

December 20, 2010

The Honorable Shaun Donovan
Secretary of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

The Honorable Timothy Geithner
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20005

Dear Secretary Donovan and Secretary Geithner:

On behalf of the millions of diverse homeowners, future homebuyers, and renters represented by our organizations, we write to provide three recommendations for you to consider as you map out the next phase of our nation's housing finance system. Ensuring that all Americans have access to fair and sustainable credit opportunities is crucial to our economic recovery. Yet our communities have long been underserved by the housing markets, targeted by predatory lenders, and denied opportunities to build housing wealth. The current policy debate surrounding the structure of our housing system, including the government-sponsored enterprises Fannie Mae and Freddie Mac, provides a unique opportunity to make improvements. The future housing finance system must affirmatively establish pathways to homeownership for qualified borrowers and safe and affordable rental homes for all families.

The federal government has a critical role to play in ensuring that the secondary market serves all borrowers in a fair and equitable manner. Without federal incentives or interventions, the housing finance system will not reach all segments of borrowers and geographic areas. We urge you to support a balanced national housing policy that facilitates a stable, liquid secondary market—accessible to small and large lenders alike—which will extend credit and capital on an equitable basis to all qualified borrowers and in all communities.

We need a financial system in which all players share accountability to protect consumers and the integrity of the system. The subprime lending and foreclosure crisis is a manifestation of unequal access to banking and financial services, not simply an isolated anomaly or the fault of a few fraudulent lenders and borrowers. Thus, one of our primary objectives in revising the national housing system is to ensure the affirmative delivery of fairly priced capital to underserved borrowers and neighborhoods. Our organizations have come together to establish a set of principles on which to base housing finance reform.¹ We are using these principles as benchmarks for evaluating all related policy proposals. Together we have reviewed the proposals publicly available on the Department of Treasury website and testimony delivered at

¹ A copy of the principles is attached and was disseminated at a series of meetings with staff from the Treasury, Department of Housing and Urban Development, and White House.

hearings hosted by the Department of Housing and Urban Development, as well as met with several of the staff from your agencies. Based on our assessment of the current state of the policy debate, we are offering three recommendations for your final proposal. These recommendations do not represent everything that there is to be said about housing finance reform. However, we consider these points to be the most critical from a civil rights perspective at this point in the conversation.

Recommendation 1: Ensure that the housing finance system furthers our nation’s fair housing goals.

The federal government is obligated to promote nondiscrimination, residential integration, and equal access to the benefits of decent and safe housing and ownership opportunities. However, clear standards for implementation have not been applied to our housing finance system. For decades our housing finance system has operated on a “dual track” where factors other than a borrower’s creditworthiness affected the terms of his or her home loan. African American, Asian American, Pacific Islander, Native American, Hispanic, immigrant, elderly, and female borrowers have been routinely steered into substandard mortgages, even when their credit warranted a prime loan.² Such loans are more expensive and more likely to go into foreclosure, costing African American and Latino families alone billions of dollars in lost wealth.³ This two-tiered financial system is known as the dual credit market.

Federal policies have allowed the dual credit market to persist, feeding the racial, ethnic, and gender wealth gaps. U.S. policy has subsidized homeowners and homeownership in a variety of ways, including through generous tax subsidies and backing for secondary market entities. These policies direct the largest subsidies to wealthier homeowners. Their lack of access to conventional credit has meant that borrowers of color, women, and other underserved groups—regardless of their income—have not had the same access to the benefits created by these federal supports. Such subsidies also benefit the corporations that can conduct a profitable business because of the federal government’s investment. As a consequence, the Obama administration must unequivocally and effectively apply fair housing and equal credit principles to our federal housing system and end the dual credit market. We offer two recommendations for this challenge:

- Require all lenders and securitizers receiving a government guarantee of any kind to affirmatively market and offer credit in a manner that promotes equal opportunity in all neighborhoods. The receipt of federal support, including insurance and guarantees,

² An analysis conducted by First American Loan Performance found that 41% of subprime loans made in 2004 went to borrowers who actually would have qualified for prime rate loans. See Ezra Klein, “Digging into Finance’s Pay Dirt: The Risky Business of Payday Loans and More,” *Washington Post*, July 25, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/24/AR2010072400153.html> (accessed December 20, 2010). Another study found that 55% of subprime borrowers in 2005 and 61% of subprime borrowers in 2006 would have qualified for prime rate loans. See Rick Brooks and Ruth Simon, “Subprime Debacle Traps Even Very Credit-Worthy,” *Wall Street Journal*, December 3, 2007, <http://online.wsj.com/article/SB119662974358911035.html> (accessed December 20, 2010).

³ Debbie Gruenstein, Keith Ernst, and Wei Li, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (Durham, NC: Center for Responsible Lending, 2010), <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf> (accessed December 20, 2010).

invokes the mandate to affirmatively further the objectives of the Fair Housing Act. Therefore, the delivery of government-supported mortgage credit or rental financing cannot be withheld from any geographic location or neighborhood. Instead, the delivery infrastructure must make deliberate provisions for the flow of credit to all qualified borrowers and neighborhoods. Moreover, the infrastructure must include a mechanism for monitoring and enforcing compliance, both by the government and the public. Simple, transparent, and timely data must be made publicly available to measure the market's progress in providing fair, sustainable capital to underserved people and communities.

- Establish the necessary mechanisms to prevent the targeting or limiting of mortgage capital by any segment of the housing finance system in a manner that is discriminatory or perpetuates segregation or redlining (including reverse redlining).⁴ Racial segregation has been a significant predictor of the share of subprime loans a neighborhood receives, even after controlling for the percentage of minorities within the metropolitan area as a whole, credit score, median home value, poverty, and education. By contrast, neither poverty nor unemployment is a statistically significant predictor of the percent of subprime loans.⁵ No one in the housing finance system—originators, private mortgage insurers, government-backed securitizers, or private label securitizers—should be allowed to adjust the levers of mortgage capital in a metropolitan area or geographic region in a manner that creates artificial barriers to favorable, sustainable credit.

Recommendation 2: Avoid overreliance on Federal Housing Administration (FHA) mortgage insurance.

FHA plays a critical role in the market by making credit available to people with modest incomes. These borrowers have the ability to repay a mortgage but may have less-than-perfect credit or limited resources for a down payment and closing costs. However, several proposals for modifying the housing finance system have suggested that borrowers who fall outside the banking industry's preferred profile (which may be based on characteristics other than risk or creditworthiness) would be best served by FHA mortgage insurance. We strongly caution against this flawed framework. Leaving an entire borrower segment and whole neighborhoods reliant on a single source of mortgage credit is bad policy for a number of reasons.

⁴ The practice of targeting borrowers and communities of color for loans on unfavorable terms is known as reverse redlining. Redlining is a practice in which banks identify communities—usually communities of color—where they refuse to make loans or extend credit. Reverse redlining occurs when lenders promote predatory credit to the same communities that found themselves starved of credit because of redlining. Reverse redlining is a recognized violation of the federal Fair Housing Act. See Raymond H. Brescia, "Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis," *Albany Government Law Review* 2, no. 164 (2009): 164–216.

⁵ Gregory D. Squires, Derek S. Hydra, and Robert N. Renner, *Segregation and the Subprime Lending Crisis*, Briefing Paper #244 (Washington, DC: Economic Policy Institute, 2009), http://www.epi.org/publications/entry/segregation_and_the_subprime_lending_crisis (accessed December 20, 2010). Squires et al. found that a 10% increase in African American segregation, on average, is associated with a 1.4% increase in high-cost lending, and a 10% increase in Hispanic segregation, on average, is associated with a 0.6% increase in high-cost lending.

The FHA program insures home loans, but FHA is not directly involved in the underwriting or servicing of those loans. This gives the federal government limited control over its implementation in the marketplace.⁶ For example, lenders are able to impose additional fees and charge higher interest rates to FHA borrowers, undermining affordability and blocking qualified borrowers from accessing the program. Limited program oversight has opened the door to a variety of abuses, including inflated appraisals, property flipping, and other fraudulent or sloppy origination practices. When these problems led to high levels of foreclosures concentrated in particular communities (often communities of color), FHA did not demonstrate the capacity to manage a large real estate owned portfolio. This, in turn, led to declining property values, the deterioration of vacant homes, and a host of other problems in affected neighborhoods. The problems associated with the overconcentration of FHA lending in communities of color and low- and moderate-income communities look very much like the problems we are currently experiencing in neighborhoods that were flooded with subprime and other exotic and unsustainable loans.

FHA works best in a competitive market where it is one of many options available to a wide range of borrower segments. Not only is this critical to keeping FHA actuarially sound, it keeps lenders engaged in the low down payment and underserved markets. In the absence of competition for their business on safe and sustainable terms, our communities face two troubling scenarios: being overrun with FHA loans and denied access to conventional credit, or being cut off from credit entirely if lenders decline to offer the FHA product. Both scenarios leave certain borrowers and neighborhoods vulnerable to a resurgence of predatory or substandard credit and enable a two-tiered financing system.

To avoid overcommitting too much of the market to FHA, the federal housing finance proposal must support responsible yet flexible underwriting within loans that receive federal backing or support on the secondary market. This should include the development of low down payment products. Doing so will keep credit markets available to qualified minority and underserved homebuyers.

Recommendation 3: Support integrated neighborhoods and equal homeownership opportunities.

Too often the rental and ownership tenures are pitted against one another in housing policy debates. However, balanced housing policy requires neighborhoods and families to have access to viable options in both markets. Safe and affordable rental housing in opportunity-rich neighborhoods is critical to breaking down the barriers of segregation. Communities hit hard by

⁶ The Department of Justice recently reached a settlement with PrimeLending to resolve alleged civil rights violations. The lender charged African American borrowers higher interest rates than White borrowers for FHA-insured mortgages in its retail loans. See U.S. Department of Justice, "Justice Department Reaches Settlement with National Mortgage Lender to Resolve Allegations of Lending Discrimination," news release, December 8, 2010, <http://www.justice.gov/opa/pr/2010/December/10-crt-1406.html> (accessed December 20, 2010); and National Community Reinvestment Coalition, *Working-Class Families Arbitrarily Blocked from Accessing Credit: NCRC's Fair Lending Investigation of Credit Score Restrictions by Federal Housing Administration-approved Lenders* (Washington, DC: National Community Reinvestment Coalition, December 2010), http://www.ncrc.org/images/stories/mediaCenter_reports/fha%20white%20paper-120810-final.pdf (accessed December 20, 2010).

the foreclosure crisis, unemployment, and divestment require unique rebuilding strategies. Homebuyers and owners who have historically lacked access to prime credit need reliable loans. These market demands can be harmonized by the secondary market with government support. We recommend the following:

- Increase the supply of affordable rental housing (both subsidized and unsubsidized) to meet demand. This will prevent low-income families from having to forgo basic necessities to pay their rent. It will also allow them to take the first steps toward homeownership—budgeting, saving, and creating a positive credit history. In addition, the way to greater civic and economic opportunity should be paved by creating incentives to locate new, affordable housing outside of areas that are racially concentrated and have high levels of poverty. Securitizers should be discouraged from isolating their financing in a manner that concentrates all market rate developments in low-poverty areas and all “affordable” developments in high-poverty areas. Rather, new standards should create incentives for mixed-income and inclusionary housing development, as well as community rebuilding. Federal support must not be used in a manner that perpetuates the concentration of poverty and racial segregation. We also note that sustaining smaller, existing multifamily housing (in the 1–4 and 5–50 unit ranges, which serve the majority of our country’s renters) in diverse urban and suburban neighborhoods requires a reliable source of long-term financing. Existence of a liquid, affordable secondary market for such loans requires involvement of the federal government and must be a part of the housing finance system of the future.
- Support a wide array of housing choices, including affordable family rentals, cooperative and shared equity housing, affordable condominiums, and starter homes. In addition, flexible and affordable mortgage products proven to be sustainable should also be supported. This includes those that are fully documented and allow for low down payments and alternative measures of creditworthiness. Such products have a track record of good performance and help to meet the credit needs of underserved communities. This type of responsible flexibility is the key to equalizing homeownership rates. It also helps to close the wealth gap among people of different races and ethnicities. This, in turn, represents a critical step toward rebuilding the wealth that has been drained from communities of color as a result of the targeted and irresponsible lending that spurred the foreclosure crisis.

We believe that these three points are essential and should be included in the Treasury’s initial proposal for housing finance reform, and we urge you to incorporate them into the plan you release next month. However, we also recognize that the complex task of rethinking our housing finance system involves a number of other factors, including investigating the impact of the Dodd–Frank Act and addressing the need to strengthen fair lending oversight and enforcement in the primary and secondary markets. These are important policy questions that we intend to address, and we hope to do so in partnership with your agencies. To discuss our recommendations further, please contact Janis Bowdler, National Council of La Raza (NCLR), at (202) 776-1748 and jbowdler@nclr.org or Debby Goldberg, National Fair Housing Alliance, at (202) 898-1661 or dgoldberg@fairhousing.org. We look forward to continuing this dialogue with you and your staff.

Sincerely,

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Civil Rights Statement of Principles for Secondary Market Reform

Equal access to mainstream financial services and affordable rental and owner-occupied housing is a critical step toward providing all families with access to wealth-building opportunities, good jobs, schools, transportation, health care, and other factors that determine positive life outcomes. Providing this access has been, and must remain, an important government policy goal.

One of the lessons of the current financial crisis is that our nation's housing finance system has not worked well for people of color and other underserved groups. Perverse incentives in the secondary market often drove unregulated brokers to target borrowers in communities of color with unsustainable loans. This fed a securitization regime so poorly understood and regulated that it ultimately destabilized the global economy. As the secondary market helped to drive this phenomenon, it also failed to make necessary investments in rental housing that met the needs of communities and opened opportunities for people.

Unregulated and often predatory subprime lending not only failed to maintain or promote sustainable homeownership opportunities but also established a dual credit market where factors other than a borrowers' creditworthiness determined the type and terms of the mortgages that were sold. All too often, families were denied the best credit for which they qualified, and their communities were flooded with unsustainable mortgage credit. As these unsustainable loans failed, the housing finance system failed to provide these families with the home-saving options that they were due. Instead of being able to use homeownership as the path to wealth-building and financial stability that our public policy promises, families have had their wealth stripped away and are facing financial setbacks that will take a generation or more to overcome.

It is because of this unfortunate history of exclusion of underserved communities from sustainable credit and housing options that civil rights organizations are invested in the housing finance reform debate and should be counted on as important civic partners. This debate is unfolding in the context of four decades of widening income and wealth inequality that have kept many borrowers from accessing the financial tools and options that provide an economic ladder to the middle class. Federal housing policy must reverse this and incorporate bold policy solutions to address inequality and segregation in the United States. It is in this spirit that we offer the following principles for secondary mortgage market reform. The principles were drafted by a group of more than 20 organizations that serve millions of members of underbanked communities throughout the United States, including African American, American Indian, Asian American, Pacific Islander, Latino, and low-income populations, as well as people with

disabilities and the elderly. The points below are critical in shaping the future secondary mortgage market.

- 1. Federal housing finance policy must align with and support longstanding federal housing goals to protect against discrimination.** The secondary mortgage market must promote residential integration, the elimination of housing discrimination, and the provision of safe, decent, and affordable housing for all.
- 2. The federal government has a responsibility to ensure that the secondary market serves all borrowers in a fair and equitable manner and to foster the equalization of homeownership rates.** Despite clear demand from qualified families, the mortgage market does not reach all segments of borrowers and geographic areas. It is incumbent upon the federal government to use its resources to facilitate a stable, liquid housing finance system that will extend credit and capital on an equitable basis to all borrowers and in all communities, with the goal of achieving the same rates of homeownership among communities of color as among whites. While not all household heads must become homeowners, a commitment should be made to achieve similar homeownership levels across all communities. In addition, the system must be made accessible by a wide range of lending institutions for both owner-occupied and rental housing.
- 3. A reformed housing finance system must eliminate the dual credit market.** Such a market has relegated people of color and other underserved groups and communities to riskier, higher cost forms of credit that strip wealth and undermine financial security. To accomplish this goal, reform of the secondary market must be coordinated with reform in the primary market for housing and other types of credit.
- 4. Regulatory oversight of the housing finance system must be rigorous and comprehensive and must include effective fair lending enforcement.** Further, oversight and enforcement must extend to all secondary market entities, whether or not they avail themselves of any federal guarantee or other support.
- 5. Secondary market transactions must be transparent and accountable to the public.** Detailed, granular data about the operations of all secondary market entities must be made available to the public on a timely and consistent basis. This includes data about the race, gender, national origin, and other relevant characteristics of borrowers; how a loan was serviced, purchased, and securitized; and the terms and conditions of the loans.
- 6. The system must have an affirmative obligation to offer capital and credit in communities devastated by the foreclosure crisis and offer access to families who were targeted for inappropriate and unsustainable mortgages.** It must engage with community-based financial institutions and community-based organizations to design sustainable solutions that are appropriate for specific locales.
- 7. The housing finance system must provide capital for sustainable rental and ownership development in all communities.** Neighborhoods require affordable and sustainable rental and homeownership opportunities to thrive. Capital, especially that which comes with a

government subsidy or guarantee, should be directed to underserved areas and investments in opportunity-rich neighborhoods. This balance will provide the maximum range of housing choices for all, as there is not currently an adequate supply of affordable housing for underserved families.

- 8. The housing finance system must support product flexibility and sustainable innovation and offer access to institutions of all sizes and in all geographic areas.** To do so requires that the secondary market avoid over concentration and that secondary market institutions have the ability to retain loans in their portfolio. Local institutions are often the first responders to local needs, adapting underwriting models to fit their clientele and funding innovation through their own deposit-based portfolios. Without a secondary market outlet, the volume of these loans will always be constrained. Further, because innovation is not always immediately scalable or easily standardized, it runs the risk of being overlooked by large financial institutions or secondary market purchasers.