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Reid, Carolina

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Wealth Inequality in the "Land of the Fee": A Conversation with Devin Fergus

By Carolina Reid

Abstract

In this essay, I explore the similarities of my own work to that of Professor Devin Fergus, who presented research from his upcoming book, Land of the Fee, at UC Berkeley recently. Both Professor Fergus and I are concerned with the ways in which practices in the financial services industry contribute to the racial wealth gap. The essay provides a brief overview of Professor Fergus's presentation and then sets it into conversation with my own work on racial disparities in access to mortgage credit. It concludes by highlighting some emerging practices in San Francisco that attempt to stem the rise of abusive financial services and help lower-income families and families of color build assets.

Introduction

Veronica, an African-American in her mid-40s, lost her home to foreclosure in the spring of 2010. In the last five years, she has seen her savings and assets disappear, and she is worried about her debts. "I've been relying on my credit cards a lot recently—there's no other way to get through the month. And there's my car loan. The house was just the first thing they took." She is angry, too—angry that her broker received a kickback from the bank for putting her into a pricier loan than her credit score would have warranted. "He makes me the maddest. He hid information from me...I trusted him, and he's the one who slapped on fees to my loan." Angry that despite repeated efforts to obtain a loan modification, the bank moved forward with the foreclosure filing. "I would have been able to pay the whole amount, if they had just been willing to give me some time." Angry that her "home" was sold to an investor for twenty-five percent of what she owed. "They're just taking the wealth out of this community and giving it to Wall Street."[1]

1. Veronica (a pseudonym) was interviewed as part of a series of research studies I am undertaking to understand household decision-making process in housing and mortgage markets.

Veronica's story encapsulates the costs of the foreclosure crisis, especially for communities of color. Approximately one in four African Americans and Latinos who bought homes during the subprime bubble of 2004-2008 had already lost their home to foreclosure or were seriously delinquent and at imminent risk of default as of February 2011.

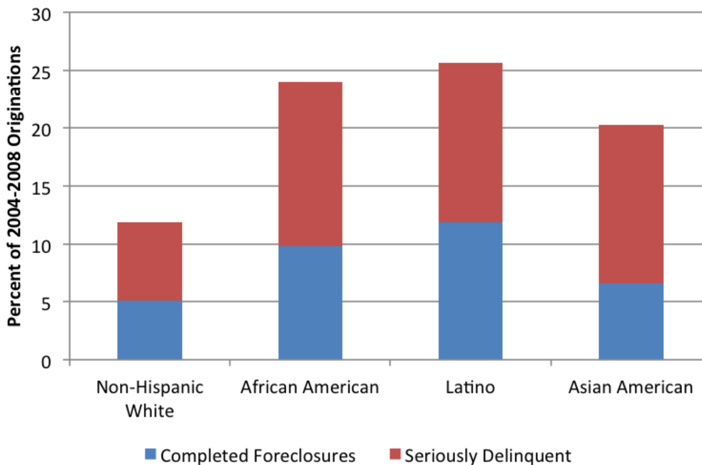

Figure 1: Disproportionate Impact of Foreclosure Crisis on Communities of Color

Source: Bocian, Debbie, et al., Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures. The Center for Responsible Lending, Durham, NC, 2011. Data reflect mortgages originated between 2004 and 2008; loan performance is measured through February 2011.

Additionally, government efforts to provide relief to homeowners have mostly sputtered along, with the number of loan modifications falling well short of expectations. Now, concerns are growing about the long-term effects of the foreclosure crisis for lower-income neighborhoods and neighborhoods of color, which are seeing new rounds of speculative activity driven by hedge fund capital and other investors buying homes in bulk for 10 cents on the dollar.

Although it will take decades before we understand the full implications of the foreclosure crisis for communities of color, some data already provide evidence that the wealth gap has grown substantially. The Pew Research Center found that in 2009, the average White family had 19 dollars in wealth for every one dollar held by an African American family, up significantly since 2004 before the crisis began, when the ratio was 11 to 1 (Pew Research Center 2011). In another recent study, researchers at Brandeis University found that the gap in net wealth between White and African American families nearly tripled over the last 25 years, from $85,070 in 1984 to $236,500 in 2009 (Shapiro, Meschede, and Osoro 2013).

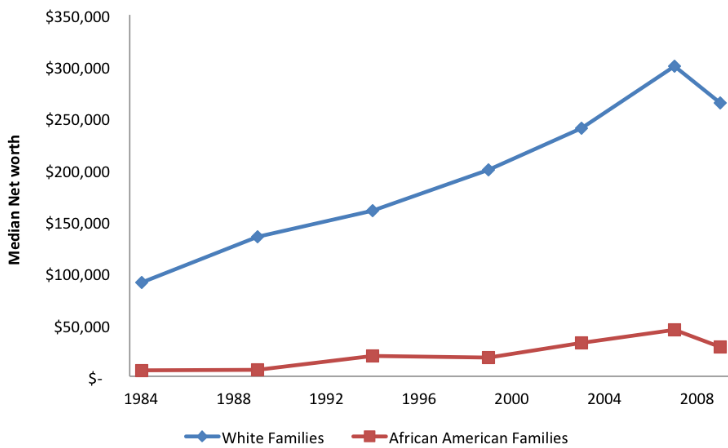

Figure 2: The Growing Racial Wealth Gap

Source: Shapiro, Thomas, Tatjana Meschede, and Sam Osoro (2013). "The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide," Institute on Assets and Social Policy Research and Policy Brief, February 2013. Available online at http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf

They find that homeownership is a key factor in explaining what has happened to the wealth of White and African American families over this time period, not only as it relates to the sustainability of homeownership, but also its returns.

But Veronica's story reveals something else as well: the growing prevalence of financial services, and financial fees, in our everyday lives, from car loans, to mortgages, to credit card debt. As our interview went on, Veronica noted how she initially took out a payday loan to cover a shortfall in her mortgage check, but then found herself trapped in a cycle of large, high-interest payments. She is still paying off her student loans—$65 a month, but "it adds up." And of course there are her credit card and auto loan payments to worry about.

In the Fall of 2012, I invited Devin Fergus, Associate Professor of African American and African Studies at the Ohio State University, to Berkeley to present an excerpt from his upcoming book, *Land of the Fee*, to be published by Oxford University Press. Professor Fergus's book chronicles the rise of a wide range of shadow fees that undermine the ability of lower-income households and households of color to build wealth. He reveals how political interests and the power of the financial industry led to regulatory changes that undermined consumer protection in four different spheres: housing, education, employment, and transportation. Professor Fergus's focus on these four areas is intentional—historically, they have been the

routes of upward economic mobility and family wealth creation. But, he argues that these routes are now closed off to many families of color, in large part due to inequalities in access to financial services and the costs of credit. His research raises important questions. In the "Land of the Fee," is it possible for African Americans to close the wealth gap through education if they are disproportionately burdened by student debt? Close it through work, if wages need to be supplemented by high cost payday loans? Close it through homeownership, if their mortgages cost twice that of whites? Professor Fergus's research presents the future of the wealth gap in stark and uncompromising terms: if these traditional routes for economic mobility are closed off due to fees, what does the path to wealth equality look like?

In this essay, I present a brief overview of Professor Fergus's talk at UC Berkeley, consider it in the context of my own research, and demonstrate how his observations contribute to an understanding of the linkages between access to credit, homeownership, and wealth. It is a conversation between a historian and a planner; we are both concerned with racial inequalities in wealth and opportunity, but we approach the problems from different vantage points. While neither of our disciplines has focused much attention on questions related to wealth inequality, engaging these disciplines is critical—the processes that create and reinforce deep racial differences in access to opportunity, particularly in the housing market but also in schools and in the workplace, are both historical and spatial.

Racial Inequalities in Access to Mortgage Credit

Professor Fergus's research and my own converge on three important points. First, we are both interested in how federal policies and regulations influence access to mortgage credit for communities of color. During the post-World War II housing boom, African-American families were routinely denied credit, often through overtly discriminatory practices on the part of both private and governmental institutions (Arrow 1998; Stuart 2003). For example, the Federal Housing Administration (FHA) and the Home Owner's Loan Corporation (HOLC) explicitly advised real estate appraisers to note "adverse influences" related to a property, which included the presence of "inharmonious racial groups" in the neighborhood (LaCour-Little 1999). The HOLC created "residential security maps" of major cities in the U.S. to indicate the perceived riskiness of real-estate investments. The maps, which outlined minority neighborhoods in red, identified areas that were deemed "too risky" to receive FHA financing; it was not until November 1965 that the FHA commissioner announced that the agency would no longer "redline" neighborhoods where blacks and other minorities resided (Stuart 2003).

As a result of the Civil Rights movement, a series of historically significant federal laws were passed to address these inequalities, including the Fair Housing Act (Title VIII of the Civil Rights Act of 1968), the Equal Credit Opportunity Act of 1974, the Home Mortgage Disclosure Act (HMDA) in 1975, and the Community Reinvestment Act (CRA) in 1977. Yet, more than three decades after the enactment of these laws, race and ethnicity continue to play an important role in shaping access to credit. In particular, researchers have documented the emergence of a "dual mortgage market," in which communities of color are more likely to be served by subprime lenders, even as overt discrimination in mortgage lending has decreased (Apgar and Calder 2005). As a result, concern over equity in the mortgage market today is less about the outright denial of credit (Munnell et al. 1996; Ross and Yinger 2002), and more about the terms and costs of that credit. Researchers have found that even after controlling for borrower and neighborhood level characteristics, communities of color pay significantly more for their mortgages (Bocian et al. 2008; Courchane 2007; Reid and Laderman 2009) and are much more likely to receive a loan with risky product features (Bocian et al. 2011).

Professor Fergus's work sheds light on this disconnect between regulatory victories and the persistence of the dual mortgage market. Although the passage of landmark regulations such as the Fair Housing Act, HMDA, and CRA ushered in a new era of greater equality and transparency in mortgage lending, his research reveals that it is a mistake to exclude from this history how "almost simultaneously, a set of deregulatory policies emerged that quietly made credit, banking, mortgage, and insurance markets less accountable to governments and consumers. The erosion of oversight escalated in the following thirty years, decimating consumer protections and fostering the rise of a new fringe financial sector, one that augured a shift away from denying credit and services to extending credit and services on high-cost terms." He shows how three other regulatory reforms—the 1980 Depository Institutions Deregulation and Monetary Control Act, the Garn-St. Germain Act of 1982, and the Tax Reform Act of 1986—set up the legal and regulatory framework that permitted the emergence of subprime lending by removing interest rate caps, by empowering banks to preempt state protections against the use of risky mortgage instruments, and by privileging homeownership through the mortgage interest tax deduction.

Understanding this longer history of deregulation is important for my research, which has examined contemporary gaps in consumer protection related to federal preemption of state anti-predatory lending laws, the coverage of CRA, as well as the uneven landscape of mortgage lending institutions (Ding et al. 2012; Reid and Laderman 2011). I have found that during the subprime crisis, African American and Latino households were much more likely to be served by non-CRA lending institutions, and as a

result, were much more likely to be placed in higher-cost loans. Professor Fergus's research reveals that even if such loans did not lead to foreclosure, the additional interest rate imposed on these borrowers constitutes a "hidden" fee with significant implications for wealth accumulation. Let me provide just one example from my research (Reid, forthcoming). In an analysis of loans originated between 2004 and 2008, I find that among borrowers who were current on their mortgage in February 2011, 27.3 percent of African American and 20.5 percent of Latino homeowners were still trapped in higher-priced loans, compared with just 6.6 percent of Asian and 9.9 percent of non-Hispanic White homeowners. These families are paying an average of 4.9 and 4.7 percentage points more for credit, which can lead to significant differences in asset accumulation over the long-term. On a loan for $300,000, the additional cost of a loan with a 4 percent interest rate to one of 8 percent is close to $275,000 over the life of the loan. Even though few families today keep a loan for the full 30 years, this is a vivid illustration of how the land of the fee perpetuates wealth inequality, particularly when higher wealth and higher-income borrowers are much less likely to be charged these fees.

Second, both Professor Fergus and I are interested in how the changing nature of financial services and credit products is linked to the rise of a neoliberal regime and the contraction of the welfare state. Professor Fergus cogently argues that while regulatory changes allowed these predatory financial practices to emerge, the unraveling of the social safety net is also critical in that it has created a consumer "demand" for financial products that cushion the instability of the post-Fordist economy. A tattered safety net, coupled with limited job security, part-time work, and fewer workplace benefits such as health care and retirement, have greatly increased the financial vulnerability of lower-income households and households of color. As a result, families have increasingly turned to financial services to fill gaps—tapping into their home equity to cover medical bills and taking on private college debt when federal funds are curtailed, and using payday lenders, pawn shops, and rent-to-own stores to make ends meet. Professor Fergus's insights on the co-emergence of the "privatization of risk" and the rise of the financialization of the American consumer has prompted me to launch a new research study that builds on my dissertation (Reid 2004) and will examine the mechanisms by which income volatility, lack of health insurance, and risk-based pricing are undermining the stability of homeownership for lower-income households and households of color. The fact that homeownership in the 1950s produced great wealth gains and contributed to the rise of solid white middle and upper-classes does not guarantee that today, in different political and economic contexts, homeownership will do the same for communities of color.

Third, both Professor Fergus and I seek to inform current policy debates. The subprime crisis has prompted a broad-based reconfiguration of the

housing finance system, and the establishment of the Consumer Financial Protection Bureau (CFPB) provides an unprecedented opportunity to shift the policy landscape to one that privileges the well-being of consumers over the right of bankers to make a profit. Already, the CFPB has passed new regulations that limit the origination of loans with risky features and high fees. But the CFPB remains politically vulnerable, and its ability to constrain unfair financial practices and hidden fees is contingent on our ability to control the narrative of what caused the crisis. There is a small but powerful chorus pushing forward a narrative focused on "risky borrowers" and "overregulation"—rather than deregulation and abusive financial practices—as the cause of the crisis (Immergluck 2011). Professor Fergus disrupts the narrative of the "risky borrower" by situating the subprime crisis (as well as the rise of various predatory financial products and hidden fees) within the deregulatory politics of the 1980s and the power and incentive structures that influenced policy-making over this time period. In this way, he challenges the idea that the rising problems of student debt, payday lending, subprime mortgages, and predatory auto lending and insurance practices are just reflections of consumer choice and ignorance.

Similarly, my research examines how loan products with risky features and predatory lending practices led to higher foreclosure rates among African-American and Latino borrowers: not their inability to become and stay homeowners. In particular, policy debates must take note of the fact that data from affordable homeownership programs provides solid evidence for the ability of lower-wealth families to buy homes and sustain them, even with minimal down payments, lower credit scores, and higher debt-to-income ratios (Reid 2009; Quercia et al. 2011). I hope to influence how policy-makers define what constitutes a "safe" mortgage (known as a Qualified Residential Mortgage), to ensure that future access to credit is not contingent on the ability to provide a large down payment (Quercia, Ding and Reid 2012). If regulators set the definition too stringently, the impact will be greatest on communities of color, further calcifying the structures that contribute to the racial wealth gap.

Emergent Practices

In addition to understanding the policies and regulations that shape access to credit, both Professor Fergus and I are interested in how local stakeholders—including community organizations, community development financial institutions, and city government—are developing new strategies to stem the tide of abusive financial services and help lower-income families and families of color build assets. These local practices can be sites of resistance against the trend toward hidden fees and the extraction of wealth from communities of color. The city of San

Francisco has been a leader in promoting the use of municipal tools to limit the expansion of predatory financial practices and to develop lower-cost financial service alternatives. For example, the city used zoning laws to restrict the establishment of new payday lenders and check cashers within low-income neighborhoods, and worked with local credit unions to develop Payday Plus SF, a low cost alternative to payday loans. The city has also launched an ambitious Kindergarten to College program, in which every kindergartner in San Francisco is eligible to open a matched-savings account that can help them to build savings toward college tuition. Nonprofits in the city are also at the forefront of innovation. In the Mission neighborhood, where payday lenders and pawnshops outnumber banks three to one, the Mission Asset Fund has been leveraging traditional, informal lending circles to help immigrant households develop formal credit scores that can then reduce their reliance on higher-priced financial services. The Mission Asset Fund has also launched an advocacy campaign to push for a "Financial Facts" label, to make hidden fees more transparent. (See Figure 3.)

Given the significance of financial practices for the production of wealth inequality, I see these emergent local practices as important interventions capable of improving the financial well-being of lower-income communities and communities of color. That said, the recent crisis and its aftermath shows that the political contest for resources continues to be shaped by financial interests and logics, with disastrous implications for the distribution of wealth in this country. In many ways, these local efforts are "swimming against the tide" of much larger private market forces and public policy reforms that support the turn toward financialization (Krippner 2012). Ultimately, I hope that my research, and that of Professor Fergus, will help to reveal the significance of financial practices for the production of inequality in the multiple spheres of daily life and open the door to emergent practices that promote wealth equality on a broader scale.

Payday Loan

Financial Facts

Loan amount $255
1 payment over 14 days

Average Amount Per Payment

Principal $255	Fees & Interest $45

	% of Monthly Debt Budget *
Monthly Payment $300	**67%**
Principal $255	
Loan Fees $45	
Interest $0	

APR 460%	• Total Fees $45
Interest Rate 0%	• Total Interest $0
Late Payment $0	• Total Paid $300

Warning: This loan exceeds the recommended portion of your monthly debt budget.

* Percent of Monthly Debt Budget value is based on the loan payment divided by the recommended consumer debt-to-income ratio of 15 percent, using a $3,000 after-tax monthly income level. Debt budget will vary according to your income level.

Income levels:	$2,000	$3,000	$4,000	$5,000	$6,000
Debt budget:	$300	$450	$600	$750	$900

Numbers rounded to nearest dollar.

Figure 3: The MAF Financial Facts Label: Increasing the Transparency of Hidden Fees

Source: The Mission Asset Fund

Carolina Reid is an Assistant Professor in the Department of City and Regional Planning at the University of California at Berkeley. Carolina specializes in housing and community development, with a specific focus on access to credit, homeownership and wealth inequality. She has most recently published research on the impact of the foreclosure crisis on low-income and minority communities, the role of the Community Reinvestment Act during the subprime crisis, and the importance of anti-predatory lending laws for consumer protection.

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