GSE Activity Report

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Refis and Systemic Racism: Part 3

Summary

It's beginning to look a lot like a major policy theme: research continues to show that GSE mortgages cost Black and Hispanic borrowers considerably more than non-Hispanic whites, especially over the course of a loan, not just at origination. In a new paper, researchers at the Federal Reserve Bank of Atlanta blame the GSEs due to their LLPAs, but monetary policy now also comes in for the equality drubbing we think it deserves – see our ***EconomicEquality*** blog and Karen Petrou's forthcoming book.

Impact

This paper follows scathing assessments from the Federal Reserve Bank of Boston and MIT researchers finding race and ethnicity gaps in both refis and overall mortgage costs. And, like these other papers, this one calls for new mortgage products directly aimed at shrinking the racial mortgage gap, recommendations we think will get considerable attention in what we have called the new, racial-equity era of U.S. consumer-finance policy.

Looking at data through end-2015 to evaluate post-2008 monetary policy, the researchers first find that the gap between the rates paid by Black borrowers versus non-Hispanic whites on active GSE mortgages peaked at 60 bps in 2012. Washing away demographic issues such as lower credit scores and even loan-officer discrimination in a counter-factual run still leaves a 30 bps racial/ethnic rate disparity in that year. Like other recent papers, the Atlanta-Fed staff study concludes this difference is due principally to slow prepayment speeds, using a new data set to disentangle prepayments due to refis and those due to sales to provide more insight into demographic-based mortgage cost.

Black borrowers are also found to be less likely than whites to refinance even when holding constant all risk-based obstacles. Interestingly and for the first time, the paper then finds that Black and Hispanic borrowers refi at like-kind rates to whites in response to idiosyncratic factors such as more home equity, but are far less responsive than whites to changing interest rates resulting from accommodative monetary policy.

Thus, as we have shown before, the Fed's longstanding belief that ultra-low rates are distributionally indifferent is sharply contradicted – the lower mortgage rates go, the farther Black and Hispanic households are left behind in terms of home-ownership affordability. The Fed has since 2008 expressly aimed unconventional policy at lower mortgage rates, wrongly assuming here as in other areas that rising tides lift all boats. If investors rewarded slow prepayment speeds with lower rates,

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then prepayment disparity due to accommodative policy might not have disparate impact, but this paper shows that they don't so policy in fact is distributionally and racially discriminatory.

Outlook

Is this the Fed's fault? The GSEs'? Anyone's? The paper doesn't say, but its data are nonetheless still more of the damning sort sure to accelerate policy changes in 2021. Based on its analysis, the paper contemplates new products to encourage Blacks and Hispanics to benefit from lower rates.

One of these is ARMs, although of course minority borrowers would lose their upside-rate protection in ARMs just as they now seem to lose downside-rate benefits with FRMs. Reflecting this, the paper also suggests "ratchet" mortgages that would only adjust down and streamlined refis.

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