GSE Activity Report

Wednesday, October 21, 2020

The Black Tax

Summary

As we noted late last week, African-Americans and Hispanics have a heck of a time enjoying the benefit of low mortgage rates despite like-kind default risk to white borrowers. A new MIT study goes farther, finding that Blacks on average pay $13,464 more than whites over the life of their mortgage loans, calling this a "Black tax" on home ownership. Like the Boston Fed study, this one finds that GSE mortgages are disproportionately pricey for Blacks, increasing political risk to Fannie and Freddie along with still more pressure on risk-based pricing.

Impact

The study finds that Blacks overall pay $743 a year more in mortgage interest, $550 more for MI, and $390 more for property taxes. Notably, these costs do not include those related to higher delinquency and default rates due to higher costs, events that of course are even more destructive to wealth equality than an over-expensive mortgage loan. Other key findings are that:

- Blacks pay higher rates at origination due to perceived risk;
- the FRB-Boston study on refis noted above found a 5-bps difference at origination;
- this paper finds a 12-bps gap for purchase loans;
- important for policy, GSE loans had a 22-bps difference attributed to risk-based pricing;
- the FHA disparity is only 6-bps;
- rate differences accelerate due to the lack of refi opportunity previously analyzed in depth;
- and while 38% of white homeowners do not need FHA or private MI, only 12% of Black borrowers are able to avoid this added expense, which is more for FHA than MI.

The paper's policy conclusions include that:

- LLPAs are a major source of at-origination price discrimination. The paper attributes the need for LLPAs to capital restoration and concludes that the cost of GSE recapitalization has thus been disproportionately borne by Blacks. Risk-based lending is said not to be needed for safe lending, just for profitable lending.
- This profit incentive also applies to servicers, who add risk-based pricing to that resulting from loan-level adjustments. As the Boston Fed points out, this paper also says that fair risk-based pricing would discount Black loans due to lower prepayment risk.
- An array of other policy steps – e.g., first-time homeownership tax credits – are necessary.

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Outlook

The FHFA capital rule drew heated criticism based not only on resulting g-fee hikes, but also because many commenters believed that it would end cross-subsidization that increases mortgage credit availability for under-served borrowers. However, these two studies combine to make a strong case that current cross-subsidization does not eliminate race-based pricing with adverse racial-equity impact. Going forward, Democrats may reduce this by pushing more loans to FHA, mandating an end to LLPAs, or otherwise adjusting the GSEs to make them more of the mortgage utilities – not private-sector firms – which many Democrats demand.

Although GSE pricing takes the brunt of this attack, private MI is not immune. Former Freddie CEO Don Layton recently renewed calls to reduce MI reliance in favor of risk mitigation from diversified insurers and capital-market players. This is a longstanding effort that will surely be buoyed by any suggestions that private MI hurts Black borrowers even if FHA premiums are a larger concern.

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