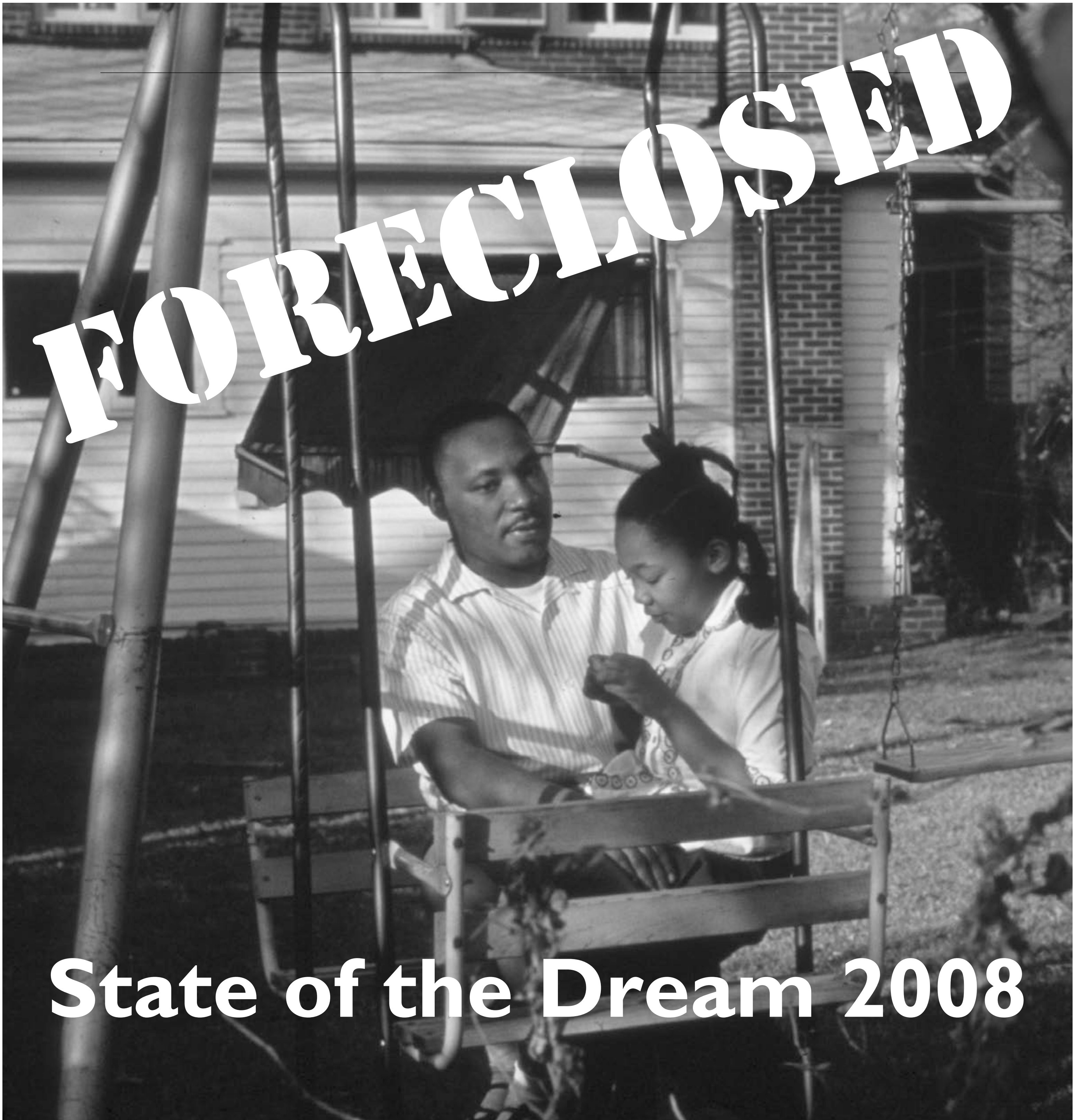

FORECLOSED

State of the Dream 2008

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January 15, 2008

UNITED FOR A FAIR ECONOMY

Foreclosed: State of the Dream 2008

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United for a Fair Economy raises awareness that concentrated wealth and power undermine the economy, corrupt democracy, deepen the racial divide, and tear communities apart. We support and help build social movements for greater equality.

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State of the Dream 2008 Report

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Executive Summary

For tens of millions of people in the US, owning a home is the essence of the American dream, representing as it does economic achievement and some measure of security. Dr. Martin Luther King, Jr., would undoubtedly agree, and he aspired to make the dream more broadly available—to people of color as well as Whites, to poor people as well as rich.

But the culture and the environment have worked against people of color in this respect as in many others, putting many obstacles in the way. There is a long tradition of economic and, more specifically, housing discrimination in the US, ranging from a century of legal slavery to exclusion from participating in wealth-building programs like the Homestead Act of the 1800s and the GI Bill of the late twentieth century. These are programs that gave millions of Americans the assistance and tools they needed to improve their economic lives, and they fostered the growth of a strong, flourishing middle class—one of the main hallmarks of America's strength and appeal.

At the beginning of the twenty-first century, millions of people at the lower end of the economic spectrum face a new obstacle, one that has spread its tentacles across the country and across the globe. The subprime lending crisis has occurred because a financial product intended for limited use by a limited number of people has been parlayed into another ill-fated bubble by some mortgage lenders lacking in integrity, foresight, and any vestige of civic concern. The crisis has ruined many economic lives and many communities. It has cost the financial institutions that underwrote massive numbers of shaky subprime loans hundreds of billions of dollars. There is talk of a government bail-out. These losses in turn triggered an ongoing global economic crisis, the end of which we have not yet seen. And the next chapter in the subprime crisis could well be a deep US economic recession.

More important than all of these consequences is the targeting of people of color and poor people as the best candidates to sign up for one of these loans. In the hands of the mortgage lending industry, subprime loans became predatory loans—a faulty product that was ruthlessly hawked even though financial institutions were aware of its defects. Even a surface check of the demographics shows that, in city after city, a solid majority of subprime loan recipients were people of color.

Hungry for new and different products, the financial services industry added features to these loans—exploding adjustable rates, balloon payments, penalties for early re-payment—that hobbled their recipients financially and made it unlikely that they would be able, after a brief honeymoon period, to repay the loans at all.

A deeper look into the crisis reveals that the subprime lending debacle has caused the greatest loss of wealth to people of color in modern US history.

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The spillover effect from the wholesale writing of bad loans is that communities are torn apart. As one house after another in a neighborhood goes vacant, squatters move in, crime and the likelihood of fires spike, local stores and businesses close. The value of the houses other people in the vicinity, who have not taken out subprime loans, live in deteriorates by thousands of dollars. The tax base for the municipality or the state erodes, since many fewer people are living there and paying taxes. This in turn leads to revenue shortfalls and the need to save money by spending less on public services, teachers, police and firefighters, repairs to bridges and schools, and other government activities that enable communities to offer residents quality of life.

The subprime crisis has pulled a large chunk of wealth away from many, many middle- and lower-income people, in the form of homes and home equity—a primary, even sole, asset for those without great wealth. The government has remained silent and inactive. But there are things that can be done.

Just as rules have favored one group of individuals or another throughout US history, so can rules be used now to help the victims of this crisis regain productive lives, wealth, and homes. There are many things that residents and their governments, working together, can do to alleviate the crisis: federal investment in financing homes, lowering the cap on the mortgage deduction, providing incentives for developers to build affordable homes, regulating the mortgage industry, and dedicating federal estate tax revenues to housing disaster relief.

It won't happen on its own. Your opinion and your actions matter. Take a moment to visit our interactive web page [http://www.faireconomy.org/dream] and register your thoughts.

Key Findings

- We estimate the total loss of wealth for people of color to be between $164 billion and $213 billion for subprime loans taken during the past eight years. We believe this represents the greatest loss of wealth for people of color in modern US history.
- From subprime loans, Black/African American borrowers will lose between $71 billion and $92 billion, while Latino borrowers will lose between $75 billion and $98 billion for the same period.
- According to federal data, people of color are more than three times more likely to have subprime loans: high-cost loans account for 55% of loans to Blacks, but only 17% of loans to Whites.
- If subprime loans had been distributed equitably, losses for white people would be 44.5% higher and losses for people of color would be about 24% lower. This is evidence of systemic prejudice and institutional racism.
- Based on improvements in Median Household Net Worth before the current crisis (from 1982 to 2004), it would take 594 more years for Blacks/African-Americans to achieve parity with Whites. The current crisis is likely to make it take much longer.
- Homeownership rates for Blacks/African-Americans compared to Whites are already starting to take back recent gains. At the current rate of improvement (from 1970 to 2006), parity will not be achieved for another 5,423 years.
- The spillover effect of the subprime crisis affects whole communities negatively, in terms of abandoned houses, increased crime, devaluation of neighboring houses, and erosion of the tax base, causing revenue shortfalls that mandate service cuts. The crisis is having a negative impact on property owners, as well as neighborhoods, and local and state governments.
- Rules made the crisis worse, and rule change can make it better via better policies. Just as many policies in the past and today have supported asset development for the wealthy, so can new policies support asset development for those injured by the subprime crisis.
- Broad racial and economic inequalities need to be addressed for the success of any policy solutions to the subprime crisis.

Introduction

Today, for millions of people in this country the American dream of prosperity and financial security is no longer a reality. For millions more, this dream was never a reality, and has become much harder to achieve. Homeownership is at the foundation of the American dream, and this foundation has crumbled under the crash of the subprime mortgage market.

The loss of wealth from the subprime crisis for all people living in the U.S. is expected to be staggering. Conservative estimates put the total direct loss for subprime loans made during the past eight years between $356 billion and $462 billion. This does not account for spillover losses from reduced property values and taxes, or losses to lenders.[1]

While the housing crisis has affected all sectors of society, it has disproportionately affected communities and individuals of color. For them, the dream that Martin Luther King, Jr. once spoke of has been foreclosed. The current housing crisis, caused in part by the predatory and unregulated practices of the subprime lending market, has had a dual effect on communities of color. It has drastically shrunk the market that helped create the opportunity for millions of people of color to gain homeownership—a key factor for class mobility in the United States. It has also stripped communities of color of one of their largest transformational assets: ownership of their neighborhoods and the collective wealth potential this ownership provides.

The foreclosure crisis is far from over. Two million additional homes are expected to foreclose in the coming year. Because of its magnitude, the impact of the housing crisis reaches far beyond the individual consumer.[2] Just as home ownership is a key component of building wealth for individuals, so does it act in a similar way for communities. Homeownership contributes to the existence of thriving schools, hospitals, local businesses and green space in all communities. As homes are boarded up or abandoned, communities fail.

Given that people of color are a disproportionate number of the subprime borrowers, and that this group's assets are mostly concentrated in homeownership, the current foreclosure crisis can be considered the greatest loss of wealth for communities and individuals of color in modern US history.

We found that all subprime borrowers of color will lose between $164 billion and $213 billion for loans taken during the past eight years. Black/African-American borrowers will lose between $72 billion and $93 billion, while Latino borrowers will lose between $76 billion and $98 billion for the same period.[3]

"America has given the Negro people a bad check; a check marked 'insufficient funds.' We refuse to believe that there are insufficient funds in the great vaults of opportunity of this nation..."

Martin Luther King, Jr.

March on Washington for Jobs and Freedom, 1963

Why focus on Wealth?

As income comes and goes like a flowing river, wealth (what you own minus what you owe) is a reservoir to handle hard economic times, make large purchases, help secure the future of new generations, and protect individuals and families as they age. While getting and keeping a job is necessary for any measure of economic opportunity, income from work by itself is often insufficient to escape poverty. While approximately 29% of people of color fall below the federal poverty line, 79% of Black people can be considered "asset poor" compared to only 40% of their White counterparts. Being "asset poor" means that an individual or family, without the flow of income, cannot maintain their current economic lifestyle for three months.

We also found that comparing projected losses for each racial group to their share of the total population shows clearly that these loans have been racially predatory. In fact, we show that if these loans had been distributed equitably, Whites would lose more wealth and people of color would lose less wealth than actual projections.

While the subprime mortgage collapse has received a lot of public attention, its causes remain obscure and elusive. Plans to solve the crisis have arisen in different parts of the country, but they are more of a band-aid than a comprehensive antibiotic for the disease of inequality. We believe that persistent racial and economic inequalities that continue to manifest broadly in US society are at the root of this crisis and need to be addressed for any policy solutions to be truly successful.

In recent years, insufficient or absent public policy has contributed to expanding the racial wealth divide, leaving communities of color lagging behind while the wealthiest and Whitest segments of US society continue to advance.

Increasing wealth access and preservation for people of color is central to addressing racial economic disparities. In the past, great asset-building public policies such as the GI Bill, Social Security, and the Homestead Act supported class mobility for millions of US residents. Despite the discrimination embedded in these bills, they create an important precedent—that the United States has the tools and capacity to address economic inequality successfully. Racial economic inequality needs to be addressed through broad-spectrum, holistic public policy. It is only through new versions of collaborative, inclusive, and culturally appropriate policy that we can prevent the foreclosure of Martin Luther King, Jr.'s dream of justice and equal opportunity for all.

Foreclosed: State of the Dream 2008 explains the mechanisms that allowed the subprime mortgage debacle to happen, explores how this crisis affects individuals and communities of color, and proposes comprehensive policy solutions to the crisis. It is an interactive document that will change and grow as people share their foreclosure stories and opinions on policy recommendations, and engage with us in exploring concrete action steps geared towards assuring that people of all colors have access to the home, and the life, of their dreams.

Please visit http://www.faireconomy.org/dream to share your thoughts with us.

1. The Subprime Crisis: Inequality by Design

"I have a dream this afternoon that one day right here in Detroit, Negroes will be able to buy a house or rent a house anywhere that their money will carry them."

Martin Luther King, Jr.

Speech at the Great March on Detroit, 1963

The American Dream and Homeownership

Homeownership is central to reaching economic equality and closing the growing divide between the wealthiest people in the US and everyone else in the country. Nearly 60 percent of the total wealth held by middle-class families resides in their home equity (the value of their home minus the amount they owe on it).[4] Furthermore, homeownership is essential in acquiring other assets, including access to high-paying, good-quality jobs (with retirement plans, healthcare and other asset options), high-performing public schools, cleaner neighborhoods, and better health.[5]

Dr. King spoke the words noted above in 1963. Forty-five years later, Detroit has become the number one city in foreclosure filings among the one hundred largest metro areas in the US.[6] Detroit also ranks number three in cities with the largest Black population, with its 775,772 Black residents making up more than 80% of the population.[7] The vast majority of the people losing their homes in Detroit are Black. This is just one example of how the subprime lending crisis is throwing into sharp relief both historical and contemporary forms of racial housing inequality.

Senator Charles E. Schumer, Chair of the Joint Economic Committee, and Representative Carolyn B. Mooney, Vice Chair, "estimate that there will be approximately 1.3 million foreclosures, and loss of housing wealth of more than $103 billion through the end of 2009 (including $71 billion in direct costs to homeowners and $32 billion in indirect costs caused by the spillover effects of foreclosure)."[8] Others project an even higher cost; for example, the Center for Responsible Lending estimated that foreclosures will cost about $164 billion for loans made in the last eight years.[9] Since African-Americans and Latinos hold a disproportionate number of subprime loans, this crisis is stripping their families and communities of assets and hard-earned wealth.

Ongoing Housing Discrimination in the US

Systematic discrimination in housing has been a pattern in American history. A report released in December 2007 titled *Residential Segregation and Housing Discrimination in the United States* said that "according to the most recent estimates from the United States Census Bureau, Latinos constitute 14.8% of the United States population, while the non-Latino population is 66.4% White, 13.4% African-American, 4.9% Asian, 1.5% American Indian or Alaskan Native, and 0.34% Native Hawaiian/other Pacific Islander.

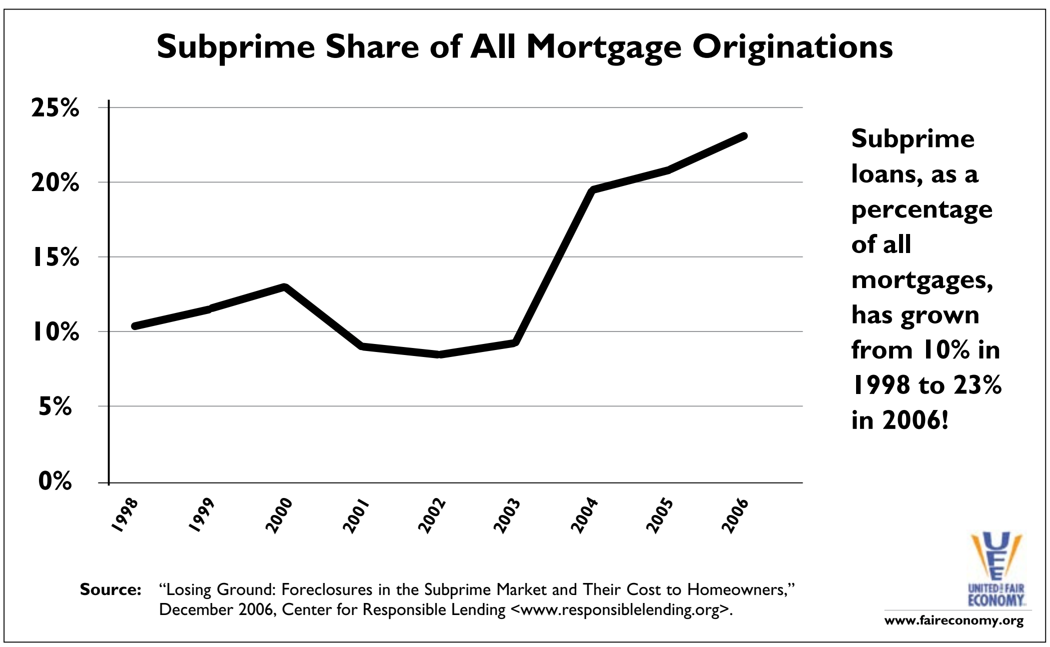
However, "[t]he average White person in metropolitan America lives in a neighborhood that is 80% White and 7% Black." In stark contrast, "[a] typical Black individual lives in a neighborhood that is only 33% White and as much as 51% Black, making African-Americans the most residentially segregated group in the United States."[10] In addition, the report establishes that "for many years, the federal government itself was responsible for promoting racial discrimination in housing and residential segregation."

Subprime Lending: A Twenty-First Century Wealth Problem

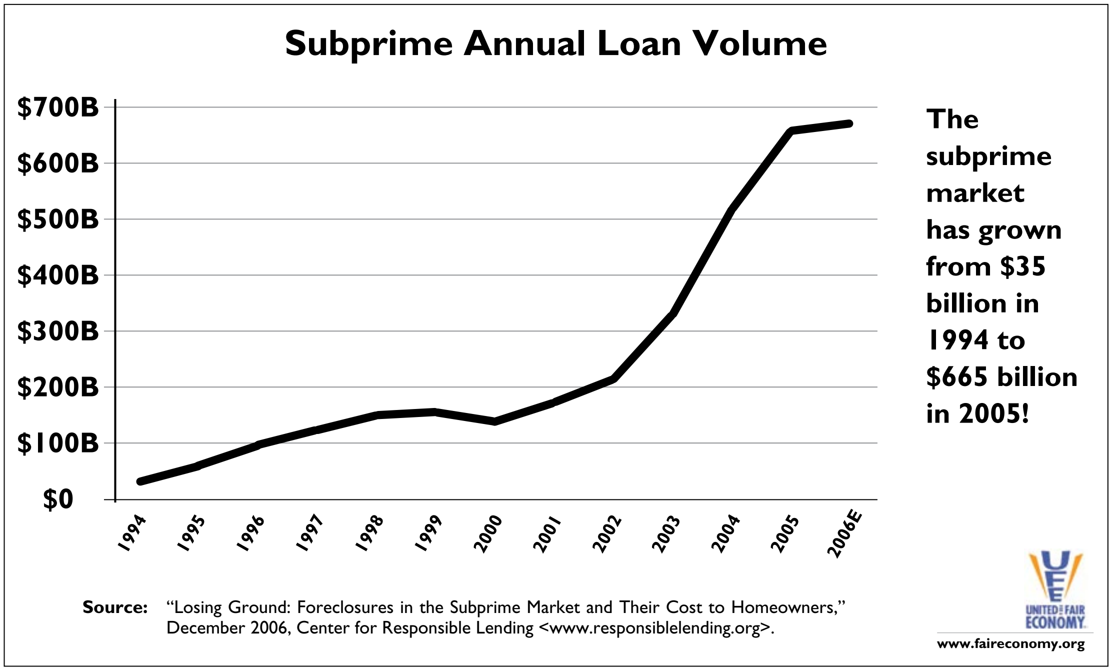
Subprime lending is a relatively recent development. It has been heralded as a tool to expand the housing market by helping those with less than ideal credit buy homes.

> "Sub-prime lending is a fancy financial term for high-interest loans to people who would otherwise be considered too risky for a conventional loan. These include middle-class families who have accumulated too much debt and low-income working families who want to buy a home in the inflated housing market. To cover their risk, lenders charge such borrowers higher-than-conventional interest rates. Or they make 'adjustable rate' loans, which offer low initial interest rates that jump sharply after a few years."[11]

Starting in the early 1990s as a small niche market, by 2006 the subprime mortgage industry rose to 20.1% of the market, growing from a $35 billion to a

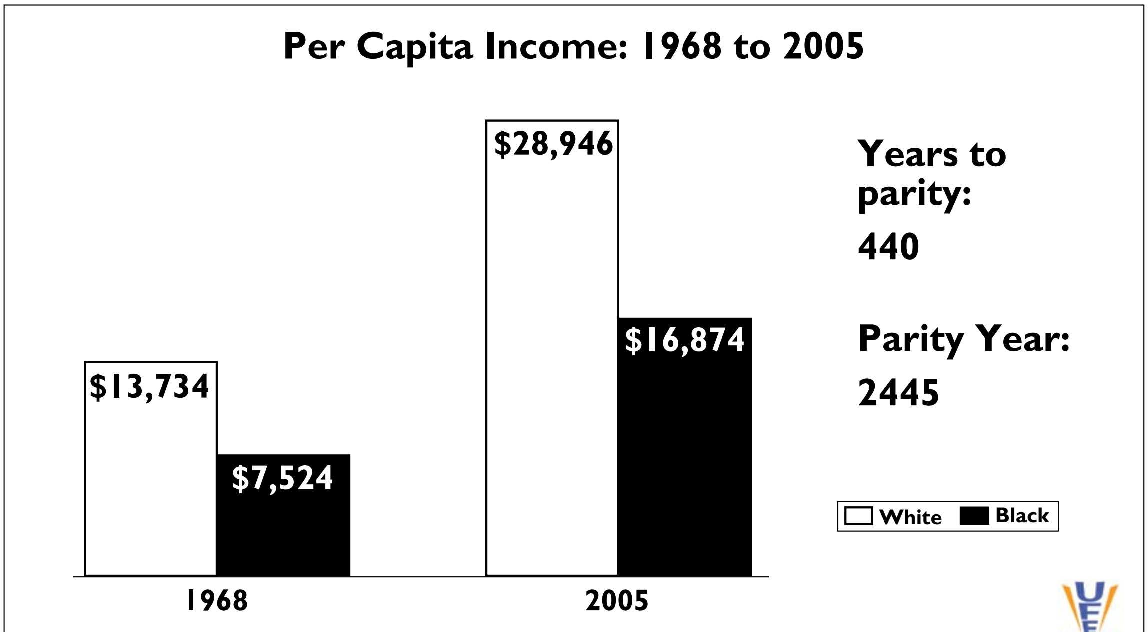


$665 billion-a year-business.[12] Unlike the banking industry, which has long been subject to significant federal oversight through regulation, the mortgage lending industry is essentially unregulated.



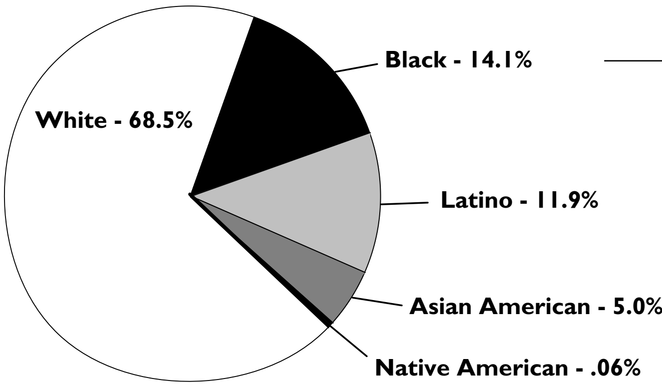
The rise in subprime loans, viewed from the demand side, was due to the rising cost of housing and the simultaneous stagnation of income for households in recent years. According to *The State of the Nation's Housing*, a 2007 report from the Joint Center for Housing Studies at Harvard University, "the number of households spending more than half their incomes on housing is rising rapidly. In 2005, the number of such cost-burdened households jumped by 1.2 million to a total of 17 million."

While other factors continue to affect the economic mobility of people of color, income is a key factor to upward mobility. Because of discrimination, suburban job locations, and lack of educational attainment, access to jobs with adequate income is often limited for people of color. Income inequality among employed individuals is further exacerbated by race. Thus, if subprime loans were meant to target households whose income was not high enough to qualify for conventional loans, this meant a majority of households of color.

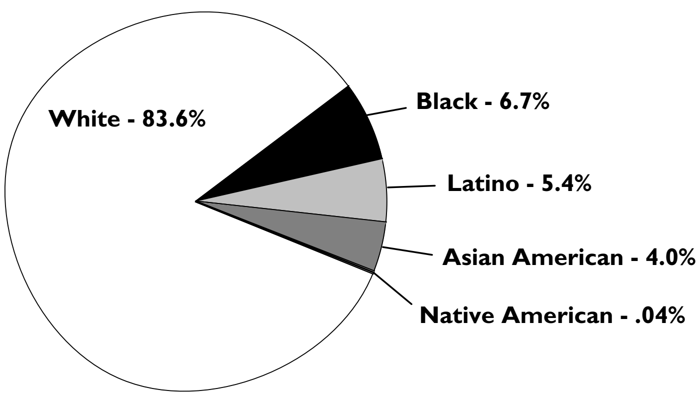


Source: U.S. Census Bureau, Historical Income Tables, Table P-1 <http://www.census.gov/hhes/www/income/histinc/p01w.

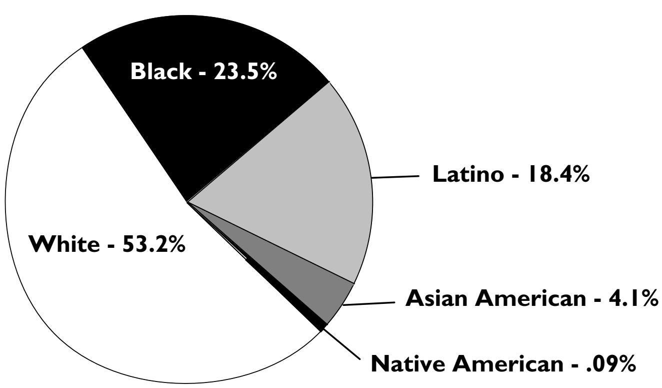
Total Labor Force by Race



Employment Status by Race
Officials and Managers



Service Workers



Source: U.S. Equal Employment Opportunity Commission

The financial industry viewed the need of many households to qualify for large loans despite low incomes as an open invitation to increase its profits significantly. This is the supply-side view. With interest rates at historic lows, money had until recently been cheap and plentiful. The more loans mortgage brokers made, the more money they made, with no consequences to themselves if the loans failed. Banks and other finance companies would then buy up bundles of subprime loans and sell them off to investors in other financial markets, such as hedge funds.[13] With the chain of accountability stretched loosely over several industries, no one had to pay the piper until rapidly increasing default rates left lenders holding bundles of worthless paper instead of lucrative subprime loans. Many subprime borrowers were refinancing existing mortgages in order to pay off credit card debt, rising in part due to the increasing cost of medical care, childcare, gasoline, and other expenses. Brokers in the unregulated mortgage market convinced low- and middle-income families that "borrowing against their homes was a sensible way to plug holes in household budgets."[14]

In addition to the economic situation and lack of regulation that allowed un-affordable loan making to flourish, the inherent risk of subprime loans added to the potential for default. Traditional loans are often made between individuals and the banks where they customarily do business. The loan then resides with the issuing bank. In the past, this relationship was essential to the home- buying process, depending on accountability between the homebuyer or refinancing household and the bank. With the subprime lending process, however, a mortgage broker gets a commission based on the cost of the loan to the buyer, with whom he or she often has no prior or subsequent connection. The more expensive the loan, the larger the commission.

Martin Eakes of the Center for Responsible Lending, in testimony in September of 2007 before Congress's Joint Economic Committee, said, "The subprime mortgage market as currently structured doesn't have adequate incentives to police itself; in fact, subprime lenders continue to have strong incentives to make harmful loans."[15] Eakes went on to present the following facts:

- Mortgage brokers, who issue approximately 70% of subprime mortgages, are not required to offer loans that are in the borrowers' best interest.
- Brokers and lenders make more money when they steer people into high-cost subprime loans, even when those people are qualified for a lower-cost prime loan. Lenders also provide brokers incentives to include prepayment penalties costing borrowers thousands of dollars and carrying significantly higher charges for foreclosure.
- Lenders, until recently, reaped huge profits by ignoring a homeowner's ability to repay the loan and/or neglecting to document the homeowner's income.
- Unscrupulous lenders gain a competitive advantage over honest lenders when they exclude the cost of taxes and insurance from monthly mortgage payments to make the loan appear more affordable.

- Since loans typically pass from broker to lender to investors, it has been easy to avoid accountability for abusive mortgages.

On the surface, subprime loan products can sound relatively simple and attractive, and some people have benefited from their use. Yet, as more details of the industry's activities began to surface, the predatory practices of many subprime loan brokers came to the forefront. Unless inexperienced borrowers asked complex questions about loan terms covered only in the fine print, they received loans that they had little to no chance of repaying. As we will see ahead, these predatory subprime loans were disproportionately and systematically aimed at people of color.

Ninja Loans

A demeaning joke circulating among bankers in recent years involved asking another banker whether he/she had heard of "ninja" loans – a loan made to someone with "no income, no job, no assets."

What makes a subprime loan predatory?

High interest or subprime loans are often difficult for a household to handle. They were intended to be used sparingly and discerningly to help people with poor credit achieve stated goals. The widespread exploitation of subprime loans, often with exotic modifications, turns a product with major limitations into one that is actually faulty, or defective. One factor that makes subprime loans predatory is their marketing and sales to inappropriate customers.

Predatory practices flourish because mortgage brokers are unregulated, and the government has been silent on the subject. According to the Center for Responsible Lending, 7.2 million families hold subprime mortgages. In the loans that originated between 2005-2006 alone, 1 in 5 will result in foreclosure. For the spectrum of subprime loans made between 1998 and 2006, 2.2 million will result in foreclosure.[16]

Here are some ways in which high-interest, subprime loans are predatory:

1. Pre-payment Penalties

According to the Department of Housing and Urban Development's 2000 report, "a pre-payment penalty is assessed against a borrower who repays his/her loan before the end of the loan term. Pre-payment can occur as the result of the mortgage borrower moving, refinancing the loan, or paying on an accelerated basis. For lenders, a pre-payment penalty is designed to reduce the incidence of pre-payment and compensate the lender for any costs resulting from pre-payment. Penalties are typically assessed only for pre-payment within a specified period of years after the loan is closed."[17] In other words, once a household has a subprime loan with a pre-payment penalty, they are unable to leave that loan early without paying a substantial amount of money as a premium. Therefore, this practice protects the Wall Street underwriters, and forces households with these loans to keep them, even once they become aware of their predatory nature. In many cases those hit with pre-payment penalties were unaware that they were part of their loans, or did not know that they were not necessary. Seventy percent of subprime loans have pre-payment penalties.[18]

2. Adjustable Rate Mortgages (Exploding ARMs)

Today the majority of subprime loans are adjustable rate mortgages, or ARMs. These loans come initially with a relatively low "teaser" rate and then increase substantially within a short time period. They are often called 2/28s and 3/27s, meaning that after the initial 2- or 3-year period the interest rate will increase by a third or more. Taking a conservative approach, a $900 monthly mortgage would increase to $1200, which does not include other expenses such as insurance and taxes. This loan structure creates what is known as "balloon" or "exploding" payments. Through the second quarter of 2006, hybrid ARMs made up 81% of the subprime sectors' securitized loans, up from 64% in 2002.[19]

Securitized loans are commercial real estate loans that are pooled with other similar loans and sold as securities. They are sometimes referred to as "commercial mortgage-backed securities."

From Timothy J. Heinrich and Patrick O. Hayes. "Borrowers Beware." *Texas Lawyer*, March 15, 2004.

Hybrid ARMs are mortgages which start out at fixed rates for several years before turning into adjustable-rate loans.

3. Exclusion of Taxes and Insurance

In an effort to appear cheaper or more desirable than traditional loans, brokers wrote subprime loans excluding taxes and other related expenses to "reduce" the amount of the initial monthly payment. This practice placed the lender in a situation that seemed to be economically beneficial, but actually created a more difficult pay-back situation, especially when the loans were ARMs.

4. Steering

This illegal and discriminatory practice manifested on both the supply and demand sides of the subprime market. Mortgage brokers and other financial institutions deliberately targeted asset-poor communities whose members were eager to acquire homes. Members of asset-poor communities were lured into loans under false premises. This practice was coupled with giving subprime loans to middle- and lower-income families and households (typically people of color) that qualified for conventional (market-rate) loans but were given higher-cost loans instead.

5. Interest-Only

An interest-only loan was originally intended for buyers acquiring properties to resell, or for buyers living temporarily in an investment property. In recent years, however, this type of loan was offered with increasing frequency to low- and middle-income families who had no intention of moving in the near future. This loan structures the payment of interest only, during the beginning phase. Once that phase ends (in previous years, around the time that investment owners were ready to sell), payments on the principal are then added to the initial payment, resulting in exorbitant payments for hapless buyers planning to stay in their homes. This product was aimed at low- and middle-income buyers because of the high commission yield that mortgage brokers could garner from its sales.

6. Lack of Stated Income/Ability to Repay

In many instances, subprime lenders exaggerated the worth of homes being refinanced, failed to document the income of households applying for loans, and/or failed to assess the ability of borrowers to repay the loan. (Traditional refinancing loans typically include a process whereby the property is assessed but higher value does not benefit the back end with higher commissions.) Documentation of income and assessment of the ability to repay are essential steps that protect both the potential homeowner or refinancer and the lending institution.

These predatory and unscrupulous practices were identified as early as 2000 by the Department of Housing and Urban Development and community groups, but concerns fell on deaf ears as the market continued its unregulated growth. This growth, very profitable for brokers and lenders, was based on the virtual destruction of the bank accounts and credit of low-income people and people of color, who are currently taking the brunt of the subprime foreclosure crisis.

Senator Charles E. Schumer's speech at the Brookings Institute, December 20, 2007

FOUR MYTHS SURROUNDING THE SUBPRIME CRISIS:

I want to focus for a few minutes on the four myths surrounding the administration's limited response to this crisis and then I want to spend some time talking about the seven steps we need to take to get a handle on this crisis and hopefully avert a recession, or at least prevent a prolonged or debilitating recession.

1. The Myth of Vastly Expanded Home Ownership from Subprime Lending

The first myth is that most of this subprime lending led to millions of brand-new, first-time homeowners in America. The fact is that only a small percentage of subprime borrowers were first time homeowners. According to the chief national bank examiner for the Office of Comptroller of the Currency, only 11 percent of subprime loans went to first-time buyers last year. The vast majorities were refinancing that caused borrowers to owe more on their homes under the guise that they were saving money. Too many of these borrowers were talked into refinancing their homes to gain additional cash for things like medical bills. Other subprime borrowers were homeowners that simply moved to another house; and too large a percentage went to investors and speculators. And the truth is, after this subprime crisis blows over, there will be a net loss of homeownership in this country.

2. The Myth of the Unqualified Borrower

The second myth is that subprime borrowers couldn't have qualified for better loans, and thus that the subprime market is the only place they could have gotten a mortgage. A corollary follows that these people can't be helped by the government or refinancing. But in truth, many of these people were PRIME borrowers. I had been talking about this myth for months, but policymakers ignored it, which is a major reason they wouldn't act to solve this problem.

Finally, to its credit, the Wall Street Journal did a study confirming what I, and others like Martin Eakes at the Center for Responsible Lending had been saying for so long—a majority of subprime borrowers would have qualified for conventional prime-rate loans. Based on the Journal's analysis of borrowers' credit scores, 55 percent of subprime borrowers had credit scores worthy of a prime, conventional mortgage in 2005. By the end of last year, that percentage rose to over 61 percent according to their study. While some will have damaged their credit in the interim, it's clear that many subprime borrowers have the financial foundation for sustainable homeownership, but may have been tricked into unaffordable loans by unscrupulous brokers.

3. The Myth that Borrowers Can Easily Obtain Perfect Knowledge of the Terms of Their Mortgage Loans

When market participants have full knowledge of transactions, the results are efficient. But we have known since shortly after Adam Smith that they do not function well when important information is lacking. We make a great mistake when we accept the myth that the borrowers in mortgage markets are fully informed. The truth is that almost no one reads his entire mortgage document's fine print, few hire special real estate lawyers to walk them through the home purchase, and frankly, many borrowers were tricked or duped into bad loans by unscrupulous brokers and lenders.

 United for a Fair Economy

Some ideologues blame the borrowers, and while that might make them feel better, it does nothing to solve this problem. That ideology is straight out of the 1890's and the early 1900's.

4. The Myth that the Free Market Alone Will Fix Everything

This administration is wedded to the philosophy that government should take a hands-off approach to governing and to dealing with economic crises. This crisis has been no exception. The myth that left to their own devices, free market forces will correct the disruptions caused by the subprime crisis has caused us perhaps the most economic pain because it has allowed the subprime crisis to wreak havoc in other areas of the economy.

Throughout the course of this year, the administration and its financial market regulators have repeated time and time again that the subprime crisis would be contained and mitigated by the strength of the U.S. economy.

Then, in August of this year, we began to witness the beginnings of a severe credit crunch in the U.S. credit markets that forced financial institutions to limit the amount of loans that they offered to individuals and companies.

As the administration looked on, the credit crisis trickled into the Alt-A and prime mortgage markets, pushing up mortgage rates for borrowers with even the best credit.

The tightening of lending and lack of confidence in credit quality has led to shrinking investment and consumption, and a slowdown in economic growth.

And the fallout wasn't limited to the U.S. We may even see a downturn in the global economy, as Secretary Summers has warned.

Today, the crisis is fueling a housing downturn that will hit every American family where it hurts the most—their equity. And as a result, we are facing an economic downturn that we haven't seen in this country since the Great Depression.

Economists like Robert Shiller estimate that a 10 percent decline in housing prices could lead to an overall $2.3 trillion economic loss at a time when this country can least afford it. $2.3 trillion in economic losses!

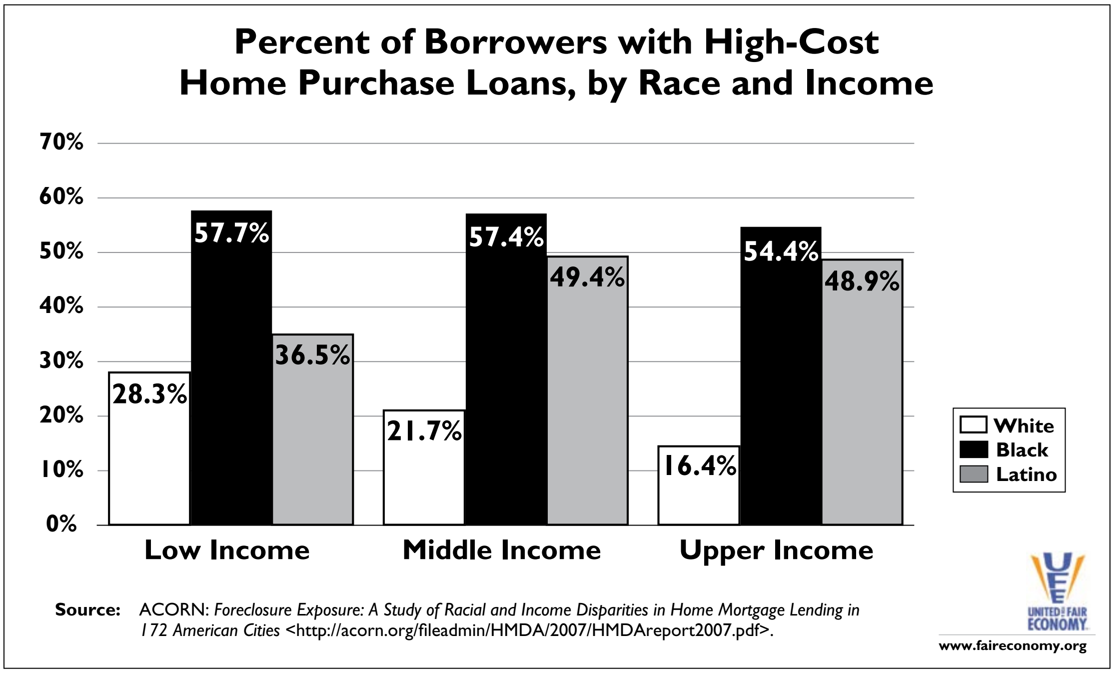
Unfettered free market forces did not contain this problem within the subprime segment of the housing market. Far from it. And the laissez-faire philosophy that allowed this crisis to spread far and wide won't get us out of this mess, either. Just ask my friend, Frank Ruggiero.

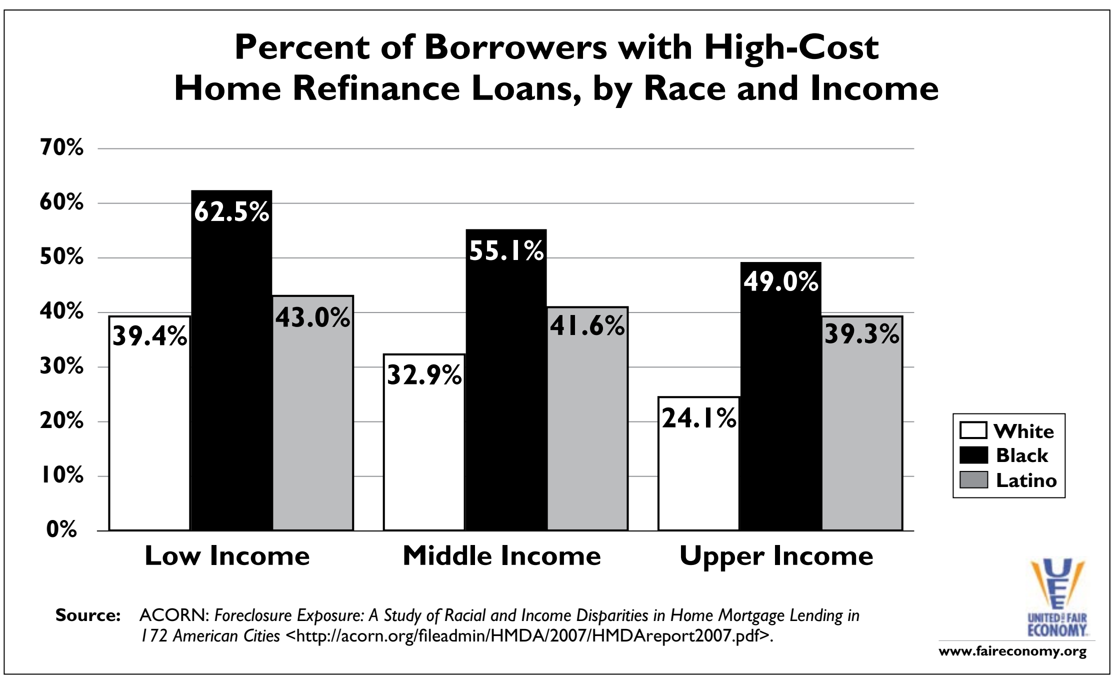
Frank Ruggiero was not a new homeowner. Frank Ruggiero had a steady income and reasonable credit, he could have qualified for a prime loan. Frank Ruggiero did not have perfect knowledge of his loan. He trusted his broker to give him accurate information. The free market did not save Frank's home. His family lost the home thanks to the unaffordable subprime loan foisted on him by an unscrupulous broker.

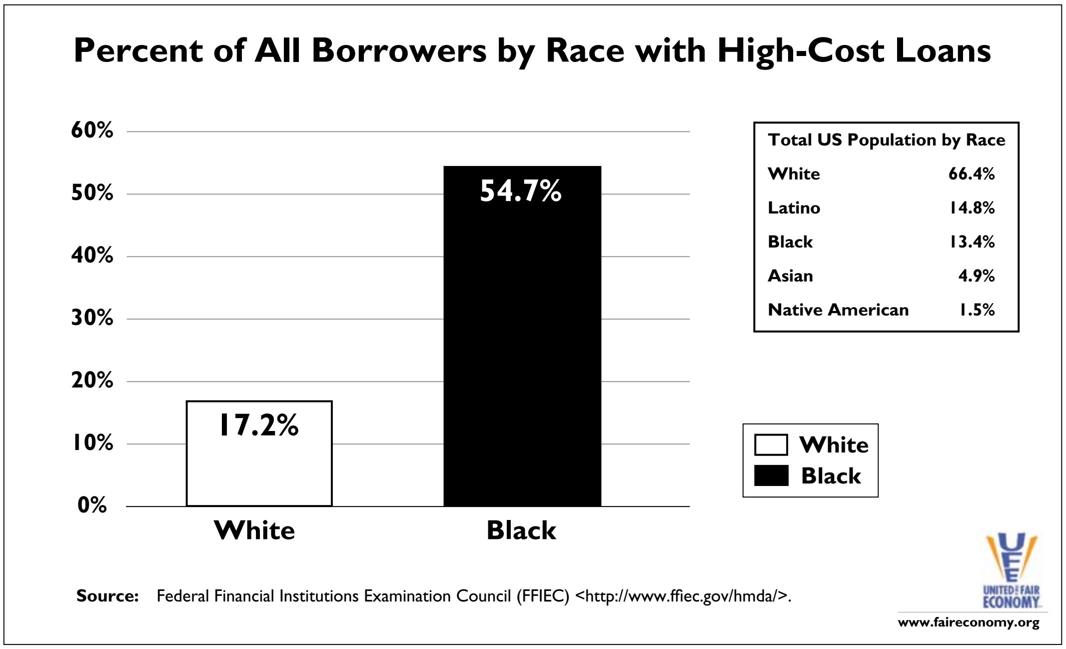
State of the Dream 2008: Foreclosed

Who was targeted?

In the twenty-first century, we continue to discover evidence of discrimination capable of eroding the dream of equality that Martin Luther King, Jr. once spoke passionately about. There is clear evidence that Latinos and African-American individuals and communities have suffered disproportionately in the subprime crisis.







A 2007 report by the Federal Reserve Board's Community Advisory Council shows that the nation's largest lenders with both prime and subprime businesses make a disproportionate share of their higher-cost loans to minority borrowers across the nation. The report, *Paying More for the American Dream: A Multi-State Analysis of Higher Cost Home Purchase Lending*, examines the cost of borrowing in six metropolitan areas: New York, Chicago, Los Angeles, Boston, Charlotte, and Rochester. It focuses on seven of the biggest lenders that issue both higher-cost subprime and lower-cost prime loans: Citigroup, Countrywide, GMAC, HSBC, JP Morgan Chase, Washington Mutual, and Wells Fargo. Some of the most significant findings of this report are the following:

- In these six metropolitan areas, African-American borrowers were 3.8 times more likely to receive a higher-cost home purchase loan than were White borrowers.
- In the same six metro areas, Latino borrowers were 3.6 times more likely than White borrowers to receive a higher-cost home purchase loan.
- For these seven lenders, the percentage of total home purchase loans to African-Americans that were higher-cost was six times greater than the percentage of higher-cost home purchase loans to Whites in the six cities (41.1 percent vs. 6.9 percent).
- In the same cities, for the same lenders, the percentage of total home purchase loans to Latinos that were higher-cost was 4.8 times greater than the percentage of higher-cost home purchase loans to Whites (32.8 percent vs. 6.9 percent).

- In each of the cities examined, the seven lenders combined showed larger African-American/White and Latino/White disparities than those exhibited in the overall lending market.
- The worst disparity for any individual lending group was observed in Chicago, where African-American borrowers were 14 times more likely to receive a higher-cost home purchase loan from Wells Fargo than were White borrowers (35.3 percent vs. 2.5 percent).

Estimated Loss of Wealth Due to Predatory Lending, by Race

Racial Group	Percent of Subprime Market*	Loss using 15.4% Rate of Foreclosure**	Loss using 20% Rate of Foreclosure
White	53.9%	$191.8	$249.1
Black	20.1%	$71.5	$92.9
Latino	21.3%	$75.8	$98.5
Total People of Color	46.1%	$164.1	$213.1
Total Subprime Borrowers	100%	$355.9	$462.2

Source Notes: Calculations of data from NCRC 2006 Report: *Homeownership and Wealth Building Impeded: Continuing Lending Disparities for Minorities and Emerging Obstacles for Middle-Class and Female Borrowers of All Races*; and Center for Responsible Lending Report: "Foreclosures in the Subprime Market and Their Cost to Homeowners," Table 6 and Figure 1.

* In 2004. ** In billions. For loans made 1998-2006.

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People of color are being hit especially hard. Just in direct losses, we found that all subprime borrowers of color will lose between $164 billion and $213 billion for loans taken during the past eight years. Black/African-American borrowers will lose between $72 billion and $93 billion, while Latino borrowers will lose between $76 billion and $98 billion for the same period.[20]

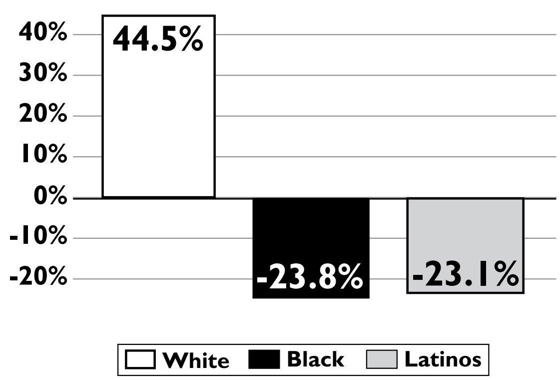
We found that comparing projected losses for each racial group to their share of the total population shows clearly that these loans have been racially predatory.

To measure the relative impact of the racially predatory approach, we compared the actual projections to what we might expect in an ideal, non-biased distribution scenario. In such a case, each racial group would receive subprime loans in the same ratio as their share of the general population.

We found that if loans had been distributed in this equitable manner, losses for White people would be greater and losses for people of color would be less. In fact, the difference between these two extremes shows a staggering difference in total direct losses between Whites and people of color due to the racially predatory nature of subprime loans.

Racial Cost of Predatory Lending

Percentage Difference between Projected Losses and Losses if Loans had been Distributed Equitably



If loans had been distributed equitably, losses for White people would be greater and losses for people of color would be less.

Source Notes: NCRC 2006 Report: "Homeownership and Wealth Building Impeded: Continuing Lending Disparities for Minorities and Emerging Obstacles for Middle-Class and Female Borrowers of All Races." Center for Responsible Lending Report: "Foreclosures in the Subprime Market and Their Cost to Homeowners." Calculations compared racial distribution of subprime loans in 2004 and 2007 US Census data for racial distribution of total population for eight years of subprime market.

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Mike Calhoun, president of the Center for Responsible Lending, states that almost half of all African-American family mortgages are subprime mortgages. To illustrate the racial discrimination present in the mortgage industry, he describes a 2000 case in which a subprime mortgage lender agreed to settle for more than $7 million after being accused of charging higher fees to African-American women than to similarly situated White males. Calhoun states that, because of the racial underpinnings of the subprime crisis, it "stands to likely be the largest loss of African-American wealth that we have ever seen, wiping out a generation of home wealth building."[21]

At the April 2007 Coalition on Homelessness and Housing in Ohio Annual Conference,[22] Kristen Komara of the Resurrection Project in Chicago related ways in which minority communities—in this case, Latinos—were cold-bloodedly targeted by subprime lenders. Foreclosures and predatory lending are significant problems among Chicago's Latino communities. Chicago foreclosures are at their highest levels in eight years.[23]

Komara details how predatory lenders target this community, including the use of high-pressure sales techniques pushing inappropriate loan products and practices such as:

- Stated-income loans
- Interest-only loans
- Automatic lender acceptance of over-stated incomes
- Failure of lenders to adequately explain terms of loans

Option ARMs are adjustable-rate mortgages that typically let borrowers choose one of four different payments each month. From smallest to largest, they are: a minimum monthly payment, an interest-only payment, full principal and interest amortized over 30 years, or full principal and interest amortized over 15 years.

Source: *Hazards of Option ARMs* by Kathleen Pender, San Francisco Chronicle, June 21, 2005.

In Chicago, lenders are investing heavily in advertising non-traditional loans in the Spanish media, and taking advantage of the fact that Latinos are historically more comfortable working with mortgage brokers than traditional bankers, in part because they believe brokers are obligated to work in their best interest.

The subprime lending industry is well aware of the historic lack of financial information and issues with credit history that prevail in the Latino community. There are often language barriers in loan negotiations. Without regulation, high-interest, high-risk loans are rampant, deliberately targeted to communities with this kind of profile. According to Komara, Latinos are 30 percent more likely than Whites to receive a high-cost home loan. Forty percent of loans to Latinos are subprime versus 19 percent to Whites. A Business Week cover story describes Option ARMs as maybe "the riskiest and most complicated home loan product ever invented."[24] In Chicago, Latinos are twice as likely as Whites to receive an Option ARM.

IRA'S LOAN

Nikitra S. Bailey, Center for Responsible Lending

Ira Cheatham is a seventy-three-year-old retired veteran who has lived with his wife, Hazel, in a predominantly African American neighborhood of Portland, Oregon, for twenty-one years. In 2002, when they had nearly paid off their mortgage, the Cheathams received a check for roughly $1,000 in the mail from a finance company. For an older couple living on limited retirement income, the sudden appearance of this money seemed like a dream come true. They cashed the check and in the process took out a very high-interest loan.

The lender followed up by calling the Cheathams and urging them to consolidate the loan with their credit card debt into a single mortgage. The Cheathams, who apparently had good credit at the time, were promised an interest rate between 5 and 6 percent. However, when the loan papers were presented, the interest rate was 9.9 percent, with an annual percentage rate of 11.8 percent. Moreover, their loan contained ten "discount points" amounting to $15,289. The lender financed these points as part of the loan, stripping away equity the Cheathams had earned through years of mortgage payments. The loan also contained a prepayment penalty, requiring the Cheathams to pay the lender approximately $7,500 to escape their predatory loan. Cheatham noted that he received a call from the lender when the lender "happened" to be right down the street with a neighbor. It seems clear that this African American neighborhood was being systematically targeted and stripped.

Conclusion

We believe that many people in the US think that racial discrimination was somehow "fixed" during the Civil Rights movement of the 1960s. Yet even a desultory poking under the surface of the subprime lending debacle shows how much and how deeply prejudicial actions remain rooted in American business practices.

A phenomenon—the subprime lending crisis—that at first glance seems to have nothing to do with race or ethnicity reveals that it is actually steeped in discrimination. Analysis indicates that it would be fair to say that racial prejudice inspired banks and brokers to deliberately and coldly seek to boost their profits by targeting minority subjects with faulty loan products. In a saturated market, questionable measures that in previous decades would have been roundly condemned as predatory and therefore unacceptable, began to look more and more attractive to an industry worried about its future profits.

Strategically speaking, what better solution for these woes could the industry find, than a new and untapped market—financially challenged would-be homeowners—in its own backyard? Such individuals and communities represented a good opportunity to sell products. But the products would have to be tailored to the target communities' characteristics. Historically, these included poor or non-existing credit, lack of liquidity, a low degree of financial literacy, and discomfort in dealing with banks. A strategic plan that would fill all these needs could well consist of using the industry's plentiful cash (due in part to unusually low interest rates) to make high-risk, subprime loans, through the intermediary of unregulated mortgage lenders, to Blacks and Latinos in the US.

The short-term gains of such a strategy were undeniable: sell more product, get higher yields due to higher rates, design and market new products (exotic loans), and subvert regulation by using mortgage lenders as agents. And the consequences—shattered lives and dreams, massive numbers of foreclosures and abandoned houses across the nation, destroyed neighborhoods, eroded tax bases, and ultimately, a worldwide economic crisis with the likelihood of a potentially severe US recession—well, somebody could deal with those later.

II. Subprime Spillover: Communities Torn Apart

"We are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly affects all indirectly."

Martin Luther King, Jr.

Letter From a Birmingham Jail, 1963

Losing the Community Benefits of Homeownership

The spate of home mortgage foreclosures has affected individuals and communities in a wide, interrelated wave that continues to spread and deepen. Because homeownership is one of the key driving forces of the US economy, the foreclosure crisis has had grave effects on neighborhoods, cities, and states.

There has been much research on the community benefits of homeownership. In a 2003 report sponsored by the Homeownership Alliance, Robert Dietz mentions youth academic achievement, civic participation, environmental awareness, and reduced crime as some of the social benefits of homeownership.[25] A 2002 study conducted by the Institute for Policy Studies at John Hopkins University concluded that homeownership improves children's educational outcomes.[26] In 2001, researchers from Harvard's Joint Center for Housing Studies concluded that homeownership increases neighborhood stability and political participation.[27] Although few studies establish a direct correlation between foreclosure rates and negative community outcomes, it is clear that if homeownership brings benefits to the community, foreclosures—and the slew of empty, boarded-up houses that follows—will have the opposite effect.

A recent study by ACORN concluded that foreclosures increase violent crime in neighborhoods, decrease property values, and "reduce city tax revenue, making it harder to provide good schools, police protection, code enforcement and other services."[28] According to Immergluck and Smith, in a study that focuses on Chicago, "one standard deviation increase in the foreclosure rate (about 2.8 foreclosures for every 100 owner-occupied properties in one year) corresponds to an increase in neighborhood violent crime of approximately 6.7%."[29] It is interesting to note that Detroit ranked number one in foreclosure filings among the one hundred largest metro areas in the US between January and June 2007,[30] and was also ranked the most dangerous city in the US for 2007 by CQ Press.[31]

The ACORN study also concludes that, as the foreclosure crisis widens, property owners, local governments, lenders, and investors stand to lose more than twenty-five billion dollars in 96 metropolitan areas studied. A 2005 report by the Homeownership Preservation Foundation states that foreclosures "involve more than a dozen agencies and twice as many municipal activities, and generate municipal costs that in some cases exceed $30,000 per property."[32] The increased municipal costs include policing and fire fighting, demolition contracts, building inspections, legal fees, and expenses associated with managing the foreclosure process. To continue with our Detroit example, in this city 2,804 of the high-cost loans made in 2006 are likely to go into foreclosure. ACORN research

CRIME IN SLAVIC VILLAGE

Foreclosures hit Cleveland early and hard. By the summer of 2007, it had four of the top 21 ZIP codes for foreclosure filings in the United States. Slavic Village tops this list, becoming the hardest hit community in the US.* Founded in the 1840s by Polish and Bohemian immigrants who worked in area steel mills and factories, the neighborhood is now mostly working class and 26% Black.

More than 800 houses now sit vacant and moldering in the area. One of the first things that happened after owners moved out was that squatters and looters moved in. Many houses in Slavic Village have had their siding stripped up to the roof-lines. When a house is abandoned, people will dump garbage in its yard, break its windows, and steal its doors. In Cleveland's cold and damp climate, the houses deteriorate quickly. Putting a house back together takes money, more money than the restored home could bring on the market.

Recent reports describe the crime wave sparked at the Slavic Village as the "perfect storm."** Some of the most notorious crimes in recent records include:

- September 1: "Cookie" Thomas, 12, was shot in the neck while walking home from the corner store after buying a bottle of Sunny Delight, a small bag of chips and two pieces of sour gum. She was hit by a stray bullet as the result of two men shooting at each other.
- July 20: Grady Smith II, 27, was working on his car when someone walked up and shot him in the face.
- March 15: Joseph Krasucki, 78, was bludgeoned to death at his house on Hosmer Avenue. Thugs had attacked him five times before.***

As the number of empty lots and abandoned houses grow where houses and residents once flourished in a tight community, there are fewer and fewer neighbors organizing to save their community.

* Les Christie. "Where Cleveland Went Wrong." CNNMoney.com. November 14, 2007.

** Les Christie. "Crime Scene: Foreclosure." CNNMoney.com. November 19, 2007.

*** Andy Netzel. "Can Anyone Save Slavic Village?" Cleveland Magazine.com. November, 2007.

estimates that the cost of these foreclosures to the local Detroit government will be $53,913,431.[33] This will significantly decrease the resources available for law enforcement and crime prevention programs.

Since foreclosures impact communities of color in disproportionate ways, the current homeownership crisis threatens to become a massive barrier in this country's journey towards racial justice. If we take into consideration that inequality continues to be a problem today, the compounded negative effects of foreclosures cannot be overlooked by those engaged in the movement towards true economic equality in the US. Hurricane Katrina and the socio-economic crisis that ensued in its aftermath illustrate the urgent need to deal with the foreclosure crisis in a racial economic justice context.

Katrina, Housing Injustices, and the Foreclosure Crisis

Hurricane Katrina showcased some of the greatest economic racial disparities that this country has seen in recent history. This natural disaster placed nearly 80% of New Orleans underwater, displacing nearly one million people who were overwhelmingly people of color. Racial injustice was alive and well throughout Katrina and its aftermath, and became evident in everything from inadequate rescue efforts to prejudiced media images, public officials' comments, and unfulfilled government promises.

Former first lady Barbara Bush, during a tour of the Houston Astrodome with her husband and other political VIPs a few days after Hurricane Katrina, observed: "Almost everyone I've talked to says, 'We're going to move to Houston.' What I'm hearing, which is sort of scary, is they all want to stay in Texas. Everyone is so overwhelmed by the hospitality. And so many of the people in the arena here, you know, were underprivileged anyway, so this, this is working very well for them."

Marketplace, National Public Radio, 9/5/05

Several years after Katrina, racial disparity continues. Before the hurricane, there was already a significant shortage of housing for low-income renters in New Orleans.[34] According to the Brookings Institute Katrina Index, housing disparities in Katrina-affected areas continue to worsen. After the hurricane, rents increased by 200% in the most storm-damaged parishes. As of August 2007, there were no rental units available below market price. From 82,000 rental units damaged in the hurricane, only 33,000 were on track for rebuilding under state-administered restoration programs.[35] The housing shortage was made worse when, amid vehement protests from neighborhood groups, New Orleans City Council recently moved to demolish thousands of low-income houses. Demolition crews will now move in to dismantle 4,500 brick buildings that had been the homes of generations of low-income residents. The units will be replaced with mixed-income housing.[36]

The creation of Recovery Zones in New Orleans has made the housing problem worse for African-Americans wanting to return. Recovery Zones were intended to help in rebuilding the city rapidly. In March 2007, Mayor Nagin announced:

> The city will provide loans and other incentives to developers interested in investing in key locations within the zones. The zones are generally high visibility sites, with sufficient land and other assets. They also have a high potential to attract investors and possess adequate resources to catalyze development such as schools and libraries.[37]

Nevertheless, redevelopment plans in these zones exclude African-American owners whose damaged properties are said to contribute to urban decay. Their properties are being seized by the city using eminent domain laws. Jacob Faber, a researcher at the Center for Social Inclusion, states that "evidence of eminent domain abuse can be found in the overwhelmingly-Black Lower 9th Ward, where the city bulldozed homes without informing their owners."[38]

The foreclosure crisis, with its deep racial economic injustice implications, will only exacerbate the housing crisis caused by Katrina. Homeowners who lost their property for lack of insurance were overwhelmingly Black. After the burst of the housing bubble and the subprime lending crisis that ensued, they are even less likely to get the loans needed to rebuild their homes or purchase new homes in the city's mixed income developments. Real Estate web information sources emphasize that:

> Credit availability and the terms for which it can be had have tightened and risk aversion has accelerated over the last month. This will continue. Lending standards are reverting to pre-real estate bubble levels. Loan-to-Value ratios on many mortgages will hit 80/20 again, which will require large cash down payments on home purchases. These conditions are going to lock many people out of buying or even refinancing. A consumer's debt-to-income and credit history is going to come into play more and more.[39]

The credit crunch is much more likely to affect Black homeowners because of deep patterns of racial disparities in income in New Orleans, where White median income is $61,000 while Black median income is only $25,000, less than half the income of Whites.[40]

New Orleans is a city struggling to heal. Countless politicians, church groups, celebrities, and average Americans have said that getting the city back to its pre-Katrina level is of paramount importance, not just to the city but to the nation as a whole. But predatory lending practices in Louisiana, combined with the subprime mortgage crisis, are digging the already-beleaguered city even deeper into poverty and trouble. The report *Fair Lending Helps Community Prosperity*, issued jointly by United for a Fair Economy and the National Community Reinvestment Coalition in April 2007 reveals that in post-Katrina New Orleans

- twice as many mortgage requests from Blacks are denied as for Whites, and
- forty-nine percent of Black homeowners received high-cost subprime loans compared to 18% of their White counterparts.

Furthermore, ACORN studied the expected costs of foreclosures in 96 metropolitan areas across the US. The price tag for New Orleans is estimated to be more than $60 million.[41]

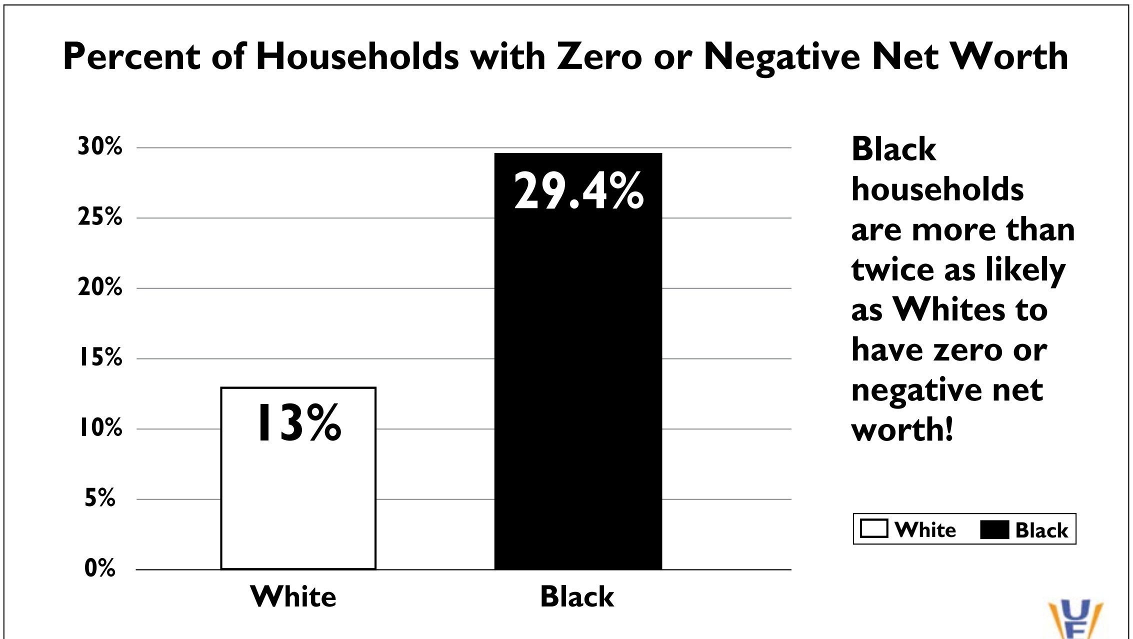
Most Americans will not soon forget the images of people, so many of them Black, stranded on rooftops, faces hopefully raised toward helicopters passing by overhead. As more incidents of racial inequality gain national media attention, it is clear that racial prejudice, and its economic implications, continues to be a problem in the 21st century.

The "Subprime Spillover" Effect

The foreclosure crisis can only exacerbate racial economic injustice, and economic inequality in general. Would anyone, for example, believe that this country has achieved full equality in its public education system? Can we say that all US children have access to quality public schools? The answer is a vehement "No!" To get quality public schools we need adequate school funding, and school funding is in jeopardy in communities with high foreclosure rates. The Center for Responsible Lending projects that, nationally, foreclosures on subprime home loans originated in 2005 and 2006 will have the following impact on property values:

- Almost 45 million neighboring homes will experience devaluation because of subprime foreclosures that take place nearby.
- The total decline in housing values and tax base from nearby foreclosures will be $223 billion.
- Homeowners living near foreclosed properties will see their property values decrease $5,000 on average.[42]

In a 2006 report, Immergluck and Smith found that the “most conservative estimates indicate that each conventional foreclosure within an eighth of a mile of a single-family home results in a decline of 0.9 percent in value.”[43]



Source: *Recent Trends in Household Wealth in the U.S. - Rising Debt and the Middle Class Squeeze* by Edward Wolff, Levy Economics Institute of Bard College <http://www.levy.org/pubs/wp_502.pdf>.

Lower property values mean lower property tax revenues and decreased funding for public schools in the numerous states that utilize property tax revenues to finance education. The Center for Responsible Lending, for example, emphasizes that foreclosures will have a negative effect on economic conditions that reach far beyond the neighborhood or town that is directly affected. Dubbing it the subprime “spillover” effect, the Center says that “foreclosures themselves further depress local housing prices.” They calculate the dollars that are being lost to the nation’s homeowners and state treasuries, in terms of lower property value and a reduced tax base for communities.

In the state of Massachusetts, for example, the projected number of homes that will be lost to foreclosure as a result of subprime mortgages negotiated between 2005 and 2006 is 15,279. More than one million neighboring homes will experience devaluation as a result of these foreclosures, for a decrease in housing values/tax base of almost $5 billion.[44] This loss is even more alarming if we consider that Massachusetts relies more than most states on local governments to provide revenue, largely by means of property taxes, for elementary and secondary public education.[45]

California, one of our biggest and most populous states, will be experiencing even more sizable aftershocks from the subprime industry crash. Tens of thousands of houses are expected to be lost to foreclosure—180,000, to be more precise. That means 180,000 families or households will suffer disruption and a damaging loss of assets, with the likely possibility that a significant percentage of the houses foreclosed will fall into disrepair or abandonment. As many as 8.4 million other houses will be devalued as a result of high foreclosure rates in their neighborhoods—$8,000 on average per house. Taken together, California's counties will have to cope with a combined decrease of $68 billion in house values and tax base—primarily property taxes—in its major metropolitan areas alone.[46] In terms of the effect of the subprime market collapse on education, consider that California funds about a quarter of its K-12 and community college education through local property taxes (about $14 billion). An additional $2 billion for education comes from other types of property taxes.[47]

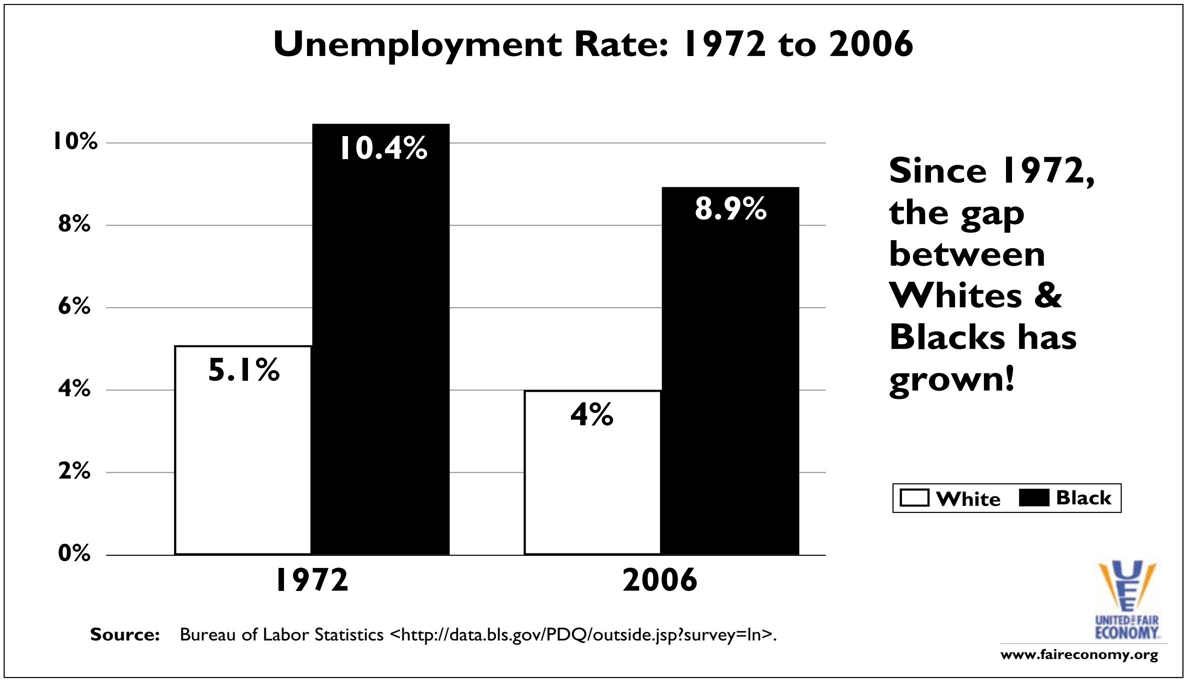
The consequences of foreclosures reach far beyond individual bank accounts to threaten essential community resources such as high-quality public schools.

How is the subprime crisis affecting your community? Share your story at:

http://www.faireconomy.org/dream

Conclusion

Communities of color, in a country that is still very far from racial economic justice, are especially threatened by the foreclosure crisis.

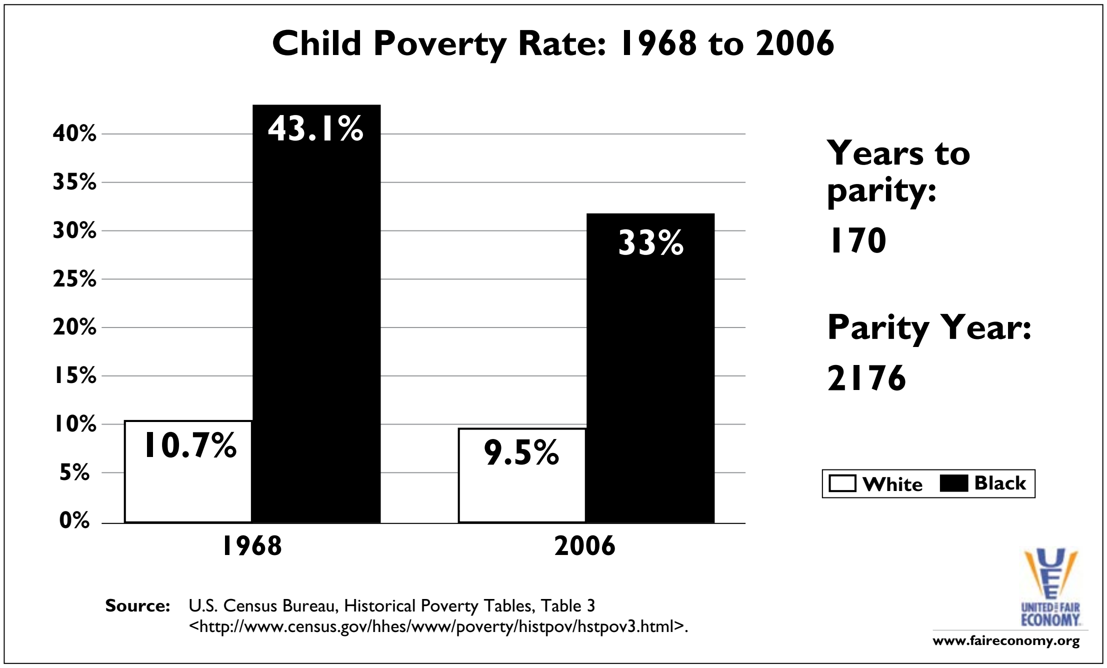


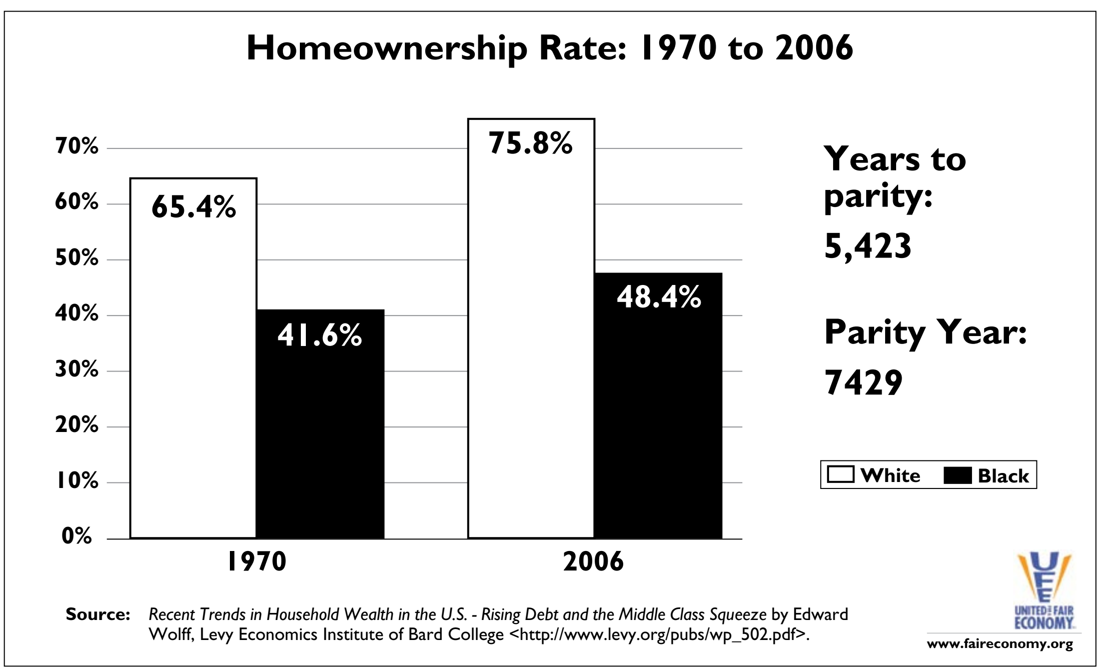
Losing homes is tantamount to losing wealth at a time when wealth disparities are already overwhelming. Many focus on income as a key to economic security for people of color, but assets are a better predictor of which individuals and families will have economic stability. The United States Conference of Mayors Task Force on Poverty says that "the magnitude of the poverty problem is daunting. More than 37 million people are still officially poor today, despite the fact the more than one-half of poor families are now working."

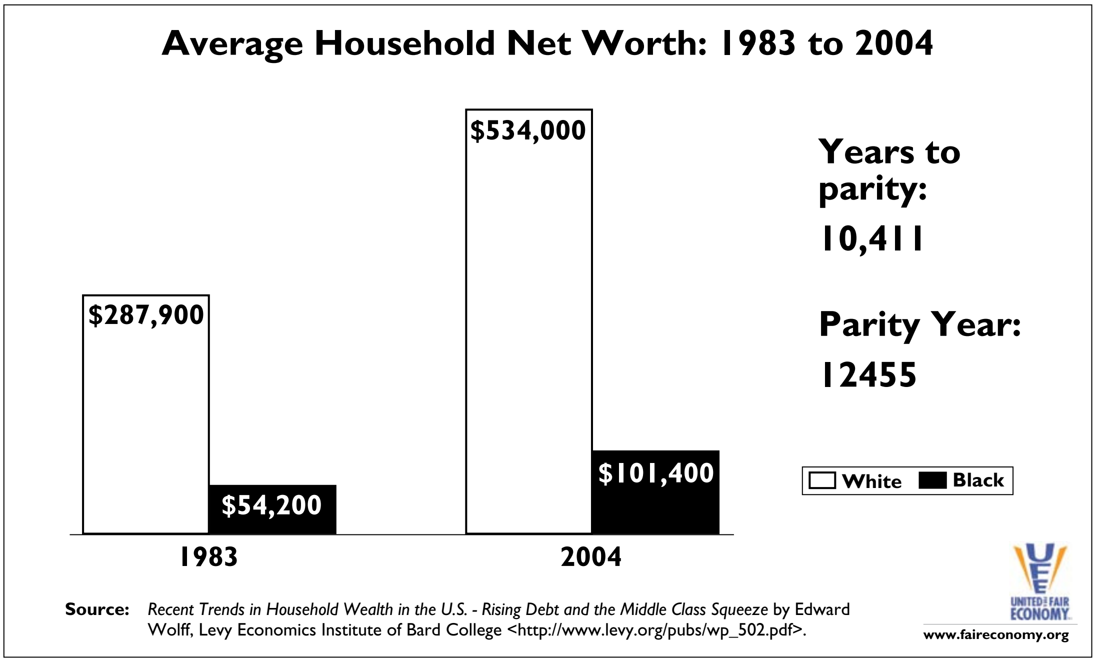
The situation is even less promising when viewed through a race lens:

- Forty-six percent of people of color own homes compared to 76% of their White counterparts
- A quarter of the Black population lives in poverty compared to 8% of Whites
- People of color are three times as likely as their White counterparts to live in poverty

- White median family income is more than twice Black median family income
- For every dollar of White wealth, people of color have 15 cents






Average Household Net Worth: 1983 to 2004
$534,000
$287,900
$54,200
$101,400
1983
2004
Years to parity:
10,411
Parity Year:
12455
White
Black
Source: Recent Trends in Household Wealth in the U.S. - Rising Debt and the Middle Class Squeeze by Edward Wolff, Levy Economics Institute of Bard College <http://www.levy.org/pubs/wp_502.pdf>.
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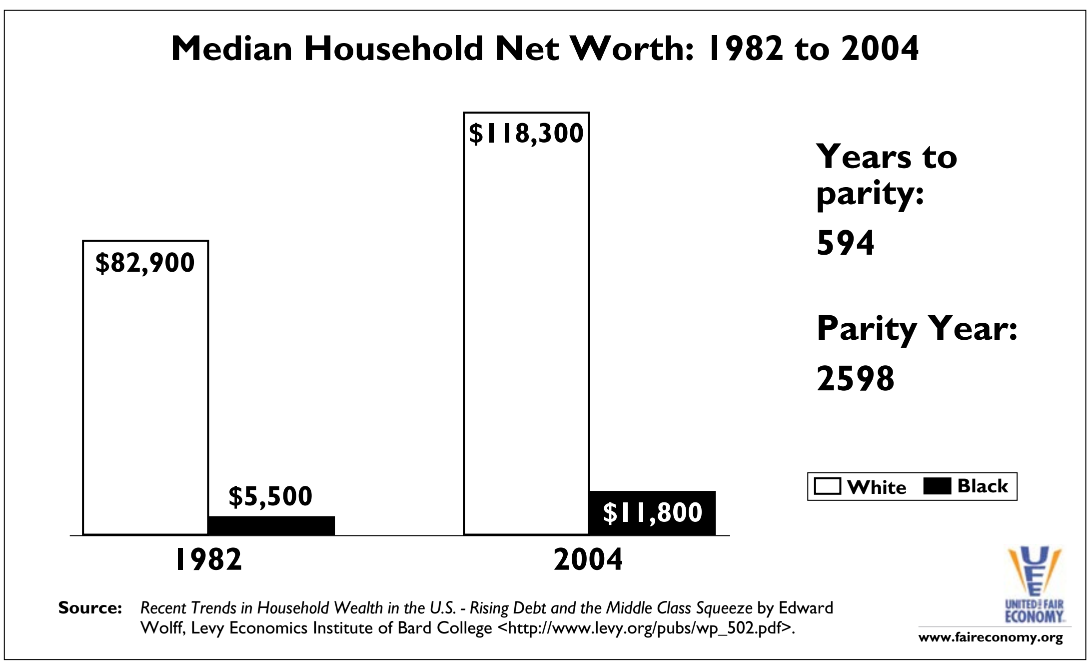
Median Household Net Worth: 1982 to 2004
$118,300
$82,900
$5,500
$11,800
1982
2004
Years to parity:
594
Parity Year:
2598
White
Black
Source: Recent Trends in Household Wealth in the U.S. - Rising Debt and the Middle Class Squeeze by Edward Wolff, Levy Economics Institute of Bard College <http://www.levy.org/pubs/wp_502.pdf>.
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These disparities are due in part to a history of discriminatory practices in asset-building economic policies enacted by our local, state and federal government. According to a report released in 2004 by the Corporation For Enterprise Development, the government spends $335 billion on asset-building policies. The report stated that federal policies “disproportionately benefit those who already have assets. Analysis of the largest spending categories shows that over a third of the benefits go to the wealthiest 1% of Americans—those who typically earn over $1 million per year. In contrast, less than 5% of the benefits go to the bottom 60% of taxpayers.”

"We must work assiduously and with determined boldness to remove from the body politic this cancerous disease of discrimination . . . , then and only then will we be able to bring into full realization the dream of our American democracy – a dream yet unfulfilled."

Martin Luther King, Jr.

Golden Anniversary Conference of the National Urban League, 1965

III: Where do we go from here

The challenge facing our nation is not a lack of wealth but a destructive distribution of wealth. Over the last 40 years, the US economy has shifted from one that was producing a strong middle class, to an economy that serves the richest among us almost exclusively and concentrates wealth among the wealthiest in society. This has created a growing wealth divide. This wealth divide has hurt historically marginalized communities like African-Americans and current low-income immigrant populations that are overwhelmingly Latino.

In 1966, A. Phillip Randolph and Bayard Rustin, stewards of the Civil Rights movement, advocated a comprehensive federal budget proposal. They called this proposal the Freedom Budget. The Freedom Budget proposed a new federal investment in the poor of the nation, an investment that for the first time would not be blocked from reaching Black Americans due to segregation. The Freedom Budget was endorsed by most mainstream civil rights organizations and even some Black power advocates such as Stokely Carmichael—yet not by our nation's legislature.

The Freedom Budget would never be implemented. The war in Vietnam would end up consuming billions of dollars and distracting the nation from healing the wounds of racial discrimination. When Dr. King was killed, along with his demise went the demise of his poor people's campaign. Fiscal conservatives would oppose increases in federal social spending, and the election of Richard Nixon would seal the door to the possibilities of the Freedom Budget. Over the last forty years we have seen a regressive economic climate where the rich are getting richer, the middle class and poor are struggling to make ends meet, and the racial wealth divide continues to keep race a mark of division in the United States.

Forty years after the assassination of Dr. Martin Luther King, we believe it is not too late to implement the economic reforms Dr. King knew were needed to make his dream a reality.

Ending the Homeownership Divide

As discussed throughout this report, homeownership is the primary form of wealth for most Americans. As is so apparent throughout American history, leaving homeownership to the dictates and uncertainty of the private market has never been adequate in developing homeownership for most Americans. Whether it was the Homestead Act of the 1800s, the GI Bill of the 1940s, or ongoing federal mortgage insurance programs, government subsidies have been a necessary component to increasing homeownership.

Between the 1930s, the time of the Great Depression, and the early 1950s, marking the beginning of the Civil Rights movement, billions were invested in

American homeownership. The post-World War II housing boom was fueled by subsidized assistance to over 35 million Americans between 1948 and 1972. During these years, 11 million families bought homes and another 22 million improved their properties.[48] The biggest beneficiary was primarily White suburbia, where half of all housing could claim Federal Housing Administration (FHA) or Veterans Administration (VA) financing in the 1950s and 1960s. The home mortgage interest and property tax deduction also disproportionately benefited suburban homeowners. Interstate highway construction served as an indirect subsidy, as it opened up inexpensive land for suburban commuters. At the end of World War II, the percentage of US citizens that owned their own home was about 44 percent. In 2004, 76 percent of Whites owned their own home, compared to 49.1% of Blacks and 48.1% of Latinos.[49]

The progressive economic measures prevailing at that time had a positive impact in strengthening the economic situations of most middle-class and lower-income Americans, but due to the openly racist nature of the country also prevalent during this time, it reinforced the economic supremacy of Whites in relation to people of color as well. Since the end of legal segregation in the late 1960s, there has not been any comparable federal mass investment in homeownership that would benefit disenfranchised people of color. The following policy solutions can change this situation.

1. Lower the Ceiling for Mortgage Deductions

One of the first steps that needs to be taken to promote equal opportunity homeownership is removing the subsidies that promote a growing economic divide in this country and redirecting these subsidies to broadening our middle-class economy. In 2005 President Bush's advisory commission on tax reform recommended lowering the mortgage interest deduction that overwhelmingly and disproportionately benefits the richest of Americans. Currently, homeowners can deduct all interest paid on mortgages as high as $1.1 million. President Bush's advisory commission recommended that the mortgage ceiling for such tax deductions be placed on a sliding scale that is related to the real estate market of an area. In 2005, the recommended ceiling was $415,000 in the most expensive areas.

Implementing this recommendation would not stop people from taking out larger mortgages. It would just prevent the American public from subsidizing the interest on mortgages greater than $415,000. Since the median price of a home in the US is slightly more than $200,000, it is clear that most homeowners' mortgage amounts would not be over this proposed limit. Mr. Bush's advisory team also recommended greater progressivity in the policy by making the mortgage interest deduction a tax credit instead of a tax deduction. To get a tax deduction, one would have to have total itemized deductions higher than the standard deduction offered. Only a third of taxpayers find it worthwhile to itemize their deductions, and these are usually the richest third. However, a tax credit would assist all taxpayers—not just those with higher incomes.

2. Increase the Development of Affordable Homes

In the private market, the sole motivating force is profit—not just the drive to make a profit, but to make the greatest possible profit. This often has limited private market opportunities for the non-wealthy, particularly as it relates to housing. The higher profit margins that come with building expensive homes have made the affordable housing market less attractive for private home development companies. But government subsidy of housing development through tax credits would make affordable housing more attractive for private development. Government regulation could also ensure that private developers benefiting from public investment fulfill their responsibility to increase the public good, not just private profit.

- *Affordable Housing Tax Credits* - The federal government could fund and have distributed by state agencies tax credits to home developers that build affordable housing. This tax credit would increase the profit margins for private companies to build affordable housing. In some cases, the cost of building affordable homes is greater than the market value of these homes. It would require a tax credit to close this "appraisal gap" and create a margin of profit. This would in turn increase the supply of affordable housing for low- to moderate-income Americans.
- *Government Mandated Affordable Housing* - In many communities throughout the country, local government mandates that a specified percentage of all new construction be designated as affordable housing. The federal government should consider a mandate that federal housing aid to states be tied to a requirement that all new construction and/or renovations in the state provide a set percentage of affordable and low-income housing. The federal government today provides billions of dollars in incentives for homeownership, particularly by means of the tax-deductible homeowner interest deduction, which serves as an indirect subsidy to housing developers. A federal mandate to have a percentage of affordable housing in every construction project would ensure that housing developers across the country pay back, in part, some of the consideration given to them by the public treasury.

3. Simplify Homeownership and Cut its Cost

Currently, much of the regulation for buying a home is at the state level, consisting of various compliance costs and practices. Housing policy varies considerably from state to state. A national standard could greatly simplify the home-buying process, and because of this the costs of compliance would lessen. For years, consumer groups have advocated strengthening the Homeownership Equity Protection Act (HOEPA), but this effort has been successfully opposed by the mortgage lending industry, which was concerned that a strengthening of HOEPA would limit the securitization of subprime loans.

As the nation now faces the possibility of a recession—primarily fueled by the subprime loan crisis and the mass securitization of bad subprime loans—we all can see how greater regulation of the mortgage lending industry would have been beneficial to the nation as a whole. In response to the subprime mortgage crisis, the Federal Reserve has finally taken a few of the many steps advocated by consumer groups years ago. It recently approved a proposal to require mortgage companies to outline more clearly how the customer will be able to make the required payments, and to show more clearly the additional costs of a loan that are often hidden in interest payments. This Federal Reserve plan is limited to subprime loans, but could and should be expanded to all home loans. All Americans deserve a more transparent home loan process. HOEPA should also be expanded to include contractors, appraisers, and other actors in real estate transactions.

As the nation now faces the possibility of a recession—primarily fueled by the subprime loan crisis and the mass securitization of bad subprime loans—we all can see how greater regulation of the mortgage lending industry would have been beneficial to the nation as a whole.

Federal legislators ought to follow the advice of the 2000 "Curbing Predatory Home Mortgage Lending" report, and simplify the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) to make the home loan process more comprehensible for the consumer. It should also demand greater accuracy in initial good faith estimates made by mortgage lenders. This would give the consumer a clearer idea of the costs of home buying.

- *Federal Government Subsidy for closings costs and down payments* - For too many would-be homebuyers, the closing costs and down payment necessary to get a mortgage are large up-front costs that make buying a home prohibitively expensive. In order to reach the people-of-color populations that were excluded from full participation in the homeownership aspects of previous programs like the GI Bill, such as low interest loans with zero down payment, a new federal program must be offered to first-time home buyers.

  A federal subsidy covering 50% of closing costs and the down payment should be offered on a once-in-a-lifetime basis for a first-time home buyer purchasing a moderately-priced home in an affordable community. Though not nearly as generous as the home buying benefits that made White Americans majority homeowners, this type of government policy would be a step forward in giving would-be homeowners a greater opportunity to acquire the number-one wealth-building asset for most Americans.

Wealth Development and Wealth Education

Our nation needs to make a dramatic re-investment in broadening wealth and opportunity. Wealth and savings are stabilizing forces for families and serve as the basis on which intergenerational transfers are made. The transfers of wealth from one generation to another open up access to higher education, home-ownership, savings, and investments. As a growing amount of sociological research reveals, the net worth of one generation contributes significantly to the wealth prospects of the next generation.[50]

Asset assistance will be all the more meaningful to people of color who disproportionately hold few or no assets.

Cutting across racial lines, families with equal wealth have similar educational results, economic practices, and health conditions. Asset assistance will be all the more meaningful to people of color who disproportionately hold few or no assets. Wealth development aimed at marginalized people of color would help fulfill the next phase of the US Civil Rights movement. Moreover, the implementation of asset-building policies that are racially and ethnically inclusive will strengthen the social fabric for everyone in future generations.

The US personal savings rate was about 11% in 1974. In 2004 the savings rate was 0%. Credit card debt tripled in the last twenty years to over $80 billion, and bankruptcy in 2005 hit a record level of 2 million people. Working together, we must make savings and wealth development a national mission, and ensure that those historically marginalized are at the forefront of this mission.

1. Individual Development Accounts

Individual Development Accounts (IDAs) are savings accounts that provide matching funds to assist and provide greater incentives for lower-income families to save and build wealth. Just as upper-income Americans often receive matching funds from their employer for 401K retirement accounts, lower- and middle-income Americans would be eligible to receive matching funds for their IDA through partnerships among various community-based organizations, government programs, and the private sector. Currently there are many small IDA programs across the country, which have provided insight into the greater possibilities of a mass wealth development program. The 2002 Millennial Housing Commission reported that "[IDA] demonstration program results show very low-income families actually save at a higher rate than the less-poor, with an average savings of $900 annually... Recent proposals have been levied suggesting a 100 percent tax credit to financial institutions to provide 1:1 matches of up to $500 annually per qualified individual saving in an IDA."

To address the chasmic racial wealth divide between White America and disenfranchised racial minorities in the United States, a comprehensive IDA program would be required. At 18 and older, a nontaxable interest-earning IDA account for low- to moderate-income Americans would be available to save for home-ownership and/or starting a business. There would be a limit to how much could be deposited in any given year. Money could be accessed tax-free if used for the closing costs and/or down payment on a home, or for costs related to starting a business.

2. Kid Savings Accounts

A version of this type of program was recently started in England. In 2003, the British Parliament established small government-financed trust funds for each newborn in the country. In 1998 US Senator Robert Kerrey introduced similar legislation in the US Congress to create what he called "KidSave" accounts. Thomas Shapiro and Melvin Oliver in *Black Wealth/White Wealth* suggest that a KidSave program be developed so that low- to moderate-income youth, upon becoming adults, have some starting capital with which they can enter their adult life. These funds could be utilized only for higher education, job training, or homeownership.

3. Strengthen Programs Providing Low Cost Credit

Providing high-cost loans to low- to moderate-income individuals with less than perfect credit can too often, as shown by our current subprime economic crisis, lead to unsustainable mortgage agreements. Low interest mortgage loans are required for more of wealth-poor America. Vehicles such as low interest, tax-free mortgage revenue bonds, currently sold to investors, need to be made more widely available so that first-time homebuyers who are low- to moderate-income have greater access to low-interest loans.

Taxing concentrated wealth and linking the revenues to programs that will spread wealth into the next generation is the political heart of a winning strategy to expand wealth and equality of opportunity.

4. A Wealth Program tied to Financial Education

With wealth development must come wealth education and financial literacy. The 2002 Millennial Housing Commission reports that face-to-face counseling reduces defaults on home mortgages by up to 34 percent. This report also points out that financial education programs for low-income people are drastically inadequate. Only 120,000 to 150,000 individuals received pre-purchase education through HUD-related programs out of approximately one million lower-income first-time homebuyers.

Creating mass wealth-building programs will provide a big network that can respond to requirements for participation in wealth education before participants receive program benefits. These wealth education programs will strengthen individuals' economic conditions as well as the national economy. Wealth education will assist individuals in using the private market to their benefit. For example, studies have shown that up to 30% of those with high-cost subprime loans could have qualified for lower-cost mortgages,[51] but were not aware of this fact.

Tax Wealth to Build Wealth

Wealth-building efforts need a revenue stream in order to have a real impact. Historically, progressive taxation has been the source of this revenue stream. Post-World War II investment in the development of the great White American middle class was paid for by a system of progressive taxation. The top income-tax rate coming out of the war was 91% (it's 35% today); the estate tax included a provision that taxed fortunes over $50 million at a 70% rate. Because many of the benefits of post-war spending were widely shared, the progressivism of the tax system enjoyed widespread political support.

Wealth taxation and wealth development need one another. Taxing concentrated wealth and linking the revenues to programs that will spread wealth into the next generation is the political heart of a winning strategy to expand wealth and equality of opportunity. The cumulative impact of a program to broaden wealth by taxing wealth would be to dramatically reduce, over a generation, the disparities of wealth in the United States.

In the last 35 years, the richest one percent of America witnessed a 62 percent drop in their federal tax rate while their incomes have increased over 80 percent. This rapid increase in income has led to an overabundance of in-hand cash requiring investment or consumption. This kind of available capital is an example of financial liquidity. The wealthy's financial liquidity, with its concomitant need to invest, is at the root of the stock market bubbles we have witnessed.

President Bush has assisted the wealthy of America develop liquidity by giving them record-breaking tax cuts. In December 2007 the Federal Reserve invested $120 billion in the banking system to assist banks with issues of liquidity that were having negative effects on the stock market. So the question must be asked: Where is the presidential aid package to assist the American middle- and working-classes with liquidity, as they struggle to make ends meet?

Increases in the cost of housing, education, and health care paired with massive decreases in government investment in affordable housing, employment, and job training and an increase in payroll taxes of 25%, have left most of America cash-poor. Americans are finding the liquidity needed to pay daily bills through debt: credit cards, refinancing, and subprime loans. The American middle and working classes are maintaining their lifestyle on a foundation of quicksand—debt they cannot afford. When will middle-class and working-class America get a slice of the bailouts and preferential treatment that those who are least in need receive?

1. Maintain the Estate Tax

In 2001, a coalition of business lobbyists and wealthy families achieved a temporary victory in their drive to abolish the nation's only tax on inherited wealth. Congress voted to phase out the estate tax by gradually raising the exemption level from $1 million in 2002 to $3.5 million in 2009. In 2010, the tax will disappear so all millionaires and billionaires who die that year will pass on their fortunes tax-free. The tax will return to its 2002 levels in 2011 unless Congress revisits the issues.

However, the abolition of the estate tax, which only affects less than the wealthiest 0.27% of Americans, would cost the nation $1 trillion over 20 years. This is revenue the federal government can ill-afford to lose. Freezing the estate tax at its 2009 level (taxing inherited fortunes in excess of $3.5 million at a rate of 45%) would generate initially $20 to $25 billion a year. In the coming decades, an enormous intergenerational transfer of wealth will occur because the wealthy baby boom generation will be passing on its financial legacy. Estate tax revenue will grow to somewhere between $157 billion and $750 billion a year, depending on the estimated annual growth rate. Using this wealth from the most elite members of society to strengthen and grow the middle class could provide a primary resource for bridging the growing wealth divide.

2. Increase Corporate Taxes

From the 1940s to the 1990s, the percentage of federal taxes collected from corporations shrank from 33% of the total revenue to 15%. This has occurred at the same time that tax contributions from individuals increased from 44% in the 1940s to 73% of tax revenue collected in the 1990s. Real people are paying more of the cost of government, yet are receiving fewer and fewer benefits.
As corporations continue to make record profits, and middle-class and working-class Americans increasingly struggle to maintain even the living standards that their parents enjoyed, our government must respond. Re-shifting much of the responsibility to pay fair taxes back onto the mighty shoulders of corporate America, so American citizens can more broadly benefit from the US economy, would be a good start.

Do you have a suggestion about the rate to which corporate taxes should increase? Please visit http://www.faireconomy.org/dream and tell us what you think this rate should be.

3. Increase the Maximum Tax Rate to 45%

Today, someone who earns $200,000 a year pays the same top marginal income tax rate of 35 percent as someone who earns $20 million a year. During one of the great growth periods in the US, the Kennedy era, the maximum tax rate was 70 percent on the wealthiest of Americans. Warren Buffett, one of the wealthiest men in the United States, recently pointed out that he thought it was shameful that he should pay the same tax rate as his secretary. A modest increase to a marginal tax rate of 40% for those with income over $5 million a year and 45% for those with income over $10 million a year, would at least symbolically reflect the popular maxim "to whom much is given, much is expected."

4. Close the Tax Gap

In our current tax system only the first $90,000 of an individual's income is counted when the IRS calculates contributions to Social Security. Since President Bush tried to dismantle this very successful anti-poverty program, conservatives have been using their leverage and their powerful voices to insist that Social Security is going bankrupt and that reforms are needed. A small reform that should take place immediately is that the entire income of the richest Americans should be counted when calculating contributions to Social Security, as is the case with the rest of our taxpayers.

Another means to ensure that the wealthiest of America contribute their fair share is by yoking the capital gains tax rate with the top income tax rate. Only the wealthiest of Americans realize significant income from capital gains, and these Americans currently pay a 15% rate on this income. A police officer, on the other hand, can end up paying a 35% tax rate on her/his income. The capital gains tax rate should reflect the progressive nature of the income tax and rise for those taking in the highest amount of capital gains.

Affirmative Action

Though affirmative action policies have been successfully attacked and eroded over the last thirty years, America must take action in this arena if we decide together to end the culture of White privilege that has stained this nation throughout its history. Re-embracing affirmative action policies aimed at disenfranchised people of color will be a necessary part of this action. Throughout the world, from Finland to Brazil to India to South Africa and in countless other countries, affirmative action policies for racial, ethnic, language, economic, gender, and other types of groups have been effectively used—and are still used—to fight institutional and historic discrimination.

A national White backlash turned against the gains of the Civil Rights movements in the last part of the previous century. It became clear that "a majority of Whites were not willing to authorize a comprehensive racially-oriented attack upon poverty and disadvantage."[52] Inadequate affirmative action policies advanced by Richard Nixon as a conservative answer to develop greater racial equality in the United States became enshrined in the American mind and American popular culture as an adequate solution to the problem. Mass government investment in the poor and disenfranchised advocated by the Civil Rights movement became a more and more remote policy alternative.

When government focus shifted away from investing in the poor and disenfranchised, affirmative action became a policy that would disproportionately benefit middle-class racial minorities. This in turn would increase class division in minority communities.

Yet for all its limitations, affirmative action would still provide one of the most successful and continuous diversity measures in American history. A rededication of the nation to affirmative action, coupled with the wealth building policies we discuss in this report, will help redirect the United States onto a path of greater racial equality, which in large part has been abandoned since the assassination of Dr. King.

Conclusion

Almost 40 years ago, a few months before the assassination of Dr. King, our nation was suffering under civil rights injustices, violations and annihilations that had remained essentially unaddressed—certainly, unaddressed by any comprehensive governmental action—since the Emancipation Proclamation of 1862. Dr. King and the millions of people he inspired helped turn the national attention toward this national shame. During this era, civil rights took a few steps forward, at the cost of the blood and tears of many brave Americans.

But that advancement was not enough.

Over the last several decades, conservative economic theory has given us a series of economic policies that have worsened economic inequality in the US. The growing concentration of wealth among the already-rich strengthens the economic divide between disenfranchised people and the strong, largely White high-net-worth class in this nation. Millions of Americans still live in communities that are separate and unequal.

The government of the United States must look back to the words of Franklin Delano Roosevelt: "No country, however rich, can afford the waste of its human resources... Morally, it is the greatest menace to our social order." We as a society must address the economic alienation of specific groups and members of society, such as African-Americans, indigenous peoples, and Latinos. We must follow our venerable shared credo that "United We Stand."

The subprime crisis threatens US society by deepening the already existing wealth divide. The foreclosure of the dream of justice and equal opportunity for all must be prevented. United, we can create and implement the holistic, progressive, broad-spectrum policies that will protect our dream.

How can we save the dream together? Share with us best practices and sound action steps at http://www.faireconomy.org/dream.

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Appendix

Calculation for Total Wealth Loss

	Percent of Loans[1]	Share of Total Subprime Market	Loss of Wealth at 15.4%[2]	Loss of Wealth at 20%[3]	Percent of Population[4]	Share of Loss if Equitable at 15.4%	Share of Loss if Equitable at 20%	Difference at 15.4%	Difference at 20%	Percentage Difference at 15.4%	Percentage Difference at 20%
White	53.9	$1,245.63	$191.83	$249.13	66.4	$236.31	$306.90	44.49	57.78	0.23	0.30
Black	20.1	$464.51	$71.53	$92.90	13.4	$47.69	$61.94	-23.85	-30.98	-0.33	-0.43
Latino	21.3	$492.24	$75.81	$98.45	14.8	$52.67	$68.41	-23.13	-30.04	-0.31	-0.40
All People of Color	46.1	$1,065.37	$164.07	$213.07	33.6	$119.58	$155.30	-44.48	-57.77	-0.27	-0.35
Total Losses		$2,202.38	$355.89	$462.2		$355.89	$462.20				

Formula Derivation:	CRL Number
Eight-Year Subprime Market Total Value:	$2,311 billion

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* Chart calculations courtesy of Prof. Irvin Morgan, Bentley College, Department of Finance, Waltham, MA.

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