware Valley Mortgage Plan (DVMP)

Nonprofit Institutions
- Asian Americans for Equality (AAFE)
- Chattanooga Neighborhood Enterprise, Inc. (CNE)
- Little Haiti Housing Association (LHHA)
- NAACP–NationsBank Community Development Resource Centers (CDRCs)
- Navajo Partnership for Housing (NPH)
- Neighborhood Housing Services of Chicago (NHSC)

The case study institutions are geographically dispersed throughout the United States; they range widely in age, with the oldest formed in 1842 and the newest established in 1996. They are further described in table 3, which also contains a synopsis of their accomplishments.

To place the case studies in a broader context, we also prepared a synthesis of Federal Reserve studies that provided recommendations for

[6] Nine of the case studies were originally examined in an analysis for HUD (Listokin et al. 1998). These nine have been expanded and updated.

Table 3. **Case Study Institutions: Profiles and Accomplishments**

Case Study Institution	Year Founded	Service Area	Description	Illustrative Accomplishments
For-profit lending institutions				
National/regional lenders				
BofA[a]	1904	National	As of 1997 (before its merger with NationsBank), the second-largest banking company in the United States, holding about 40 percent of its assets (about $50 billion) in residential mortgages	Maintains a comprehensive program of lending to underserved populations through its Neighborhood Advantage affordable products program, launched in 1990. Made a 10-year, $37 billion commitment to LMI home lending as part of an overall lending goal of $140 billion
Countrywide	1969	National	Principal subsidiary of Countrywide Credit Industries, Inc., which provides vertically integrated financial services. One of the nation's leading single-family mortgage originators and servicers	About one-sixth of its mortgages made to African-American, Hispanic, or American Indian borrowers. Largest lender to the Hispanic market, according to 1998 Home Mortgage Disclosure Act data
Norwest[b]	1906	National	As of 1998, the nation's largest originator and second-largest servicer of residential mortgages. Vertically integrated mortgage subsidiary of Wells Fargo & Company	The nation's top mortgage originator to minorities and LMI consumers. Offers integrated initiatives to reach underserved populations and neighborhoods
People's	1842	Regional (New England)	Large regional savings bank in New England and the leading residential lender in Connecticut. Held $2.2 billion in residential mortgages in 1996	Integrated efforts to reach underserved markets beginning in the early 1990s. Offers Building Foundations—a $200 million initiative comprising state, government-sponsored enterprise, and portfolio affordable mortgages. In 1998, Building Foundations extended approximately $96 million in affordable mortgage loans and helped 941 people buy homes

Table 3. **Case Study Institutions: Profiles and Accomplishments** *(continued)*

Case Study Institution	Year Founded	Service Area	Description	Illustrative Accomplishments
For-profit lending institutions *(continued)*				
Community lenders				
Berean	1888	Philadelphia	The nation's oldest minority-owned and -operated thrift institution, specializing in single-family lending in the largely minority West Philadelphia area	About 95 percent of mortgages granted to minority borrowers and about 50 percent to LMI borrowers
FNBF[c]	1902	San Juan County, NM	Small commercial bank, located in a border community (Farmington, NM) next to the Navajo Nation, providing mortgage and other banking services to American Indians	A leader in the development of mortgage markets and other financial services to the Navajo Nation. Closed the first federally insured mortgage loan on the Navajo Nation
Industrial	1934	Washington, DC, area	Largest African American–owned commercial bank in the United States, but with a small volume of residential lending in Washington, DC, and Prince George's County, MD	Customized, personalized efforts toward outreach, underwriting, and postpurchase retention in minority markets of the Washington, DC area. Mortgage volume is modest (e.g., 32 mortgages in 1997), but mortgage lending is primarily to African-American (81 percent in 1997) and LMI (56 percent in 1997) borrowers.
Trent[d]	1986	Los Angeles	Small mortgage brokerage company specializing in FHA lending to LMI, minority, and immigrant borrowers and neighborhoods in South Central Los Angeles and surrounding areas	Made about 90 percent of its loans to people of color with low or moderate incomes
Lender consortia				
AMC[e]	1988	Fulton and DeKalb Counties, GA (including Atlanta)	Nationally recognized consortium established in response to "The Color of Money" redlining study in 1988	Provided outreach and education along with flexible loan products through nine member banks. Closed a total of 1,815 loans with a value of $95 million. Seventy percent of AMC loans went to minorities with incomes at or below 80 percent of the area median.

Table 3. **Case Study Institutions: Profiles and Accomplishments** *(continued)*

Case Study Institution	Year Founded	Service Area	Description	Illustrative Accomplishments
Lender consortia (continued)				
DVMP	1975	Originally Philadelphia; later expanded to a six-county area	One of the nation's longest-running, collaborative mortgage-loan programs; established in response to local activism that predated the Community Reinvestment Act	From 1975 through 1998, 27,952 mortgages with a total value of $763 million granted under DVMP auspices. In 1996, 73 percent of DVMP loans were made in Philadelphia, 75 percent were made to minorities, and 60 percent were made to very low income households.
Nonprofit institutions				
AAFE	1974	Asian neighborhoods in New York City	Community-based, nonprofit civil rights and housing organization dedicated to providing housing development (both rental and owner occupied), housing assistance (e.g., homeownership counseling and tenant advocacy), citizenship courses, financial counseling, and a variety of other social and economic services to Asian Americans in the New York metropolitan area	Aided its clients in obtaining a cumulative total of $63 million in home mortgage loans, provides homeownership counseling to about 500 persons annually, raised almost $18 million in private and public capital to develop 185 affordable apartments, and is currently involved in $26 million in projects that will produce about 250 affordable rental and homeownership units as well as commercial improvements
CNE	1986	City of Chattanooga, TN, and Hamilton County, TN	Nonprofit organization that facilitates financing, development, and renovation of affordable housing and prepares home buyers through education and counseling; an affiliate of the Neighborhood Reinvestment Corporation (NRC)	Financed, produced, or renovated more than 4,600 units ($140 million investment), including origination or facilitation of almost 2,000 home-purchase loans ($92 million). In 10 years, purchase loan volume grew from 7 to more than 300 home mortgages annually. Leverages private-sector investment, captures public investment, and provides extensive services to borrowers.
LHHA	1987	Little Haiti (and nearby neighborhoods) in Miami	Uses housing as a primary vehicle to improve the shelter and socioeconomic conditions of Haitians in Miami's Little Haiti neighborhood. Applies a comprehensive integrated housing strategy that produces rehabilitated and new affordable housing and provides both rental and homeownership assistance.	As of February 1999, had provided extensive homeownership counseling to 180 families. Of the 57 families that purchased houses, not one has experienced a foreclosure; and the delinquency rate is zero percent. LHHA is in the process of rehabilitating about 70 multifamily units and building a new 33-unit for-sale townhouse project.

Table 3. **Case Study Institutions: Profiles and Accomplishments** *(continued)*

Case Study Institution	Year Founded	Service Area	Description	Illustrative Accomplishments
Nonprofit institutions *(continued)*				
NAACP–NationsBank[a] Community Development Resource Centers	1991	Atlanta; Austin, TX; Charlotte, NC; Columbia, SC; Ft. Lauderdale, FL; and Richmond, VA	Partnership between a civil rights organization and a leading national bank. Provides education, technical assistance, and counseling along with home mortgage, consumer, small business, and community-development lending.	Between 1993 and 1996, made 443 home mortgage loans with a total value of $32.3 million. About 98 percent of those loans were to minority borrowers, mostly LMI households.
NPH	1996	Navajo Nation (AZ, NM, UT)	Nonprofit affiliate of the NRC devoted to homeownership on the Navajo Nation. (Through 1994, not a single conventional mortgage had been closed on the Navajo Nation, an Indian reservation with a land area larger than that of nine states.) Offers home-buyer education and counseling, provides intermediation for the buyer with tribal and governmental authorities, and makes available other services.	Involved on many fronts in surmounting the many legal and institutional barriers to collateralized mortgage lending on Indian lands. As of mid-1998, only one home purchase on the Navajo Nation, involving two separate mortgages, had been facilitated, but 13 loans had been approved. NPH had provided individual counseling, group homeownership training, or both to almost 150 people. Developed homeownership education materials especially for American Indians.
NHSC	1975	Chicago (All LMI areas, with a focus on 20 target neighborhoods)	Largest member of the NRC network. Nonprofit organization that administers loan programs to finance home improvement, purchase, and rehabilitation for LMI families; buys and redevelops single-family and multifamily properties; builds new affordable housing; and engages in community-building activities through neighborhood-based programs.	Has provided about 6,800 loans—including home improvement, purchase-rehabilitation, and purchase loans—to borrowers in LMI Chicago census tracts. Sixty percent of the borrowers earned 80 percent or less of the area median income, and 90 percent were ethnic minorities, racial minorities, or both. Other accomplishments include rehabilitation or new construction of 21,000 housing units.

[a] In September 1998, NationsBank and BankAmerica merged to form Bank of America.
[b] In November 1998, Wells Fargo & Company merged with Norwest Corporation, the parent of Norwest Mortgage. In April 2000, Norwest Mortgage changed its name to Wells Fargo Home Mortgage.
[c] FNBF was acquired by Wells Fargo Bank New Mexico in March 2000.
[d] Trent Financial ceased operations on December 31, 1999.
[e] AMC disbanded in 1997 in response to greater industrywide attention to underserved markets and consortia instability.

expanding homeownership and eliminating discrimination in the mortgage finance and support industries (e.g., real estate, appraisal, and insurance). These studies were conducted by the Federal Reserve Banks of Boston, Cleveland, Chicago, New York, San Francisco, and St. Louis.

The case study analyses consisted of telephone and on-site interviews with principals such as nonprofit executive directors and senior bank staff responsible for affordable lending. In a few cases, we also contacted beneficiaries of the efforts of the case study organizations, such as new homeowners or individuals being counseled. Where relevant, census housing and social data were analyzed to set the stage. Other information sources included annual reports, employee training manuals, advertising copy, market studies, and newspaper articles and other literature.[7]

We acknowledge the limitations of our approach. No precise way of identifying "leaders" exists; furthermore, our case studies include only a small share of the larger group of institutions so identified. In any event, our case studies are limited in number and our investigation is qualitative. We also do not have a control group of less highly regarded institutions whose practices we could compare with those of our leaders. But given how little is known about how institutions are expanding homeownership opportunities to the traditionally underserved, an exploratory, qualitative case study investigation is appropriate and timely. To better understand the challenges confronting our case study organizations in opening markets, and to appreciate what they accomplished, we present a theoretical framework of the influences on the underserved market, including contemporary trends in the finance industry.

Theoretical framework: Correcting mortgage market imperfections

Standardization, routinization, and efficiency

The United States is characterized by a historically entrenched system favoring homeownership through a complex array of supply- and demand-side subsidies (Jackson 1985; Krueckeberg 1999). However, in the absence of a highly efficient mortgage lending industry, subsidies are not enough to support homeownership. Contemporary mortgage lending achieves such efficiencies in two ways: (1) Standardization of loan products and underwriting guidelines reduces the costs of match-

[7] The interviewing and background research were conducted by the authors; Larry Keating, a professor at the Georgia Institute of Technology; Kristopher Rengert, then a doctoral student at Rutgers University; and Barbara Listokin, then a consultant to the Rutgers University Center for Urban Policy Research. See Listokin et al. (2000) for the full case studies and the synthesis of the Federal Reserve studies.

ing borrowers to appropriate loan instruments, and (2) Routinization of application procedures and other business practices reduces the transaction costs of evaluating applicant creditworthiness. Standardization and routinization have been the central pillars of housing finance since the 1930s, but in recent years significant advances have further reduced borrowing costs for conventional mortgage credit. Most underwriting is now at least partially automated, and the current shift toward fully automated underwriting, credit scoring, and various forms of risk-based pricing are all believed to offer still further efficiencies.

Information-related market imperfections

Standardization and routinization allow efficiency gains and can potentially make underwriting more color-blind by stressing objective risk factors. (We will discuss this latter point shortly.) At the same time, standardization and routinization may exclude borrowers from the mainstream market. Information-related market imperfections take numerous distinct but related forms (see table 4).

First, on the demand side, imperfect or incomplete information about the home-buying or mortgage finance process may lead potential borrowers to avoid entering the market. Language barriers may also play a role. Over the long run, unfamiliarity with mortgage finance can mean that households fail to develop a financial profile matching the requirements of standardized (and increasingly automated) credit evaluation procedures.

Second, on the supply side, imperfect understanding of underserved populations may lead lenders to ignore profitable markets that do not conform to standard criteria. As on the demand side, language barriers, in addition to cultural differences (for instance, many lenders' unfamiliarity with the rotating credit associations common among some immigrant groups), may be important.

Incomplete or imperfect information may contribute to systemic market imperfection in the long-run intersection of supply and demand. A long history of lenders' unfamiliarity with underserved markets, and of certain groups' unfamiliarity with conventional mortgage finance, reproduces and reinforces information biases. Standardization and automation simply institutionalize these market imperfections. Credit record evaluation, for example, is based on a highly specific set of assumptions and values that have evolved over decades in the American consumer-lending sector; these values and criteria may not translate verbatim to the underserved sector. Standardized credit scoring, which is increasingly emphasized in a standardized and routinized lending industry, may therefore work to exclude a wide range of potentially

Table 4. **Informational Problems in the Traditionally Underserved Lending Markets**

Theoretical Framework

Demand Side		Supply Side	
Problem	Result	Problem	Result
Insufficient knowledge of the of banking system[a]	Cash-based, unrecorded transactions; little or no credit history	Insufficient understanding of the cultural aspects of money management	Failure to approve mortgages for creditworthy home buyers
Insufficient knowledge of the home-buying process	Creditworthy households desiring homes do not enter the market[b]	Insufficient knowledge of the lending area	Inaccurate appraisals, overpriced insurance, increased denials of profitable loans[d]
Language barriers	Inability to engage the supply side of the market[c]	Language barriers	Inability to reach large segments of the demand side of the market

Illustrations from Case Studies and Synthesis of Federal Reserve Studies (Listokin et al. 2000)

[a] LHHA and AAFE case studies reveal the largely cash-based economies of Haitian and Asian-American communities.

[b] BofA consumer research on LMI Hispanic renters reveals that many Hispanics do not enter the homeownership market because of misconceptions (e.g., that a high down payment is required or that a higher documented income is necessary to qualify for a home mortgage). BofA consumer studies found that many Hispanics believed that the first person to be consulted in purchasing a home is the real estate agent, reflecting the Hispanic culture's tendency for the "uninitiated" to rely on the "expert." Yet the agent may not be the best source of information on financing options.

LHHA and AAFE case studies show how cultural history can affect immigrants' perceptions of the home-buying market. In Haiti, people tend to build their own houses on family-owned habitations; new homes are constructed over time from savings rather than through a mortgage. Haitians coming to the United States are therefore unacquainted with buying a fully built home with a mortgage. In Korea, most homes are paid for in cash or with a very high down payment; Korean mortgages rarely exceed a 20 percent loan-to-value ratio. Hong Kong home buyers typically put 30 percent down, and home loans may be based in part on personal collateral. Korean or Hong Kong immigrants to the United States are understandably unacquainted with low–down payment mortgages fully collateralized by real property.

The AAFE case study reveals that Asian-American home seekers, knowing little about the home-buying process and encountering language barriers, often rely on cultural brokers. While cultural brokers can be helpful, they may have limited knowledge of financing options and may perpetuate misconceptions, such as the requirement for a high down payment.

Table 4. **Informational Problems in the Traditionally Underserved Lending Markets** *(continued)*

Illustrations from Case Studies and Synthesis of Federal Reserve Studies (Listokin et al. 2000) (continued)

[c] The AAFE case study shows the challenge of language in dealing with immigrant populations. AAFE's clients speak many languages (e.g., Chinese, Korean, Hindi, and Urdu), and these languages often have nuances of dialect (e.g., different words for *mortgage* in Mandarin and Cantonese). Language can be an enormous barrier to homeownership.

BofA's consumer research revealed that language was a key issue restraining Hispanic renters from homeownership. Many of those renters depended entirely on Spanish for communication, they wanted to speak Spanish with who was helping them purchase a home, and they preferred to read mortgage and other documentation in Spanish.

[d] The Federal Reserve synthesis summarizes a test by the Federal Reserve Bank of Cleveland of appraisal consistency: On one property in Cleveland, four different appraisers gave valuations ranging from $36,000 to $84,000. A 1994 study in Massachusetts found that 57 percent of insurance agents in urban areas did not have contracts with any of the state's top 20 insurers.

Source: The theoretical framework was developed by George McCarthy, and illustrations were assembled by the authors.

creditworthy borrowers. That information imperfection can restrict credit access and diminish a potentially profitable market for lenders.

The case studies illustrate many of the information-related market imperfections noted above. The lower portion of table 4 gives examples. BofA consumer research found that many LMI Hispanic renters did not enter the homeownership market because of misconceptions, such as the requirement for a high down payment. Cultural experience can also reinforce misconceptions. In Haiti, homes are often paid for entirely from savings. Understandably, Haitian immigrants may believe that the same is true in the United States. Misconceptions can be compounded by language difficulties. One Chinese home buyer described in the AAFE case study summed up his experience by noting, "I had a terrible time.…I didn't know how to communicate and I didn't know the process."

Finance-related market imperfections

Even if perfect information were available, the financial characteristics of traditionally underserved households and the homes they purchase complicate both the demand and supply side of the underserved market (table 5). Consider, for instance, the limited income and assets of minority populations, especially minority renters. We previously noted that African-American and Hispanic renters had average household incomes in the low \$20,000 range and average assets of about \$2,000. Such constrained resources severely limit home buying through traditionally structured loans, and minority renters may therefore opt out of the home-buying and home mortgage market (i.e., their effective demand will be weak). Thus, mortgage supply can be constrained because traditionally underserved populations will tend to need high loan-to-value (LTV) loans, which the market has historically viewed as riskier.

Credit problems can have similar effects. LMI minority households may have credit blemishes that preclude them from meeting the credit requirements of traditional mortgage products, thus lessening effective mortgage demand. On the supply side, the credit problems of the traditionally underserved may lead risk-averse lenders to shun this market.

The case studies illustrate and provide insight into such issues. Home mortgage lending on Indian lands is a classic conundrum: Indian poverty plus credit, legal, and many other problems have deterred lenders from offering home mortgages on reservations. The absence of mortgage offerings curbs Indians' demand for homeownership and related financing, and lenders are therefore hesitant to mount the expensive effort needed to create a home mortgage market on native lands.

Table 5. **Financial Problems Associated with Traditionally Underserved Lending Markets**

Theoretical Framework

Demand Side		Supply Side	
Problem	Result	Problem	Result
Insufficient assets/asset verification[a]	Inability to make required down payment	Insufficient assets/asset verification	Higher perceived risk because of higher LTV loans
Insufficient or unsteady flow of income	Inability to afford payments on traditional products	Insufficient or unsteady flow of income	Higher perceived risk because of uncertain repayment ability
Credit problems[b]	Inability to meet credit requirements	Credit problems	Higher perceived risk because of uncertain repayment behavior
Income/asset/credit constraints steer borrowers into lower-priced neighborhoods[c]	Purchase of homes with higher upkeep costs; increased probability of value loss because of declining neighborhoods	Income/asset/credit constraints steer borrowers into lower-priced neighborhoods	Lower appraisal estimates—higher declinations[d] Higher perceived risk because of uncertain prospects for house price appreciation

Case Study Illustrations (Listokin et al. 2000)

[a] LHHA and AAFE case studies reveal that informal savings accounts in *sous-sous* (Haitian) and *kye* (Korean) were traditionally not recognized as acceptable assets to close. LHHA counselors described the *sous-sous* as an informal savings circle of anywhere from 4 to 20 people who agree to set aside a given amount per week for a stipulated period of time, say $100 a week for 10 weeks. A responsible individual, often called a "key person," holds the weekly contributions. When the *sous-sous* is formed, participating members agree what the payout schedule will be: That is, in week one, a certain individual could withdraw the amount that he or she ultimately would contribute ($1,000 in the above example), and in week two another individual could do the same, and so on. The key person sets the schedule of withdrawals and actual payments. Many Korean immigrants turn to a *kye,* a rotating credit association involving monthly restaurant dinners during which participants pledge a stipulated amount that they can ultimately withdraw (Ratner 1996). The *kye,* common for staking business acquisitions or expansions, may be used for accumulating the capital needed to purchase a home. It is important to note that government policy may dissuade LMI families from saving in formal accounts. LHHA found that Haitians were reluctant to use banks because keeping more than $1,500 in a savings or checking account would disqualify them from receiving food stamps and Medicaid.

Table 5. **Financial Problems Associated with Traditionally Underserved Lending Markets** *(continued)*

Case Study Illustrations (Listokin et al. 2000) (continued)

[b] The vast majority of the American Indians NPH counseled had blemished credit records. Of those without blemished credit records, many could not be evaluated by looking at nontraditional credit histories because they lacked a traceable, regular cycle of payments (e.g., they resided with relatives and therefore paid no rent, or in a unit with no utilities and therefore paid no utility bills).

Most of the borrowers coming to Berean and Trent had credit issues.

Our case studies reveal how economic, historical, and cultural influences reinforce a propensity for credit problems among traditionally underserved populations.

FNBF attributes the high rate of Indian credit blemishes to a number of forces. Little economic resilience exists on the reservations; therefore, if a debtor is laid off or injured, finding another job is difficult. The Catch-22 is that, because credit has generally not been freely available to American Indians, the awareness that abusing credit is detrimental to one's future is not as strongly imbued in American Indian culture as in others. FNBF also notes instances of excessive consumer debt, such as for car loans. Ironically, that high personal debt level, according to FNBF, has in part been fostered by historically low Indian housing costs relative to income. Indians have tended to live with their families or in inexpensive public housing—often precluded from the opportunity of conventional homeownership afforded to other Americans. Personal debt for automobile and other purchases has often been marketed aggressively by vendors targeting the Indian market.

[c] Constraints contribute to spatial concentrations, which are illustrated in the LHHA and AAFE case studies: Haitians in Little Haiti and Asian Americans in New York's Chinatown and similar neighborhoods.

[d] NHSC encountered an appraisal gap in many Chicago neighborhoods, whereby the appraised value of rehabilitated properties was often less than their combined property-purchase and construction costs.

Source: The theoretical framework was developed by George McCarthy, and case study illustrations were assembled by the authors.

The case studies also reveal how some cultural influences can aggravate finance-related lending problems among traditionally underserved populations. Haitians and Asian Americans are inclined to assist an extended circle of family and friends; however, when this assistance involves cosigning on a loan that is ultimately not repaid, the result is tarnished credit. Our case investigations also show how financial problems dissuaded lenders from supplying credit to certain markets. In Chicago's traditionally underserved neighborhoods, much of the housing suitable for homeownership needs purchase-rehabilitation financing. Overseeing such loans is very labor intensive for lenders, and in low volumes those loans were costing Chicago banks as much as $5,000 to $10,000 per loan in overhead, an expenditure that made such lending uneconomical.

Discrimination-related market imperfections

Even with perfect information and no resource disparities, a market could still fail if potential consumers were discriminated against because of their race, ethnic origin, gender, or other protected characteristics. While much progress has been made in countering the blatant abuses of the past, discrimination still lingers (Federal Reserve Bank of Cleveland 1994; Turner 1992, 1993; Yinger 1995).

The case studies reveal some instances of discriminatory behavior. The AAFE analysis notes that a group of residents of the SoHo area of Manhattan launched a campaign against property sales to Asians in their neighborhood, alleging that the character of the neighborhood would change and property values would fall (AAFE 1997). Some real estate agents shunned Haitians in Miami, while others took advantage of Haitians' unfamiliarity with the home-buying process by tacking on dubious charges.

To a certain extent, the trend toward standardization of the mortgage market can help reduce discrimination by lenders. By stressing objective factors in "black box" underwriting, automation should obviate discrimination on the basis of race, ethnicity, and gender. But even with this progress, a discriminatory patina may linger. The choice of which black box to use (conventional, FHA, or subprime) may have a racial undertone (i.e., minorities who could potentially qualify for lower-cost prime lending are steered to subprime markets). Also, the data that inform the black box, such as credit bureau reports that are the basis for credit scores, may have a discriminatory tarnish. To illustrate, LHHA found that its Haitian immigrant clientele often had blemished credit resulting from many factors, including abuse of credit, a culturally induced readiness to aid an extended circle of family and friends, and possibly discrimination. LHHA found that in many cases accounts that were listed on the Haitians' credit reports as collections were in fact paid before the collection process was initiated, but the creditors had failed to acknowledge the payment in a timely fashion (St. Louis and François 1998). LHHA attributed these failures to processing errors as well as an undercurrent of discrimination against Haitians.

Illustrative strategies for addressing market imperfections

Current efforts to expand conventional lending to traditionally underserved borrowers attempt to address the market imperfections described above. They expand markets by providing essential information and expertise on the supply side, the demand side, or both. Examples are LHHA informing Haitians of low–down payment mortgages and Norwest's conducting research on minority LMI communities to better serve them and thereby "make" those markets. In a similar vein, current efforts reach the traditionally underserved by addressing finance-related limitations on either the supply or demand side, or both. Case study illustrations include People's offering very high LTV mortgages, NPH counseling Navajos, and NHSC assuming much of the administrative burden of overseeing purchase-rehabilitation financing for Chicago lenders. Finally, a market for the underserved is made by confronting discriminatory barriers. Case study examples include BofA requiring everybody at its mortgage company to take and be tested on an instructional program titled the "Fair Lending Challenge" (described later) and AAFE combating bias against Asian Americans. Examples such as these are the essence of this study.

In attempting to change multiple, long-ingrained market imperfections that have kept the underserved from the American dream, case study organizations face a Herculean task. Further adding to that challenge are the contemporary demands of the mortgage industry. Those who wish to reach traditionally underserved populations confront a choice between the efficiencies of standardization or routinization and the market-making benefits of custom, specialized, and narrowly targeted interventions. Severe and entrenched market imperfections require customized programs tailored to the specific perceptions, idiosyncrasies, or needs of various borrowers (or, on the supply side, underwriters, real estate professionals, or others). The high costs of specialized and customized interventions, however, demand deep subsidies and limit such efforts to small volumes. Our study captures targeted LMI and minority lending initiatives in an important transitional period in which a proliferation of customized programs is beginning to allow partial, selective standardization to achieve efficiencies and support larger volumes. As we shall see later from the case studies, this synthesis is often achieved by nonprofits that do the necessary custom-crafted preparation of borrowers as part of broader housing and neighborhood development efforts. With traditionally underserved populations and areas made more bankable by such efforts, lenders can bring to bear the efficiency of the standardized financing market.

Organizational framework

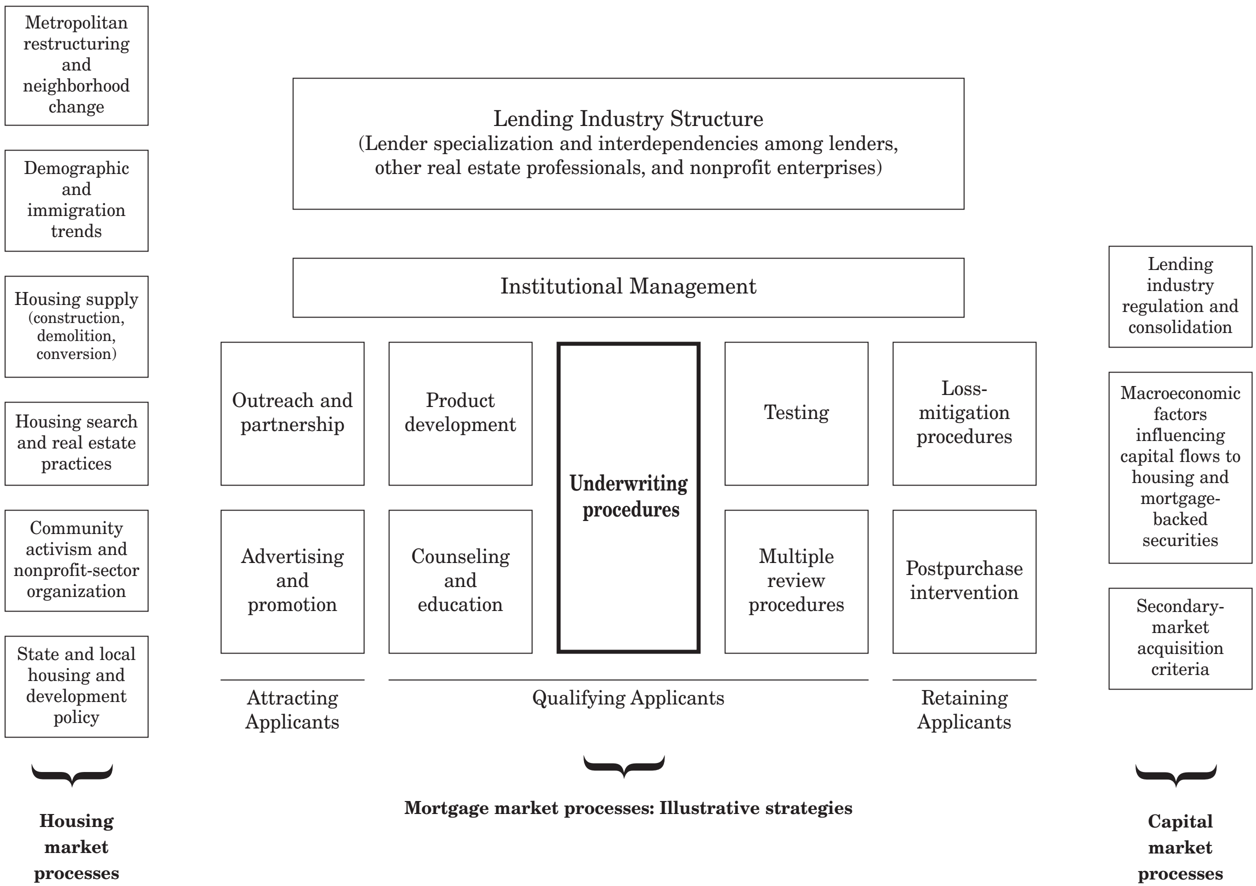
Efforts to expand homeownership opportunities for the underserved take place in the context of broader housing, capital, and industry forces. Figure 1 shows these broader forces, each of which encompasses numerous elements. For instance, the housing market is influenced by metropolitan restructuring and demographic trends. Lending industry structure is affected by the market specialization of banks and other lenders and by the networks and interdependencies among lenders and other real estate professions (e.g., real estate agents and appraisers). The capital market is affected by macroeconomic capital flows, changing regulations, and other larger forces. The illustrative strategies described in our investigation for the most part comprise microlevel mortgage market processes as shown in the center of figure 1.

We organize strategies using a *process* model of the prerequisites for creating a mortgage loan: establishing and operating an entity to do the financing (referred to here as “institutional management”), “attracting” mortgage applicants, “qualifying” these applicants, and then “retaining” the resultant borrowers. *Institutional management* includes an organization’s motivation for expanding activity in the underserved market as well as the management structure it uses to do so. Efforts to *attract applicants* include outreach, advertising, and strategic partnerships. *Qualifying applicants* includes the core activity of underwriting, but also encompasses related activities such as counseling, product development, and multiple review policies. *Retaining homeowners* involves postpurchase servicing, counseling, monitoring, and loss-mitigation procedures. We use this framework to organize the analysis presented below and to examine the tensions between customized, specialized interventions and efficient, standardized programs.

Institutional management

Nonprofits and some lenders, such as minority-owned, neighborhood-based institutions, have long tended to the credit and housing needs of minority, LMI, and immigrant populations. For others, such as many mainstream lenders, reaching the underserved is a marked change beyond their traditional role of serving mainly middle-class white families with financial profiles that match the templates of established mortgage screening mechanisms. It is instructive to understand why bank management opted for that difficult reorientation. There is no question that statutory, regulatory, and public pressure (“sticks” of different

Figure 1. **Conceptual Framework of Lending to Underserved Markets**



types) all compelled lenders to become more proactive. These sticks include the requirements of the CRA, the Fair Housing Act, the Equal Credit Opportunity Act (ECOA), and other statutes; an invigoration of regulators' enforcement of those statutes; the release of loan-level HMDA data; the growth of community activist organizations, which have become quite proficient in analyzing and presenting HMDA information; and an industrywide trend toward mergers, accompanied by a very public look at the fulfillment of CRA obligations.

The case studies illustrate those pressures. Atlanta lenders became more receptive to increasing lending to minority and LMI populations when the Atlanta Community Reinvestment Alliance brought HMDA-based loan information on minority lending disparities to the fore. A group of lenders formed the AMC two weeks after those disparities became front-page news in the *Atlanta Journal-Constitution*'s much publicized "Color of Money" series. Merger-related CRA scrutiny also prompted case study institutions to increase affordable lending. PNC Bank became a much more active DVMP participant at the time of its merger with the Bank of Delaware and attendant protests by the activist group ACORN (Association of Community Organizations for Reform Now); NationsBank's partnership with the National Association for the Advancement of Colored People (NAACP) coincided with its national expansion; and BofA expanded its American Indian and Hispanic mortgage outreach efforts with its acquisition of First Interstate of Arizona.

Although statutory, regulatory, and public pressures may have prompted the initial expansion of minority and LMI lending, the potential profitability of serving previously untapped markets has sustained it. The growth of minority, ethnic, immigrant, and nontraditional households in the United States forced a widespread reevaluation of core markets and potential for growth. Echoing that demographic shift, Thomas Hylinski, a People's vice president, stated, "If we are not in this market, [composed] of minorities and immigrants, lenders will be chasing an ever-shrinking pool of white, middle-income households" (1997). The lure of a huge nontraditional market was also echoed in our discussions with Norwest. The underserved market was viewed not only as vast, but also as profitable in its own right because of numerous factors such as more flexible secondary-market criteria, lower prepayment risk on affordable loans,[8] and the lure of additional business from new

[8] Most public discussion of affordable lending has focused on delinquency and foreclosure—not surprising in light of experiences with products such as FHA loans (the 90-day delinquency rate for FHA-insured loans is commonly three or four times the conventional delinquency rate). Yet profitability also hinges on prepayment risk, and on this measure, affordable loans can be more lucrative than mortgages made to higher-income families. For instance, borrowers who secure loans through multilayered public subsidies or grants will be unable to respond quickly to interest rate fluctuations by refinancing.

customers. Countrywide, for example, notes that even if it loses money on its affordable home-purchase mortgages, it will likely make money later on home equity loans and other ensuing business with the heretofore underserved borrowers (Van Dellen 1997). One of the reasons that FNBF became involved in mortgage lending to Navajos and continues to pursue the business even though the bank continues to lose money in these transactions is that American Indians are an essential FNBF customer base, contributing in recent years to about one-third of FNBF's consumer growth (Coleman 1997).

Ultimately, judging the profitability of lending to the underserved market depends on a wide range of factors—who holds the note, who does the servicing, who bears the delinquency and prepayment risk, what time horizon yields are measured on, and whether ancillary business is considered. To our knowledge, there has been no definitive research to suggest that efforts to reach underserved markets are, on balance, riskier or less profitable than lending to higher-income borrowers. What we can say unequivocally is that our interviews with lending industry professionals—in this and previous studies—reveal a broad and growing consensus on the profitability of prudent efforts to reach underserved markets.

The case studies illustrate the broad management strategies that have been adopted to tap the affordable lending market. We organize these strategies in the following categories: *management commitment*, *management structure*, *lending goals*, *compensation formulas*, *workforce development policies*, and *market research*. Examples of these strategies are shown in table 6 and discussed below.

Management commitment

While it may appear obvious, an important management practice for reaching the underserved is a clear, high-profile management commitment to that goal. Norwest, for example, has a corporate objective of being the largest lender to LMI and minority consumers. Countrywide has adopted a similar philosophy, as evidenced by its "We House America" campaign, and BofA has staked a similar position. NationsBank's partnership with the NAACP sends a similar message. Reiterating the commitment to affordable and fair lending in bank mission statements, lending policy statements, and similar defining documents is important.

A corporate commitment to expanding mortgage opportunities is further reaffirmed by the involvement of senior management. CRA oversight should be the line responsibility of, or supervised by, senior bank personnel. Such was the case at Countrywide (its fair lending committee includes the company's highest executives) and at several of the

Table 6. **Illustrative Strategies for Managing Enhanced Mortgage Lending to Traditionally Underserved Communities: Case Study Examples**

Management Strategies	Case Study Examples
Management Commitment	
Ensure an overall corporate commitment to the underserved market.	**Norwest's** corporate goal is to be the largest and most profitable mortgage originator and servicer to LMI and minority consumers.
Stipulate the corporate commitment in defining documents.	**DVMP** bank participants (e.g., PNC and CoreStates) have vision statements reiterating their commitment to affordable lending.
Involve senior-level management.	**Countrywide's** fair lending committee is composed of the president, the heads of major production divisions, and other senior officials. **Norwest** established the position of executive vice president of affordable housing; the officer in that position sits on the parent company's executive board. **FNBF's** CRA officer reports to an executive vice president, with oversight provided by the board of directors.
Management Structure	
Allow for a creative mix of specialized and companywide units involved in affordable lending.	**BofA** has community-lending underwriters and two special processing units expressly designated to handle low-volume community lending products; however, affordable lending is done throughout the company. **Norwest** has staff members who focus on affordable lending (e.g., community development sales representatives [CDSRs]) and has an affordable housing underwriting group, although the company in general engages in affordable lending and underwriting. **Countrywide** has about 20 retail branches in inner-city locations; however, the company's 440 retail offices make affordable loans.
Lending Goals	
Set concrete goals for affordable lending.	**BofA** sets three lending goals (for LMI census tracts, LMI borrowers, and minority borrowers) for every operating level. **Norwest's** performance objectives for division, area, and regional managers include specific numeric goals for LMI and minority lending. **People's** incorporates CRA objectives into annual goals for each of its business areas.

Table 6. **Illustrative Strategies for Managing Enhanced Mortgage Lending to Traditionally Underserved Communities: Case Study Examples** *(continued)*

Management Strategies	Case Study Examples
Compensation Formulas	
Set compensation that encourages working on affordable lending.	**BofA** ties compensation and bonuses to affordable loan performance and offers other incentives for such lending (e.g., peer recognition). **Norwest** links manager compensation to LMI and minority mortgage production and provides its CDSRs with a base salary plus commission. (This system allows CDSRs to perform functions that do not immediately generate loan applications; however, in time, all CDSRs revert to full commission.) Compensation of **Countrywide** retail loan officers is based on the number (not the value) of the mortgages granted. **People's** account officers working in central cities have a special compensation system. **Industrial** loan officers receive a higher-percentage commission on smaller loans.
Workforce Development	
Educate the workforce on affordable and fair lending and promote workforce diversity and cultural sensitivity.	**BofA** offers a Fair Lending Challenge (interactive CD-ROM program) as well as other fair housing–CRA training, and it aggressively recruits minority and bilingual personnel. **People's** branch account officers and others involved in the lending process (e.g., appraisers) receive in-house training on fair lending. **FNBF** provides staff training on the Navajo culture.
Market Research	
Analyze the potential and performance of affordable lending.	**BofA** market research identifies the needs and perceptions of the underserved community and guides the development and promotion of its Neighborhood Advantage Mortgages. **Norwest's** Market Intelligence Group identifies market opportunities and helps develop marketing strategies.

other case study organizations (see table 6). Senior management's involvement is also manifest through participation in civil rights, affordable housing, and other organizations important to minority and LMI populations. People's CEO is active in the Bridgeport, CT, NAACP; a BofA executive staff member served on the National Committee for Affordable Lending; and FNBF's CRA officer is on the board of the NPH.

Senior management involvement also means allaying staff concerns about working in affordable lending (i.e., that it is "low profile" compared with other higher-profile tracks) and supporting affordable lending staff in sometimes controversial situations.[9]

Management structure

Among the most critical management decisions is how to structure targeted lending initiatives in the context of the entire institution. For small, neighborhood-oriented lenders, this decision is normally made by history and by the local setting: Witnessing decades of neighborhood change, in-migration, and out-migration, these lenders survive by designing all aspects of their business to carve out a profit from underserved markets.[10] That mission was personified at Berean and Industrial. Regional and national lenders, by contrast, must balance a wide set of considerations when attempting to change a large organization geared toward traditional banking practices. Creating a specialized division for community lending or CRA mortgages can enhance unit efficiency and innovation but risks marginalizing staff and operations from the rest of the institution—thereby retarding genuine, across-the-board transformation of business practices. However, it is difficult to implement affirmative lending across the entire organizational chart at once. In practice, the most successful models involve a well-funded, high-profile unit specializing in affordable lending, in combination with more fundamental changes throughout the fabric of the institution, often with specific timelines for integration of various practices.

[9] An event at People's is illustrative. The senior vice president in charge of residential lending became aware of a *Wall Street Journal* investigation of major lenders (including People's) that was to focus on the high percentage of minority mortgage rejections compared with white rejections. The investigation coincided with People's expansion into the minority community and a rising number of minority loan applications, many from less qualified borrowers who had never applied for a mortgage before. In short order, People's experienced a rising number of minority rejections. It was faced with the choice of either backpedaling its marketing efforts to "show better statistics" or pursuing its initiative, a course likely to draw adverse notice in the pending *Wall Street Journal* article. The senior vice present approached People's CEO and explained the situation. The CEO told him, "Don't back off, we will support you." The CEO was willing to support the minority lending initiative—and the staffers associated with the initiative—despite what could have been adverse publicity.

[10] For many years, these institutions survived by charging higher fees or interest rates, which was made possible by credit rationing on the part of mainstream lenders. Recent liberalization in the secondary market and among mainstream conventional lenders has almost certainly threatened these neighborhood lenders by inducing adverse selection. In our interviews, many small lenders emphasized the challenges associated with these trends, as they face new competitors from "above" (large conventional lenders discovering new markets) and from "below" (the expansion of subprime lending). Survival will require increased efficiency or the development of portfolios that cross-subsidize inner-city loans with business in high-growth suburban markets.

The national and regional lenders in our study exemplify that last approach. BofA established the national position of director of community development lending, who reports directly to the corporation's Executive Committee, and BofA maintains a staff of 40 designated community lending underwriters with full authority to approve borrowers for the company's most flexible products (Smith 1998). Yet branch managers throughout the retail division are responsible for monitoring lending to LMI borrowers, neighborhoods, or both. Norwest created the position of executive vice president of affordable housing; the company also has specially compensated community development sales representatives (CDSRs), who focus on underserved markets. At the same time, however, Norwest maintains affordable housing specialists across all divisions and offices to incorporate such practices throughout the fabric of the company and expects CDSRs to revert to the same commission structure as other loan officers after a transitional period (Russell 1998). Finally, as part of its targeted We House America effort, Countrywide opened retail branches in inner-city neighborhoods of Atlanta, Baltimore, Boston, Chicago, and other cities. The company also maintains nationwide policies and monitoring procedures to track lending at each of its more than 400 retail branches.

Regardless of organizational structure, proactive management practices within subsidiaries, divisions, or departments are critical to ensure the success of lending to underserved markets. Day-to-day practices are most directly influenced by four sets of management decisions: lending goals, compensation formulas, workforce development policies, and market research.

Lending goals

Clearly defined lending goals are the concrete expressions of management's commitment to developing new markets among LMI borrowers, racial and ethnic minorities, recent immigrants, and inner-city neighborhoods. As with many other broad management decisions, specific lending goals are most crucial for large institutions. By contrast, nonprofits or consortia (such as AAFE, LHHA, NPH, and DVMP) generally have charters that target underserved borrowers or neighborhoods, while small inner-city lenders, such as Berean and Industrial, have always served the underserved.[11] For large lenders, though, reaching new

[11] Our interviews with small, minority-owned institutions revealed anecdotal evidence of a long-standing tension: Lenders whose mission is to serve minorities excluded from the traditional housing finance system sometimes see increasing numbers of white applicants who have been referred—usually informally—by staff members at larger institutions unable to provide underwriting flexibility. This tension is disappearing with the growth in standardized affordable products, however, and there is increasing competition for many groups of borrowers.

markets requires specific numerical lending targets defined according to some combination of borrower race or ethnicity, borrower income, and neighborhood racial composition or income. The exact formulas and thresholds are often proprietary. Among the lenders we studied, BofA maintained some of the most detailed goals. Goals are set for loans to (1) low-income census tracts, (2) LMI borrowers, and (3) minority borrowers. BofA's annual goals are based on a formula comparing overall market trends with the bank's activity in the previous year. Those goals are set for every operating level from regional managers to branch sales managers, with separate targets for the 70 metropolitan statistical areas in the institution's CRA assessment area.

Norwest uses proprietary formulas to define lending goals and also maintains a sophisticated Market Intelligence Group that uses internal data, public records, and databases obtained from outside vendors to profile potential markets at geographic scales as fine as the tract or block level. Data requirements for establishing lending goals and researching potential markets should be borne in mind when policy makers evaluate the regulatory burden of HMDA and other disclosure statutes. Those regulatory requirements generate a torrent of useful information, and lenders seeking growth opportunities gain valuable insight from their own files as well as from the public disclosures of all institutions in the mortgage market.

Annual lending goals are rarely enforced in any strict sense. Indeed, self-defined lending targets are similar to—and often the direct result of—voluntary CRA agreements, which are generally recognized as unenforceable except through press attention or public opinion (Schwartz 1998). Nevertheless, institutions seeking to expand loans to underserved markets make these targets an essential component of managers' performance reviews. Fortunately, the expansion of standardized, securitized affordable products in the past decade has effectively carved out new frontiers for institutions interested in tapping new markets: Among the lenders we studied, those who have established numerical targets almost always meet or exceed them.

Compensation formulas

Compensation policy plays a crucial role in institutional change. Compensation formulas distill broad directives and mission statements into the tangible, material incentives needed to reward the work involved in matching traditionally underserved borrowers with suitable financing. For decades, the industry norm was to peg commissions at a percentage of loan size, usually with bonuses for high annual dollar volumes. Such practices encouraged individual loan officers to focus their efforts on the highest segment of the housing market allowed by their expertise, referral networks, geographic location, and institutional resources. Over the past decade, fair lending efforts have pushed institutions to scrutinize compensation formulas according to the same adverse-impact legal tests applied to other institutional practices (see Vartanian et al. 1995). Even so, many industry observers see a tension between the imperatives of companywide profitability and the need to provide sufficient incentives for the investment of staff time in developing new markets in underserved neighborhoods or populations. The nature of this apparent trade-off—between immediate payoffs and long-term growth potential—depends on how revenues are defined and allocated. Among the lending institutions in our study, a consensus exists that home-purchase lending to underserved markets generates sufficient growth in home improvement and consumer lending (or savings deposits) to justify the increased effort required to produce a larger number of smaller, and often more complicated, loans.

Institutions can pursue a variety of approaches to make compensation policies more conducive to lending in underserved markets. Norwest's CDSRs begin on a dual compensation structure composed of a commission and a base salary, the latter allowing them to devote time to homebuyer fairs, meetings with community groups, and other activities that do not generate immediate increases in loan applications. All CDSRs are required to revert to full commission after an appropriate development period, however (Smith 1998). Countrywide takes a different approach under which compensation for personnel in branch retail offices consists of a base salary augmented with a bonus determined primarily by the *number* of loans closed. Industrial devised a system by which loan officers receive a base salary augmented with a commission percentage that rises for smaller loans (Williams 1998). BofA's mortgage division, responsible for a large, complex network of professionals in many different markets, developed a system of monthly payment factors to boost incentives for loan officers specializing in community-development products. Payment factors are awarded for loans to LMI borrowers or to borrowers seeking homes in LMI neighborhoods; an additional payment factor is awarded for loans to LMI borrowers who are buying homes in LMI neighborhoods. Bonuses for regional managers are also tied to success in meeting community-development goals, and the bank's recognition program rewards officers according to the number of loans as well as their total dollar volume (BankAmerica Mortgage Corporation 1998). People's has established a special compensation structure for account officers who make loans primarily in central-city locations (Williams 1997).

Workforce development policies

One facet of the lending discrimination debate—employment policy—has received relatively little attention. The cultural affinity hypothesis (Hunter and Walker 1995) suggests that a racially diverse workforce can help reduce adverse-impact discrimination. Kim and Squires (1998) conducted a multivariate analysis of mortgage loan decisions and institutional characteristics in five metropolitan areas (Atlanta, Boston, Denver, Milwaukee, and San Francisco) and found that a 1 percent increase in African-American administrative and professional employment was associated with a statistically significant increase of 0.72 percent in a lending institution's approval rate for African-American loan applicants. Those findings provide the most rigorous and recent evidence to support the use of workforce development policies as a means of expanding a lender's presence in underserved markets.[12]

Many of the case study institutions are trying to assemble a workforce that better reflects the many minority and ethnic communities they serve. Of the last 20 loan officers BankAmerica Mortgage hired in Southern California, 80 percent were members of minorities, the bulk of them bilingual. Half of that company's processing/operations staff members are bilingual. Countrywide, Norwest, and People's actively recruit employees from a variety of racial and ethnic backgrounds. Working in the polyglot market of Los Angeles, Trent actively recruits minorities by going to job fairs staged by the Los Angeles Urban League or by participating in other kinds of minority hiring programs. Members of minorities account for about 90 percent of Trent's workforce.

Besides working to create a more diverse workforce, almost all of the case study institutions trained their employees extensively, either in-house or through outside consultants, in fair lending (e.g., the basic provisions of the CRA, Fair Housing Act, and ECOA), cultural sensitivity, and other subjects to foster fair access to mortgage credit. Two innovative examples stand out. First, BofA augments a fairly standard menu of diversity training programs with a customized, interactive CD–ROM (the "Fair Lending Challenge") that simulates interactions between a loan applicant and a loan officer or underwriter. The software quantifies a user's conformance to fair lending regulations, and company policy requires that employees attain a score of 80 percent. Second, FNBF pursued innovative workforce training as part of its effort to spearhead mortgage lending on Navajo Nation lands. The bank hired Navajo facilitators to conduct training sessions on Navajo culture and on perceptions of mainstream financial institutions.

[12] The Interagency Regulatory Task Force (1994, p. 18271) addressed the question of minority employment in the lending industry as follows: "The employment of few minorities in protected classes, in itself, is not a violation of the FH [Fair Housing] Act or the ECOA [Equal Credit Opportunity Act]. However, employment of few members of protected classes in lending positions can contribute to a climate in which lending discrimination can occur by affecting the delivery of services" (18271). The task force recommended that lenders consider outreach steps such as targeting job advertisements and seeking referrals from current minority employees, minority real estate boards, and other local minority institutions. Discrimination suits and settlement decrees often stipulate that lenders accused of discrimination undertake efforts to recruit minority loan professionals as part of broader remedies (Vartanian et al. 1995).

Market research

Rigorously researching the traditionally underserved market is a time-consuming, expensive endeavor. Not surprisingly, only larger institutions typically conduct such research. BofA and Norwest are illustrative. As part of its Affordable Housing Initiative launched in 1996, Norwest established a Market Intelligence Group that analyzes in-house and commercial databases to identify markets for expansion. BofA surveyed LMI Hispanic renters in California and Arizona in 1998 (Hispanic and Asian Marketing Communication Research 1998). Although those renters aspired to homeownership, they perceived many obstacles to that goal, including low incomes, limited savings, blemished credit, and communication difficulties. Sometimes the perceived problems involved misconceptions concerning down payment requirements (believed to be high) and other matters (see table 4). Such research (1) helped guide BofA in developing products such as its Zero Down mortgage, (2) underscored the importance of hiring bilingual loan officers and making mortgage applications available in Spanish and other languages, and (3) informed strategies for attracting applicants.

AMC conducted research that showed that many of its potential clients did not believe homeownership was possible. Common misconceptions included beliefs that (1) down payments of 20 percent are required, (2) past credit problems are an absolute barrier to acquiring a home, or (3) households with modest incomes cannot qualify for mortgages. In response, AMC designed home-buyer education programs to correct these misconceptions and mortgage products with high LTV and other characteristics to address affordability.

Attracting applicants

As recently as a generation ago, most mortgage markets were locally oriented, as exemplified by neighborhood-based S&Ls. Restructuring of the financial services sector has replaced this local model with a much more integrated system. The result—at least in those neighborhoods that are well served by the current system—is a broad array of choices between large and small lenders, depositories and nondepositories, and locally oriented thrifts and national full-service banks. Large institutions with expansive market areas, however, often lose the familiarity with local markets that is sustained by informal, day-to-day information networks and business practices (Granovetter 1985). One solution to this problem is organizational and takes the form of decentralized underwriting and loan processing. Another solution involves marketing to attract applicants.

Growing recognition of latent demand in LMI and minority communities has spurred increasingly sophisticated, competitive marketing and outreach efforts. Increasing competition for new borrowers has yielded some outreach practices that are aggressive and perhaps even intrusive. Efforts to attract underserved mortgage applicants, therefore, reflect a tension between the need to reach prospective borrowers, on the one hand, and the potential for intrusive consumer probing (e.g., through survey and focus groups) or the "commodification" of community institutions (such as churches), on the other (Curry 1997; Goss 1995).

Small lending institutions and nonprofits, particularly those based in inner-city markets, usually have little difficulty tapping into latent demand in the surrounding community. Berean, for example, does almost no advertising to sell its mortgage products but finds instead that loan applications "come naturally from existing customers" (Kepler 1997). Innovative techniques are sometimes important, however. To disseminate information as well as to make its services known to the Asian-American community, AAFE published *Housing Access.* This magazine, which was available in both Chinese and Korean, covered a wide range of fair housing, tenants' rights, and homeownership issues and described AAFE's activities (Community Information Exchange 1997).

In contrast to neighborhood-based banks and nonprofits, most large lending institutions must mount a more proactive campaign to attract traditionally underserved customers. The transition from renting to owning is deeply embedded in informal social networks among friends, relatives, and neighbors (Ratner 1996), so effective strategies must locate and use these networks. Because LMI minority populations may be apprehensive about dealing with institutional banks, lenders must try to assuage those fears. Furthermore, segmenting the market of potential homeowners is essential if lenders are to craft specific messages to different groups of consumers with varied perceptions and deeply rooted assumptions about banks, credit, and the homeownership institution itself.

Such complexities necessitate a comprehensive mosaic of strategies to attract traditionally underserved mortgage applicants. Those strategies include establishing a presence in underserved areas (e.g., opening branches in central cities), meeting potential customers in nonthreatening informal gatherings (e.g., street fairs), reaching out through different media with sensitivity to language and culture (e.g., advertising on Spanish radio), and networking through already established neighborhood "institutions" (e.g., community groups, churches, and minority-oriented real estate agents). Table 7 draws on the case studies to illustrate these and other strategies. For example, DVMP is publicized by individual participating lenders as well as through a regional economic development partnership, the Greater Philadelphia Urban Affairs Coalition. As a consortium of large lenders, DVMP pursues outreach efforts in the broader context of public-private initiatives to spur revitalization in distressed neighborhoods in Philadelphia and surrounding communities (DVMP 1998; Sitner 1997). As another example, AMC's home-buyer information sessions were held in local churches and were announced during Sunday services.

To further convey the richness of lender outreach, we briefly summarize the broad strategies of the large national lenders in our study. As noted earlier, Countrywide opened retail branches in inner-city neighborhoods in several large cities as part of its We House America initiative. Countrywide also networks with local community groups and with national urban and minority organizations (including the Black and Hispanic Congressional Caucuses, the National Community Reinvestment Coalition, and the NAACP) (Countrywide Credit Industries, Inc. 1999a; Van Dellen and Bielansky 1997). BofA routinely distributes brochures and announcements of new loan products in English, Spanish, Chinese, and Vietnamese; maintains a bilingual loan staff on its toll-free *Presta Linea;*[13] and sponsors events for Cinco de Mayo, Juneteenth, and other ethnic celebrations. BofA also maintains extensive partnerships with neighborhood organizations such as AAFE (New York City), the Phillips Neighborhood Initiative (Minneapolis), and the Watts Homeownership Center (Los Angeles).

Norwest is aggressive as well in attracting applicants from underserved populations. Like the other large lenders, Norwest maintains close ties with national organizations (the Greenlining Institute and the National Association of Affordable Housing Lenders) to reach potential homeowners; however, it also undertakes comprehensive efforts of its own. It established a special program ("Sharing Advantage") to increase outreach to churches; the effort involves coordinating with pastors and distributing literature recommending homeownership (Russell 1998). While the program includes no special discounts for the borrower, Norwest donates $300 to the church (or a charity of the applicant's choice) when the loan is approved (Russell 1998). Norwest further strengthened its efforts to tap into community networks through churches in 1997, when it entered into a joint venture to create the Revelation Mortgage Corporation of America (Muolo 1997; Russell 1998).

Revelation Mortgage is a for-profit company owned jointly by Norwest and the Revelation Corporation of America, which was itself founded in 1996 as a joint venture between a white Memphis entrepreneur and the nation's five largest African-American denominations (Branch 1996; Muolo 1997). The corporation was conceived as a means of focusing the combined purchasing power of African-American churches to secure discounts and other benefits in the style of the AARP and similar groups. Contracts with participating companies stipulate a commission for Revelation; that commission is then divided between the con-

[13] *Presta Linea* is a toll-free Spanish-language phone center staffed by specially trained bilingual loan and information experts.

Table 7. **Illustrative Strategies for Attracting Traditionally Underserved Mortgage Applicants: Case Study Examples**

Strategies for Attracting Applicants	Case Study Examples
Through a Presence in Underserved Communities	
	BofA has offices in South Central Los Angeles, in Chicago's South Side, and in similar areas. **Countrywide** has retail branches in inner-city locations in Detroit; Newark, NJ; and numerous other cities. **Norwest** has 800 locations nationwide, many in underserved neighborhoods. **Berean** and **Industrial** emphasize their role as community-based and minority-owned lenders. **FNBF** opened the first full-service banking facility on the Navajo Nation.
Through Informal Gatherings	
	BofA sponsors many community-based ethnic events (e.g., Cinco de Mayo festivals). **Countrywide** sponsors housing fairs following the opening of House America branches. **AAFE** participates in housing fairs in Asian-American neighborhoods.
Through Different Media	
	Trent uses infomercials. **DVMP** sends press releases to various Philadelphia-area media and distributes brochures and other informational materials to would-be DVMP clients. **LHHA** hosts a weekly radio program and advertises on Haitian radio broadcasts. **AAFE** publishes *Caring Community*, which discusses homeownership and related topics, and encourages articles on its operations in the Asian-American ethnic press. **NPH** publicizes its program in the *Navajo Times* and on the Navajo radio station. **NHSC** advertises on Chicago's African-American and Spanish-language radio stations and on minority-oriented cable television.
Through Language/Cultural Sensitivity	
	BofA advertises in English, Spanish, Chinese, Vietnamese, and other languages. BofA affordable lending materials are translated into Spanish or other languages. **FNBF** markets in the Navajo-language newspaper and on the Navajo-language radio station. **LHHA** advertises in Creole. **AAFE** distributes educational materials in English, Chinese, Korean, Hindi, Urdu, and other languages and is sensitive to language nuances (e.g., different words for *mortgage* in Mandarin and Cantonese).
Through Working with Neighborhood and Other Institutions	
1. Churches	**Norwest** partners with local churches (e.g., the Sharing Advantage Program and Revelation Mortgage Corporation). **People's** works with churches, social clubs, and other entities active in minority communities. **AMC** worked closely with Atlanta's Concerned Black Clergy. **Industrial** is a charter member of the Collective Banking Group, an organization composed of more than 60 churches in the Washington, DC, area.

Table 7. **Illustrative Strategies for Attracting Traditionally Underserved Mortgage Applicants: Case Study Examples** *(continued)*

Strategies for Attracting Applicants	Case Study Examples
Through Working with Neighborhood and Other Institutions (continued)	
2. Community groups	**BofA** partners with **AAFE**, Watts Homeownership Center, and other groups. **FNBF** networks through **NPH**, Navajo legal services, and Navajo schools. **NationsBank** partners with the **NAACP**, and **Countrywide** also networks through the NAACP.
3. Real estate agents	**BofA** networks with minority real estate agents (e.g., sponsors golf tournaments for Los Angeles African-American real estate agents). **Trent** educates real estate agents in affordable FHA and other products. **CNE** conducts monthly workshops for local real estate agents.
4. Banks	**NPH** has received referrals from **FNBF**, **Norwest**, and other banks. **NHSC** works with many Chicago banks and has partnerships with 250 companies.
5. Government	**NPH** has received referrals from the U.S. Rural Housing Service.
6. Other institutions	**Norwest** partners with the Greenlining Institute and the National Association of Affordable Housing Lenders. **DVMP** is administered by the Greater Philadelphia Urban Affairs Coalition. **CNE** partners with hospitals and police departments.
Through Multiple Points of Contact with Consumers	
	BofA *Presta Linea,* a bilingual (English-Spanish) phone center, offers loan information and can intake loan applications. **People's** mortgage calling-officers meet customers at their homes, its supermarket branches accept mortgage applications, and its video banking provides mortgage services. **Trent** and **NPH** offer homeownership seminars at workplaces. **Industrial** sends loan officers to meet applicants at the location of their choice.
Through Employees	
	Berean recruits customers through its African-American employees, and **FNBF** recruits through its Navajo employees. **CNE** encourages its employees to refer friends and family members to CNE for homeownership and other assistance.

gregant's church and a national housing fund (Branch 1996; Muolo 1997). Revelation advertises through church bulletins, holds homeownership seminars, and offers applicants the full range of loans provided by Norwest Mortgage (Russell 1998). Revelation does all underwriting, while Norwest retains loan servicing. Not surprisingly, the commodification of the African-American church and the use of its credibility as a community institution to enhance profits have generated considerable controversy (Branch 1996).

Qualifying applicants

Matching borrowers from underserved populations to suitable mortgage credit entails a wide range of activities, each of which involves a different balance between standardized procedures and customized interventions. Traditionally, most research on lending discrimination has fastened on the role of mortgage underwriting in producing disparate treatment of, and sometimes disparate effect on, racial minorities and other protected classes. In recent years, however, the expanded scale and sophistication of attempts to reach new markets have drawn attention to the wide variability of formal and informal practices used in the qualification process. The various strategies have evolved and adapted in response to distinctive social, institutional, and geographic contextual factors. We group these strategies into the categories of providing education and counseling, providing affordable financing and housing opportunities, and fostering fair access to credit. These approaches are illustrated by the case studies in table 8 and are further discussed in the following sections.

Education and counseling

Home-buyer education and homeownership counseling represent a continuum between the dissemination of standardized, packaged information and one-on-one intervention. Despite wide variation across programs, their common, essential purposes are to correct misperceptions and to fill the vacuum created by generations of discrimination, poverty, or reliance on informal and subprime consumer credit—in short, to correct information-related market imperfections—and also to reduce the likelihood of mortgage delinquency. Programs typically cover the benefits and responsibilities of homeownership, strategies for locating and evaluating a suitable home, household budgeting strategies, credit reporting and evaluation, and the intricacies of the mortgage underwriting and lending process. Specialized efforts, however, have emerged to address distinctive needs or misperceptions among varied groups of renters in particular cities or neighborhoods.

Not surprisingly, counseling and education programs diverge sharply by institution type. Large national lenders capitalize on efficiencies of scale and brand recognition to reach a broad audience with standardized educational materials developed by Fannie Mae, industry groups, or government agencies. Nonprofits and consortia, by contrast, usually include education or counseling as central pillars of their charters; therefore, these groups have developed the most comprehensive and contextual programs.

The case studies reveal a variety of customized education and counseling efforts. AAFE provides group workshops and individual counseling

Table 8. **Illustrative Strategies for Qualifying Traditionally Underserved Mortgage Applicants: Case Study Examples**

Strategies for Qualifying Applicants	Case Study Examples
Provide Education and Counseling	
1. Lender-facilitated instruction	**Norwest** provides home-buyer education using instructional materials from Fannie Mae, GE Capital, and Mortgage Guaranty Insurance Corporation (as well as instruction conducted by nonprofits). **Countrywide** distributes a credit repair manual *(Your Credit and You),* often on referral from Countrywide's House America Counseling Center (HACC). **CNE** provides FasTrak homeowner counseling.
2. Nonprofit-facilitated instruction (often with lender partnership)	**BofA** partners in counseling with National Council of La Raza and other community groups. **People's** refers home seekers to the counseling services offered by ACORN in addition to its own instruction. **Berean** relies on ACORN and other Philadelphia nonprofit counseling agencies. **LHHA**, **AAFE**, and **NPH** all provide culturally sensitive homeownership training (e.g., instruction given in Creole, Chinese or Korean, and Navajo, respectively). **NHSC's** HomeBuyers Club provides peer support, education, and credit repair.
3. Training and certification	**DVMP** has trained more than 300 counselors; it also certifies counseling agencies.
4. Telecounseling	Potential borrowers can work with a counselor from the **Norwest** Homebuyers Club via telephone and mail contact. **Countrywide's** HACC provides centralized homeownership counseling via a toll-free number.
Provide Affordable Financing and Housing Opportunities	
1. Affordable mortgages	
a. Government and government-sponsored enterprise (GSE) affordable products	**Countrywide's** lending consists primarily of FHA, Fannie Mae, and Freddie Mac products. **NPH**, **FNBF**, and **Norwest** use HUD Section 184 (and other products) to enable lending on Indian lands.
b. Lenders' own affordable products	**BofA's** Special Allocation program provides financing to LMI borrowers or census tracts not meeting standard guidelines. **People's** community lending fund, or CRA pool, allows high LTV mortgages without mortgage insurance and has interest rate discounts and other affordable features. **Berean** allows debt-to-income ratios over 40 percent, well above industry standards. **Industrial** has no absolute debt-to-income ratio maximum on its portfolio loans. **AMC** allowed a 50 percent total debt ratio (later reduced to 42 percent). Participating **DVMP** lenders sometimes offered below-market-interest-rate (BMIR) financing and did not require private mortgage insurance on high LTV loans. **AMC** participants discounted interest rates by 50 basis points.

Table 8. **Illustrative Strategies for Qualifying Traditionally Underserved Mortgage Applicants: Case Study Examples** *(continued)*

Strategies for Qualifying Applicants	Case Study Examples
Provide Affordable Financing and Housing Opportunities (continued)	
2. Flexible underwriting	
a. Credit	**BofA** Credit Flex mortgages are targeted to LMI borrowers with lower credit scores, no credit history, or limited credit history. **People's** allows a strong nontraditional credit record to offset blemished formal credit (typically nontraditional credit is referenced only when formal credit records are unavailable). **Trent** draws heavily on FHA mortgages because FHA's credit underwriting is less stringent than that of other (e.g., GSE) products. **Berean** pays little heed to formal credit reports because it frequently finds them to be incorrect or outdated for its LMI borrowers. Lenders financing homes rehabilitated by **LHHA** did not run a credit score on LHHA's mortgage applicants. FHA, Fannie Mae Community Home Buyer's Program, and Freddie Mac Affordable Gold products offer numerous underwriting flexibilities with respect to credit and other underwriting criteria.
b. Property standards and appraisals	To improve the accuracy of appraisals in city neighborhoods, **People's** uses a combination of in-house appraisers familiar with city housing markets and similarly knowledgeable outside appraisers. **Industrial** prefers "inside the Beltway" appraisers, who are generally more knowledgeable about Industrial's market. **Berean** focuses on the particular property being mortgaged and not on the neighborhood or block in which it is located. **DVMP** underwriting focuses on the block rather than the entire neighborhood.
c. Employment and income	Lenders working with **AAFE** waived the standard requirement that a mortgage applicant have worked for at least two years (AAFE showed that its Asian-American clientele had often worked abroad for many years). **CNE** waives a two-year employment requirement under certain conditions (e.g., home buyer previously steadily employed). AAFE lenders waive formal income verification (e.g., a W–2) and accept other documentation (e.g., employer letter) instead.
d. Asset verification	A GSE pilot program accepted the informal *sous-sous* savings of **LHHA's** mortgage applicants as adequate funds to close. Similarly, lenders working with **AAFE** accepted savings drawn from the Korean *kye.* (Acceptance of informal savings later became industry practice.) AAFE also convinced lenders to accept flexible-repayment loans from extended Asian-American families as a permissible asset to close.

Table 8. **Illustrative Strategies for Qualifying Traditionally Underserved Mortgage Applicants: Case Study Examples** *(continued)*

Strategies for Qualifying Applicants	Case Study Examples
Provide Affordable Financing and Housing Opportunities (continued)	
3. Housing subsidies	**BofA** participates in 14 state bond programs offering BMIR mortgages, uses credit certificates in 20 cities and counties, and is approved for approximately 200 local and state down payment assistance programs. **Norwest** participates in more than 600 mortgage assistance programs (e.g., for down payment and closing cost assistance, insurance writedown, and purchase-cost reduction). In 1996, **Countrywide** was involved in 448 BMIR mortgage revenue bond programs and 475 soft second mortgages, which reduced down payment and closing costs for LMI borrowers. **People's** partners with the Connecticut Housing Finance Authority (CHFA) and others (e.g., a CHFA–People's product offers 100 percent LTV-BMIR home mortgages to current residents of public housing). **Berean** participates in a University of Pennsylvania employee mortgage program that allows loans with up to 105 percent LTV. **Industrial** participates in the DC Housing Finance Agency and other bond programs offering BMIR mortgages with closing cost assistance. **DVMP** participating lenders took advantage of soft seconds from the City of Philadelphia and of BMIR financing from the Pennsylvania Housing and Finance Agency. **FNBF** gave BMIR financing for Navajo housing through a grant received from the Federal Home Loan Banks' Affordable Housing Program (AHP). **AAFE** uses a variety of subsidies (e.g., building on city-owned land and using New York City–State BMIR financing). **LHHA** uses Community Development Block Grant, HOME, AHP, and Miami–Dade County surtax subsidies. **NPH** used AHP and other subsidies. **NHSC** partners with the City of Chicago, foundations, and lenders to provide affordable purchase, purchase-rehabilitation, and other financing.
4. Affordable housing	**AAFE** has developed 185 affordable apartments; it is currently producing about 250 affordable rental and homeownership units, as well as making commercial improvements. **CNE** has constructed more than 100 single-family homes and has renovated or constructed approximately 400 multifamily units. **NHSC** has been involved in the rehabilitation or new construction of almost 21,000 housing units, including 334 units of LMI rental housing that it owns and manages.

Table 8. **Illustrative Strategies for Qualifying Traditionally Underserved Mortgage Applicants: Case Study Examples** *(continued)*

Strategies for Qualifying Applicants	Case Study Examples
Foster Fair Access to Credit	
1. Multiple reviews	**Norwest** loans not immediately approved by automated underwriting are referred to more detailed manual underwriting. Norwest's Affordable Housing Underwriting Group offers additional underwriting assistance. At **People's**, any mortgage application that is rejected gets at least two reviews; a special review committee examines rejected LMI and minority home seekers; and a senior vice president further reviews all rejections of minority loans, regardless of income. Lender participants in **DVMP** had multiple internal bank reviews in addition to DVMP peer review.
2. Ensuring fairness	**Countrywide** statistically analyzes the denial disparity index of its retail branches, performs matched applicant pair (minority/majority) testing, and has a special representative hear fair-lending complaints. **CNE** annually reprocesses 10 percent of its loans to test for fairness.
Other Qualifying Strategies	
	NPH, **FNBF**, and **Norwest** are working to address the legal, bureaucratic, and many other obstacles to mortgage lending on American Indian lands (e.g., formulation of an innovative homesite lease that allows lenders to protect collateral while addressing the inalienability of tribal lands).

in many languages and dialects: Cantonese, English, Fukinese, Hindi, Japanese, Khmer, Korean, Mandarin, Spanish, and Urdu (AAFE 1998). CNE developed a Fannie Mae–approved counseling program that allows low-income households without serious credit problems to purchase homes with CNE affordable financing in as little as six weeks (Gross 1998; Pope 1998). An important component of the NAACP–NationsBank partnership is the classroom instruction conducted jointly by members of both organizations.

NPH, an affiliate of the Neighborhood Reinvestment Corporation (NRC), illustrates the dedication required to foster homeownership in the distinctive cultural, housing-market, and institutional context of the Navajo Nation. NPH developed a comprehensive education and counseling program attuned to the challenges on both the demand and supply sides of the market. Its small-group sessions cover household budgeting, credit, and other borrower issues with standard materials based on Fannie Mae's *Guide to Homeownership* (1999a) and other nationally distributed models. The sessions also depart from familiar territory to deal with the intricacies of HUD programs pertaining to American Indians and to the complex land-tenure arrangements required to collateralize a mortgage with real property on a sovereign American Indian nation. Counseling also focuses on relations between prospective buyers and contractors, because the poor conditions of the existing housing stock on the Navajo Nation require most borrowers to build new structures (Drake 1998; NPH 1997).

In a very different context, LHHA has developed an unusually well integrated program to prepare Miami's low-income Haitians for homeownership. LHHA acts as an intermediary between clients and primary-market lenders, marshaling a complex, multilayered set of subsidies to make ownership possible for households earning as little as $12,500 a year (Harder 1998). Clearly, this segment of the market requires an extraordinary level of support and individualized attention. In counseling, that support and attention translate into a comprehensive, long-term process by LHHA that begins with household financial assessment and screening (including detailed verification of immigration status and of employment, income, and credit histories) and culminates in a homeownership training program requiring participants to attend weekly sessions for seven consecutive weeks. The program is usually conducted in Haitian Creole, but it is occasionally offered in English and Spanish as well. Distinctive features of the program reflect the context of Little Haiti. For example, the prevalence of an informal barter and cash economy necessitates training on the principles and practices of household finance expected by mainstream American lending institutions (as well as advice on building alternative credit histories). The program also emphasizes homeowner insurance in response to the growth of overpriced and fraudulent insurance practices in parts of Miami in recent years (Harder 1998; St. Louis and François 1998).

In addition, for-profit lenders have developed a wide array of education and counseling programs. As a rule, smaller institutions with limited resources tend to develop relations with local nonprofits specializing in borrower education; larger institutions perceive a comparative advantage in standardized materials delivered to a large regional or national audience. Norwest, for example, makes extensive use of courses developed by Fannie Mae, GE Capital, and Mortgage Guaranty Insurance Corporation (MGIC), as well as of selected courses offered by local nonprofits (subject to approval by the company's Affordable Housing/Emerging Markets Division). The company also offers a free credit counseling program, centralized in two locations, that allows borrowers to complete a home-study course and gain preapproval for Norwest's affordable mortgages (Norwest Mortgage, Inc. 1998b; Russell 1998).

Similarly, Countrywide maintains a large, centralized telephone counseling center in California as part of its We House America initiative. A bilingual staff of counselors can prequalify borrowers or guide callers through a home-study program for up to a year; counselors refer those with serious credit problems to local affiliates of a network of nonprofit agencies (Van Dellen and Bielansky 1997). Such "telecounseling" may be appropriate only for marginal borrowers with minor problems that can be solved at a distance, but clearly the program reaches a fairly large audience. At the end of 1998, after less than three years in operation, Countrywide's center had completed counseling for almost 17,000 potential borrowers (Countrywide Credit Industries 1999b).

Education and counseling have been integral to expanding homeownership opportunities in recent years (Listokin et al. 1998; Rohe et al. 1998; Schwartz 1998).[14] Nevertheless, the achievements of the programs documented in our work and in similar studies should not blind us to the challenges inherent even in the most successful efforts. The programs are confronting information gaps, misinformation, miscommunication, and apprehensions that have been ingrained across generations. Wide variability in the content and quality of education and counseling programs also exists, leading to efforts to enhance quality control in the instruction being provided.

As an example, DVMP attempted to coordinate fragmented home-buyer counseling. Limited education and counseling were part of its activities from its inception in the 1970s, but by the early 1990s DVMP had moved into a fundamentally different role—certifying community counseling agencies and training individual counselors.[15] DVMP trained about 300 counselors from almost 60 community agencies and provided continuing education for counselors (DVMP 1994). A growing share of mortgage applicants to this consortium have received counseling (from one-quarter in the early 1990s to one-third in recent years). DVMP credits the increasing approval rate of mortgage applications (from about 60 percent in 1989 to roughly 85 percent in recent years) to the growing prevalence of counseling, especially higher-quality and more comprehensive counseling. On a national level, the American Homeowner Education and Counseling Institute is attempting to duplicate the DVMP

[14] Some experts perceive a downside to counseling. Counseling that reaches would-be home buyers at progressively earlier stages of the housing search can undermine the intentions of fair lending reporting requirements such as those under HMDA. In this view, counseling arrangements with nonprofits serve as a preselection mechanism that insulates a lender from rejecting—and reporting—a large number of poorly qualified applicants. Partnerships and affiliations with nonprofits may thus become attractive to certain lenders in that such linkages allow access to qualified borrowers (even in high-risk, low-income populations) while eliminating the regulatory scrutiny and bad publicity of high rejection rates. The counterargument to this negative view is that counseling that filters out potential applicants who are not yet ready for homeownership truly benefits both applicants and lenders.

[15] In recent years, DVMP ceased training counselors, as this role was assumed by Housing Counseling Associates of the Delaware Valley. DVMP continues to certify counselors, however.

effort to improve both counselor training and the quality of education and counseling programs.

Affordable Financing and Housing

Providing affordable mortgages, tapping housing subsidies, and developing affordable housing. Affordable lending has undergone a dramatic transformation in the past decade. Expanded lending to LMI, minority, and inner-city submarkets has proceeded simultaneously with shifting boundaries between (1) conventional, prime mortgage credit, (2) government-insured lending, and (3) subprime lending activities. In turn, secondary-market practices and policies have influenced all of those segments, creating a closer link between housing and capital markets. It is only a slight exaggeration to say that Wall Street is just outside the front door for most new homeowners, along with a lender, servicer, insurer, and an untold number of investors holding mortgage-backed securities (MBS).

The growth of MBS and other secondary-market financing mechanisms has radically altered the role of primary-market institutions. In 1998, approximately $990 billion in conventional, conforming, single-family mortgages was originated, and 54 percent of that amount was sold to Freddie Mac and Fannie Mae (Freddie Mac 1999). The secondary market (1) accelerates the flow of long-term capital investment into immediate loans for home purchases, (2) reduces regional and local variations in the cost of credit, and (3) provides a safe and relatively liquid investment vehicle. The mortgage instrument itself has been altered in the process, because loans must be standardized to permit assembly into securities that can be assessed for risk and yield. The benchmarks and guidelines adopted by Fannie Mae and Freddie Mac, therefore, have helped eliminate unnecessary duplication and coordinate a fragmented landscape of individual loan products.

Secondary-market forces have not eliminated all variations in primary-market lending, however, and such a scenario is neither likely nor desirable. Two factors are most important in this regard. First, community activism and regulatory scrutiny in the 1980s and early 1990s induced many depository lenders to create affordable lending units and other infrastructure based on special portfolio loan products (Listokin et al. 1998; Schwartz 1998). Securitization of CRA loans and greater flexibility in secondary-market criteria eliminate the need for many of these efforts, but the transition remains uneven and sometimes gradual.[16] Second, most lenders working in underserved markets make ex-

[16] In Fannie Mae's most recent public information statement, the analysis of the organization's competitive position included this point: "Competition is particularly intense for multifamily mortgage loans eligible for government subsidies which have

tensive use of public (and private) subsidies designed to encourage homeownership in specific locations or among particular groups. Even the use of a single, standardized loan product would not eliminate the complexity involved in such efforts. An institution's choices and strategies for navigating the dense web of subsidies and the requirements of federal, state, and local governments should be regarded, from a theoretical as well as a practical standpoint, as the contemporary version of product development.

The case study institutions, both large and small, provide vivid illustrations of such product development. Countrywide is involved in 148 mortgage-revenue-bond lending programs in 38 states, providing access to below-market-interest-rate (BMIR) loans. Countrywide also participates in 475 second-mortgage programs across the country, in which state funds, local funds, or both are used to help first-time or LMI borrowers meet down payments or closing costs (Countrywide Credit Industries 1999a; Van Dellen and Bielansky 1997). Norwest participates in more than 600 mortgage assistance programs, ranging from state housing finance agency programs to scores of local efforts to subsidize down payments, interest rates, or closing costs (Norwest Mortgage 1998a; Russell 1998). People's similarly engages BMIR financing from the Connecticut Housing Finance Agency and other sources (Williams 1997).

Nonprofits tend to be even more tightly enmeshed in the distinctive local webs of programs designed to solve particular housing and affordability problems. NHSC, the largest member of the NRC's NeighborWorks network, has developed several innovative programs to foster the renovation and rehabilitation of Chicago's inner-city housing stock. Those programs involve partnerships with several local banks, the City of Chicago, Freddie Mac, and Bank of America Illinois, among others (NHSC 1997; Toppen 1997). NHSC has been involved in the rehabilitation of almost 21,000 housing units; it is currently partnering with for-profit developers to build new, affordable, single-family detached homes for sale in Roseland and other Chicago neighborhoods. AAFE works to package state and city subsidies to build new, affordable units, including construction on city-owned vacant lots and use of property tax exemptions and other subsidies (Stanton 1998). AAFE, like NHSC, is also involved in affordable housing development (table 8). CNE develops affordable housing and provides affordable mortgages by tapping a potpourri of sources (e.g., Community Development Block Grants [CDBGs], Tennessee Housing Development Authority, Chattanooga Police Department, and the Lyndhurst Foundation).

low-income rent and occupancy restrictions. As a prerequisite to expansion or merger plans, commercial banks must fund such loans to meet certain obligations under the Community Reinvestment Act, and they are often willing to do so at or below their own cost of funds. Fannie Mae competes for these same investment opportunities to meet its housing goals" (Fannie Mae 1999b, 9).

In many respects, the efforts of LHHA exemplify the complex affordable housing development and subsidy packaging necessary to bring homeownership to the poor—in LHHA's case, to families earning as little as $12,500 a year. Most of LHHA's homeownership activities involve the acquisition and rehabilitation of foreclosed FHA properties, which are then sold to graduates of the organization's intensive homeownership training program. Financing typically involves three layers (Harder 1998; St. Louis and François 1998). A local lender provides a small first mortgage at market interest but with no points. Because of a low LTV, the first loan requires no mortgage insurance. A second mortgage is usually obtained from federal sources (HOME, HOPE [Homeownership for People Everywhere], or CDBG) or from a Miami–Dade County program funded through deed transfer surtaxes. Repayment requirements on these second mortgages vary by program, sometimes involving no cost to low-income borrowers who remain in the home beyond a specified period. Third mortgages are sometimes obtained through the Affordable Housing Program of the Federal Home Loan Bank.

Subsidies and other supports must be crafted to meet varying local needs. For instance, closing costs in the city of Philadelphia are extremely high (about 10 percent of the purchase price), thus adding to the problems of LMI families aspiring to homeownership in that city. In response, the City of Philadelphia, DVMP, and Fannie Mae developed "soft" second mortgages to offset the closing cost burden. Other case study institutions similarly crafted custom responses to meet the particular needs in their respective markets. Their actions are the antithesis of a "one size fits all" approach.

A final factor working against homogenization is the need for continued innovation in particular markets. Large national lenders and local depositories responding to CRA pressures developed affordable loan products well before the advent of national templates such as Fannie Mae's Community Home Buyer's Program and Freddie Mac's Affordable Gold program (both launched in the early 1990s). Many observers see a continued role for new product development among primary-market lenders, in partnership with nonprofits and the public sector. The leading edge of such development normally involves retaining products in portfolio for "seasoning" until secondary-market purchasers judge them safe. Several of the institutions in our study continue to develop flexible new products that exceed current secondary-market guidelines. BofA, for example, launched two major products in 1998 (BankAmerica Mortgage Corporation 1998). The Neighborhood Advantage Zero Down, targeted to LMI borrowers with good credit, allows a 100 percent LTV as well as gifts or grants to cover closing costs. The Neighborhood Advantage Credit Flex provides flexibility to LMI borrowers subject to a documented alternative credit history. People's offers a portfolio mortgage that encompasses a high LTV without private mortgage insurance, as well as discounted interest, closing, and other costs.

Underwriting considerations. Historically, many of the traditionally underserved failed to secure mortgages because they fell short of expected underwriting standards with respect to credit, property standards, employment stability, and asset verification. Strategies for making markets have thus involved a change in underwriting requirements to allow more flexible standards, some of which are provided in table 8. To illustrate, DVMP shifted the locus of property standards and appraisals from the overall neighborhood level, a standard that traditionally disqualified many West and North Philadelphia areas, to the block.

Yet underwriting involves not only the nominal standard but also the way in which it is applied; in this regard, the underwriting process has been changing from manual to automated processing. The latter is part of the standardization, routinization, efficiency, and commodification of modern mortgage finance. Automated underwriting has been a flash point of controversy in the debate on the impact of technology on housing finance. Automated underwriting has threatened the occupations of loan officers and underwriters, has inspired some observers to proclaim the dawn of perfect objectivity in the loan transaction, and has led others to suggest that new forms of discrimination (frequently called "automated adverse impact") may overshadow blatant forms of bias and differential treatment (Ladd 1998; Yinger 1995, 1997).[17] Indeed, as we noted earlier, the effect of automation will depend on whether it simply institutionalizes certain types of market failures—and removes them from public scrutiny behind a patented commercial product.

Those alternative interpretations are certain to fuel continued debate in the industry, among policy makers and scholars, and among the public at large. Regardless of the correct interpretation of automation's impact, underwriting is being reshaped at a rapid pace. The earliest case studies included in our research, conducted in 1997, captured the middle phases of efforts to diffuse standardized affordable loan products

[17] There is a certain twisted logic to arguments that technology will eliminate all forms of disparate treatment and adverse impact. Many of the individuals and institutions advocating automation as a means of eliminating subjectivity also dismiss discrimination as an economically irrational behavior and explain disparities in loan rejection rates as fully justified by minority members' lower assets and poorer credit histories. Yet the most widely used mortgage-scoring and automated-loan-approval software provides immediate "green light" results only for applicants who are clearly qualified and need no further documentation. If the primary benefit of automation is found in eliminating subjectivity, then the result may be to reinforce discrimination by granting faster approvals to clearly qualified applicants while relegating marginal borrowers to the subjective efforts of human underwriters. That kind of reasoning is implicit in the cultural affinity hypothesis (Hunter and Walker 1995).

and underwriting software throughout the industry. In a series of telephone interviews in 1997 with more than 50 lenders whose efforts to reach underserved markets were highly regarded, we encountered widespread uncertainty and concern—at least in affordable lending divisions—over the possible effects of automated underwriting (Listokin et al. 1998). In our present research, receptivity to automation generally mirrors differences in institution type and size. Larger lenders see dramatic reductions in per transaction costs permitting increased affordable lending volumes. Small nonprofits perceive their comparative advantage not in scale, but in the scope of services they provide to neighborhoods and residents. For those groups, automation is valuable only insofar as it facilitates increased flexibility for particular groups of borrowers or coordinates fragmented parts of the housing-finance infrastructure.

One component of automation, credit scoring, is very controversial.[18] There is statistical evidence that credit scores "work well for all types of borrowers regardless of income and race" (Wildavsky 1996, 307). Calem and Wachter (1998) have also found that credit scoring helps in underwriting affordable loans. Some of the case study institutions praised credit scoring's ability to help them better manage their customers' applications. One loan official (anonymous) at a DVMP-participating bank noted, "If the score is high enough, I move them [the applicants] to sellable (i.e., secondary market) products. If I know that I have problems with credit that will not get past the secondary market, then I move them to a portfolio product and/or refer them to counseling."

At the same time, nonprofits in our study voiced apprehension about credit scoring. One such institution (anonymous) decried credit scoring's mechanistic approach as not incorporating the cultural nuances of credit that characterize the African-American households it counsels.

> We're very leery…because who put together the models? A banker. They don't have a clue. They don't know. They go in at eight and come out at five. They don't have a clue. All they know is that their bills get paid.
>
> I'm trying to get lenders…to get underneath the veneer and see what caused the rejection based on the model. Was it the slow paying?…Was it the medical payment? What was it that bounced

[18] Credit scores are developed from credit bureau reports. The most common is the one developed by Fair, Isaac and Company, Inc., known as the *FICO score*. FICO scores are based on a complex statistical evaluation of the raw data in credit bureau reports and include those factors most highly correlated with credit repayment performance. FICOs run from above 800 to below 400. The scores purportedly rank-order applicants according to the likelihood that they will default in the future, with higher scores indicative of lower default risk and lower scores indicative of higher default rates.

> them out of the system? Was it a missed child care payment that sent the score down?…I am appalled at the credit scoring. We have told several lenders, if you use it, you will become a nonlender to our community again.

Other case study institutions also voiced misgivings on credit reports and credit scoring as related to traditionally underserved populations. Berean and LHHA spoke of numerous minority clients who had bad credit histories because they had received a dunning notice from a department store or hospital that was in error, but simply did not know enough or did not have enough time to clear up the matter.

All of these trends in underwriting intersect in a complex mixture of traditional practices, contemporary innovations, and limited pilot programs. Many, if not most, lenders use mortgage scoring systems developed by MGIC, PMI Mortgage Insurance, GE Capital, TRW/Mortgage Resource Group, or United Guaranty Residential Insurance Company. Fannie Mae and Freddie Mac provide more sophisticated "approve or refer" systems, but these have not yet eliminated traditional underwriting. In 1998, more than 7,800 reporting institutions filed records pursuant to the HMDA. By comparison, Fannie Mae's Desktop Underwriter was used by approximately 800 lenders in 1998, while Freddie Mac's Loan Prospector had a subscriber base of 760 (Fannie Mae 1999b; Freddie Mac 1999).[19] Subsequent growth has almost certainly increased those figures, and both Fannie Mae and Freddie Mac systems are being used, at least in pilot programs, to evaluate jumbo, Department of Veterans Affairs, FHA, A-minus, and Alternative-A loans (Fannie Mae 1999b; Freddie Mac 1999).

The case study institutions mirror this hybrid of traditional and automated underwriting practices. Most lenders involved in underserved markets tailor underwriting to government-sponsored enterprise (GSE) guidelines, but CRA-related initiatives and state and local subsidies remain important elements of portfolio lending. BofA organizes its affordable lending programs under the Neighborhood Advantage banner, and its products predate Fannie Mae's Community Home Buyer's Program (BankAmerica Mortgage Corporation 1998; Smith 1998). Since 1990, the company has originated more than $15 billion in Neighborhood Advantage home loans to LMI borrowers (BankAmerica Mortgage Corporation 1998). BofA's new products—including Zero Down, Credit Flex, and several pilot programs—require both flexibility and extensive documentation on a number of financial parameters. BofA has even launched a $250 million special allocation program, authorizing select underwriters to approve loans that are judged suitable risks even when

[19] Fannie Mae (1999b) estimates that 22 percent of its loan acquisitions in 1998 were processed through Desktop Underwriter, up from 9 percent in 1997. The figure for December 1998 was 26 percent.

in excess of GSE guidelines (BankAmerica Mortgage Corporation 1998). In a similar vein, People's offers both GSE-compatible mortgages and affordable loans that depart from secondary-market criteria. For example, mortgages granted from People's CRA Pool sometimes have a 95 percent LTV ratio without mortgage insurance.

FHA versus conventional underwriting. The case studies allow us to better understand the role that FHA plays in providing mortgage credit to traditionally underserved communities. Recent literature (Bradford 1998) documents the fact that FHA financing has sometimes been applied in a questionable fashion in minority LMI areas. Our investigation points to a more nuanced use of FHA loans. In Chicago, NHSC bemoaned unscrupulous real estate agents' frequent and harmful practice of pressuring poorly qualified homeowners to buy through readily available FHA mortgages (Toppen 1997). Haitians in Little Haiti were sometimes victimized, and many moved too quickly into an FHA-financed home that they soon abandoned (Harder 1998). Rehabilitating FHA-foreclosed houses, in fact, is LHHA's main activity.

By contrast, CNE uses FHA very constructively. The FHA 203(b) loan is CNE's most popular product, accounting for approximately 85 to 90 percent of all the loans it originates (Pope 1998). The popularity of this product is attributed to FHA's more flexible underwriting guidelines, including (1) no income ceiling, (2) assumability, (3) no prohibition on secondary financing, and (4) no requirement for private mortgage insurance. (CNE views private insurance as more problematic than FHA coverage—a view shared by Berean, Industrial, and other case study institutions.)

Trent overwhelmingly uses FHA because it realizes more profit from such lending (as a result of the additional points it charges) and because FHA offers numerous underwriting advantages for Trent's traditionally underserved customers (Sorgenfrey 1998). Trent finds that borrower-paid closing costs are lower on FHA loans than on GSE loans. Also, FHA is more tolerant in allowing relatives and friends to assist the purchaser by acting as nonoccupant cosigners. Of equal or greater importance was FHA's more flexible underwriting with regard to credit and other matters.

> With the GSEs, it is one strike on the borrower and he is out. With FHA, it's three strikes before you are out. A borrower can have two problems with FHA, a credit problem and a high ratio, and still be accepted. And our borrowers often have two strikes. (Sorgenfrey 1998)

The following real-world mortgage applicants had "issues" that led a Trent loan officer to refer them to FHA loans:

- Borrower 1—Relatively high FICO but sixty 30-day late payments. Back-end ratio is high (45 percent), but the borrower has higher assets ($2,000 liquid and $36,000 in a 401[k]) than is typical of Trent's applicants. Because of the late payments and high back-end ratio, the borrower was referred to FHA.

- Borrower 2—703–749 FICO, but a 38 percent front-end ratio. The latter was deemed too high for a GSE product.

- Borrower 3—Husband with a 628 FICO, despite a recent bankruptcy; wife with a 607 FICO (has perfect credit yet is at the credit limit on charge cards).[20] Income instability for both and high debt ratio. Because of the bankruptcy, unstable employment, and high debt ratios, the borrowers were referred to FHA.

Thus, underwriting is key not only to opening up mortgage opportunities for the underserved, but also in influencing which mortgage product is selected. The brief description of just three borrowers also points to the highly variable nature of credit seekers. Given that variability, it is most challenging to standardize underwriting to meet the demand of mass financing for commodification. Also, in changing the protocol and technology of underwriting, the lending industry must guard against losing the nuanced underwriting that most case study institutions used effectively to open markets to the underserved.

Fostering fair access

One way to guard against unfair treatment by an individual underwriter, as well as to prevent the loss of business opportunities, is to have prompt, impartial multiple reviews of rejected applications. Many case study institutions implemented a formal, multiple (two, three, and four) review process after an initial loan denial. Practices at CoreStates, one of the DVMP members, illustrate the breadth and depth of that approach. Once an application is submitted to CoreStates, the path to an approval or rejection decision is highly formalized and standardized. At no time during the process can any one party force the application to be rejected; the decision must be consensual, arrived at by all involved in the decision-making process. An underwriter in CoreStates's affordable lending unit reviews the application and makes a recommendation. An approval requires the borrower to obtain private mortgage insurance; a rejection sends the loan application to a second underwriter, who reviews it and makes a recommendation as well. If the application is rejected again, and if it is from the metropolitan Philadelphia mar-

[20] It is incongruous that despite a recent bankruptcy, the husband has a higher FICO than his wife.

ket, the application is forwarded to the DVMP credit committee to be examined at its weekly meeting. If one of the other member lenders of the DVMP is willing to underwrite the loan, the applicant is referred to that institution. If the application is from outside the metropolitan Philadelphia area, after a second rejection it is sent to CoreStates's internal credit committee for review. If that committee rejects it, or if none of the DVMP members is interested in picking up an application from Philadelphia, it is sent to be reviewed by CoreStates's fair lending committee to ensure that treatment was fair. The fair lending committee is part of the CoreStates compliance unit, which must review all loan applications that are categorized as part of a "protected class" before they can be denied.

As the above example attests, a lender's multiple review process is an intricate matter. We do not trace this process for all of our case study institutions. Many, however, impose demanding multiple reviews to root out any tinge of discriminatory behavior. At People's, for example, all applications that are initially denied are reviewed by a vice president, whose sign-off is required before a rejection is final. LMI applications got a third review by a committee. As a further level of reconsideration, the senior vice president for residential lending attends a high-level review committee meeting every quarter and justifies in detail all declinations for minority loans, regardless of the applicant's income. The justifications are submitted in writing (about one to two paragraphs for each applicant). The justifications and the committee's decision (the committee can overturn the initial denial) go into the bank's minutes, which regulators can review.

Besides multiple reviews, testing to see that fair, consistent standards are being applied is yet another strategy used by our case study lenders. CNE, for example, totally "reprocesses" 10 percent of its loan files each year. It takes the information that had been gathered originally and then reprocesses each loan, using a different appraiser, processor, and underwriter to reach a decision (approve or disapprove). That decision is compared with the original to measure the bank's consistency in deciding whether—and how much—credit should be extended. If inconsistencies are spotted, CNE scrutinizes them for possible racial or other bias.

Understandably, the larger lenders often did the most comprehensive testing. Countrywide, for example, does the following:

1. Performs matched pair (minority and nonminority) testing of the credit application process.

2. Contacts people (minority and nonminority) who have applied for a loan to ascertain how they were treated.

3. Conducts a monthly statistical analysis of all of its branches. It measures what it calls the denial disparity index, which is the ratio of the denials to minority applicants over the denials to white applicants. If a branch's denial disparity index is significantly greater than 1, Countrywide examines the branch's policies and staff.

4. Measures market share because "you can have a low denial rate to minorities because you don't get any applications from minorities. So market share is another measure of service that we scrutinize" (Van Dellen 1997).

Retaining new homeowners

The mortgage transaction is only one facet of a complex web of housing market processes. Even this single transaction, however, has grown more complex over the past generation. Mortgage contracts have been split into their constituent parts, with specialization and market competition setting prices for the various functions involved. For new homeowners, these changes are most apparent in postpurchase servicing; for those who encounter financial difficulties, the changes appear in delinquency intervention and other retention activities.

The expansion of secondary mortgage markets has separated the ownership of repayment obligations from the many activities involved in loan servicing. Servicing typically involves not only collecting and remitting principal and interest payments to the note holder, but also administering escrow accounts, supervising any changes in ownership or security interests, granting necessary easements, and, if necessary, negotiating workouts or foreclosure proceedings on nonperforming loans. Servicers are typically compensated through the deduction of a contractually specified portion of each interest payment. The vast majority of GSE loans are serviced through members of a large network of providers approved by Fannie Mae, Freddie Mac, or both; many of these agents are primary-market lenders who retain servicing on loans they sell to the GSEs (Fannie Mae 1999b; Freddie Mac 1999).

Such separation of functions provides the context for the strategies employed by the case study organizations to sustain homeownership among traditionally underserved populations. Table 9 illustrates the strategies used, which include *ensuring ongoing communication with and education of borrowers*, *enhanced oversight*, *quick response to delinquency*, *workouts as necessary*, and, more generally, *overall neighborhood support*.

Most affordable loan products include provision for some sort of enhanced attention to past-due borrowers, but approaches to bringing

Table 9. **Illustrative Strategies for Retaining Traditionally Underserved Homeowners: Case Study Examples**

Strategies for Retaining Homeowners	Case Study Examples
Communication with and Education of Borrowers	
	A **Countrywide** video, *Living the Dream: A New Homeownership Survival Guide*, covering the basics of budgeting, home maintenance, and similar topics, is required viewing for all retail borrowers. New borrowers are notified by **Trent** that the company is available to help borrowers in times of need. **LHHA's** Homeowners' Club offers new homeowners an opportunity to meet for social and educational activities (e.g., to hear about fire and hurricane safety). **NHSC** mails newsletters to its borrowers to apprise them of ongoing services, programs, and opportunities with NHSC and with citywide and statewide programs.
Enhanced Oversight	
	DVMP lenders would often drive through the neighborhoods where mortgages were granted and "windshield" survey the condition of the DVMP properties. **LHHA's** family outreach specialist visits each borrower bimonthly to inquire about problems with the house or neighborhood. The specialist also notes whether repairs to the house are needed, makes a visual inspection of the immediate neighborhood, and attempts to address observed problems (e.g., by referring the homeowner to reliable tradespeople).
Quick Response to Delinquency	
	Many GSE and similar affordable products mandate a quicker servicer response to delinquency (e.g., the servicer contacts the borrower 15 days after a payment is late, rather than waiting for 30 days to elapse). On all its loans (portfolio and those sold to the secondary market), **Berean** intervenes before a payment is 30 days past due to work out a solution. **Industrial** acts similarly. Long before it became industrywide practice, participating **DVMP** lenders responded quickly to delinquency. **AMC** closely monitored delinquencies, and the AMC executive director visited the homes of newly delinquent borrowers to initiate workouts.
Delinquency Workout	
	Postpurchase delinquency counseling, often by nonprofits, is required in conjunction with many affordable lending products on an as-needed basis. The borrower authorizes the servicer to share relevant account information with a third-party counselor should the borrower become delinquent. **People's** provides counseling on budget management and debt restructuring to challenged borrowers (e.g., those experiencing a job loss) and also refers those borrowers to an independent, nonprofit counseling organization. On an as-needed basis, People's will work out a delinquent loan to keep it performing by modifying the interest rate or stretching out the repayment schedule. **NHSC's** Foreclosure Intervention Program provides mortgage-delinquency counseling and financial aid (e.g., NHSC can arrange a loan through Chicago's Homeowners Emergency Lending Program).

Table 9. **Illustrative Strategies for Retaining Traditionally Underserved Homeowners: Case Study Examples** *(continued)*

Strategies for Retaining Homeowners	Case Study Examples
Overall Neighborhood Support	
	LHHA's Homeowners' Club (described above) sets a framework for collective neighborhood action with respect to public safety, economic activity, and social programs (e.g., organizing block and neighborhood watches). In addition, LHHA provides youth and after-school programs, resource centers for art and computer instruction, and a Service Exchange Program (through which LHHA homeowners barter services, such as providing gardening in exchange for child care). LHHA has also fostered a Little Haiti credit union/ economic development corporation. **AAFE** provides many support services for its target Asian-American neighborhoods, including civil rights advocacy, citizenship and other education, landlord-tenant dispute counseling, and economic development through such means as obtaining affordable financing for local businesses and rehabilitating or building new commercial stores. **CNE** improves neighborhood conditions through strategies ranging from commercial development to improved public safety through its Police Officer Next Door Program. **NHSC** supports revitalizing neighborhoods through beautification (e.g., cleanup of a CSX railroad embankment), commercial development (assembling properties in the Roseland neighborhood), and enhancement of public safety (e.g., participating in a "super block" intervention combining enhanced police protection and improved social services and infrastructure).

payments to current status vary. The large lenders in our case studies have developed formal procedures and behavioral models to predict the likelihood of foreclosure (and thus to put in order of priority resources devoted to contacting past-due borrowers). Countrywide makes extensive use of these types of models. In addition, its targeted We House America loans require applicants to submit a detailed household budget, designed to help new owners navigate postpurchase financial issues, before final loan closing (Van Dellen and Bielansky 1997). Norwest also employs comprehensive automated delinquency analysis along with enhanced procedures for mail and telephone contact at specified points in the delinquency cycle. Postpurchase counseling, funded by mortgage insurers, is required on most of Norwest's affordable loans and is initiated on the 31st day of delinquency through a network of local nonprofits (Norwest Mortgage 1998b; Russell 1998). BofA has similar procedures and requires applicants to authorize sharing their account information with PMI Mortgage Insurance (designated for BofA's new Credit Flex) and GE Capital Mortgage Insurance (designated for Zero Down) (BankAmerica Mortgage Corporation 1998).

Smaller institutions and nonprofits often maintain direct contact with borrowers (rather than by way of contracts with specialized servicers). People's was forced to allow a large number of workouts on problem portfolio loans in the early 1990s in the wake of a collapsing New England real estate market—thereby necessitating the development of enhanced policies and practices on postpurchase contact (Williams 1997). DVMP incorporates delinquency analysis provisions similar to those of large national lenders, but postpurchase contact is maintained through the participating institutions (DVMP 1994; Sitner 1997).

LHHA maintains the most comprehensive and innovative retention procedures among our case study institutions. Reflecting the organization's central mission of promoting homeownership as part of broader community economic and social development, postpurchase contact is explicitly set within related functions. LHHA maintains postpurchase contact with every graduate of its homeownership training program. Contact involves bimonthly visits by an association outreach specialist, who initiates informal discussions of all aspects of the family's situation—from changes in household circumstances to actual or perceived neighborhood problems (St. Louis and François 1998). Such a relationship allows personalized attention to possible financial problems well before the first signs of delinquency but is only possible as an outgrowth of the trust embedded in the organization's comprehensive community-building activities. Widespread replication of such an approach is exceedingly difficult and could not be contemplated without raising privacy concerns. Nevertheless, LHHA's comprehensive efforts serve as an important model for community development. Beyond postpurchase visitation, the organization coordinates an active Homeowners' Club and a highly innovative Service Exchange Program through which residents barter services such as maintenance, gardening, child care, transportation, and even translation (Harder 1998; St. Louis and François 1998).

Selecting from the menu: Considerations in applying the strategies

We have presented a broad menu of strategies designed to create new mortgage markets for traditionally underserved populations and communities. Individual strategies vary considerably, however, in their practical applicability, which is affected by several factors. First, the relevance of some strategies varies depending on institution type. Second, the menu of strategies itself has evolved, and will continue to evolve, in response to changes in consumer needs and industry structure and practice. Over time, some strategies become more useful and others less so. Finally, the strategies are constrained to the mortgage market and therefore do not apply to all real estate processes that affect the ability of traditionally underserved populations to attain and sustain homeownership. The remainder of this section describes these factors in greater detail.

The first and probably most obvious factor affecting applicability is that the relevance of strategies differs depending on institution type. Given that nonprofits come from and are parts of their communities, they have less need to establish credibility and to effect outreach than institutional lenders. This community base puts nonprofits in a good position to assume such demanding roles as assembling housing subsidies and contributing to the long-term support of new home buyers and challenged neighborhoods. Larger lenders are more likely to provide telecounseling and to offer portfolio products than their smaller peers; yet the latter can make do by capitalizing on the counseling materials and services developed by others and by offering mortgages that can be sold on the secondary market.

We must also recognize that strategies for making new mortgage markets are a moving target because they are developing within a rapidly evolving context of consumer needs and industry structure and practice. This changing context causes the usefulness of strategies to vary over time. For example, when DVMP's predecessor, the Philadelphia Mortgage Plan (PMP), was established in 1975, its 95 percent LTV mortgages with 25/35 percent front-end/back-end ratios went far beyond the prevailing mortgage terms at the time. Today, PMP-like mortgages would be considered conservative, and in fact DVMP lenders offer much more aggressive products. AMC mortgage terms were also a moving target; participating lenders first experimented with a back-end ratio of 50 percent, and when that proved too high, the consortium retrenched to a total debt-to-income ratio of 42 percent. Such experimentation is part of the moving target philosophy.

Indeed, as affordable lending has become more common and as the lending industry has continued to consolidate, the need for lending consortia has come into question. When banks first started to address underserved markets, the newness and challenge of those markets prompted many to seek the comfort of their peers by forming local consortia. As experience with affordable lending grew, the need for such arrangements was less pressing. Of the two consortia studied here, AMC and DVMP, the former ceased operations in 1997 and the latter revamped its focus. Adding to the challenges local consortia face is the trend toward regional and national banks in which underwriting is often done at distant satellite offices. Remote underwriting makes it much harder for local lending officers to come together to provide peer review and support—a key feature of the consortia approach. Consortia may still have a role in some places (i.e., where local underwriting prevails; affordable lending is still new; and, possibly, where special needs, such as rehabilitation financing or personal delinquency intervention, lend themselves to group action), yet their time may largely have passed.

Changes in industry structure have also influenced counseling strategies. In the early 1990s, when counseling of potential homeowners was less developed and uneven in quality, DVMP trained and certified counselors. As counseling developed into an industry, DVMP was able to drop its training role. (It continues to certify counselors, however.) As the counseling curriculum and the practitioners further professionalize, there will be less need for DVMP-type oversight, although a need for development of specialized counseling programs for Haitians, Asian Americans, American Indians, and other groups that face special obstacles to homeownership and thus have special counseling needs will remain.

Obstacles to homeownership have also changed in relative importance over time, and thus consumer needs for mortgage products and services have changed as well. In the 1970s, only about one-quarter of DVMP mortgage applicants were denied loans because of poor credit, but today that share is about half. Recognizing the growing credit barrier to affordable mortgage financing, DVMP in recent years increased its efforts to improve the availability and quality of credit counseling in the Philadelphia area.

New needs have also arisen as growing numbers of traditionally underserved households have attained homeownership. When affordable lending was newer, attention understandably focused on management reforms and strategies for attracting and qualifying underserved applicants, both of which were needed to jump-start a new market. As more underserved consumers have attained homeownership, the need to focus on the long-term nurturing of that market has grown. Therefore, more comprehensive borrower and neighborhood supports, similar to those offered by LHHA, are necessary. The very scope of such efforts makes them challenging to replicate and sustain.

Rehabilitation financing is another area of growing need. Housing suitable for affordable homeownership often needs renovation. Even if rehabilitation is not immediately necessary, home repairs will ultimately be needed and may be difficult to finance for some traditionally underserved consumers. Thus, a new frontier of strategies must include affordable purchase-rehabilitation and home-repair financing. That some of our more mature nonprofits, such as NHSC and CNE, are confronting the rehabilitation challenge is no accident. DVMP is also reorienting its focus toward rehabilitation.

Maximizing the reach of minority-owned institutions is yet another area of growing need. These institutions are natural lenders to the underserved, yet their modest capitalization constrains their mortgage operations. Efforts are being made to address that barrier (for example, a GSE $500,000 investment in Berean), but more could be done.

Larger lenders could form correspondent banking arrangements with their minority-owned peers. Seed funding could jump-start the latter, tying in with the secondary market. Eight Berean staff members worked over a four-month period to do the first loan sale to Fannie Mae. Such a large obligation of work hours is a tremendous burden to a small institution; a seed loan or grant could alleviate some of that burden. Also, bank regulators must be sensitive in applying standard industry measures of performance to minority institutions.[21] The latter were historically one of the few sources of mortgages for minorities, and with industry and regulatory support, they can continue to play an important role for the underserved.

In the future, strategies for expanding homeownership opportunities will continue to evolve in response to changes in the mortgage industry. Industry transformation is not abating; in fact, it is likely to accelerate in the wake of financial modernization. Future strategies will be shaped by such forces as increased automation, risk-based pricing, and the trend toward giant financial conglomerates. If history is a guide, those forces offer both opportunities and challenges for enhanced affordable lending. Automated underwriting may further the march toward color-, ethnic-, and gender-blind loan evaluation, but it may not capture the full economic and cultural nuances and variety that characterize the underserved market. Risk-based pricing can carve out markets for some underserved households that heretofore did not meet minimum acceptable underwriting standards. But risk-based pricing, especially if coupled with insensitive automation, can also result in some of the financial harm currently attributed to predatory lenders. A hypothetical example from the case studies is illustrative. Low-income Haitians in Miami will likely be accorded a high risk-based price. A nonprofit such as LHHA can intervene to lower that price—but does an LHHA-type intervention comport with an automated, risk-based price regime?

The agglomeration of financial institutions is a mixed blessing with respect to the underserved. Among the case studies, the biggest volumes of affordable lending were achieved by the financial superstores of tomorrow (BofA, Countrywide, NationsBank, and Norwest). Those institutions had the deep pockets to afford the initial losses and the infrastructure (specialized lending units and telecounseling) that accompany the making of new markets. National institutions have also

[21] An example is the ratio of general and administrative costs to total assets. Given their modest assets, modest-sized mortgages, and higher costs per closed loan, minority institutions that stress affordable lending will have nominally less desirable general and administrative costs and similar ratios. For that, they should be rewarded—not penalized—by regulators.

been high-profile targets for community group scrutiny, and that scrutiny has inculcated affordable lending. Thus, on numerous counts, scale bodes well for further progress in reaching the underserved. Yet, as was indicated in the DVMP case, as local institutions merge into national and regional entities, an immediacy to and knowledge of underserved markets dissipate as well.

The final consideration related to the applicability of the case study strategies is that they are largely limited to the mortgage lending industry and do not extend to the broader set of real estate industries and professionals, including real estate agents, appraisers, insurance companies, and credit agencies. Each of these industries or professionals is integrally related to creating new mortgage markets. For example, a study in Massachusetts found that 57 percent of property insurance agents in urban areas did not have contracts with any of the state's top 20 insurers (Federal Reserve Bank of Boston 1997). Therefore, consumers in those areas were often effectively limited to one option: the Mass Fair Plan, the insurer of last resort for the state, and an expensive carrier.

It is beyond the scope of this article to consider the strategies appropriate to the gamut of real estate industries and professions that affect homeownership opportunities. Some of these, however, are discussed in the synthesis of six Federal Reserve housing and mortgage credit studies (Listokin et al. 2000, appendix). Some recommendations from those studies include the following:

1. Property insurance companies should proactively provide coverage to traditionally underserved areas, objectively determine premiums (based on use-loss ratios), and eliminate potentially discriminatory underwriting criteria (e.g., minimum insurance amounts and "pride of ownership guidelines"). Such efforts would mirror actions taken by lenders (e.g., eliminating minimum loan amounts).

2. The appraisal industry should incorporate second reviews (similar to the multilevel review of loan applications), and the Uniform Standards of Professional Appraisal Practice should prohibit the use of buyer characteristics, owner characteristics, or both (a possible source of bias).

3. Credit agencies should improve turnaround time for correcting erroneous data, and the credit industry should review the effect of credit scoring on traditionally underserved populations.

We will discuss the opportunity and challenge of expanding mortgage markets at greater length in the following concluding section.

The opportunity and challenge of new mortgage markets

The 1990s opened with several intersecting trends that began to transform the American housing finance sector. A short recession deflated real estate prices and dampened housing market activity, while an avalanche of new, publicly disclosed mortgage-lending data fueled heated debates over the extent and severity of racial and ethnic discrimination among lending institutions (Munnell et al. 1992, 1996). Consolidation and competition intersected with continued demographic trends to force a search for new market opportunities. Regulatory and judicial developments coalesced to push the industry to root out discrimination against protected classes of borrowers as well as low-income and minority neighborhoods, and 1992 legislation established purchasing goals for Fannie Mae and Freddie Mac.[22]

In response to those trends, housing finance institutions made large commitments to affordable lending during the 1990s. In 1994, Fannie Mae announced a commitment of $1 trillion to help finance more than 10 million new homeowners among underserved populations and neighborhoods through 2000. That goal was reached eight months early, and Fannie Mae then pledged a new 10-year $2 trillion "American Dream Commitment" to serve 18 million targeted American families (Fannie Mae 2000a, 2000b). In 1999 alone, Freddie Mac guaranteed $108 billion in mortgages for 1.3 million very low, low-, or moderate-income families and households in underserved areas. That last figure represents more than 55 percent of all families served by Freddie Mac in 1999. Numerous case study institutions made affordable lending commitments of their own. Examples include a $37 billion BofA pledge to LMI lending, a $10 billion pledge by NationsBank, and a $200 million "Building Foundations" initiative from People's. In less than a decade, industry unease with fair lending and community reinvestment oversight has evolved into intense competition for new markets.

The weight of those large institutional commitments—in the context of an unprecedented economic expansion—has accelerated efforts to make homeownership an option for ever-increasing numbers of residents and communities that would have been written off only a few years ago. Discrimination and fair access to housing opportunities remain a severe problem in parts of the industry and in certain entrenched urban processes (Holloway 1998; Wyly and Holloway 1999; Yinger 1995, 1997)

[22] The 1992 Federal Housing Enterprises Financial Safety and Soundness Act specified financing goals for GSEs (Fannie Mae and Freddie Mac). GSE goals are of three types: (1) "low and moderate income" (targets mortgages for families with incomes less than or equal to the area median income); (2) "geographic" (targets mortgages for housing in areas underserved by mortgage credit institutions); and (3) "special affordability" (targets mortgages on housing for families with incomes below 60 percent of area median or families with incomes less than 80 percent of median buying in low-income areas).

and continue to be a public policy concern. But the substantial funds directed to underserved markets have pushed public policy to examine the material benefits actually delivered by homeownership. Although there is evidence that homeownership provides several benefits (Colton and Crowe 1998; HUD 1995), homeownership finance is limited as a policy tool. Even the most innovative mortgage loan program, pursued in isolation, can do nothing to reduce poverty, improve school districts, or provide a long-term solution to suburbanization processes that inject vitality and asset appreciation into an elite favored quarter at the expense of the central city and inner-ring suburbs.

The efforts documented in the case studies mirror all of these challenges. The efficient, standardized services of Countrywide, Norwest, and BofA provide opportunities for hundreds of thousands of households nationwide but cannot tackle the full range of contextual problems faced by clients of the LHHA or CNE. Yet the cost and scope of the customized interventions pursued by groups such as LHHA and CNE greatly limit their scale and replicability. It is also clear that liberalized underwriting, while opening homeownership opportunities for many, poses significant risks not only to lenders and investors, but also to households with high debt ratios and limited initial equity. Indeed, under some circumstances, borrowers obtaining FHA-insured loans can start out with negative equity—surely a precarious position in today's buoyant land markets (Bradford 1998).

The risks faced by such highly leveraged households raise the issue of sustainability. Are lending industry institutions, nonprofit organizations, and government agencies doing enough to ensure that low-income buyers can withstand disruptions in income, unexpected maintenance costs, rising energy expenses, or a combination of these factors? The historical record gives one pause. The 1968 Section 235 homeownership program, with its very attractive financing terms (a 40-year, 1 percent mortgage) was considered a model in its day, yet many Section 235 mortgages ended in foreclosure because homeowners were financially unable to cope with subsequent rising energy and maintenance costs.[23]

The geography of the contemporary effort to foster homeownership also warrants attention. A recent study provided evidence that large and growing shares of minority and low-income home buyers are attaining suburban homeownership, but the study also pointed out that such buyers are not necessarily locating in higher-income or less segregated communities (Joint Center for Housing Studies 1999). In fact, the same study found that only one-third of low-income home buyers purchased homes in neighborhoods whose residents had incomes at least equal to the metropolitan area median. Another recent study in Chicago revealed that a large proportion of African-American home

[23] The Section 235 program was also plagued by fraud and many other problems.

buyers are purchasing homes in neighborhoods where most of the other buyers are also African American, suggesting the persistence of spatially segregated homeownership patterns in that city (Immergluck 1998).

If traditionally underserved households are achieving the American dream mostly in urban, lower-income, or racially segregated areas, important policy implications follow. If pursued on a sufficient scale, efforts to funnel mortgage credit to underserved borrowers or neighborhoods may support inner-city revitalization, but those efforts counteract attempts to broaden access to the well-funded school districts, employment opportunities, and healthy price appreciation of favored suburban markets. Even if one accepts the legitimacy of a possible urban-focused geography of contemporary affordable lending efforts, there is yet again an inherent tension. We may be getting poor people into homeownership by capitalizing on relatively low urban housing prices; yet in the very act of opening up urban mortgage markets, mortgage initiatives may cause urban housing prices to rise and strain affordability.

None of those tensions detract from the important accomplishments of lenders and nonprofits working in underserved markets. To the degree that public policy and market processes continue to favor ownership over renting, efforts to increase mortgage lending to underserved populations are essential to broadening economic opportunity. Nevertheless, the advancing state of the art in these affordable lending programs demands an equally aggressive pursuit of broader goals in homeownership sustainability, economic development, and equity. Ultimately, the long-term effects of the present rush to tap new mortgage markets will depend on changes in the implicit and explicit distribution of risks and rewards in America's central socioeconomic institution—homeownership.

Authors

David Listokin is a Professor at the Center for Urban Policy Research at Rutgers University. Elvin K. Wyly is an Assistant Professor in the Department of Geography and the Center for Urban Policy Research at Rutgers University.

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