MEASURING MORTGAGE DEFICIENCY AND ITS DETERMINANTS

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Abstract

This paper examines alternative measures of mortgage deficiency, and suggests that an acceptable index should take account of variations in effective demand among neighborhoods. The proposed index includes income (or, if unavailable, house value), number of households and owner occupancy rates as its main components, and these variables are shown to be significant determinants of inter-tract variations in dollars loaned in Los Angeles. When the mortgage deficiency index incorporates variations in effective demand, race has no influence on mortgage deficiency. However, visual measures of neighborhood and dwelling quality remain important determinants of mortgage lending.

I. Introduction

In recent years there has been a growing concern with the problems of denying mortgage loans to certain neighborhoods ("redlining"), presumably on the grounds of either low incomes of households living there or because the housing is so dilapidated that downward trends in property values make it possible that loans might not be covered. The main source of debate is that it is often unclear whether loan denials are due to race, sex, age, or merely location. This paper examines this problem in Los Angeles, California. The State of California anticipated possible action at the Federal level by introducing Fair Lending Regulations in August 1976. Apart from giving people the right to know why loans are denied and the establishment of grievance procedures, the main point of these Regulations was the "prohibition of redlining and any other lending discrimination based upon race, color, religion, sex, marital status, national origin or ancestry and age" (2, Vol. I, p. 2).

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Many of the early studies (for example (9)) found that loans per capita were much lower in black than in white neighborhoods, but the results were invalid because of the failure to correct for income differentials. Although some of the case studies presented to the U.S. Senate Committee on Banking, Housing and Urban Affairs during hearings on the Home Mortgage Disclosure Act of 1975 did take account of income, none of the studies simultaneously controlled for income, race and neighborhood conditions (10). In their well-known study of housing markets and racial discrimination, Kain and Quigley (7) did not explicitly discuss redlining, but their home ownership and home purchase regression models generated negative and significant race coefficients that were not explained by tastes, differences in wealth, or income. They argued that racial discrimination was the "most plausible" explanation and that "supply restriction on black choice of location and on kinds of housing available to black households are largely responsible" (7, p. 144).

More recent studies have offered a more balanced view. Hutchinson and his colleagues (6) argued that in Toledo, Ohio, redlining does not exist on the basis of race. Racially mixed neighborhoods received more government-insured loans, and their evidence suggested that redlining practices stem from risk aversion on the part of lenders not from discrimination. Race was not a statistically significant variable in Ahlbrandt's study of Pittsburgh (1), and he suggested that a more conservative approach to lending in neighborhoods with higher racial concentrations was probably due to an emphasis on income and neighborhood risk factors. Since most of these studies refer to Eastern cities, this paper offers some evidence for the largest city in the West.

II. Measures of Mortgage Deficiency

The basic data requirement for a "redlining" study is an index of mortgage lending activity to be used to identify mortgage deficient areas (MDAs). Like many other agencies and groups involved in this problem, the California Department of Savings and Loan, which oversees more than two-thirds (by assets) of the mortgage loan industry in California, uses a dollars loaned per capita index as a measure of mortgage deficiency. The Department defined census tracts as MDAs where new mortgage lending in the years 1974 and 1975 was below $250 per capita (approximately 50 percent of the average dollars loaned per capita in Los Angeles County). On this criterion 41.7 percent of California's census tracts were considered mortgage deficient. This figure is too high to pinpoint "redlined" neighborhoods; a more sensitive criterion is needed. Also, many MDAs have few mortgages because they are predominantly industrial or commercial in character. Furthermore, the use of dollars loaned biases the index against cheap housing areas, especially older neighborhoods with lower housing valuations and low loan-to-value ratios.

In general, the dollars loaned per capita has three critical defects. First, it does not adjust for the variation in the number of households among census tracts, which makes it especially vulnerable when land uses are predominantly non-residential. Secondly, it takes no account of the housing tenure distribution, i.e., variations in the relative share of owner-occupied and rented dwelling