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The Role of Federal Housing Administration Mortgage Insurance in Revitalizing Latino Homeownership

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Submitted by:

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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, 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 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.

NCLR is deeply concerned about the lack of progress in restoring stability and ownership opportunity to the housing market. Not only are Latino families losing their homes at record rates, but many that should be able to take advantage of the newly affordable home prices are unable to access credit. We are hearing from hardworking families from across the country wondering when they will see the effects of economic relief efforts. The Federal Housing Administration (FHA) mortgage insurance program is an important way for Congress and the administration to directly help families begin to rebuild their financial future. Nationwide, millions of families are relying on FHA to purchase their first home or help them avoid foreclosure. This is certainly true for Latino homebuyers, 45% of whom received an FHA mortgage in 2008. While the increase in claim rates against FHA's insurance fund is causing concern, the fact that FHA is fulfilling one of its primary roles in the market by stepping in to lend where others will not is essential.

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 Owner Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to credit. In addition, NCLR is the only 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 FHA borrowers to ensure they are prepared for homeownership and to help them avoid predatory scams.

Working families will not recover economically until jobs return to their communities and the housing market is stabilized. A robust FHA mortgage insurance program that can help guide communities of color and all families hit hard by the recession into homeownership, and maintain their investment through times of fiscal emergency, is an important government recovery tool that must be maximized. FHA has made significant strides in recent years to meet the demand of the market and respond to spikes in unemployment and foreclosures. Still, the program could be strengthened to better serve both borrowers and taxpayers.

In my testimony today, I will discuss the role of FHA in revitalizing homeownership opportunities for communities of color and others underserved by the mainstream market and provide recommendations on how to strengthen the program overall.

Federal Housing Administration

For more than 70 years, FHA has served low- and moderate-income families, often providing their only affordable loan option. During that time, FHA has repeatedly changed the face of the affordable lending market through its product innovations, such as the 30-year amortizing mortgage and low downpayment requirements. While the private market has evolved to offer more affordable products, FHA is unique in its public mission to provide homeownership opportunities to underserved communities. Over the last decade, FHA's share of the market has varied dramatically. In 2001 for example, 35% of all low- to moderate-income homebuyers, and 38% of Latinos, had an FHA-insured mortgage. In 2005, that number dropped to 13% of low- to moderate-income homebuyers and 5% of Latino buyers.[1] In the face of a severe credit crunch, lenders in search of security and liquidity returned to FHA insurance. As a result, the FHA reports that its market share shot up to 30% overall in fiscal year 2009 and 45% among Latino borrowers.

The quality of the FHA program and its ability to positively impact local conditions has also been mixed. In the 1990s, FHA came under increased scrutiny and criticism for lax oversight and accountability procedures that allowed unethical lenders to run flipping refinance scams on vulnerable borrowers and were heavily concentrated in communities of color. Some argued that the lack of oversight also permitted unaffordable mortgages, contributing to FHA's foreclosure rates being higher than conventional loans. As the program lost market share, lenders and industry stakeholders criticized the program's dated technology and processing systems. In high-cost areas, FHA's loan limits were seen as being too low for even the average-priced homes that first-time homebuyers would be seeking.

Underperformance of the FHA program has consequences for the market as a whole. When well-executed, FHA has been a benchmark by which lending to underserved communities can be measured. When it is dysfunctional, the baseline disappears. For example, the combination of challenges the FHA faces contributed to its declining market share in the first half of the decade. As the presence and influence of the FHA eroded, subprime lending skyrocketed to 40% of the market and, in many cases, replaced adequate loan products with risky and volatile substitutes. The devastating effect of toxic subprime mortgages on the housing market and broader economy is well known. Communities of color, low-income families, and first-time homebuyers—FHA's target market—have been disproportionately impacted. In 2009 alone, more than 700,000 Black and Hispanic households are expected to lose their home to foreclosure.[2] On the other hand, a strong, flexible FHA loan program can spur market innovation and provide affordable financing

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[1] Federal Financial Institutions Examination Council, *Home Mortgage Disclosure Act (HMDA) of 1975*, "HMDA National Aggregate Report," http://www.ffiec.gov/hmdaadwebreport/NatAggWelcome.aspx (accessed November 30, 2009).

[2] Center for Responsible Lending, *Projected Foreclosures to Latinos and African Americans by State* (Durham, NC: Center for Responsible Lending, 2009).

alternatives to those of modest means. Underwriting and loss mitigation standards implemented by the FHA program are frequently adopted by other lenders and set the standard for the market.

Economic Recovery through Revitalized Homeownership Opportunities

As the economy continues to struggle and credit remains scarce, all home loan borrowers stand to benefit from a reinvigorated and assertive FHA program. With home prices dipping to new lows, many potential buyers are able to find homes in their price range for the first time. However, few are able to take advantage of the newly affordable home market because they cannot secure financing. This is certainly true for Latino families, many of whom have unique needs that the mainstream market has consistently struggled to meet. For instance, 22% of Latinos do not have enough payment information on file to create a credit score, and one in six does not have traditional banking or savings accounts. Multiple wage-earners and sources of income in a household are also common characteristics of first-time Latino homebuyers. The flexible, prime loans that once accommodated these features have nearly disappeared from the market. FHA loans have become a lifeline for local real estate markets. The importance of keeping credit flowing to communities of color and distressed neighborhoods cannot be understated. Deep-pocketed investors are moving quickly to buy homes before local residents are able to get their financing in order, shifting wealth out of neighborhoods and into the hands of absentee landlords.

An effective FHA mortgage insurance program should fill the gaps in the private home loan market through direct participation and by driving innovation in origination and loss mitigation procedures while also remaining fiscally sound. By shoring up local housing markets, the FHA program can directly contribute to the stabilization of the national economy. NCLR is encouraged by FHA’s recent progress in meeting the needs of potential homebuyers and homeowners at risk of foreclosure. Notwithstanding, the recent increase in claims is an invitation to review what more can be done to strengthen the program and its underlying mission to expand homeownership and prevent home losses and, therefore, future claims. Specifically, NCLR has identified three areas that can be strengthened:

- **Lender review and enforcement.** Much of the unexpected spikes in delinquencies can be attributed to originator behaviors or economic conditions rather than the design of the FHA loan product. According to the FHA’s *Annual Management Report: Fiscal Year 2009*, had loans not been made using seller downpayment assistance programs, known for being a haven for fraud and abuse, its capital reserve ratio would still be at the recommended 2%. In addition, anecdotal reports from housing counselors raise concerns that dubious brokers and lenders that once peddled predatory subprime products have turned to FHA as their primary business vehicle. FHA administrators report that more is being done to screen out bad actors, but there is little transparency in the process. It is also unclear what consequences unethical lenders face for defrauding taxpayers and the federal government and what actions have been taken. More focus should be placed on purging the list of FHA-eligible originators of unethical lenders and enforcing strong protections throughout the life of an FHA loan.

- **Innovative lending.** Successful FHA lending demonstrates how flexible home loans, underwritten according to borrower affordability, can lay the foundation for sustainable homeownership. Low downpayment requirements in particular have allowed millions of families to purchase a home and begin building wealth for their future. On the other hand, the program administrators removed a risk deterrent when they eliminated the pre-purchase counseling requirement for first-time homebuyers. In a shortsighted attempt to compete with the subprime market, administrators canceled the counseling requirement to streamline its underwriting process. To effectively serve first-time homebuyers and other vulnerable borrowers, FHA must maintain its product flexibility and maximize its opportunities to reduce risk through homeownership counseling.

- **Effective loss mitigation.** FHA has strong loss mitigation tools that have successfully kept millions of families in their home. However, these services are of little use to a family that does not receive them. While HUD mandates that servicers of FHA loans aggressively pursue loss mitigation, few resources are dedicated to enforcing this provision. Furthermore, because the mandate is not a right afforded to borrowers and there is no private right of action, individual borrowers that fall through the cracks or are overlooked by servicers have no way to defend themselves against foreclosure. HUD has the right to penalize servicers for failure to implement the loss mitigation program, yet NCLR is unaware of any attempts by HUD to exercise its enforcement power. Newly established loan modification programs, such as Making Home Affordable, have not changed this dynamic. Furthermore, the fact that claim rates are likely to remain high due to unemployment underscores the need for a broader strategy to prevent foreclosures among families that have experienced a temporary or permanent loss of income. In the cases where foreclosure is unavoidable, more can be done to ease the family's transition back into the rental market.

Recommendations

FHA is doing much to fulfill the demand for credit in underserved communities. Administrators have also stepped up their loss mitigation efforts. While economic conditions are presenting new challenges to the program, FHA administrators and policymakers cannot allow these pressures to jeopardize its social mission or shy away from deploying its resources as a recovery tool. A dynamic FHA program is critical to stabilizing the housing market and the broader economy. In that spirit, NCLR makes the following three recommendations to strengthen the FHA program, restore homeownership opportunities, and protect homeowners and taxpayers:

- **Tighten lender standards for the privilege of originating an FHA loan.** When lenders originate FHA mortgages, they borrow a brand that is backed by the full faith and credit of the federal government. Given the trust borrowers place on FHA and the exposure of taxpayers, FHA has an obligation to keep its list of eligible originators free of unscrupulous lenders. NCLR recommends that HUD institute an originator code of ethics under which all FHA originators would pledge to uphold FHA's mission and responsibilities. The code of ethics would serve as a quality control tool and should protect the integrity of the borrower-broker or borrower-lender relationship, promote transparency and prudent underwriting in the mortgage transaction, prohibit pressure sales tactics, and ensure that the borrower has access to accurate and timely information regarding their loan. The code of ethics should be coupled with more rigorous oversight and audit procedures of FHA originators and brokers and meaningful consequences for breaching the code. HUD should also employ monitoring techniques such as accepting consumer complaints, comparing the delinquency rates of lenders to their peers and the market, and interviewing FHA borrowers shortly after closing to evaluate the customer experience.

- **Establish incentives to receive pre-purchase housing counseling.** Congress has invested millions of public dollars into creating a solid housing counseling infrastructure. Families that participate in pre-purchase counseling sessions are less likely to default on their mortgage, preventing foreclosures and future claims. However, since the removal of the housing counseling requirement, fewer borrowers seek out or are informed of this free service. NCLR recommends that FHA establish an incentive in the form of premium discounts for borrowers who successfully complete one-on-one homeownership counseling from a HUD-approved counseling organization in a timely manner before the closing of their mortgage. To ensure that reliable counseling services are available to meet demand, FHA should pay counselors directly for providing advice to FHA borrowers and maintain the integrity of the nonprofit network by adopting high standards of care and professionalism.

- **Make loss mitigation accessible to all FHA borrowers.** HUD must direct greater resources into ensuring that all servicers are following the FHA servicer guidelines mandating loss mitigation. Servicers should be required to demonstrate that borrowers were ineligible for protocols or programs that could prevent the loss of the home before proceeding to foreclosure and certainly before they could file a claim. Failure to do so should be grounds for reversing a foreclosure and come with strict penalties for servicers. Furthermore, HUD should adopt a zero-tolerance policy and vigorously enforce its mandate and fine violators of the statute.

Conclusion

Hardworking families across the country are wondering when economic relief will find them. While the federal government has a number of tools at its disposal, the FHA program is one that is easier to control and should be maximized to the benefit of all families trying to break into homeownership or keep their wealth and equity from evaporating through foreclosure. For most, homeownership represents the bulk of household assets that will help families move more firmly into the middle class. A strong, competitive FHA program should support this goal, especially during a credit crunch. As private capital begins to flow again, FHA should serve as a benchmark for service to low- and moderate-income borrowers, borrowers of color, and others unable to access traditional credit.