

H.R. 3043: Zero Downpayment Pilot Program Act 2005

Submitted to:

**U.S. House of Representatives Committee on Financial Services
Subcommittee on Housing and Community Opportunity**

Submitted by:

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My name is Janis Bowdler, Housing Policy Analyst for the National Council of La Raza (NCLR). As part of NCLR's Economic Mobility Initiative, I conduct research, policy analysis, advocacy, and program assistance on affordable housing issues. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. On behalf of NCLR, I am pleased to present this statement for the hearing on H.R. 3043: Zero Downpayment Act of 2005 (ZDA). NCLR is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve life opportunities for the nation's Hispanics. As the largest national Hispanic constituency-based organization in the U.S., NCLR serves all Hispanic nationality-groups in all regions of the country through a network of more than 300 affiliate community-based organizations.

NCLR has a deep interest in increasing the rate at which Latinos own and build equity in their home and thereby accumulate wealth that will provide financial stability in the years to come. Over the past two decades, NCLR has been a leader in advocating and conducting research on affordable housing issues important to the Latino community. This work focuses on issues such as asset accumulation and barriers to homeownership, access to affordable mortgage products, and programs and legislation that support fair lending. NCLR's most recent publications include *Hispanic Housing and Homeownership*, June 2004; *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*, March 2004, prepared for the National Fair Housing Research and Policy Forum; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*, June 2005.

In addition, since 1997 NCLR has been the national intermediary designated by the Department of Housing and Urban Development (HUD) to distribute funds for housing counseling. The NCLR Homeownership Network (NHN) consists of 38 NCLR affiliates in 19 states that provide pre-purchase bilingual homeownership counseling to low-income families in predominately Latino neighborhoods. NHN counsels more than 20,000 families each year, more than 3,500 of which become homeowners. NHN has sophisticated partnerships with some of the nation's largest providers of home mortgages such as Bank of America, Countrywide, JPMorgan Chase, Washington Mutual, Wells Fargo, as well as Fannie Mae and Freddie Mac. Our extensive research and service delivery experience puts us in a unique position to comment on the Zero Downpayment Act.

Latino Homeownership

Increasing Latino homeownership is critical to the financial security of Latino families and the economic stability of the broader community. While Hispanic homeownership still falls behind that of Whites according to HUD's most recent statistics (48% versus 76%, respectively), Hispanic families are entering the mortgage market in record numbers. Between 1993 and 2003, the number of Hispanic households grew by 92% while the number of Hispanic homeowners grew by 96%. For most American families, a home is their primary asset and homeownership represents their single greatest wealth-building vehicle; this allows households to leverage equity to send children to college or start a business, and to build strong and stable communities. Unfortunately, the Latino homeownership rate lags behind that of Whites by 28 percentage points, and the gap is no longer decreasing at a rapid rate. Low homeownership rates are the

primary factor contributing to the 27-to-1 wealth gap between Whites and Latinos. Latino families face a number of barriers when attempting to purchase their first home, including:

- **Lack of information:** Many first-time Hispanic homebuyers are also first-generation homebuyers, and many have low levels of interaction with mainstream financial institutions. In addition, historically low levels of advertising and outreach from the financial services sector to low- and moderate-income Latino families have contributed to the lack of information and access to affordable mortgage products.
- **Systemic Barriers:** Many Hispanic households have “thin” or no credit histories, sometimes due to a preference not to carry debt, which often results in artificially low credit scores. Due to a “one-size-fits-all” approach to financial and credit-scoring systems, an otherwise mortgage-ready family may be unable to qualify for a loan, or may be paying too much for their financing.
- **Affordability:** Although the Hispanic population is growing in many areas of the country, more than one-third live in California and New York, two of the least affordable states in which to own a home, according to the National Low Income Housing Coalition. More than two in five Hispanic households, and more than a third of Hispanic owners, dedicate more than 30% of their income to housing, the federally-recommended standard for affordability.
- **Market Failure:** Many financial institutions are experimenting with pilot products and innovative underwriting criteria; however, more should be done to meet the needs of a dynamic marketplace. Most institutions use a passive product-driven outreach system that assumes that the same product is sufficient to meet the needs of all or most buyers, rather than an assertive market-oriented approach that would value different credit behaviors and use innovative underwriting criteria (such as nontraditional credit). Using such an approach, financial institutions would create products that more adequately serve a dynamic market.

Positive Steps Toward Increasing Latino Homeownership

The federal government created the Federal Housing Administration (FHA) in 1934 to insure the mortgages of families with solid jobs, but without the cash to make the 20% downpayment that was required at the time; now, for example, many families have the opportunity to purchase a home with a 3% downpayment. FHA has been crucial to making homeownership more affordable for many families who may have otherwise gone unserved by mainstream mortgage lenders. One in five Hispanic families with a mortgage in 2003 had an FHA-insured mortgage. While the private market has evolved to offer more affordable products, FHA still serves low- and moderate-income families that may not have other mortgage-financing options. However, in 2004 FHA loans were more than five times as likely as prime loans to be in foreclosure. Moreover, many consumer advocates and municipalities have criticized FHA products as being vulnerable to abuse by bad players in the marketplace whose unethical practices have robbed families of their hard-earned equity and left them vulnerable to default and foreclosure. On average, a family loses \$7,200 in net worth during a foreclosure, and the community

stakeholders, including the lender, stand to lose approximately \$73,300 per FHA foreclosure (according to the National Multifamily Housing Council and the National Apartment Association). As a public agency, FHA has a responsibility to see that their products promote the best interest of the consumer and the American public.

NCLR applauds this committee's ongoing commitment to fair and affordable homeownership. In the previous Congress, this committee increased the FHA multifamily loan limits in "hot markets" throughout the country, including many cities with high Latino populations. The FHA Multifamily Loan Limit Adjustment Act of 2003 will level the playing field for those urban areas where high land costs drive housing prices beyond what many families can afford. In addition, the committee has shown strong support for increased funding and capacity for housing counseling. Housing counseling is a powerful tool that effectively moves low- and moderate-income Latino families into homeownership. NCLR's NHN counseling agencies, for example, provide bilingual pre-purchase counseling services to families in low-income Latino neighborhoods and spend three months to three years helping families become financially-secure homeowners. These agencies are a testament to the value of homeownership counseling. In 2004, NHN organizations counseled 24,000 families and helped more than 3,500 become homeowners (which count only those closed through the NHN system); 63% of NHN clients earn less than 50% of Area Median Income (AMI), and another 27% earn between 50% and 80% AMI. Families that became homeowners through the NHN had a 6% interest rate on average.

Zero Downpayment Act

NCLR commends Congressman Tiberi on the improvements in the Zero Downpayment Act over the version introduced in the previous session. One hundred percent financing is financially risky for many families. In the case of FHA-insured products, many borrowers are likely to find themselves owing more on their home than its total appraised value. This situation, often called an "upside down mortgage," would be devastating in the event of an unforeseen event such as job loss or divorce, which are the more common reasons for default. The addition of pre-purchase and default counseling provisions to the more recent version of the legislation will help vulnerable families make educated decisions about this product. Pre-purchase counseling has been shown to decrease the risk of 60-day delinquency, which translates into a potential savings to taxpayers (according to research conducted by Freddie Mac). That said, we, along with other advocates, believe that the bill could use more improvements. NCLR makes the following recommendations to ensure that the legislation achieves its objective of effectively providing fair and affordable financing to low- and moderate-income families:

- **Ensure adequate resources for housing counseling agencies.** Housing counseling agencies provide the mortgage industry with a valuable service by preparing families for responsible homeownership. H.R. 3043 should clearly state that housing counseling agencies can be compensated based on the value of the services they provide to a financial institution. Given the number of families who would need pre- and post-purchase counseling under this legislation, housing counseling agencies must be able to generate consistent fee-based revenue to increase capacity and meet the market demand. This, however, does not negate the need for HUD funding. Currently, HUD recommends that funding for housing counseling agencies not exceed 20% of the program budget.

These funds are critical to creating new counseling programs and strengthening existing ones.

- **Ensure timely access to counseling.** H.R. 3043 requires that counseling be received before application for a ZDA loan. It is critical that the HUD-certified counseling program be **completed** before the application date of the ZDA. This ensures that the borrower has had enough time to receive counseling and make the decision that is best for their family without being rushed or pressured by the lender or mortgage broker. This and the above recommendation will help counseling agencies maintain the viability and quality of the services delivered, which is essential to the thousands of families who rely on them.
- **Prevent unethical lending practices.** The committee can curb the potential for abuse by allowing this product to be offered only by FHA-approved lenders with the highest ratings under HUD's *Credit Watch* program.

Conclusion

Affordable mortgage products with innovative underwriting criteria are important for increasing sustainable Hispanic homeownership. As the committee considers other approaches to affordable home financing, NCLR makes the following recommendations:

- **Reinstate mandatory counseling for FHA borrowers.** Rising foreclosure rates and reports of abuse by FHA lenders demonstrate the need that FHA borrowers have to receive pre-purchase housing counseling. Counseling should be provided by HUD-approved counseling agencies. Moreover, counseling agencies should be compensated based on the value of the work they provide to financial institutions and FHA.
- **Graduate FHA-insurance premiums.** Reward timely payments and reduction of risk, demonstrated through pre- and post-counseling or on-time payments for the first 24 months of the loan, by gradually lowering the cost of FHA insurance.
- **Create flexible products.** FHA could better assist first-time homebuyers by offering a subordinate second mortgage (often called a "soft-second") that would buy down the cost of the loan without an excessively risky Loan-To-Value rate.

NCLR thanks the committee for the opportunity to share our views on the legislation.