NATIONAL COUNCIL OF LA RAZA

Challenges to Building Sustainable Homeownership in Latino Communities

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Mortgage Market Turmoil: Causes and Consequences

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Submitted by:

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My name is Janis Bowdler, Senior Policy Analyst on Housing at the National Council of La Raza (NCLR). I conduct research, policy analysis, and advocacy on affordable homeownership, and provide technical assistance to NCLR housing counseling grantees. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. During my time at NCLR, I have published on a number of housing issues important to the Latino community, including *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos* and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market.* In addition, I recently provided expert testimony before the House Financial Services Subcommittee on Housing and Community Opportunity and before the Board of Governors of the Federal Reserve.

I would like to thank Chairman Dodd and Ranking Member Shelby for inviting NCLR to testify before the Committee. NCLR is deeply concerned that the home mortgage system does not work well for Latino families. Much like all Americans, Latinos rely on homeownership to build wealth for their long-term fiscal health. With research predicting that one in twelve Latino loans will end in foreclosure, the hallmark of the American dream is threatening to leave millions of families without homes, access to credit, or a financial safety net.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and HOEPA, supporting strong fair housing and fair lending laws, increasing access to financial services among low-income people, and promoting homeownership in the Latino community. In addition to its policy and research work, NCLR has been helping Latino families become homeowners for nearly ten years as a sponsor of housing counseling agencies. The NCLR Homeownership Network (NHN) works with 20,000 families annually, nearly 3,000 of whom become homeowners. NCLR has sophisticated relationships with major financial institutions, which allows NHN counselors to prequalify their mortgage-ready families according to the product specifications of their partners. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $400 million in financing for locally-based development projects throughout the country, building the capacity of local nonprofits and creating opportunities for Latino communities. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market.

Latino families are entering the mortgage market in record numbers. Latino homeownership reached an all-time high of 49.5% in 2005, up from 42% in 1995. Despite these gains, evidence suggests that barriers existing in the mortgage industry impede Latino families' access to the best and most appropriate home loans. Recently, cooling home prices, rising interest rates, and an industry struggling to maintain the high loan volumes it saw three years ago have exacerbated the situation. In some instances, families are facing a cycle of wealth-draining refinances, and for others it could lead to foreclosure.

Obviously, these are not the reasons families decide to pursue homeownership. Homebuyers choose ownership because they believe that with it they will build the nest egg that will send their kids to college and provide for their family in times of financial crisis. However, in my testimony today I will explain how many Latino families face unique barriers that make achieving this dream difficult. The mortgage market has serious flaws that prevent it from serving Latino families well. That said, we believe there are practical solutions, which I will cover in my recommendations.

Challenges to Sustainable Latino Homeownership

Latino families face significant barriers when approaching the homeownership market. The most common barriers cited for Latino families are affordability and lack of information. While that is certainly true, the biggest challenges they face are endemic to the mortgage system itself. Many Latinos have unique borrower characteristics that are not a perfect match to the average homebuyer. Over the past decade the mortgage industry has been able to increase its efficiency for many consumers by moving to automated underwriting. If a family does not match the traditional borrower profile, they often get passed over by prime lenders, or those with the most competitively priced home loans. This is often the case for Latino families. For example, 22% of Latinos have a "thin" credit file, or no credit history, which usually results in a "0" credit score, compared to only 4% of Whites.[1] Approximately 35% of Latino families do not have basic checking or savings accounts.[2] Many Latino families have multiple wage earners or some cash income and savings. Products exist that accommodate such attributes, but they often require manual underwriting. In an automated world this translates into increased costs in terms of employee time and missed commission opportunities. As a result, many Latino families are channeled to the subprime market, which is traditionally reserved for borrowers with damaged credit. The expansion of this market has helped some families with poor credit history access home loans. However, subprime loans are typically more expensive, riskier, and, oftentimes, easier to abuse.

Latinos and other minorities often find themselves channeled toward the products most profitable to the lender, but which may be expensive and risky for borrowers, regardless of their creditworthiness. Research shows that Latinos are 30% more likely than Whites to receive a high-cost loan when purchasing their home. Other research shows that nontraditional mortgage products such as Option Adjustable Rate Mortgages (Option ARMs) and Interest-Only Mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM. In some cases, lenders sell Latino families Stated-Income loans rather than take the time to verify their cash income and savings. Lenders protect themselves with a business model that anticipates some losses. Needless to say, most families do not have such protection available to them.

The Rivera family is a good example of how this happens. This family came to visit an NHN affiliate in Seattle. They were having trouble making the payments on their mortgage, even though they had been in their home a short amount of time. Despite the family having a long

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[1] Stegman, Michael, et al., "Automated Underwriting: Getting to 'Yes' for More Low-Income Applicants," Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America Center for Community Capitalism, University of North Carolina-Chapel Hill, April 2001.

[2] Pew Hispanic Center/Kaiser Family Foundation, *2002 National Survey of Latinos*. Washington, DC: 2002.

history of good credit, they were in a subprime loan. The family did not understand what a subprime loan was until the counselor pointed out the high rate and fees they were paying. They unknowingly had two mortgages; the first loan is a 2/28 with a five-year interest-only option. After the first two years their payments will increase every six months. They were also unaware they had a balloon on the second mortgage with a $50,233.31 payoff due in 15 years. It became clear to the counselor that the family never could have afforded this loan and should have been in a prime loan in the first place. The family reported, however, that they were referred to this mortgage broker who could help them because they had several sources of income. The Rivera family brought in the documentation for each source but were unaware they were in a Stated-Income loan, and that their loan documents misstated their income several thousand dollars a month over their actual income.

A Broken System

Given the large increase in Latino and immigrant families entering the market each year, NCLR is troubled at the mortgage industry's lack of capacity to respond to their needs. Immigrants accounted for 17% of first-time homebuyers in 2002 and 2003. As described above, these new borrowers and homeowners have unique needs that the marketplace is not equipped to meet. Unfortunately, this means they are vulnerable to predatory lending. Latino and immigrant families beginning their homeownership search often draw information and advice from informal sources such as word-of-mouth and Spanish-language outreach (print and radio media) and are likely to seek out a "trusted advisor" whose credibility has been established within these networks. Anecdotal comparisons of Spanish-language newspapers and mainstream English-language papers demonstrate a stark contrast between the products targeted to different communities. Spanish-language papers almost exclusively display advertisements from subprime financers and mortgage brokers. Even when mainstream institutions place advertisements in the Spanish-language press, they mirror those products advertised by the other lenders: Interest-Only, Option ARM, 100% financing, and Stated-Income loans. English-language newspapers, however, feature convenient charts that compare the major local mortgage institutions and their competing rates for standard mortgage products. Since financers of subprime and high-risk mortgage products have little if any incentive to up-sell their clients to less-risky mortgage products, many Latinos and other underserved communities are set on a path early on which limits the mortgage options they will be presented.

Homeowners attempting to refinance their mortgage face different challenges. Increasingly, homeowners are the focus of push marketing tactics of mortgage brokers, real estate agents, and wholesale lenders who are under increased pressure to produce volume in a shrinking market and tight profit margins. A survey completed for NCLR in 2005 revealed that 76% of Latino homeowners had been solicited to refinance their home by a financial institution within the previous year. Reports from across the country confirm that the most egregious of these predatory lending cases occur when independent third-party agents – such as mortgage brokers, real estate agents, or appraisers – partner to solicit homeowners and convince them to refinance. In most cases, borrowers are solicited for the highest-cost and riskiest mortgage products regardless of whether they fit the financial goals and capacity of the family.

Latino homebuyers and owners rely heavily on mortgage brokers, who often act as a bridge connecting them to mainstream financial institutions. In fact, many brokers are outperforming the prime and retail institutions in their service to Latino families by diversifying their workforce, offering a wider range of products, and adopting a one-on-one style that makes Latino families feel comfortable. Latino borrowers often rely on bilingual and bicultural brokers to serve as a bridge to the mainstream mortgage market. However, despite the fact that most borrowers believe their mortgage broker is obligated to work on their behalf to find "the best deal," most have few, if any, legal or professional ethical responsibility to the borrower. Yield Spread Premiums (YSPs) offered by lenders provide another financial incentive to steer borrowers to products that earn higher profits rather than those that fit the client's needs best.

This was the case for Mary and her husband in Wisconsin. Responding to advertisements, the couple began exploring the option of refinancing their home – which they purchased a year earlier for $109,000 – to catch up on some bills. Their broker had their home appraised, and they were surprised to find out that their home was worth much more than the purchase price, at $147,000. At the closing, the loan did not match up with the Good Faith Estimate (GFE) and the fees were nearly double, but the broker pressured the family into signing the documents anyway. Because of the high fees, the couple received less than expected to consolidate their outstanding debt. Their new loan payment is $1,300, which is nearly 80% more than their original loan payment. Mary reached out to an NHN organization in Waukesha, Wisconsin. Unfortunately, the family has few options since the appraisal was faulty. They recently discovered their home is only worth $112,000 and they are in a negative equity situation.

Many industry stakeholders point to the borrower's responsibility to be a savvy consumer, to shop around for the best deal and enter the mortgage transaction with a healthy skepticism. While NCLR certainly believes that shopping is an important part of the homebuying process, enhanced shopping capacity alone will not correct the market's shortcomings. Consumers do not have the tools necessary to shop effectively. Mortgage packages vary considerably from lender to lender and change often, sometimes daily, making it difficult to compare multiple loan opportunities. GFEs are not guaranteed, and many Latino consumers report feeling obligated to complete the loan process with a given agent once they have begun, especially at the late hour of closing. Perhaps more importantly, the mortgage transaction has become so complex that it is unreasonable to assume a borrower could, or should be obligated to, become a regulatory force in the market. As the earlier stories demonstrate, the borrowers were at a complete information disadvantage. They did not understand the terms and features of their loans or, worse, were not even aware of inclusion of certain terms and features in their mortgage. Most consumers rely heavily on mortgage brokers to shop on their behalf and trust their advice. With approximately 40% of all loans made to Latinos being subprime (compared to 19% of loans to Whites), NCLR is deeply concerned that borrowers are being mismatched to loan products that do not meet their needs simply because they have nontraditional borrower profiles or because of how they access the credit market. The common experiences described above are problematic since industry best practice is to price a clean, nontraditional credit history as prime credit. Equating these characteristics as inherently more risky has a disparate impact on Latino and immigrant borrowers.

NCLR serves many of the families targeted by the subprime market through NHN. Nine out of ten NHN families have incomes below 80% of Area Median Income (AMI), more than a third make use of alternative credit, and many have at least some cash income. Recently, NCLR conducted a survey of mortgage products most commonly used by families who closed loans through their NHN homeownership counselor. More than half used a 30-year fixed rate mortgage product of some sort to purchase their first home.[3] This information and experience busts the myth that the exotic mortgage products dominating the subprime mortgage market are the only avenue for underserved communities to access the market. Some have argued that tightening underwriting standards would result in credit drying up. We disagree. Tightening of underwriting standards should help guarantee that families are matched to better products since there are products in the marketplace that are clearly successful and safe alternatives for hard-to-serve borrowers. Rather, the system is broken, preventing families from connecting to the home loan that fits them best.

Recommendations

The mortgage market clearly has some challenges meeting the needs of low-income, Latino, and immigrant borrowers. Although some suggest that investors realigning their investments in the secondary market will lead the primary market to self-correct, there is still a need for intervention from Congress. In the wake of a dramatic increase in foreclosures and the shrinking of the mortgage market, many families will be stuck with bad loans they cannot afford. Congress must explore models for saving homes and helping families maintain their fiscal safety net. Moreover, Congress must put the tools in place now to deal with abusive loans that are likely to resurface during the next housing boom. Regulators and lawmakers must put borrowers on a level playing field with originators and investors. NCLR makes the following recommendations:

- **Improve originator accountability standards.** Borrowers need a higher level of security and transparency when purchasing their home. Similar to how average families rely on the professional legal and ethical responsibilities of other experts – such as doctors, lawyers, accountants, and stockbrokers – originators should be obliged to give consumers information they can trust. Congress and regulators should craft a standard of accountability that protects the integrity of the borrower-originator relationship. Such a standard should expressly prohibit steering consumers to a high-cost product or an entity that exclusively offers high-cost products and should promote the making of affordable loans. Mortgage brokers and independent agents must declare on whose behalf they are working and be held accountable according to the relationship.

- **Strengthen enforcement and consumer remedies.** The existing HOEPA regulation was intended to solve predatory practices common in the mid-'90s, which primarily consisted of abuses in the refinance market. Much of the abusive activity in the Latino community

[3] This includes conventional 30-year fixed rate mortgage (FRM) products, 30-year FRMs without mortgage insurance, and 30-year FRMs insured through the Federal Housing Authority (FHA).

occurs during the initial home purchase stage, often setting a family up to refinance a few years later. HOEPA should be amended to address home purchase abuses such as targeted and push marketing, steering to high-cost products and lenders, and the use of teaser interest rates. The new interagency guidance on nontraditional mortgages promotes stronger underwriting practices. The Federal Reserve should set a high standard for compliance by holding unethical lenders accountable and ensuring that victims have access to meaningful remedies. Moreover, the guidance should be extended to all mortgage companies.

- **Invest in homeownership and foreclosure prevention counseling.** While many industry stakeholders have held increased education as a potential remedy for the lack of information in the marketplace, few are doing enough to support and strengthen the counseling industry. NCLR urges Congress and regulators to establish an incentive for investing in housing counseling. We applaud Congress for its continued support of the HUD Housing Counseling Program and urge appropriators to drastically increase funds available for this program given the anticipated rise in the number of families who need such services. Moreover, Congress should create a national foreclosure rescue program to address the needs of the millions of families likely to face foreclosure in the next two years. Federal intervention in the foreclosure crisis could come in the form of emergency funds for short-term financial challenges, refinance rescue loan products, and tools for foreclosure prevention counselors to work with mortgage servicers to resolve a family's delinquency. Such a program should be available to borrowers who are facing financial crisis through no fault of their own, or who are the victims of abusive lending tactics.