Mortgage Lending to Minority Owned Small Businesses

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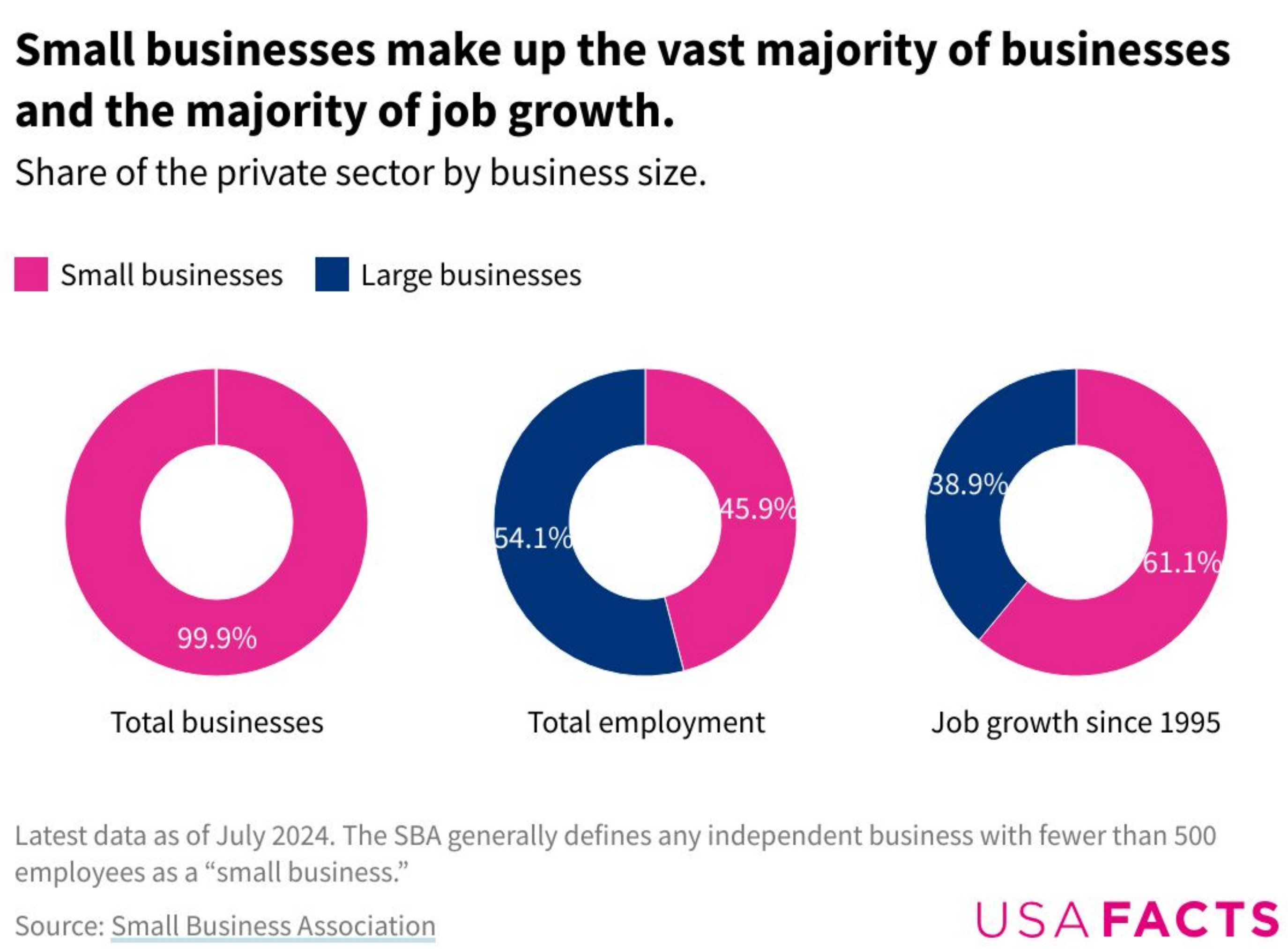
Introduction

In May 2020, as a result of the COVID-19 pandemic, America had its largest recession since World War II, affecting small businesses as well as minority and poor communities in particular: 29.7% of small businesses closed from January 2020 to the end of December 2020 and there was a 41.0% decline in black-owned businesses, according to Bloomberg. The economy as a whole relies heavily on small businesses and minority business ownership is crucial for building toward socio-economic equality. <u>Small businesses are defined as having a gross annual income of less than $500,000 for this project.</u>



Methods

Data Acquisition & Preparation

- Data come from the Home Mortgage Disclosure Act (HMDA) between the years 2019-2023 in each specified Metropolitan Statistical Area (MSA).
- Clean and combine the data into a single dataset for each year using STATA.

Data Filtering

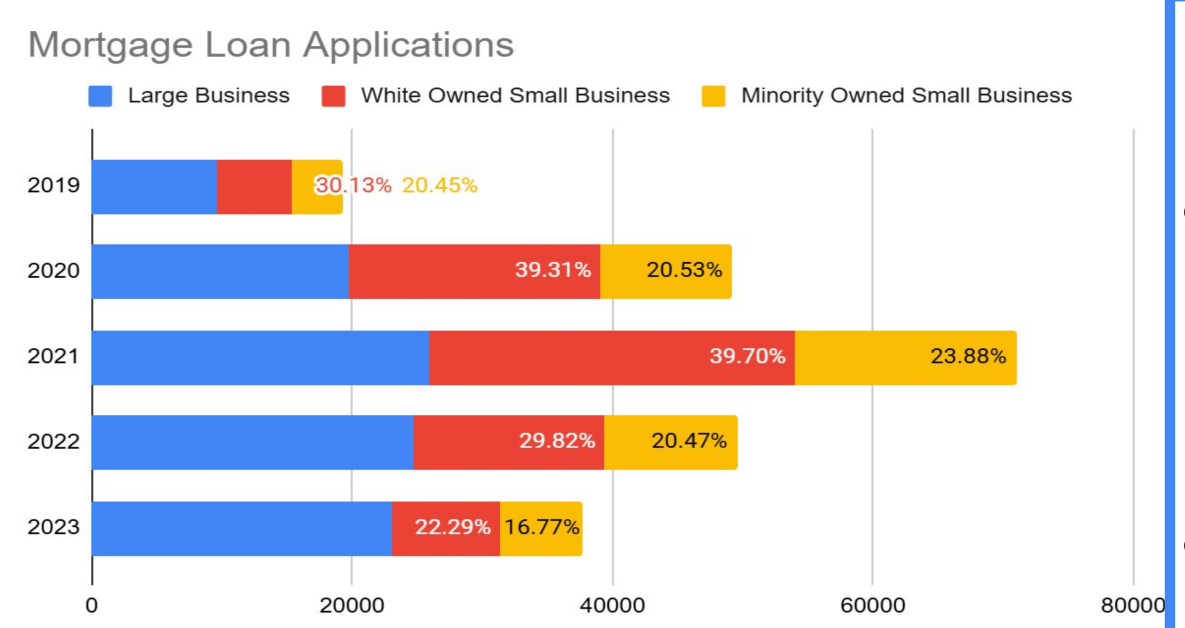
- Exclude mortgages not used primarily for business purposes.
- Distinguish between business types: large, white owned small, and minority owned small businesses.

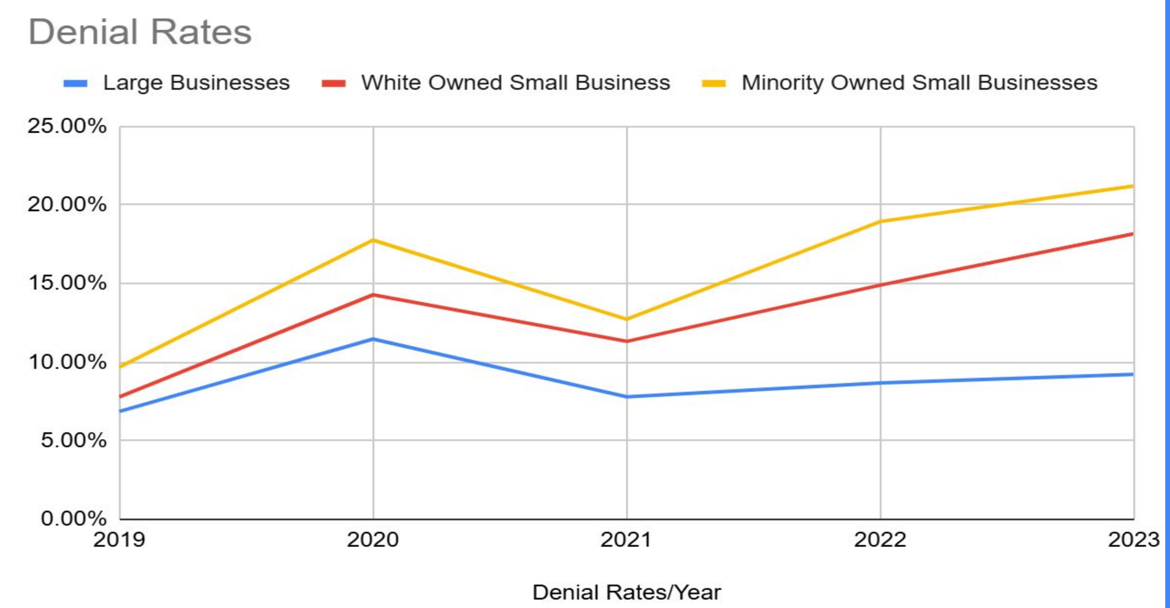
Analysis

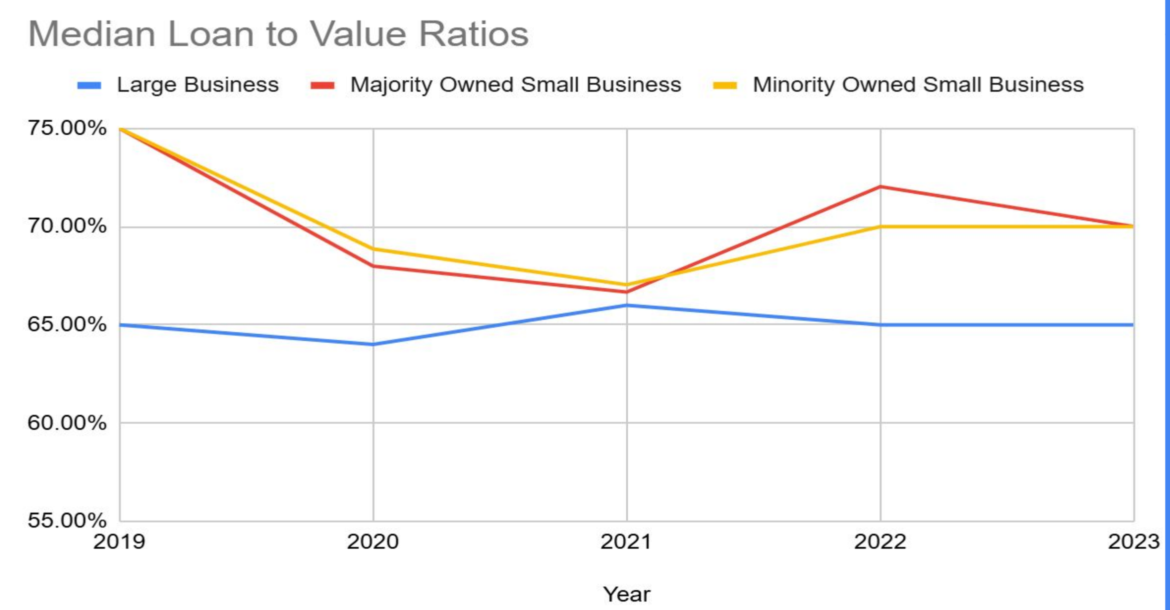
- Compare minority small business owners to white business owners by year for each MSA.
- Compare denial by merit (not including applications uncompleted orwithdrawn by prospective borrower) between business types
- Calculate aggregate measures: mean, median, and standard deviation for approval rates, loan to property value ratios, interest rates, etc.

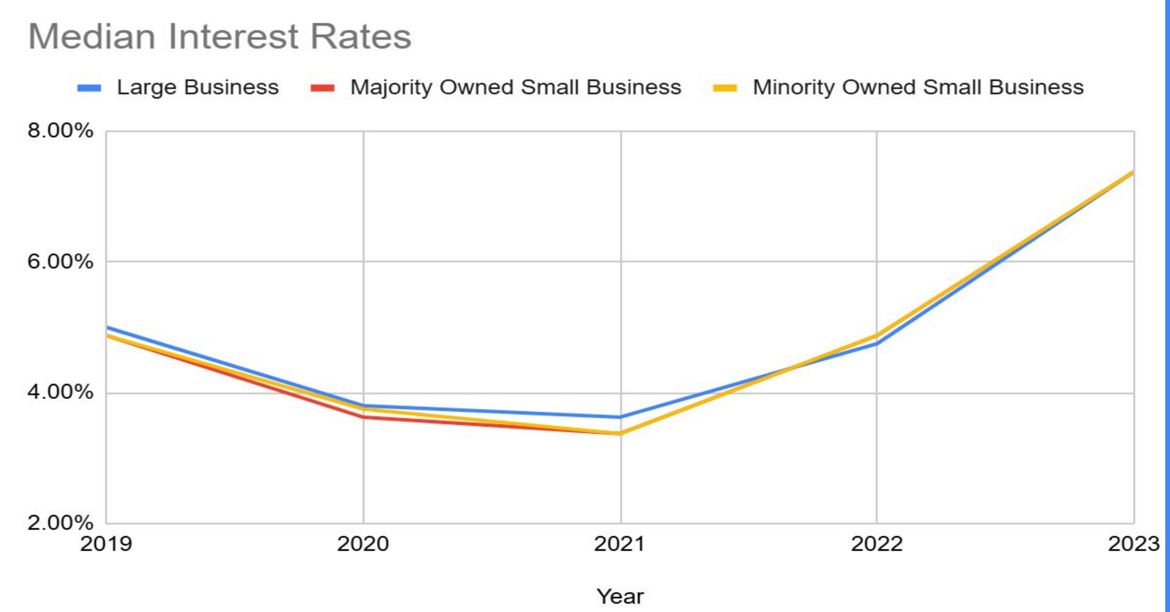
Research Question:

How has the COVID-19 pandemic influenced mortgage lending practices for minority small-business owners in **Boston, Chicago, Minneapolis, Seattle, and New York City** since 2019, specifically in terms of approval rates, loan amounts (relative to property value), and interest rates?









Findings

- Total mortgage applications peaked in 2020 and decreased slightly in 2021. However, business applications specifically peaked in 2021.
  - Small businesses made up between 39% (2023) and 63% (2021) of business applications.
  - Both white and minority owned small businesses peaked in 2021 by both total applications and proportion of all business applications.
- Minority owned small businesses had significantly lower median gross annual income than white owned businesses.
  - This remained true when only looking at applications denied by merit and loans originated
- Minority owned small businesses have a significantly higher denial-on-merit rate than white owned small businesses, which in turn have a higher denial rate than large businesses.
  - While the difference between white and minority owned small businesses has remained steady, the gap between large businesses and small businesses has greatly increased since the pandemic.
- Loan to value ratios were significantly lower for large businesses, and did not differ significantly between small businesses.
- Median interest rates did not differ significantly between business types and closely followed national mortgage rates.

Conclusions

Minority owned small businesses face a significantly higher mortgage denial rate than white owned small businesses. This is partially because of confounding factors, but even when comparing borrowers with similar incomes white small business owners were more likely to have their loans originated. The pandemic exacerbated these issues due to more total mortgage applications, especially for small business owners. Since 2019, the difference in denial rates has gotten even larger. However, given the loan was originated, all small businesses faced similar loan to value ratios and interest rates, suggesting these outcomes are unaffected by racial bias. It is possible the difference in denial rates are due to confounding variables beyond the income of the borrowers, as was found by "Mortgage Lending in Boston: Interpreting HMDA Data.", but nevertheless further research is necessary to determine what these confounding variables may be and how to reduce their affects on the mortgage lending market. Higher denial rates for minority owned small businesses means they will have a harder time acquiring office space necessary to expand and will negatively impact social mobility.

Resources:

This project is guided by scores of previous literature, including Blanchflower, David G., et al. "Discrimination in the Small-Business Credit Market," Munnell, Alicia H., et al. "Mortgage Lending in Boston: Interpreting HMDA Data," and Asiedu, Elizabeth ; Freeman, James A. ; Nti-Addae, Akwasi. "Access to Credit by Small Businesses: How Relevant Are Race, Ethnicity, and Gender?". HMDA, or the Home Mortgage Disclosure Act, will be the main source of data for this project. This research will be done alongside Dr. Patrick Meehan's "Racial Equity in Small-Dollar Mortgage Lending" project, which I am assisting in and similarly analyzes HMDA data to find cities with significant racial bias in mortgage lending.

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