NCLR
NATIONAL COUNCIL OF LA RAZA

REBUILDING HOMEOWNERSHIP OPPORTUNITIES FOR LATINO FAMILIES: PRINCIPLES FOR REFORMING THE U.S. HOUSING FINANCE SYSTEM

Presented at

Housing Finance—What Should the New System Be Able to Do?
Part I—Government and Stakeholder Perspectives

Submitted to
U.S. House of Representatives Committee on Financial Services

Submitted by
Janis Bowdler
Deputy Director, Wealth-Building Policy Project

March 23, 2010

Raul Yzaguirre Building
1126 16th Street, NW
Washington, DC 20036

www.nclr.org

Good afternoon. My name is Janis Bowdler. I am the Deputy Director of the Wealth-Building Policy Project at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. I oversee our research, policy analysis, and advocacy on issues critical to building financial security in Latino communities, such as homeownership, consumer credit, auto lending, and financial counseling. During my time at NCLR, I have produced a number of publications on housing issues important to the Latino community, my most recent being *The Foreclosure Generation: The Long-Term Impact of the Housing Crisis on Latino Children and Families*. In addition, I have served as an expert witness before Congress and the Federal Reserve. I would like to thank Chairman Frank and Ranking Member Bachus for inviting us to share our views on this important topic.

For more than two decades, NCLR has advocated for policies and programs that support sustainable Hispanic homeownership. NCLR conducts research and analysis on relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to credit. In addition, NCLR is the only U.S. Department of Housing and Urban Development (HUD) housing counseling intermediary focused on the Latino community. The NCLR Homeownership Network (NHN) provided first-time homebuyer and foreclosure prevention counseling to more than 50,000 families last year alone. NHN counselors are working closely with Federal Housing Administration (FHA) borrowers to ensure that they are prepared for homeownership and help them avoid predatory scams.

Historically, Hispanic families have struggled to achieve homeownership at the same rates as their White peers. In recent years, significant advances had been made in home financing that enabled millions of families to purchase their first home. While the bubble years have become infamous for the glut of damaging financial products invented—such as toxic mortgages and fee harvester credit cards—we must also take into consideration positive innovations that advanced homeownership in a sustainable manner. They should be the foundation on which we rebuild our mortgage finance market or consider reform.

Today's hearing should be the first in a series of dialogues on the important question of what is needed from a reformed or redesigned housing finance system. In my brief remarks I will lay out a series of principles to guide the reform in a way that will promote sustainable homeownership opportunities for communities of color. I will also address the specific questions put forth by the committee.

Background

NCLR has testified several times over the last five years and published a series of documents[1] on the unique challenges Latino families and other borrowers of color face when they enter the

---

[1] NCLR has published several reports and presented testimony before the U.S. House of Representatives and the U.S. Senate on these issues. These are available at www.nclr.org. Key publications include: Janis Bowdler, Roberto Quercia, and David Smith, *The Foreclosure Generation: The Long-Term Impact of the Housing Crisis on Latino Children and Families* (Washington, DC: NCLR and Center for Community Capital, 2010); Janis Bowdler, *The Role of FHA Mortgage Insurance in Revitalizing Latino Homeownership* (Washington, DC: NCLR, 2009);

mortgage market. In addition to the shortage of affordable housing, Latino families were often overlooked by conventional lenders unwilling to take the extra steps necessary to process loans that did not fit the narrow box created by automated underwriting. Instead, many were steered toward subprime loans, even when they had good credit. Moreover, the absence of strong competition from mainstream banks offering prime loans left a vacuum that subprime lenders and brokers quickly filled. In many neighborhoods of color, there were few credit options available, leaving borrowers dependent on subprime credit to pursue their goal of homeownership.

It is important to note that there is a role for a robust and competitive subprime market. However, during the bubble years, the secondary market's seemingly insatiable appetite for high-profit mortgages led to a flood of high-risk loans and, eventually, toxic securities backed by these loans. The result was predictable: exotic and risky mortgages flooded the market and became heavily concentrated in where borrowers were cut off from better options and reliable information and advice that could objectively warn them of the risks. Many relied on their mortgage professionals for advice about the home loan and, as it turns out, the real estate market. The vast majority of borrowers could not see the behind-the-scenes incentives built into the mortgage system that favored short-term profits over long-term sustainability. This proved a reckless combination, not just for Latino families, but for the national economy.

Still, there have been critical advances over the last ten years in mortgage finance that should not be lost. Using the standard 30-year fixed-rate mortgage as the foundation—once a groundbreaking innovation on its own—lenders have been able to bring more homeowners into the fold using flexible and innovative underwriting criteria, including nontraditional credit, homeownership counseling, and affordable yet sound mortgages with lower down payments. While Wall Street funded investments in toxic mortgages, the Community Reinvestment Act, mortgage insurance from the Federal Housing Administration and the Veteran's Administration (VA), and the affordable housing goals placed on Fannie Mae and Freddie Mac drove much of the investment in affordable and sustainable homeownership opportunities for low-income families and communities of color. Without these tools, there is little evidence that mainstream banks would have financed such home loans. In fact, in the current market, where credit comes

---

Janis Bowdler, *Laying the Foundation for Equal Access to Credit: How Improved Financial Oversight Can Build Wealth for Hispanic Borrowers* (Washington, DC: NCLR, 2009); Janet Murguía, *Putting Our Communities on the Map: The Road to Economic Recovery for Latinos and Other Communities of Color* (Washington, DC: NCLR, 2009); Janet Murguía, *Laying the Foundation for Improved Access to Credit for Hispanic Families* (Washington, DC: NCLR, 2009); Graciela Aponte, *Putting an End to Predatory Lending in Minority and Latino Communities* (Washington, DC: NCLR, 2009); Graciela Aponte, *Principles for Reforming the Mortgage Market to Promote Sustainable Mortgages for Latino Families* (Washington, DC: NCLR, 2009); Janet Murguía, *Eroding a Generation of Wealth–Abusive Lending Practices Targeting Latino Communities* (Washington, DC: NCLR, 2008); Lot Díaz, *Leveraging the FHA Loans to Build Wealth in Latino Communities* (Washington, DC: NCLR, 2007); Janis Bowdler, *Challenges to Building Sustainable Homeownership in Latino Communities* (Washington, DC: NCLR, 2007); Beatriz Ibarra, *Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers* (Washington, DC: NCLR, 2007); NCLR and National Association of Hispanic Real Estate Professional, *Saving Homes, Saving Communities: Hispanic Brokers Speak Out on Hispanic Homeownership* (Washington, DC: NCLR and National Association of Hispanic Real Estate Professional, 2007); Janis Bowdler, *The Impact of the Home Equity Lending Market on Latino Consumers* (Washington, DC: NCLR, 2006); Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Mortgage Market* (Washington, DC: NCLR, 2005).

at a premium, housing counselors are reporting much difficulty in securing conventional financing for qualified families.[2]

As a housing counseling intermediary, NCLR has helped more than 135,000 families purchase their first home, all with prime or FHA home loans. Based on our experience working with thousands of families over the last 12 years, there are three areas of innovation that are particularly important to communities of color:

- **Housing counseling.** Over the last ten years, the federal government has made a significant investment in housing counseling, mostly through the Housing Counseling Program at the Department of Housing and Urban Development and most recently through the National Foreclosure Mitigation Counseling program at NeighborWorks. Research has shown that families who attend one-on-one housing counseling before they purchase their home are far less likely to default than their peers.[3] In an independent evaluation of NCLR's program, the Morrison Institute found that the tailored advice borrowers received from trained counselors was a significant contributing factor to their ability to buy a home.[4] The field of housing counseling has evolved to become increasingly professional. HUD-certified agencies are audited every two years and commit to high industry standards regarding staff certification, client procedures, and relationships with the industry.[5] These high standards are necessary to ensure that these nonprofit resources remain objective and trusted in the community. However, despite these advances in this field and their clear value to low-income families and first-time homebuyers, housing counseling has not been well supported by the home finance market. Many conventional lenders dropped their requirements for first-time homebuyers to attend housing counseling before receiving certain loans, with Fannie Mae, Freddie Mac, and FHA quickly following suit. Each claimed that they were "forced" to do so to remain competitive in the market. The message was clear: the housing finance market had no time for the slow and steady development of mortgage-ready homebuyers. Housing counseling organizations were often seen as too small, not producing significant enough volume to be a serious market player, or worse, a nuisance that kept lenders from getting to clients faster. In the wake of record-setting foreclosure rates, housing counselors have become first responders in their neighborhoods, many hiring and training new staff to meet demand. This capital in the form of highly trained and sophisticated community-based institutions should not be lost in the next imagining of the housing finance market.

- **Flexible underwriting.** One of the most important advances in mortgage finance was the creation of FHA- and VA-insured mortgages that would allow borrowers who lacked

---

[2] Housing counseling survey conducted by NCLR in January 2010. Actual question: "With home values declining, many new homebuyers are looking to purchase their first home. How easy or difficult has it been for your clients to purchase a home in this market?" **Very Easy=2.2%, Easy=22.9%, Difficult=62%, Very Difficult=12.8%**

[3] Abdighani Hirad and Peter M. Zorn, *A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, 2001).

[4] Ryan M. Johnson and Elsa Macias, *Home to Own: A New Model for Community-Based Low-Income Mortgage Lending* (Phoenix, AZ: Morrison Institute for Public Policy, Arizona State University, 1995).

[5] For more information, please visit www.homeownershipstandards.com.

cash but had significant income to purchase a home. Over time, the industry has learned more about how to accommodate different borrower profiles in a manner that does not jeopardize the financial safety and soundness of the family or the bank. For example, Latino borrowers are more likely than others to have a cash income, multiple co-borrowers on the same loan, or multiple sources of income, and they are less likely to have a traditional credit history. As the underwriting process became automated, these features became harder to process. Many community banks, credit unions, and mainstream lenders, as well as Fannie Mae, Freddie Mac, and state housing finance agencies, have been able to model these characteristics and create loan products that earn a return and still gave the family a fair deal. In addition to advice from their counselor, borrowers interviewed as part of the Morrison Institute's evaluation of NCLR's counseling pilot stated that they would not have been able to qualify for their home without the use of the flexible underwriting. Both the counseling and the underwriting criteria were ranked above down payment assistance in terms of what was the most helpful in purchasing their home. However, many of these products struggled to gain traction in local markets. In some cases, they were overlooked by loan officers in favor of a product that earned a higher profit. In other cases, the lenders offering the product lacked market share. Moving forward, the lessons learned from the pioneers of affordable lending should become a centerpiece for a revived lending system.

- **Nontraditional credit.** In 2002, one in five Latinos did not have enough information in their credit file to produce a score. Credit scores from the three mainstream bureaus—Experian, Equifax, and TransUnion—are built by the voluntary reporting of major creditors. However, individuals who do not use these products, or do not use them often enough (six months of inactivity will result in a score of zero), will not have a score mortgage lenders can use. To get around this barrier, several major data companies, including the credit bureaus themselves, have experimented with different data sources and the predictability of various trade lines. For example, regular payment for utilities, cell phones, child care, cable, and rent can be documented and analyzed. Many lenders had successful pilot programs using various methodologies and data providers, opening the doors to homeownership for a new segment of borrowers. Loan products that used nontraditional credit have dried up in the current market. Losing them altogether would unnecessarily decrease homeownership opportunities for qualified families.

All too often, these positive innovations were subsumed in the market by high-risk, high-profit loans and by industry players with little incentive to think past the commission they made at origination or securitization. As we consider how to strengthen our housing finance market, the advancements in underwriting and outreach discussed above should be built in the foundation.

Principles for the Future of Home Lending

The question of how to rebuild our mortgage finance market is timely and critical. The collapse of the credit markets and subsequent recession has thrown millions of families off their path to financial security. However, the silver lining of the burst housing bubble is that homes are now affordable for many that had been previously priced out of the market. Unfortunately, many borrowers of color, low-income families, and others are struggling to gain access to credit in this tight credit market. For this reason, many market commentators persuasively argue that the pendulum has swung too far away from easy credit to the point of making it unavailable for those who need it most. Thus the timing is right to consider how to bring balance and opportunity back into the market.

NCLR has two primary goals for a revived homeownership market: 1) To ensure that qualified Hispanic families of modest means have the opportunity to access a home loan at fair, equal, and affordable rates; and 2) To ensure that their home purchase will develop into an asset they can share with their children. With that in mind, we have developed the following set of six principles to guide the shaping of the future home lending market.

- **The federal government has a role in providing liquidity and innovation in the mortgage market.** Of the market advances discussed above, none would have come to fruition absent some government intervention. Whether directly, through incentives and market interventions, or through quasi-public agencies, the federal government can help facilitate the adequate flow of mortgage and housing capital throughout the country. For many years this was the role of Fannie Mae and Freddie Mac, which drove the rise of the secondary mortgage market and served as a primary source of liquidity for lenders of all types. The need for capital and liquidity is even more important for certain geographic regions, such as urban cores and rural areas, underserved populations, and first-time homebuyers for which financing options have traditionally been limited. While the federal government should bolster—not replace—the private market, it should set the standard for innovative, affordable, and sustainable home loans, secondary market credit, and rental financing. This can be done by example through direct lending programs, or indirectly through market controls, regulation, and limits on capital investments or other benefits.

- **Mortgage and housing finance credit must be equally accessible and available to all communities and qualified borrowers.** There are a number of reasons why mortgage credit is not equitably distributed among creditworthy homebuyers; thus, the solutions are necessarily varied. Still, in reforming the mortgage financing market, policymakers must be careful not to exacerbate the tendency of the market to favor the easiest-to-serve borrowers. In fact, controls and investments will be necessary to ensure that those who are hard to serve, yet creditworthy, are able to access the same credit at the same rate as their similarly situated peers. One way to do this is to invest in lending tools that might be unattractive to private, primary lenders but for which there is a strong public purpose. For example, the federal government or a quasi-public agency should purchase loans from small institutions (nonprofits, community banks, credit unions, community development financial institutions (CDFIs) where the volume may be too small to attract the private market; issue, insure, or purchase loans with flexible underwriting criteria, such nontraditional credit histories, multiple co-borrowers, or multiple sources of income; and conduct robust pilot programs to test new products and further understand effective credit criteria, enhancements, and other tools in creating affordable and fiscally responsible loans. For example, pilot programs should test loans that do not require mortgage insurance, use homeownership counseling to accommodate lower credit scores, and criteria around nontraditional credit.

- **Standard, fiscally sound, yet affordable and sustainable mortgages should be the norm.** The share of subprime mortgages in the overall market grew in accordance with the secondary market's appetite for risky loans, not with real demand for such loans on the ground. Policymakers should seek to restore balance so that the mortgage financing system reflects true market demand from the bottom, not the top. Standard mortgages with flexible underwriting but without hidden traps or exotic features should be the first product offered to most homebuyers. In practice, this would mean that compensation incentives are aligned so that features designed to maximize affordability and long-term sustainability become the priority for lenders. Strong consumer protections are essential to provide a balance to the market's inherent preference for short-term profits at the expense of long-term societal interest. The federal government can play a role by ensuring market liquidity for standard mortgage products that promote sustainable homeownership, such as those insured by FHA and those purchased by Fannie Mae and Freddie Mac. Issuers of government-backed or government-insured mortgages must be governed by a strong duty of care. Those that perform poorly should risk the privilege to originate government-backed loans. Under no circumstances should federal investments of any kind further predatory or discriminatory lending.

- **Diverse delivery and outreach channels must be incorporated.** A key lesson from the financial fallout in 2008 is that prime retail banks did not compete well against their more agile, less scrupulous subprime competitors. The reasons for this are the subject of ongoing debate, but policymakers can prevent homeowners from suffering from lack of competition for their business by supporting origination opportunities through a wide array of delivery and outreach channels. The nonprofit community is an underused resource in this respect. Homeownership counseling agencies, credit unions, CDFIs, and other nonprofit lenders offer safe, affordable mortgage products but are unable to compete in the local lending market. They lack the marketing budget and brand recognition that national outlets have, and they often have more conservative underwriting or procedures that leave them at a competitive disadvantage. The federal government has played a critical role in supporting the growth and professionalization of the nonprofit sector. To capitalize on their investment, they must ensure that skilled nonprofits are weaved into the fabric of the revitalized homeownership market.

- **Predatory lending should be eliminated.** As has been referenced in several places so far, much of the best home financing innovation developed in the last ten years was blocked from the borrowers who needed it the most. Abusive practices routinely beat the "slow and steady" practices on the ground. Policymakers must avoid the trap of encouraging sustainable homeownership through a variety of mechanisms without following with a zero tolerance policy on discrimination and unethical lending.

- **Affordable rental housing is critical to creating sustainable homeownership opportunities.** In some respects, the goals of creating a steady stream of affordable rental stock and helping low-income families achieve homeownership have been pit against one another. On the contrary, it is nearly impossible for families of modest means to build a savings and prepare for homeownership if too much of their income goes toward unaffordable rent payments or costly transportation expenses because the only affordable homes were miles from their place of employment. This is particularly important for Hispanic families, one-quarter of which dedicate at least half of their income to housing. Housing finance reform must be considered in light of a national housing agenda that weighs the needs of all families. The federal government can support affordable rental housing by fully funding the National Housing Trust Fund, as well as through direct appropriations, construction loans, loan insurance or other credit enhancements, pooling capital, and other tools.

In addition to being guided by the principles laid out above, NCLR strongly urges Congress to use a data-driven, empirical approach to reshaping Government-Sponsored Enterprises (GSEs) and other market reforms. For example, we encourage the testing of GSEs' loan products and loans held in portfolio to determine the combination of loan characteristics that have produced viable and sustainable mortgages. Policymakers should use their unique access to data to produce a study that examines lending across the system with the goal of promoting the most promising and successful elements of the old structure.

There is a strong public demand for a robust housing finance market that delivers a steady flow of affordable credit on fair terms in all corners of the country. History has shown that this is not likely to happen without targeted investment from the federal government. The private market will not adequately serve low-income, minority, senior, or immigrant borrowers on its own. As Congress debates the new role for the federal government and the GSEs in the mortgage market, it must adhere to these six principles. Moreover, it is important to note that the federal government has access to more data now than ever in the past.

In closing, NCLR makes the following recommendations on steps Congress can take in the near future to facilitate the recovery of the mortgage market:

- **Stop foreclosures.** NCLR thanks members of the Financial Services Committee for their dedication to this issue, having held hearings and voted to create or support programs that directly help families. Unfortunately, neighborhoods across the country are still reeling from high rates of foreclosure. Various measured steps to halt the steady stream of foreclosures and evictions have come up short. Congress can help families by creating a program to sustain unemployed homeowners until they find a job.

- **Continue the work of FHA and GSEs.** In 2008, 45% of Latino homebuyers relied on FHA financing. In some markets, GSE financing represents the bulk of capital available for home purchases. Without the work of these agencies, there would be little home lending market to speak of. We urge Congress to support the work of these agencies until more long-term reforms are put in place and the private market has recovered.

- **Invest in soft landing strategies.** By now it is painfully clear that not all delinquent homeowners will be able to avoid foreclosure. Yet servicing companies, investors, and neighborhoods are still unable to keep up with the volume of foreclosures. As a result, homes are abandoned, leading to crime and maintenance issues, furthering damaging surrounding property values. Congress and the administration should invest in "soft landing" strategies that help owners transition out of their mortgage with less damage to their family, the neighborhood, and the investor. One example are programs that allow owners to stay in their homes as renters, perhaps even earning their way back to an ownership position.

Thank you for offering NCLR this opportunity to share our views. I would be happy to answer any questions.