The Kirwan Institute for the Study of Race and Ethnicity

National Fair Housing Alliance

National Council of La Raza

Center for Responsible Lending

Poverty and Race Research Action Council

The Opportunity Agenda

PolicyLink

National Urban League

Building Housing and Credit Opportunity for All: A Civil Rights Response to "Reforming America's Housing Finance Market: A Report to Congress"

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Introduction

The undersigned fair housing, civil rights, and consumer protection organizations share the goal of promoting a housing finance system that ensures that all qualified borrowers have access to sustainable and affordable mortgages, regardless of their race or ethnicity, or where they live.[1] A reformed housing system must not steer buyers to higher-priced loans when they qualify for prime mortgages. Ensuring that a reformed housing finance system affirmatively establishes pathways to ownership opportunities for qualified borrowers and safe and affordable rental homes for all families is critical for our economic health as a nation.

There are some laudable principles in "Reforming America's Housing Finance Market: A Report to Congress" (the "White Paper").

- The deregulated private market contributed greatly to the subprime lending and foreclosure crisis.
- Fannie Mae and Freddie Mac's housing affordability goals did not drive the failure of the Government Sponsored Enterprises (GSEs), nor did they drive the subprime crisis.
- There must be affordable rental options in high opportunity communities because many low-income families face high rental burdens.

- Aspiring homeowners must have access to sustainable mortgage products for aspiring homeowners and Americans must "have choices in housing that makes sense for them and for their families."

- Regulatory oversight, consumer protection, access to information, transparency of markets, and accountability in the housing finance market must be strengthened. Many of these reforms are currently being worked out through the Dodd Frank Wall Street Reform and Consumer Protection Act.

- A robust, well-resourced, well-staffed Consumer Financial Protection Bureau is critical to the accomplishment of these goals.

Options 1 and 2 discussed in the White Paper will not achieve these principles. Simply stated, the complete privatization of the housing finance market will fail too many prospective homeowners, renters, and communities. The ongoing subprime and foreclosure catastrophe is only the most recent iteration of private market failure. Therefore, we have focused our response to a discussion of Option 3. Option 3 is characterized by a largely privatized system of housing finance, with the government role limited to providing affordable borrowing options for lower-income consumers through the Federal Housing Administration (FHA), U.S. Department of Agriculture (USDA) and Veteran's Administration (VA), and to providing catastrophic reinsurance.

We address several big picture concerns about the White Paper, including (1) the lack of a detailed plan for ensuring equitable and sustainable access to credit for borrowers; (2) the restriction of affordable housing and credit through overreliance on the FHA; (3) the likely increased costs of mortgages, including under the proposed Qualified Residential Mortgage (QRM) standards; (4) the potential for big banks to grow even bigger; and (5) the lack of a clear data collection process and enforcement structure to support fair lending compliance in the secondary mortgage market. These points are discussed below. We look forward to working with the Administration regarding how we can advance an inclusive, racially just housing finance market that serves all qualified borrowers and all communities equitably.

1. **Any proposal must include an affirmative plan for ensuring equitable and sustainable access to credit.**

The White Paper fails to address the causes and consequences of the dual credit market, which is characterized by plentiful prime credit in high-income neighborhoods, while unnecessarily high-cost, high-risk loans are offered to families and communities of color. The dual credit market does not properly assess risk, in that factors other than a borrower's actual credit risk determined the quality and quantity of credit extended to purchase and refinance consumers. Historically, redlining created credit-starved communities ripe for exploitation. Unfortunately, the demand for credit in underserved neighborhoods was met largely by unregulated brokers peddling the most expensive and riskiest products. People of color were often relegated to products that strip wealth and undermine financial security, rather than stabilizing families and neighborhoods with assets.

Many of the new protections established under Dodd-Frank will address the scams and abuses common in the mortgage market, such as steering, unnecessary prepayment penalties, negative amortization and other risky loan features and lending without ability to repay. However, these regulations alone will not solve on-going credit discrimination and exploitation experienced by communities of color. To complement the newly created consumer protections, an explicit plan for the affirmative promotion of equitable and sustainable credit is needed.

The government must make an affirmative commitment to overcome existing barriers in the mortgage market and create better opportunities for future generations of all Americans. Government must help ensure that all qualified borrowers, especially borrowers of color, receive credit on fair and sustainable terms. Government must also promote robust housing choices in neighborhoods of opportunity. Without this strong government involvement, we may perpetuate barriers to homeownership and its benefits, such as the ability to build savings and other opportunities for subsequent generations.

2. Affordable housing and credit options must be available beyond the FHA.

The White Paper suggests that affordable housing and credit needs would be best served through the FHA. We strongly disagree on this point. We support the continued operation of FHA as a program that provides a path to homeownership for those with limited assets and less than pristine credit records. However, FHA has its shortcomings, and should not be the only -- or even the primary -- type of loan available to borrowers of color and low- and moderate-income borrowers. Recent market experiences illustrate that neighborhoods with excessive levels of FHA lending have been exploited. High levels of fraud in the 1980s and 1990s were devastating to communities that had been flooded with FHA loans. The concentrated foreclosures and consequent high volumes of vacant homes foreshadowed the current foreclosure crisis. Even though FHA rules have since been changed, the damage done to the neighborhoods was never remedied. In order to promote healthy neighborhoods, the housing finance system should foster a competitive marketplace in all communities, giving creditworthy borrowers access to a variety of safe, sound and affordable mortgage options.

FHA holds some other disadvantages for borrowers. FHA loans are often more expensive than conventional mortgages, with higher rates and fees. This makes homeownership more costly for these borrowers and detracts from their ability to build wealth. Further, some sellers are reluctant to accept purchase contracts from buyers using FHA because of the cumbersome program requirements and longer loan approval time. This is true in today's environment, where conventional alternatives are very limited. It is likely to be even more problematic when the private market rebounds, placing borrowers who are forced to rely on FHA at a greater disadvantage in competing for the homes of their choice.

Moreover, the availability of FHA does not translate into widely available credit. This can be seen by the low share of FHA loans made during the subprime boom. The GAO found that from 1996 through 2005, FHA's share of home purchase mortgages declined by 13%, while subprime shares grew by 13%.[2] The biggest declines were in shares to borrowers of color and low-to moderate-income borrowers, while subprime shares to these groups increased. We do not want to set the stage for the resurgence of predatory subprime products, while simultaneously depressing the availability of responsible alternatives.

The government is looking to decrease FHA's share of the market, which makes it even worse to relegate a whole segment of the population to a product that will be harder to get. Recent changes to FHA policies (such as increasing down payments, and minimum FICO scores) have the potential to further limit access for marginalized borrowers and communities. FHA works best in a competitive market where it is one of many options available to a wide range of borrower segments. This is critical in keeping FHA actuarially sound, and in keeping lenders engaged in the low down payment and underserved markets.

3. Any plan must maintain affordability for borrowers.

There are three factors discussed in Option 3 which will increase mortgage costs for borrowers. First, the White Paper acknowledges that the increased costs associated with the government reinsurance would likely be passed through to the borrowers. Second, it is also likely that the QRM exemptions would bias investors to the QRM-market only, to the neglect of the non-QRM pool. Third, higher down payment standards would put homeownership beyond the reach of many otherwise qualified borrowers.

Indeed, some of the particular features being proposed for the Qualified Residential Mortgage (QRM) exemptions under Dodd Frank, if enacted, could price low-to-moderate income borrowers completely out of the market. We are most concerned about proposals calling for a "wealth standard" (i.e. down payment) that would unnecessarily restrict credit to otherwise qualified borrowers. The private market is beginning to move this way already.

The proposed down payment requirements do not accurately reflect risk of default, and could harm potential borrowers without protecting lenders, the financial system or taxpayers. Low down payment loans have been a staple of the mortgage market for decades, and when they are well underwritten, fully documented and fairly priced, they have performed quite well. On the other hand, research *is* clear that mortgage default risk during the subprime crisis was most significantly associated with the terms of the loans themselves, not the characteristics of the borrowers, i.e.: "the broker-origination channel, the adjustable-rate terms, and the prepayment penalty."[3]

Analysis by the Center for Responsible Lending shows that increasing down payments will shrink the mortgage market, without a corresponding improvement in loan performance.[4] Increasing down payments will also slow the housing economy: CRL estimated that it would take 9 years for the typical American family to save enough money for a 10% down payment, and 14 years for a 20% down payment.[5] In 2009, 47% of <u>all</u> borrowers made a down payment of less than 10%.[6] In other words, even a 10% down payment requirement would potentially cut out half of the market.

High down payment requirements would also lock out a majority of renters who have limited cash savings but are ready for homeownership. Fifty-four percent of all households of color are renters and possible aspirants of homeownership, and well over 75% would not be able to meet a 10% down payment requirement.[7] Most higher-income African-American and Latino renters lack sufficient cash on hand to make a 10 % down payment on a median-priced home, because their cash on hand averages a little over $2,000.[8] Higher-income white renters also lack sufficient cash on hand to cover a 10% down payment on a median priced home, with average savings of $5,000.[9] Many of these renters would otherwise have all the qualifications necessary to become successful homeowners but would find a 10% down payment a significant barrier to achieving that goal.

The on-going racial wealth gap is largely represented by disparities in homeownership rates, and the racial homeownership gap is driven by differences in ability to provide a down payment. A July 2011 study by Pew Research reported that the housing bust and the ensuing recession have had a much more devastating impact on the wealth of households of color than for whites, resulting in the largest wealth gaps in the 25 years the data has been collected. From 2005 to 2009, the median wealth holdings of Hispanics declined by 66%, of Blacks by 53%, and of whites by 16%.[10] Despite these barriers and setbacks, owning a home is often the single most important wealth asset for people of color. Increased down payments would continue to throw barriers in the way of a valued and critical asset that can provide intergenerational social mobility.

The combined impact of investor bias and down payment requirements could mean that thousands of credit-worthy borrowers will be locked out of the prime market, and once again forced to rely on high-cost, subprime loans, if they can get a loan at all.

4. **Any plan should support small banks and community lenders, not help big banks get even bigger.**

Community lenders play a critical role in meeting unique borrower needs not easily handled by large, nationwide institutions with highly standardized operations. Research has shown that loans by community lenders are less likely to go into default.[11] Government support for local and community lenders and CDFI's must be radically *strengthened*, not undercut. Local financial institutions need to benefit from the capital raised by the secondary markets. As Sarah Rosen Wartell testified, "without consistent and equitable access to a fairly priced secondary market, the country will be in danger of losing the services of lenders that can meet the needs of their communities."[12] If not carefully constructed to support community lenders, the mortgage market will become increasingly concentrated and the "Too Big to Fail" banks will maintain an unfair advantage over small lenders to the detriment of underserved borrowers. When the White Paper was released, 60% of mortgages were originated through the four largest banks (JP Morgan, Bank of America, Citigroup, and Wells Fargo).[13] The potential for increasing dominance by a few large institutions is especially troublesome because fair housing and fair credit are still today, even in this age of globalization and technology, largely local affairs.[14]

5. **Any plan must include fair lending enforcement and enhanced data collection**

The White Paper is silent on fair lending enforcement in the secondary market. While it recognizes the need for improved reporting and transparency in secondary mortgage market transactions, it glosses over the need for fair lending enforcement. To fairly assess the fair lending performance of the secondary market, enhanced data collection is a must. Federal regulators should gather information about the geographic location of the loans bundled into securities, and the racial, ethnic, and other protected class characteristics of borrowers and they should make the data publicly available.

The Dodd Frank Act has taken steps to ensure consumer protection in the primary market and made numerous changes to the regulation of banks and other financial entities, including the establishment of the Office of Fair Lending and Equal Opportunity within the Consumer Financial Protection Bureau. It also made amendments to the Equal Credit Opportunity Act (ECOA) and the Home Mortgage Disclosure Act (HMDA). Fair lending enforcement in the secondary market is needed to complement the reforms in Dodd Frank, and ensure that communities of color have access to fair and sustainable mortgage products. This requires a regulatory agency that is well resourced, and has fair lending oversight and enforcement as a central component of its mission. Further, oversight and enforcement must extend to all secondary market entities whether or not they avail themselves of any federal guarantee or other support.

Conclusion

Only a housing finance system that is inclusive and fair can be truly safe and sound. We cannot afford to repeat the mistakes of the past. Our organizations are ready and willing to work with the Administration to develop a system that is inclusive and just, that provides housing choices—ownership or rental—for all families in neighborhoods of opportunity, and that provides for wealth building opportunities for generations to come. We look forward to the opportunity to partner with the Administration during this time of momentous change. For further information, please feel free to contact Janis Bowdler jbowdler@nclr.org at National Council of La Raza, Debby Goldberg dgoldberg@nationalfairhousing.org at the National Fair Housing Alliance, or Christy Rogers rogers.441@osu.edu at the Kirwan Institute.

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[12] *Id.* at 4.

[13] *Id.* at 12.

[14] Rogers, Christy et.al. "Fair Housing and Fair Credit in the Wake of the Subprime lending and Foreclosure Crisis: Findings from the Kirwan Institute Initiative." The Kirwan Institute for the Study of Race and Ethnicity. February 2010.