Low- and Moderate-Income Home Financing: What Are the Trends in Kansas City?

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Homeownership and home financing are critical elements in fulfilling family housing needs and in supporting local neighborhoods and public services. Over the last decade, many significant developments have taken place in home lending and U.S. mortgage markets—developments that are likely to have a strong influence on individual housing choices and neighborhood conditions. For instance, prosperity and declining interest rates over the past ten years or so have spurred record levels of home building and mortgage lending. Technology and financial market innovation have also played key roles during this period, dramatically changing the lending and credit evaluation process, the role of different lenders, and the importance of secondary market activities and mortgage-backed securities. Another notable factor in the changing mortgage market is the legislative and regulatory environment, which has placed an increasing emphasis on such objectives as fair lending, affordable housing, and community development.

In the Kansas City metropolitan area, a rapid increase in the rate of homeownership is one sign that all these recent developments have greatly influenced the local housing market. Between 1994 and 2002, the percentage of households in the Kansas City area that owned their own homes jumped from 63 percent to just over 75 percent.[1] This jump is all the more remarkable, given the relative stability in Kansas City homeownership rates over the previous thirty years.

Rising homeownership rates across the metropolitan area, however, only show part of the picture. Of equal or greater interest is how households in different income groups or neighborhoods have fared in their quest to become homeowners. In particular, much of the legislative and regulatory efforts over the last decade have been aimed at encouraging greater homeownership among low- and moderate-income households and within lower income neighborhoods. Also, technological change and the "information age" are commonly viewed as helping lenders to assess and take advantage of lending opportunities in lower income areas, where information costs may have once been too high. Consequently, a key set of questions to ask now is: how have recent changes in home financing affected low- and moderate-income borrowers in Kansas City; has their access to credit improved substantially; which lenders are most active in providing this credit; and how is home financing being distributed across different neighborhoods?

This study attempts to address these questions by looking at trends in home financing over the last decade for low- and moderate-income borrowers and neighborhoods in Kansas City.[2] The first part of the paper will examine the various developments that have influenced mortgage lending over the last decade. The next part will be an overview of mortgage lending patterns throughout the Kansas City area. The final two sections will examine home lending to low- and moderate-income borrowers and within low- and moderate-income neighborhoods.

CHANGES AND DEVELOPMENTS IN HOME LENDING

Over the last decade, a variety of factors have significantly influenced home financing trends and lending to low- and moderate-income borrowers, both nationally and in the Kansas City area. As a result, such factors are likely to provide both perspective and understanding to recent developments in the Kansas City housing market. Among the most important of these are economic conditions, technological developments, regulatory and legislative changes, and the growth and influence of community organizations and special lending programs.

Economic conditions

Economic conditions are expected to have an important role in housing markets by influencing both the willingness of households to undertake the long-term commitments required to purchase and finance homes and the willingness of lenders to provide the necessary financing. On an individual level, such factors as current employment status, recent job history, financial resources, and optimism about the future are likely to be significant in making a home purchase decision. Also, mortgage interest rates are another factor with a direct bearing on one's ability to buy a house, since they are a critical variable influencing the level of mortgage payments and the overall affordability of housing.

With regard to the housing market, the nation's economy over the last decade has provided one of the most stimulative environments on record. The U.S. economy experienced a ten-year expansion between 1991 and 2001, which was the longest period of uninterrupted growth in the country's history.[3] During this period, the unemployment rate dropped from a high of 7.8 percent in June 1992 to a cyclical low of 3.8 percent in April 2000. This expansion period consequently provided almost all potential home purchasers with good employment records, and the length of the expansion left many with an optimistic view about their future financial positions. These beneficial effects may be particularly significant for low- and moderate-income borrowers, who are commonly viewed as being the first to suffer from less prosperous conditions.

A further stimulus to homeownership has come from a substantial decline in mortgage interest rates. During 1990, the average interest rate charged on a new 30-year, fixed-rate mortgage was 10.13 percent.[4] By 1998, this annual average interest rate had fallen to 6.94 percent. After some increase in 1999 and 2000, mortgage rates declined again, falling to an annual average of 6.54 percent in 2002 and then remaining below six percent for the first half of 2003—a level last seen in the 1950s and 1960s.[5]

An outgrowth of these highly favorable economic and financial conditions has been a surge in both home construction and mortgage borrowing. Nationwide, the number of private housing starts has increased by more than 62 percent from the beginning of 1992 to the end of 2002. In the Kansas City metropolitan area, the number of building permits issued in 2002 exceeded the 1992 level by nearly 50 percent. Over the same period, the total home mortgage debt of households grew by more than 123 percent. In comparison, household income increased by less than 75 percent during this time, and total household real estate equity rose by 101 percent, which would seem to indicate that home financing became more available and more heavily used by the average household over the last decade.[6]

Technological developments

Until the 1980s and 1990s, all home lending had followed virtually the same format. Lending decisions were based on personal interaction with lending officers and one-on-one credit evaluations, and after loans were made, most depository institutions held the loans in their own portfolios. Since then, the lending process has been dramatically transformed by innovations in information processing, telecommunications, and financial instruments and markets. The "information age" and access to large data sources on borrowers and on neighborhood housing markets now allow large financial institutions to make credit decisions and price loans for risk largely on the basis of their own credit scoring and automated underwriting systems. Furthermore, the development of mortgage-backed securities and the derivatives market is bringing a much wider group of investors and lenders into the mortgage market, helping to even the flow of housing funds over time and across the country.

Several aspects of this financial innovation are of particular importance for low- and moderate-income home purchasers. For example, lenders are gaining access to a much richer set of information on such individuals and their neighborhoods—information that is helping to reduce the cost and risk of lending. This rapid decline in information costs is also bringing in a broader and more competitive range of lenders, including subprime mortgage lenders to serve borrowers with impaired or limited credit histories. Another outgrowth of technological and financial innovation is an increased flow of funds into low- and moderate-income lending as new ways are found to package and sell such loans. Financial innovation is thus providing new avenues for expanding credit availability in lower income markets.

Regulatory and legislative change

Although much of the fair housing and community reinvestment legislation was first put in place between 1968 and 1977, some of the most significant steps in fostering compliance with these laws did not occur until the late 1980s and the 1990s. These steps, as well as other important developments in home lending markets, are now giving financial institutions strong incentives to increase the amount of funds they lend to low- and moderate-income households and neighborhoods.

The Community Reinvestment Act—The Community Reinvestment Act (CRA) was passed in 1977 with the purpose of encouraging depository institutions to help meet the credit and development needs of their own communities, particularly those of low- and moderate-income persons and neighborhoods, in a manner consistent with safe and sound operations. CRA compliance is largely based on an institution's low-income lending record within its "assessment areas," which are those areas surrounding its deposit-taking offices. From an enforcement standpoint, regulators must consider an institution's CRA performance when the institution or its parent company applies to open a branch or other deposit facility, acquire or merge with another institution, or form a bank holding company.

Among the key factors that have served to intensify CRA enforcement and the incentives for low-income lending in recent years are public disclosure of CRA examination ratings beginning in 1990 and the issuance of new regulatory standards in 1995. The bank merger boom of the last decade also made favorable CRA ratings imperative for expansion-minded organizations. The public disclosure of CRA ratings, for instance, gave institutions an added inducement to achieve high ratings as a means of preserving their public reputations and discouraging CRA protests by community groups. The substantial reworking of CRA requirements in 1995 sought to create a more "performance-based" system by providing a more quantitative approach to CRA and by emphasizing how an institution actually performs with regard to low-income lending in its assessment areas.

Similarly, the importance of CRA for organizations pursuing mergers increased notably after the Federal Reserve Board of Governors' 1989 denial of an application based on deficiencies in CRA performance. This denial of Continental Illinois' proposal to acquire a bank became a major turning point in CRA enforcement and sent a strong signal to bankers that "satisfactory," if not "outstanding," CRA performance ratings would be a critical factor in pursuing acquisitions and avoiding criticism from community groups.[7]

***The Home Mortgage Disclosure Act*—**The objective of the Home Mortgage Disclosure Act of 1975 (HMDA) is to have mortgage lenders disclose information about their lending in urban areas, thereby giving the public and regulators the means to determine which lenders best meet community housing needs. To create a more comprehensive picture of home lending patterns in urban areas and to spur lending to low- and moderate-income groups, Congress amended HMDA three times between 1987 and 1991, increasing both the types of institutions required to report and the information they must report. As a result, the act now covers virtually all institutions making home loans in metropolitan areas, including banks, savings associations, credit unions, the mortgage lending subsidiaries or affiliates of these institutions, and independent mortgage companies.[8] Moreover, since 1990, lenders have had to report data on each home purchase, refinance, or improvement loan application received, and this data must include loan purpose, loan amount, property location by census tract number, and final disposition of each loan request—approved, denied, withdrawn, etc.[9] To the extent possible, lenders must also record each applicant's gender, race, and income level. All of this information is available to the general public from the lenders themselves and the regulatory agencies.

Over the last decade, HMDA and its increased reporting requirements have played a critical role in encouraging low- and moderate-income lending. Most notably, the expanded HMDA data have given community groups, researchers, mortgage lenders, regulators, and the U.S. Department of Justice a starting point for comparing institutions' home lending records and possible compliance with fair housing laws and the CRA.

Community groups, in particular, have come to realize the value of HMDA data in analyzing home lending records and using this information to monitor progress or criticize performance at local institutions. Several highly publicized studies based on HMDA data have also caught the public's attention and sent a strong message to many lenders.[10] HMDA data have further provided much of the basis for several regulatory investigations and Department of Justice lawsuits under the fair lending laws, beginning with the Justice Department's settlement of a race discrimination lawsuit against Decatur Federal Savings and Loan Association in 1992.[11] As a consequence, HMDA has played a very significant role in providing the information necessary to assess the performance of lenders in meeting low- and moderate-income credit needs.

Growth of community organizations and special lending programs

A final set of factors that has been important in fostering lower income lending is the growth of community organizations and special lending programs. Nearly 20 community development corporations (CDCs) now operate in portions of the Kansas City metropolitan area, providing a wide range of services to the low- and moderate-income neighborhoods they serve. These services expanded rapidly in the 1990s both in terms of scope and usage, and depending on the organization, may include development of affordable housing; homebuyer education and counseling programs; support for neighborhood restoration and rehab projects; employment, job training, and educational assistance; and a variety of social services. From a homebuying standpoint, some of the CDCs perform a much needed conduit function, preparing prospective buyers for all aspects of the lending process and then linking them with appropriate lenders.

The 1990s have also seen substantial growth in special housing programs. Some examples at the federal level include the Community Development Block Grant Program and HOME Investment Partnership Program. At the state and local levels, housing and mortgage assistance programs include various revenue bond programs to provide reduced-rate, low down-payment, and first-time homebuyer loans; state housing development commission programs; low-income tax and mortgage credits; financial support for local CDCs; and the formulation of community development plans and strategies. In addition, Congress passed legislation in 1992 that calls for the U.S. Department of Housing and Urban Development to establish annual affordable housing goals for Fannie Mae and Freddie Mac to meet in their mortgage purchases covering low-income areas and borrowers.

Table 1
Home Purchase Lending
(Kansas City Metropolitan Area)

	(Average annual amount per period)		
	1992-1994	**1995-1998**	**1999-2001**
Total Number of Loans	20,939	29,298	38,462
Loans Per 100 Owner-Occupied Units	4.71	6.60	8.66
Total Amount of Loans (In millions of $)	$1,798.9	$2,806.9	$4,350.6
Average Size of Loan	$85,924	$95,807	$113,115

Sources: HMDA reports and 1990 and 2000 U.S. Census data.

OVERVIEW OF HOME LENDING IN KANSAS CITY

The previous section suggests that several factors—the economy, technological innovation, tighter regulation, and a growing role for CDCs and special loan programs—would be expected to have a highly favorable effect on home lending over the last ten years, especially for low- and moderate-income lending. This section will provide an overview of mortgage lending trends for the entire Kansas City metropolitan area from 1992 to 2001 and examine whether such trends are generally consistent with the expectations described above.

As shown in Table 1, home purchase lending for all income groups in Kansas City, as reported by HMDA filers, rose substantially from the first part of the 1992-2001 period to the last part (for information on how these numbers and the other numbers in this study were derived from HMDA and U.S. Census information, please see the box at the end of this article entitled, "Data Sources and Methodology").[12] For instance, the average annual number of home purchase loans granted to Kansas City area residents jumped from less than 21,000 during the first three years of this period to more than 38,000 over the last three years, which is more than an 83 percent increase. From 1999 to 2001, this lending represented a yearly average of 8.66 home purchase loans for every 100 owner-occupied housing units in Kansas City.

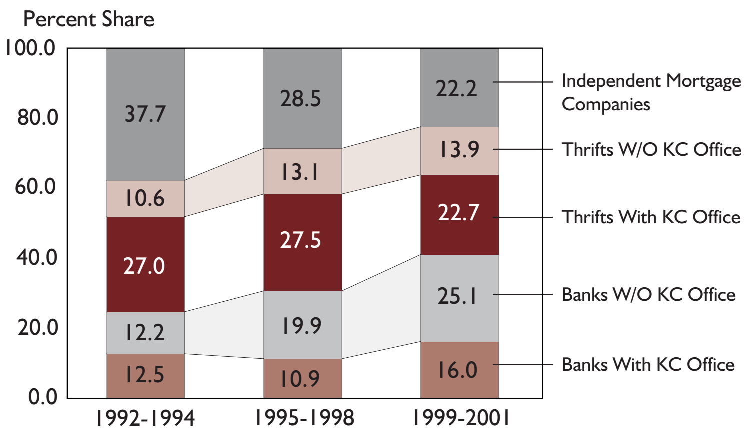
The total dollar volume of home lending also rose substantially from an annual average of just under $1.8 billion during the early years to over $4.3 billion in the final years of the period—an increase of nearly 142 percent. In comparison, the GNP price deflator—a measure of inflation—rose by less than 14 percent over this time, which suggests that little of the increased lending can be attributed to inflation.[13] Similarly, population growth appears to have played a fairly small role in the home lending surge, with the Kansas City metropolitan area population rising by just over 12 percent during the 1990s. Table 1 further shows that the average size of home purchase loans in Kansas City grew from just under $86,000 to more than $113,000.

The significant growth in overall home lending between 1992 and 2001 does not provide an insight into low- and moderate-income lending or the relative contribution of the factors mentioned above. However, for such an increase to occur across the metropolitan area, the economy, itself, must have provided a major boost to the Kansas City housing market.

Chart 1

Share of Home Purchase Loans Approved By Lender Type

(Kansas City Metropolitan Area)



Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

Chart 1 shows the share of home purchase lending done by the different types of lenders. Commercial banks—both those with deposit-taking offices in Kansas City and those without a local banking office presence—experienced the greatest gains in market share, while independent mortgage companies suffered the largest declines.[14] Particularly noteworthy is the rapid increase in the importance of banking organizations without deposit-taking offices in Kansas City. Such organizations more than doubled their market share and now have a larger portion of the market than any other lending group—a 25.1 percent share. This share, moreover, is held almost entirely by large banking organizations with more than $10 billion in assets and primarily reflects the activities of their mortgage banking affiliates.[15] While a variety of factors are undoubtedly behind these trends, financial and technological innovation may have given these larger organizations the means to expand and become major players within the Kansas City market.

LENDING TO LOW- AND MODERATE-INCOME BORROWERS

With the rapid growth in lending across the entire Kansas City housing market, a key question is how much of this lending has gone to households in low- and moderate-income groups—those with less than 80 percent of the median household income in the Kansas City metropolitan area. This question is of interest because the steps that were taken to tighten CRA and HMDA regulations during the 1990s should have provided incentives for local lenders to increase their business with low- and moderate-income groups. Also, recent innovations in financial markets should have increased greatly the amount of financial information available on lower income borrowers, while community organizations and special loan programs should have helped to expand the resources going toward this lending.

As shown in Table 2, the total volume of home purchase loans extended to low- and moderate-income borrowers throughout the Kansas City area grew substantially from the first part of the 1992-2001 period to the last part. A yearly average of $1,021 million in home lending took place during the last three years of this period, which is nearly triple the $343 million average for the first three years. This lending, moreover, increased as a portion of all home purchase lending in Kansas City—rising from an average market share of 19.1 percent between 1992 and 1994 to an average share of 23.5 percent from 1999 to 2001. As a result, the rate of growth in home purchase lending to low- and moderate-income borrowers exceeded the rapid pace for all such lending in the metropolitan area.

The vast majority of this lending to low- and moderate-income borrowers has taken place outside of low- and moderate-income census tracts. Table 2, for instance, shows that of all the home purchase loans approved for low- and moderate-income borrowers between 1999 and 2001, a yearly average of $127.4 million was in low- and moderate-income census tracts, while $893.7 million—or nearly 88 percent of this lower income lending—was in other parts of Kansas City. Lending in both areas, though, has increased markedly, and the 1999-2001 annual volume of such lending in low- and moderate-

Table 2

Home Purchase Lending to Low- and Moderate-Income Borrowers (Kansas City Metropolitan Area)

(Average annual amount)

	1992-1994		1995-1998		1999-2001	
	Amount (Millions$)	Share of All Lending	Amount (Millions$)	Share of All Lending	Amount (Millions$)	Share of All Lending
All Low- and Moderate-Income Borrowers	343.4	19.1%	592.5	21.1%	1,021.1	23.5%
Low- and Moderate-Income Borrowers in Low- and Moderate-Income Census Tracts	35.7	2.0%	64.8	2.3%	127.4	2.9%
Low- and Moderate-Income Borrowers in All Other Census Tracts	307.7	17.1%	527.7	18.8%	893.7	20.5%

Sources: HMDA reports and 1990 and 2000 U.S. Census data.

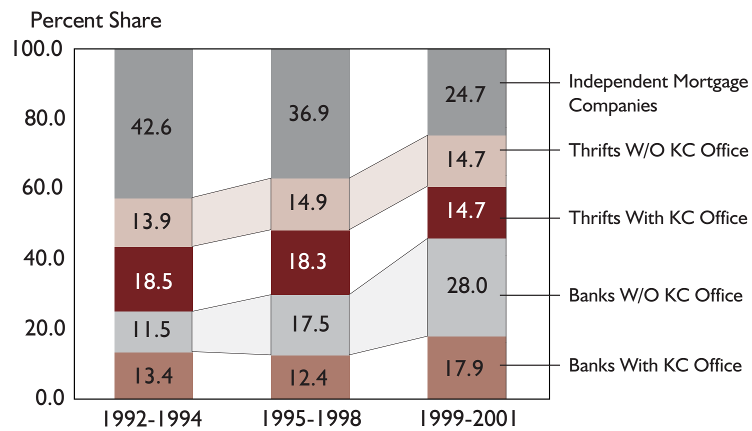
income census tracts is approximately three and one-half times that of the 1992-1994 base. The numbers in Table 2 thus imply that home lending to low- and moderate-income borrowers is dispersed across the metropolitan area—an indication that these borrowers are looking for a range of opportunities in housing, employment, and public services.

As shown in Chart 2, commercial banks—both with and without banking offices in Kansas City—have been the most successful at increasing their share of low- and moderate-income lending throughout the Kansas City area. Independent mortgage companies have experienced a substantial drop in market share, as have thrifts with Kansas City offices. Thus, for lenders with deposit-taking offices in Kansas City, who would be evaluated for CRA purposes on low- and moderate-income home lending, two different patterns have emerged—a rising share of lending by banks and a decreasing share by thrifts.[16] While these patterns suggest that banks have responded more successfully to the changes in CRA and HMDA regulations, other factors could also be at work, including differences in bank and thrift office locations within the market, size of operations, merger and expansion trends, gains in efficiency and innovation, and other market patterns.

As with the overall home lending trends in the metropolitan area, the biggest growth in low- and moderate-income lending was by banking organizations without deposit-taking offices in Kansas City. Their share of the home purchase market rose quite rapidly from 11.5 percent in the 1992-1994 period

Chart 2

Share of Home Purchase Loans Approved By Lender Type To Low-to-Moderate Income Borrowers (Kansas City Metropolitan Area)



Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

to 28 percent by the 1999-2001 period. The vast majority of this lending was by banking organizations with more than $10 billion in assets—a group that has developed into a very competitive force in Kansas City home lending (see Table 3). Table 3 further shows that, among banks with Kansas City offices, much of the low- and moderate-income home lending has been done by banking organizations with more than $10 billion in total assets, although banks under $1 billion in assets have also played a notable role.

Table 3

Home Purchase Lending to Low- and Moderate-Income Borrowers By Type and Size of Lender (Share of average annual lending, 1999-2001)

(Kansas City Metropolitan Area)

	Market Share According to Size of Organization by Total Assets				
	$0-100 Million	**$100-1,000 Million**	**$1-10 Billion**	**Over $10 Billion**	**Total Share**
Commercial Banks with Kansas City Offices	1.65%	3.75%	1.60%	10.86%	17.86%
Commercial Banks without Kansas City Offices	0.01%	0.64%	2.89%	24.48%	28.01%
Thrifts with Kansas City Offices	0.30%	6.36%	6.72%	1.34%	14.72%
Thrifts without Kansas City Offices	0.004%	8.36%	1.00%	5.35%	14.71%
Independent Mortgage Companies*					24.70%
Total					100.00%

*Comparable measures of asset size are not available for independent mortgage companies.

Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

Overall, this increase in home purchase lending to low- and moderate-income households implies that access to credit has improved for this group—both within lower income census tracts and throughout the metropolitan area. Not only has home lending grown rapidly for lower income households, it has also risen at a rate that exceeds that for other income groups in the Kansas City market. In addition, other important changes appear to be taking place in low- and moderate-income borrowing. The growing competitive influence of large banking organizations, particularly those with no banking offices in Kansas City, suggests that technology, credit scoring, automated underwriting systems, and secondary mortgage markets may be providing ways to eliminate rigidities in local housing markets and serve lower income lending needs more efficiently and effectively. CRA enforcement and HMDA disclosures still provide incentives on their own for lower income lending. However, the success of large organizations that have no Kansas City banking offices—and thus are not evaluated for CRA purposes on the basis of their Kansas City record—indicates that other factors may be even more important.

LENDING IN LOW- AND MODERATE-INCOME CENSUS TRACTS

The CRA stresses the importance of depository institutions serving lower income neighborhoods. In addition, community organizations and public lending programs have the goal of preserving or improving the housing stock in these neighborhoods and providing opportunities for individuals to become homeowners. These efforts further provide a basis for maintaining or improving other aspects of a neighborhood, including its stability and future, quality of family life, and public services. As a consequence, this section will look at the lending trends within the low- and moderate-income census tracts of Kansas City.

According to the 1990 Census data used to track home lending in this study, 147 census tracts, or nearly 35 percent of the 426 tracts in the Kansas City metropolitan area, were low- or moderate-income tracts. Most of these tracts are inner-city neighborhoods located near the central business districts of Kansas City, Kansas and Kansas City, Missouri (See Map 1).[17] Apart from lower incomes, other common characteristics these census tracts generally share are an older housing stock and less new construction, more rental properties, higher minority population, fewer employment opportunities within the census tracts, and higher levels of unemployment.[18] Between 1990 and 2000, these tracts experienced a decline of nearly seven percent in the total number of owner-occupied housing units located there. In contrast, middle-income census tracts in Kansas City had a six percent increase in owner-occupied housing, and high-income tracts had more than a 28 percent jump.

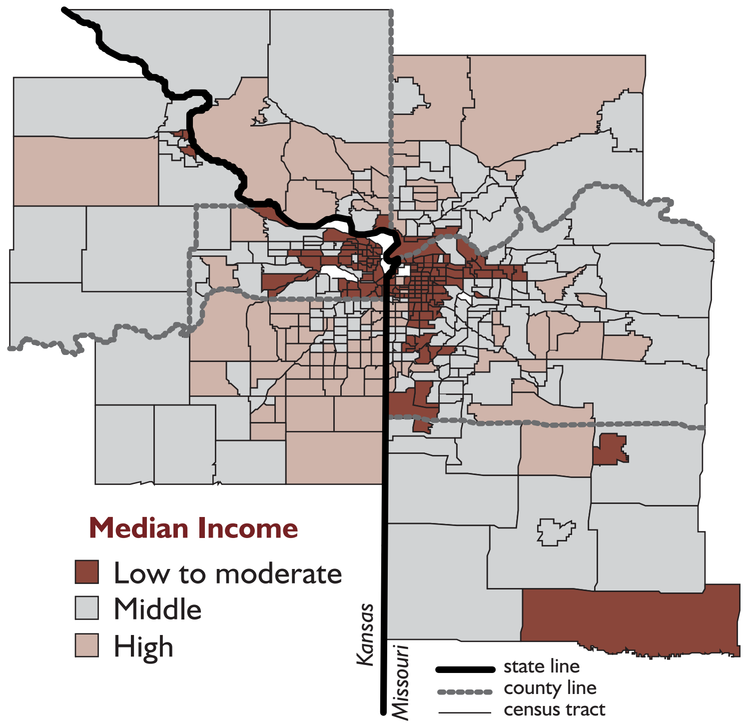
The previous section showed that, even with somewhat less favorable neighborhood characteristics, the volume of home lending rose substantially to low- and moderate-income households in these census tracts. Lending to other income groups within these neighborhoods could also provide significant support to the neighborhood. As shown in Table 4, the average annual amount of home purchase lending in low- and moderate-income census tracts that went to households above the moderate-income level was $40.6 million between 1992 and 1994, or 53.2 percent of all home lending in these tracts. For the 1999-2001 period, lending to such households amounted to $97.5 million, which represented a drop to 43.4 percent of the total amount of home purchase lending in these census tracts. Thus, lending to those with incomes above the low and moderate levels has been a major factor supporting the housing market in lower income neighborhoods, but such lending hasn't grown as rapidly as that to low- and moderate-income borrowers.

Table 4 also shows that low- and moderate-income census tracts make up a fairly small portion of the overall home lending in Kansas City, even though these census tracts represent nearly 35 percent of all Kansas City tracts. Such lending, though, appears to be growing at a more rapid pace than that of the entire metropolitan area. For example, the average annual number of home purchase loans approved in low- and moderate-income census tracts was 1,733 in the 1992-1994 time frame, which was around 8.3 percent of the metropolitan total. Over the 1999-2001 period, the comparable figures are 3,988 loans and 10.4 percent of all such lending in Kansas City.

Map 1

Income Distribution by Census Tracts — 1990

(Kansas City Metropolitan Area)



Sources: HMDA reports and 1990 and 2000 U.S. Census data.

Table 4

Home Purchase Lending – By Type of Census Tract (Kansas City Metropolitan Area)

(Average annual amount)

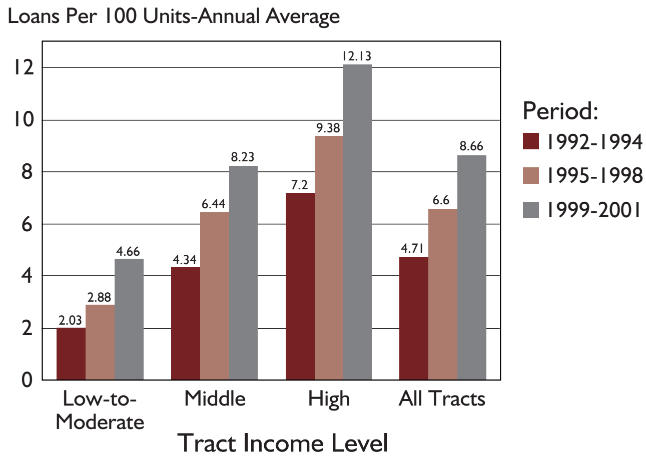
Census Tract Median Income	1992-1994 Number Of Loans	1992-1994 Amount (Millions$)	1995-1998 Number Of Loans	1995-1998 Amount (Millions$)	1999-2001 Number Of Loans	1999-2001 Amount (Millions$)
Low-to-Moderate Income	1,733	$76.2	2,467	$119.2	3,988	$225.0
(LMI* borrowers)	(1,006)	($35.7)	(1,581)	($64.8)	(2,615)	($127.4)
(Above LMI* borrowers)	(727)	($40.6)	(886)	($54.4)	(1,373)	($97.5)
Middle Income	10,046	$722.9	14,903	$1,181.1	19,045	$1,806.2
High Income	9,157	$999.7	11,929	$1,506.7	15,430	$2,319.4
Total	20,936	$1,798.9	29,298	$2,806.9	38,462	$4,350.6

*LMI means low-to-moderate income.

Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

Chart 3

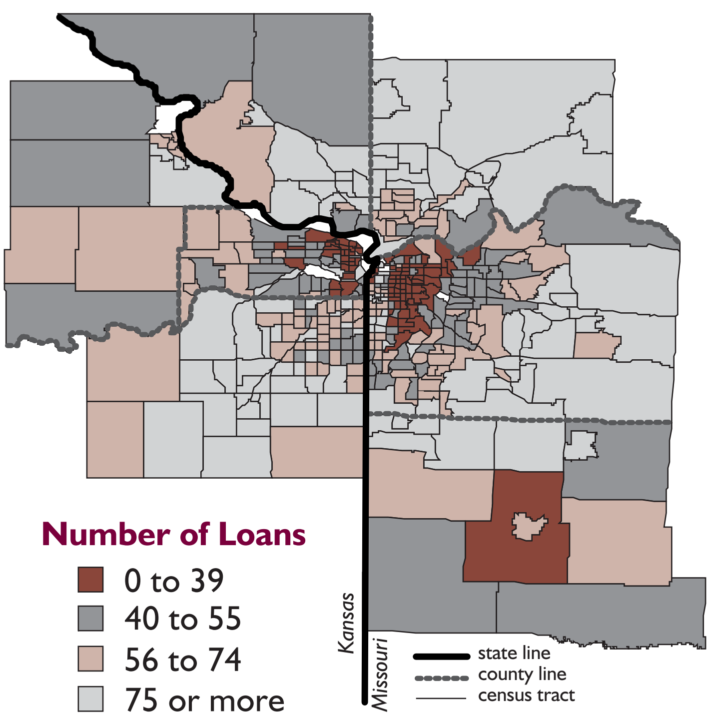
Home Purchase Loans Approved Per 100 Owner-Occupied Units By Tract Income Level (Kansas City Metropolitan Area)



Sources: HMDA reports and 1990 and 2000 U.S. Census data.

Map 2

Distribution of Home Purchase Loans Per 100 Owner-Occupied Units 1992 to 2001 Census Tracts (Kansas City Metropolitan Area)



Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

A better way to look at the relative level of lending in low- and moderate-income neighborhoods may be to compare the number of home purchase loans approved annually to the number of owner-occupied housing units.[19] Such a comparison helps to adjust for housing differences across census tracts, particularly between neighborhoods composed primarily of single-family homes and neighborhoods where rental housing may be a much more significant factor. Chart 3 consequently looks at the number of loans made annually per 100 owner-occupied dwellings.

As shown in this chart, fewer loans relative to the number of owner-occupied units have been made in low- and moderate-income census tracts compared to other Kansas City neighborhoods—a pattern that individually holds true across most of these neighborhoods (see Map 2).[20] However, the rate of such lending has more than doubled from the 1992-1994 period to the 1999-2001 time frame, when an annual average of 4.66 loans were approved for every 100 owner-occupied homes in low- and moderate-income neighborhoods. Thus, although the latter figure is still well below the metropolitan area average of 8.66 loans, it indicates that home lending in low- and moderate-income census tracts is growing at a more rapid rate than in other neighborhoods.

It is not clear whether this lower level of lending in low- and moderate-income neighborhoods largely reflects differences in credit availability or other, mostly demand-related, factors. Housing turnover, for example, could be slower in lower income areas because of older homeowners holding on to their homes and less new home construction. Also, some homeowners may have received loans through special lending programs and may stay in their homes longer to take advantage of this financing. In addition, existing and prospective homeowners in lower income neighborhoods may not have the financial resources to fund more frequent housing changes, particularly when down payments, loan closing costs, and moving expenses are considered. All of these factors could thus influence the demand for new loans and rate of home purchase lending.

Table 5

Home Purchase Lending – By Type of Census Tract and Lender (Kansas City Metropolitan Area)

(Number of loans made annually per 100 owner-occupied dwellings)

	1992-1994			1995-1998			1999-2001		
Type of Lender	**LMI***	**Middle**	**High**	**LMI***	**Middle**	**High**	**LMI***	**Middle**	**High**
Commercial Banks with Kansas City Offices	0.76	0.73	0.72	0.72	0.83	0.83	1.14	1.53	1.83
Commercial Banks without Kansas City Offices	0.16	0.48	0.92	0.46	1.24	1.92	1.45	2.38	2.94
Thrifts with Kansas City Offices	0.34	0.88	2.18	0.45	1.25	2.86	0.53	1.21	3.05
Thrifts without Kansas City Offices	0.21	0.53	0.78	0.28	0.85	1.26	0.45	1.15	1.71
Independent Mortgage Companies	0.57	1.72	2.59	0.97	2.27	2.50	1.09	1.96	2.60
Total — All Lenders	2.03	4.34	7.20	2.88	6.44	9.38	4.66	8.23	12.13

*LMI means low- and moderate-income tracts.

Sources: HMDA reports, 1990 and 2000 U.S. Census data, FDIC Summary of Deposits reports, Federal Reserve NIC financial institution structure and financial data.

Another part of the picture for lending in low- and moderate-income neighborhoods is the question of which lenders are playing a major role in this market. Table 5 examines this topic by looking at different lender types and the number of loans they made per 100 owner-occupied housing units in Kansas City neighborhoods. During the first three years of the study period (1992-1994), commercial banks with Kansas City offices had the highest lending ratio of all lenders in low- and moderate-income census tracts, and this lending slightly exceeded the rate these banks achieved in both middle- and high-income neighborhoods. This group's rate of lending per 100 owner-occupied units increased further in each income category by the end of the study period (1999-2001), although the greatest increase was in high-income tracts. Compared to other lenders, the rate of lending in low- and moderate-income neighborhoods by commercial banks with Kansas City offices was much closer to their lending rates in other neighborhoods, and this relationship held true for all three periods listed in Table 5.

While commercial banks without deposit-taking offices in Kansas City did little lending in low- and moderate-income neighborhoods between 1992 and 1994, they greatly expanded this form of lending by the 1999-2001 period and became the most frequent lenders in this category. As shown in Table 5, lending by these banks in other parts of the metropolitan area also grew substantially, and between 1999 and 2001, their rate of lending was more than twice as high in high-income census tracts as in low- and moderate-income tracts. Lending by thrifts—both those with Kansas City offices and those without—also increased in relation to the number of owner-occupied homes. Thrifts, though, were much less likely to be lending in low- and moderate-income neighborhoods than in other parts of Kansas City, perhaps because many thrifts maintain much of their office structure in suburban areas. The rate of lending by independent mortgage companies showed very little change over the ten-year period, except in low- and moderate-income neighborhoods where these companies became more frequent lenders.

The lending rates in Table 5 thus show that banks are the most common lender in low- and moderate-income neighborhoods. Banks with Kansas City offices, in fact, have continued to maintain their lending support in lower income neighborhoods, and unlike other lenders, have achieved fairly similar rates of lending throughout the metropolitan area. This result supports the view that these bank's lending patterns, in part, reflect the objectives of the CRA and HMDA. These lending patterns, undoubtedly, have also been influenced by the growing demand for home financing in the Kansas City area, substantial innovation in mortgage markets, and growing competition from outside lenders. The emergence in home lending by banking organizations without deposit-taking offices in Kansas City is the most significant change in the Kansas City home lending market and another sign of the significant changes in mortgage finance.

SUMMARY

Several noteworthy factors have influenced the demand and supply for home financing in the Kansas City metropolitan area. Over the past decade, a strong economy and declining interest rates have helped to increase the amount of home financing demanded by all income groups in Kansas City. Technological and financial market innovation have further enabled this increasing demand to be realized. Among low- and moderate-income borrowers and neighborhoods, changes in the CRA and HMDA during the 1990s have provided additional incentives for local lenders to serve these markets. Also, community organizations and special lending programs have supplied another form of support for low- and moderate-income lending.

All of these factors are reflected to some extent in Kansas City lending patterns. The total annual dollar volume of home purchase lending, as reported by HMDA filers, rose by nearly 142 percent from the 1992-1994 time frame to the 1999-2001 interval. Also, while the rate of lending per 100 owner-occupied homes was lower for low- and moderate-income neighborhoods than for other neighborhoods, this lending experienced strong gains over the last ten years. In addition, much of the lending to low- and moderate-income households took place throughout the Kansas City market and at a faster rate than other forms of home lending. Perhaps the most notable development among home lenders was the substantial growth in lending over the entire metropolitan area by banking organizations without deposit-taking offices in Kansas City.

As a result, Kansas City lending patterns imply that credit has become more available for low- and moderate-income borrowers and neighborhoods. The CRA, HMDA, and fair lending laws have played an important role in this increased credit availability. However, the most important group of factors seems to be the growing presence of lenders that do not have deposit-taking offices in Kansas City and the financial market innovations that have allowed this competition to emerge and prosper. From a longer-term perspective, the emergence of such competition is a very positive development for low- and moderate-income lending. This new competition is a sign that lower income lending can meet the same market tests as other forms of lending and, going forward, may not have to rely as much on regulatory incentives. To the extent this is true, a much broader range of lenders and investors will be interested in serving low- and moderate-income borrowers, and a more continuous source of financing will be available to support and improve lower income neighborhoods.

ENDNOTES

[1] U.S. Census Bureau, *Housing Vacancy Survey*, Annual Survey 2002, Table 14.

[2] A wide range of studies have looked at low- and moderate-income lending, both within markets and on a nationwide basis. Some of these are: Robert B. Avery, Paul S. Calem, and Glenn B. Canner, "The Effects of the Community Reinvestment Act on Local Communities," Board of Governors of the Federal Reserve System, March 2003; Mark Duda and Eric S. Belsky, "The Anatomy of the Low-Income Homeownership Boom in the 1990s," *Low-Income Homeownership Working Paper Series*, Joint Center for Housing Studies of Harvard University, July 2001; Jeffrey W. Gunther, Kelly Klemme, and Kenneth J. Robinson, "Redlining or Red Herring," *Southwest Economy,* Federal Reserve Bank of Dallas, May/June 1999, pp. 8-13; and Kirk McClure, "The Twin Mandates Given to the GSEs: Which Works Best, Helping Low-Income Homebuyers or Helping Underserved Areas?" *Cityscape: A Journal of Policy Development and Research,* Vol. 5 (2001), U.S. Department of Housing and Urban Development, pp. 107-143.

[3] According to the National Bureau of Economic Research, the official arbiter of business cycle durations, the United States was in a growth cycle from March 1991 to March 2001.

[4] Federal Home Loan Mortgage Corporation, *Primary Mortgage Market Survey,* Monthly Average Commitment Rate and Points on 30-Year, Fixed-Rate Mortgages.

[5] Points charged on 30-year, fixed-rate mortgages have also declined from an average of 2.1 in 1990 to 0.6 in 2002, thus reducing the cost of homeownership even further.

[6] The figures in this paragraph are derived from the U.S. Census Bureau and U.S. Department of Housing and Urban Development, "New Residential Construction," *Joint Release;* and the Federal Reserve Board of Governors, *Flow of Funds.*

[7] See Continental Bank Corporation, 75 Federal Reserve *Bulletin* 304 (1989).

[8] Some financial institutions are exempt from reporting under the act because they do not have any metropolitan offices, fall below a fairly small size threshold, or, in some cases, devote only a small portion of their portfolio to mortgage lending.

[9] HMDA reporting requirements are to be expanded further in 2004. One significant addition will be the reporting of loan pricing information. For home purchase, refinance, and home improvement loans, lenders will be required to report the spread between the annual percentage rate on such loans and the yield on comparable U.S. Treasury securities, provided this spread exceeds 3 percentage points for first-lien loans and 5 percentage points for subordinate-lien loans. The intent behind collecting this loan pricing data is to address fair lending concerns related to loan pricing and to foster better understanding of the mortgage market, particularly subprime lending.

[10] Among the more noteworthy of these studies are: "The Color of Money," a series of articles by Bill Dedman in the *Atlanta Journal Constitution* in 1988 describing lending patterns in Atlanta that seemed to favor white borrowers, and "Mortgage Lending in Boston: Interpreting HMDA Data," a study conducted by the Federal Reserve Bank of Boston in 1992 that investigated disparities in white and minority mortgage denial rates.

[11] For more on this, see U.S. Department of Justice, *Press Release,* "Department of Justice Settles First Race Discrimination Lawsuit Against Major Home Mortgage Lender," September 17, 1992.

[12] In Federal Reserve Regulation C (Home Mortgage Disclosure), a home purchase loan is defined as "any loan secured by and made for the purpose of purchasing a dwelling." Under Regulation C, lenders use other categories or codes for reporting home-improvement, refinancing, and multifamily dwelling loans.

[13] The change in the GNP deflator was calculated from the midpoint of the 1992-1994 time frame to the midpoint of the 1999-2001 interval. The midpoint was used because the lending amounts were a yearly average over these years and this average would presumably correspond most closely to the midpoint of each time frame.

Box1

Data Sources and Methodology

This study combines information from four separate data sources: 1990 and 2000 demographic data at the census tract level of aggregation from the U.S. Census Bureau; Home Mortgage Disclosure Act (HMDA) data on individual mortgage loan applications from 1992 through 2001; financial data on lenders from the reports they filed with regulatory agencies from 1992 through 2001; and information on the organizational structure of each lender from 1992 through 2001, including parent entity and branch locations, from the Federal Reserve's National Information Center database.

To allow a direct comparison of census tracts between 1990 and 2000, this study takes 2000 census data and analyzes it on the basis of the 1990 census tract definitions for the Kansas City Metropolitan Statistical Area (MSA). This was done by aggregating the 2000 data from the block level into census tracts, using the geographic tract definitions that existed in 1990. The number of owner-occupied housing units in each census tract was derived from both the 1990 and 2000 census data and averaged by tract, creating an average value for each tract's owner-occupied units between 1990 and 2000.

Each census tract was defined as either low- and moderate-income, middle-income, or high-income, based on whether the 1990 median household income within the census tract was below 80 percent of the MSA median income, between 80 and 120 percent of the MSA median income, or above 120 percent of the MSA median income. The low- and moderate-income criteria is the same as that used in the Community Reinvestment Act (CRA) in evaluating a lender's record in meeting credit needs.

The HMDA data used in this study include all approved home purchase loan records available for the Kansas City MSA, for the 1992 through 2001 period. The 1992-2001 period was chosen because the same definition of low-to-moderate income areas, which was based on 1990 census data, applied throughout this period for lending institutions subject to CRA compliance. The study aggregates HMDA data on the number and dollar volume of approved home purchase loans into three periods: 1992 through 1994; 1995 through 1998; and 1999 through 2001. The principal reasons for aggregating the data into periods are to simplify the analysis and smooth any year-to-year fluctuations, thereby providing a clearer picture of the overall trends in home lending. The split between 1994 and 1995 is purposely chosen to correspond to the significant changes made in CRA regulations in 1995. HMDA data on the income characteristics of each borrower were also used in the study to divide borrowers into low- and moderate-, middle-, and high-income groups, using the same cutoff levels defined for census tracts.

Both the HMDA lending data and the census-derived housing unit data were aggregated by census tract within each of the three census-tract income groups. This allowed the lending data (both number and dollar volume of loans) to be scaled by the average number of owner-occupied units for tracts within each income group. Thus, for instance, in the 1992 through 1994 period, there were an average of 1,733 home purchase loans approved annually in low- and moderate-income tracts. The average number of owner-occupied housing units from the 1990 and 2000 census in low- and moderate-income tracts was 85,549. Thus, the number of loans per 100 owner-occupied units was 2.03 (100 x 1,733 / 85,549). Scaling the number or dollar value of loans by the number of owner-occupied units helps to adjust for differences in basic loan demand characteristics across census tracts with different income characteristics. This may provide a more accurate measure of how well credit needs are being met across income groups.

Each home lender in this study is identified as either a commercial bank, insured thrift, or independent mortgage company on the basis of financial and structural data. Credit unions are excluded from the analysis, because their home purchase lending made up less than one percent of the amount approved by all HMDA reporters during the study period.

The study also tracks lenders according to the overall size of their organization. For banks and thrifts owned by holding companies, their size group reflects the total assets held by all subsidiary banks and/or thrifts within each organization. All lender size references in this paper thus refer to all the depository institutions in an organization and not to individual banks or thrifts. Comparable measures of asset size are not available for independent mortgage companies, and they are excluded from any organizational size comparisons.

The CRA is based on the principle that depository institutions should meet the credit needs of their communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. Accordingly, the CRA only evaluates insured depository institutions within those MSAs in which they have at least one deposit-taking office. This study consequently uses branch office structure data to divide institutions into two separate groups: those that have a deposit-taking office in the Kansas City MSA and would have their Kansas City lending factored into their CRA rating; and those with no deposit-taking offices in Kansas City and that would be lending outside of the CRA framework. The second group would include organizations with mortgage banking operations or loan production, but not deposit-taking, offices in Kansas City or that take loan applications through such means as by telephone, through mail solicitations, over the Internet, or from mortgage brokers.

[14] This study divides both banks and thrifts into two separate groups: those with deposit-taking offices in the Kansas City metropolitan area and those without a local banking office. The reason for drawing this distinction is that local lending by depository institutions with Kansas City offices would be factored into their CRA rating, while such lending by institutions without a local banking office would be outside of the CRA framework.

[15] Of all the home lending between 1999 and 2001 that was done by banks without deposit-taking offices in Kansas City, almost 91 percent was by banking organizations with total assets of more than $10 billion.

[16] These banks and thrifts with offices in the Kansas City area include not just those that have their headquarters or main banking office in Kansas City, but also those that have bank branches in Kansas City and a main office elsewhere, such as Bank of America and World Savings.

[17] To provide greater detail, Map 1 and Map 2 omit four counties that are in the Kansas City metropolitan area (all four counties are included in the tables and charts in this study). The four counties—all of which are partially rural and thus have smaller amounts of home purchase lending—are Miami County in Kansas and Clinton, Lafayette, and Ray Counties in Missouri.

[18] For a more detailed description of lower income census tracts in Kansas City, see McClure, "The Twin Mandates," pp. 112-122. McClure uses a different definition of lower income areas, but his analysis would include many of the low- and moderate-income census tracts from this study.

[19] See the side box—Data Sources and Methodology—for a detailed discussion of how these lending rates were computed for this part of the paper.

[20] The number of home purchase loans reported in Map 2 is the total number of loans approved in each census tract between 1992 and 2001 per 100 owner-occupied housing units on average in that tract. For example, in the category "40–55 loans," between 40 and 55 loans were approved over the ten-year period for every 100 owner-occupied units in the census tract. Each of the four loan categories in Map 2 includes one-fourth of the census tracts in the Kansas City metropolitan area.