



# Tennessee Housing Development Agency Issue Brief: Racial and Ethnic Disparities in Home Mortgage Originations in Tennessee

Part Two of a Six Part Series Examining Issues of Fair Housing in Tennessee

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January 2021

## Key Findings

- Race is a stronger predictor of loan denial than income and associated indicators of creditworthiness
- Loan applications from Black Tennesseans are almost twice as likely to be denied as applications from their White counterparts.
- The Black-White racial disparity in denial rates is greater among higher income borrowers. High-income Black loan applicants are twice as likely to be denied as their White peers.
- THDA and its partners are taking action to address these impediments to homeownership and wealth accumulation.

## Introduction

This brief is second in a series addressing fair housing issues in Tennessee. The issue brief series presents a summary of research THDA performed between 2018 and 2020 to identify impediments to fair housing choice. The analysis of impediments research forms the basis of THDA's 2020 – 2024 Fair Housing Plan (FHP). The plan includes actions and strategies to eliminate or reduce the negative effects of specific impediments based upon the analysis of impediments research<sup>i</sup>.

The Fair Housing Plan identifies two impediments to housing choice related to racial disparities in residential mortgage originations:

- 1) Lack of knowledge of the home buying process and awareness of rights during home purchase that would allow the

- prospective homebuyer to recognize discriminatory lending practices, which may disproportionately impact persons in a protected class, particularly minorities; and
- 2) Less opportunity to achieve homeownership among minority populations, particularly among African American households, especially in the Memphis area.

## Overt Acts and Disparate Impacts

This research examines mortgage market outcomes, not discriminatory intent. Unequal access to credit on the basis of membership in a protected class limits housing choice. Impediments to housing choice in the area of mortgage finance can take the form of intentional discrimination manifested by disparate treatment of individuals based on a protected characteristic.<sup>ii</sup> They can also take the form of business practices, which unintentionally result in disparate outcomes.<sup>iii</sup> Discriminatory conduct on the part of individuals and financial institutions limits access to homeownership and narrows the range of housing opportunities available to families and individuals. Regardless of intent, it is otherwise unexplainable racially disparate outcomes in lending which limit access to homeownership.

## Identifying Disparities Using Loan Application Data

Unequal access to credit is observable in the housing market. Disparities in access to credit and quality of accessible credit sources (i.e. the lack of traditional lenders like banks in a community) result in barriers to purchasing and maintaining a home on the basis of membership in a protected class. One way to detect potential acts of discrimination, as well as unequal access to credit on the basis of membership

in a protected class, is to evaluate data related to home loan applications and originations. The primary source of information for this analysis is the Home Mortgage Disclosure Act (HMDA) data reported by institutions in Tennessee for the years 2013-2018.<sup>iv</sup> These data have been supplemented with information from other sources. The Act requires many financial institutions, including banks, credit unions, and other mortgage originators, to collect and submit loan data that can be used in identifying possible discriminatory lending patterns.<sup>v</sup> These data include demographic information about borrowers, the location of the proposed collateral, the type, purpose and characteristics of each loan and the outcome of the loan application.

The data include useful demographic variables for observation of patterns and correlation. However, the reporting required under HMDA does not include all factors which go into underwriting a mortgage loan. For this reason, HMDA data alone do not indicate the causes of disparities. The data can, however, reveal where disparities exist and what policies and practices may lead to uneven outcomes in mortgage lending.

### **Racial Disparities in Denial Rates**

Over the five-year period of 2013-18, improving economic conditions resulted in loan denial rate declines across racial and ethnic groups in Tennessee. However, the rate of improvement has been uneven. The denial rate disparity between Black and White Tennesseans grew during the period.

Loan applications can result in various outcomes. The three most common outcomes are that the loan is originated; the applicant withdraws the application; or the lender denies the application. There are many reasons that a financial institution may deny a loan application. Legitimate reasons for denial include excessive debt-to-income ratio, insufficient employment history, poor credit history, insufficient collateral, insufficient funds for down-payment and closing costs, and inability to obtain mortgage insurance.

Disparities in treatment and access to credit can result from inconsistent application of underwriting standards across protected classes, unlawful reasons for denying a loan application (e.g. redlining), and fundamental differences in social and economic opportunities, which lead to disparate impacts even when standards are applied consistently.

The period of time covered by this analysis corresponds to an increase in overall loan activity following the Great Recession. Prior to the COVID-19 pandemic, the sustained economic expansion increased incomes, rebuilt home equity, and restored normal liquidity to mortgage markets. Consequently, a greater share of all loan applications were successful. Between 2013 and 2018, mortgage lenders in Tennessee reported an overall increase in loan originations. Over the five-year period, financial institutions in Tennessee reported 627,736 home purchases loan applications for primary residences.

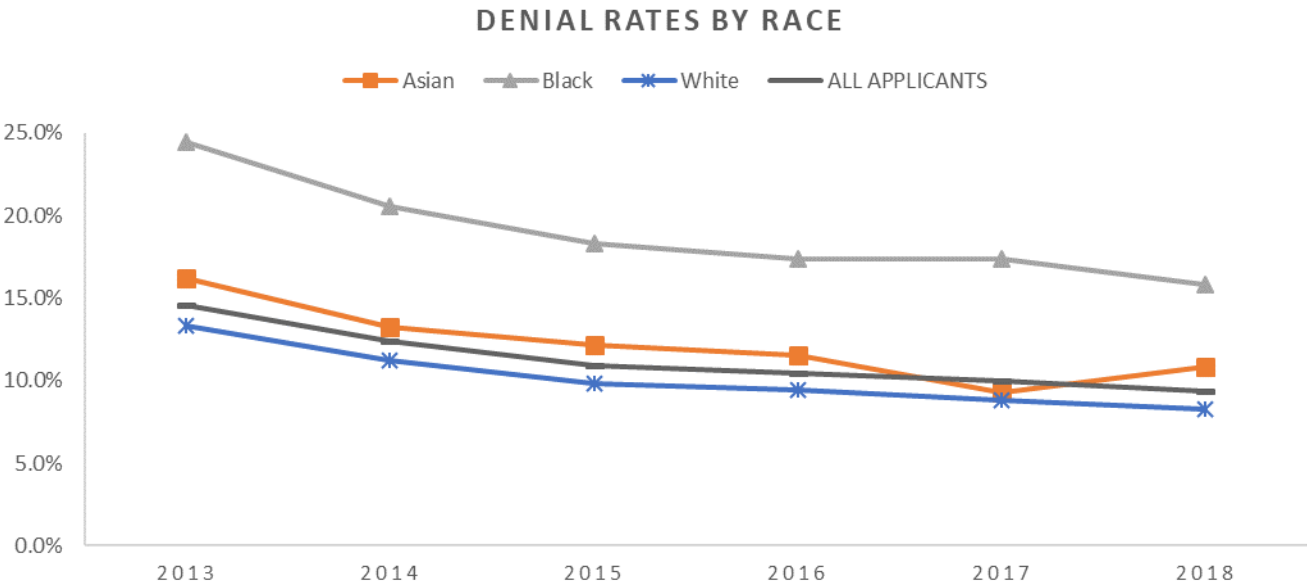
The majority of reported applications resulted in originations. Approximately 70.4 percent of all loan applications. During the same period the denial rate fell from 20.4 percent in 2013 to 14.8 percent in 2018.

Denial rates have fallen for all races during each year the period evaluated. The denial rate among White applicants was 13.3 percent in 2013, declining to 8.3 percent in 2018. For Black applicants, the denial rate declined from nearly a quarter (24.5 percent) of all loan applications in 2013 to one-sixth (15.8 percent) in 2018. Among Asian applicants, the denial rate declined from 16.2 percent in 2013 to 10.9 percent in 2018.

Disparities in loan denial rates increased during the time period, despite the overall improvement in access to credit. In 2013 Loan applications from Black Tennessean were 84 percent more likely to be denied than White loan applicants. Five years later, Black Tennesseans were 90 percent more likely to be denied than their White counterparts.

The rate of denial has fallen by more than 37 percent among Whites, 35 percent among Blacks, and 33 percent among Asians. The more rapid decline in denial rates among Whites, combined with their lower denial rate at the beginning of the

period evaluated, has led to a widening disparity in access to credit, even as access to credit improved within each racial category.



**Racial Disparities in Denial Rates are Not Explained by Income Differences**

The racial disparities in loan denial rates observed in the HMDA data are not explained by differences in income across racial groups in Tennessee. In fact, the Black-White disparity in loan denial rates increases with income. That is to say, race is a stronger predictor of loan denial than income and associated indicators of creditworthiness.

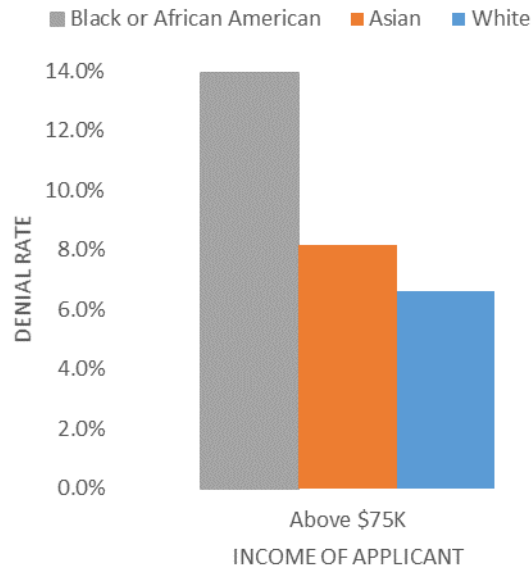
Overall, denial rates decrease as applicant income increases across racial categories. Financial institutions deny loan applications from White Tennesseans with incomes between \$15,000 and \$30,000 annually at a rate 3.2 times greater than those with incomes over \$75,000. Similarly, Black Tennesseans with annual incomes between \$15,000 and \$30,000 face rates of denial 2.4 times greater than those with incomes over \$75,000.

Asian households with moderate incomes are denied three times more frequently than higher incomes Asian households.

However, the disparity between racial categories, especially between Black and White applicants, persists across income ranges. The HMDA data show that during the period 2013-2018, the disparity in denial rates between Black and White Tennesseans with annual incomes over \$75,000 was greater than between lower-income Black and White Tennesseans. Incredibly, Black Tennesseans with the highest incomes are more than twice as likely as their White peers to experience a mortgage application denial. White Tennesseans with annual incomes between \$30,000 and \$40,000 are less likely to be denied than Black Tennesseans with twice as much income.

<b>HMDA data show that a Black Tennessean with an income of...</b>	\$0 to \$15K	<b>is</b>	1.32	<b>...times more likely to be denied when applying for a mortgage than a White Tennessean with similar income.</b>
	\$15K to \$29K		1.54	
	\$30K to \$44K		1.65	
	\$45K to \$59K		1.72	
	\$60K to \$74K		1.74	
	Above \$75K		2.11	

### High Income Black Borrowers are 2.11 times as likely to be Denied for a Mortgage than High Income White Borrowers



#### Focusing on Outcomes

The disparities described in this brief result from a complex social and economic factors which extends beyond the area of housing. However, these disparities are compounded by a lack of knowledge of the home buying process that would allow the prospective homebuyer to recognize discriminatory lending practices. Similarly, inflexible underwriting standards and lack of knowledge about various mortgage products on the part of lenders may lead to unnecessary loan denials.

Mortgage market participants are incentivized to make loans and close transactions. Intentional disparate treatment motivated by prejudice certainly occurs. However, providing equal access to credit serves the rational self-interest of professionals involved in origination and

underwriting. Therefore, there are likely additional explanations for the disparity in access to mortgage credit for relatively high income Black Tennesseans. A much larger share of Black Tennesseans live in metropolitan areas than White Tennesseans.<sup>1</sup> Metropolitan areas generally have higher home prices than rural areas requiring higher incomes to support a purchase money loan.

That could only explain part of the disparity. It must be that the application of underwriting standards to Black homebuyers, and the homes they choose to purchase have a discriminatory effect. These practices constrain the housing choice of Tennesseans on the basis of race and color.<sup>2</sup> The gap in homeownership rates between Black and White Tennesseans is most pronounced in and around Memphis, home to more than 40 percent of Black Tennesseans.

#### THDA is Taking Action to address these Impediments

The THDA Fair Housing Plan, part of the state's five year Consolidated Plan, addresses the issue of unequal access to credit described in this brief. The plan describes the agency's ongoing activities to close the racial gap in homeownership and loan denial rates. In response to limited fair housing information available to homebuyers, THDA is working to raise awareness of its mortgage programs among underserved populations, particularly eligible Black homebuyers. These efforts primarily take the form of strategic partnerships and outreach with business partners and community stakeholders.

- The agency is working with the National Community Reinvestment Coalition to secure Fair Lending reports for regions throughout the state. This effort will help identify areas with lending disparities. With this information, THDA can develop a plan

<sup>1</sup> Metropolitan areas account for 92.6 percent of Black Tennesseans and 74.3 percent of White Tennesseans. See Table B02001, ACS 2014-2018 5yr estimate.

<sup>2</sup> The ways in which current appraisal practice undervalues collateral in neighborhoods with high minority concentrations, effectively redlining, is further discussed in the Appraisal Practices brief in this series.

for targeted outreach through its mortgage programs.

- In partnership with the national Mortgage Bankers Association, THDA is supporting a pilot program to increase homeownership opportunities among African-Americans in Memphis.
- Additionally, THDA is offering downpayment assistance and manual underwriting for the Great Choice mortgage program. These programmatic actions may avoid automatic denial for reasons which correlate strongly with race and ethnicity but do not reflect the creditworthiness of a specific borrower. These efforts will expand access to homeownership among underserved populations.

### Further Considerations

#### Novel Coronavirus Pandemic

The data used in this brief cover the period prior to the COVID-19 pandemic and associated economic contraction. The pandemic is known to have disproportionate health and employment impacts among racial and ethnic minorities. It is also known that the extraordinary measures taken by the Federal Reserve and the U.S. Treasury in response to the crisis have reduced the cost of borrowed funds

inducing an increase in mortgage refinance. However, at the time of this writing, reliable data are not available to meaningfully evaluate the impact on Tennessee's housing markets. In the future, THDA may evaluate the effects of the pandemic on the housing choice of Tennesseans.

### Other Briefs in This Series

Anderson, Teresa, "Housing Opportunities for Persons with Disabilities." Tennessee Housing Development Agency, *forthcoming*.

Anderson, Teresa; Swanson, Laura "Overview of Findings Supporting the Fair Housing Plan & Perspectives on the State of Fair Housing." Tennessee Housing Development Agency, January 2021.

McCarthy, Kevin C., "State of Publically Assisted Rental Housing in Tennessee." Tennessee Housing Development Agency, *forthcoming*.

McCarthy, Kevin C; Randle, Zelinka, "Barriers to utilizing Housing Choice Vouchers" Tennessee Housing Development Agency, *forthcoming*.

Webb, Megan, "Fair Housing Impacts of Utility Costs and Broadband Access in Tennessee." Tennessee Housing Development Agency, *forthcoming*.

<https://thda.org/research-reports/issue-briefs>

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### ABOUT THDA

As the State's housing finance agency, the Tennessee Housing Development Agency (THDA) is a self-sufficient, independently funded, publicly accountable entity of the State of Tennessee. THDA's mission is to ensure that every Tennessean has access to safe, sound, affordable housing opportunities. More information about THDA programs can be found online at [www.thda.org](http://www.thda.org).



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<sup>1</sup> Between 2015 and 2017, HUD implemented a new AFFH rule that required grantees to perform a more expansive Assessment of Fair Housing (AFH). Only a few jurisdictions had completed an AFH when the process was suspended in 2018.

For two years, the regulatory requirement reverted to an AI. This time period coincided with preparation of THDA's five-year consolidated plan. In September 2020, the Preserving Community and Neighborhood Choice rule took effect. The new

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rule eliminates the requirement to produce a document memorializing a formal analysis of barriers to housing choice. However, the rule is explicit that grantees must “take active steps to address discrimination in the rental and sale of housing” and that grantees must “at a minimum, to evaluate potential barriers to affordable housing.” The new framework “returns control” to states and local governments, freeing them to perform a more meaningful analysis of fair housing, sensitive to their own unique circumstances. Also, see the forthcoming brief in this series “Fair Housing Implementation in Tennessee under Preserving Community and Neighborhood Choice.”

<sup>ii</sup> The Fair Housing Act prohibits discrimination in home loan financing on the basis of membership in a protected class. Intentional discrimination can take the form of lenders offering different terms to borrowers on the basis of sex, gender, race, color, national origin, religion, familial status, or disability. The practice of redlining – refusing to originate loans in specific areas regardless of particular collateral or the creditworthiness of the individual borrower – is another example of prohibited intentional discrimination.

<sup>iii</sup> Policies and practices, which have the effect of limiting housing choice on the basis of membership in a

protected class are also prohibited by the Fair Housing Act. Public sector policies and private business practices create impediments to fair housing. For example, a public sector program to promote homeownership may produce racially disparate benefits due to uneven demographics across a jurisdiction. Identifying impediments of this kind allows the entities which implement housing policy to affirmatively further fair housing and expand equality of opportunity. A business practice of disregarding sources of income highly correlated with membership in a protected class when underwriting loans could also have the effect of limiting access to housing.

<sup>iv</sup> The figures cited in this analysis are for purchase money loans in the first lien position intended for owner-occupants, unless otherwise noted.

<sup>v</sup> Small financial institutions, institutions that do not have any branch in a metropolitan statistical area (MSA) and institutions that are not federally insured or regulated are exempt from reporting HMDA data.