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# THE IMPACT OF FHA REFORM ON LATINO AND OTHER UNDERSERVED COMMUNITIES

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"The FHA Reform Act of 2010"

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Submitted by:
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Good afternoon. My name is Graciela Aponte. I am the Legislative Analyst for the Wealth-Building Policy Project at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic[1] civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. I conduct legislative analysis and advocacy on issues pivotal to building financial security in Latino communities, such as affordable homeownership, foreclosure prevention, consumer credit, financial counseling, and credit scoring. For more than seven years, I have been working on issues that impact low-income communities, providing assistance to constituents and nonprofit community-based organizations on behalf of congressional representatives in Maryland and New York City. Prior to joining NCLR, I worked in Prince George's County, Maryland as a bilingual housing counselor at a housing counseling agency that was approved by the U.S. Department of Housing and Urban Development (HUD). I was honored by HUD for outstanding assistance and having a direct impact on the Latino community, making homeownership a reality for many. In addition, I currently serve on the Consumer Advisory Council for the American Association of Residential Mortgage Regulators (AARMR). On behalf of NCLR, I would like to thank Chairwoman Maxine Waters and Ranking Member Shelley Moore Capito 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 Owner Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to credit. In addition, NCLR is the only HUD-approved housing counseling intermediary dedicated to serving 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 that they are prepared for homeownership and to help them avoid foreclosure and predatory scams.

NCLR is deeply concerned about the lack of progress in restoring stability and ownership opportunities 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. Hardworking families from across the country are wondering when they will see the effects of economic relief efforts. The Federal Housing Administration (FHA) mortgage insurance program provides a critical platform through which Congress and the administration can directly help families begin to rebuild their financial future. Nationwide, millions of families are relying on FHA to help them purchase their first home or avoid foreclosure. In fact, in 2008, 45% of Hispanic homebuyers financed their home with an FHA mortgage. While the increase in claim rates against FHA's insurance fund is causing concern, the fact remains that FHA is fulfilling one of its primary roles in the market by stepping in to lend where others will not.

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

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 impact of changes proposed in the "FHA Reform Act of 2010" on Latino and other underserved communities and provide recommendations on how to further 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 down payment 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.[2] 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, a combination of challenges confronting FHA 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. It is estimated that more than 2.3 million Black and Hispanic households are expected to lose their homes to

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

foreclosure between 2009 and 2012.[3] On the other hand, a strong, flexible FHA loan program can spur market innovation and provide affordable financing 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. Meanwhile, investors with deep pockets have moved quickly to buy homes before local residents are able to get their financing secured, 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. The recent increase in claims faced by FHA due to mortgage defaults 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.

FHA is seeking new legislative authority to make the programmatic changes it believes are necessary to bolster the program's balance sheet, improve its relationships with customers and lenders, and better protect taxpayers. NCLR analyzed FHA's proposal for 1) its impact on the ability of Latino homebuyers to secure affordable credit; 2) the extent to which consumers would be protected against fraud, scams, and predatory lending; and 3) the long-term impact on sustainable homeownership and wealth preservation. Specifically, we found that legislative changes will not likely create any new barriers to affordable credit for low- to moderate-income Latino families, but more can be done to expand homeownership opportunities to underserved communities.

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

**Expand Homeownership Opportunities**

The legislative and regulatory changes proposed in the "FHA Reform Act of 2010," including an increased down payment for borrowers with a credit score of 580 or below and increased up-front and annual mortgage insurance, are important to the future financial stability of FHA and are likely to have minimal impact on access to mortgages for the Latino community. However, these changes must go hand in hand with flexible lending models, increased efficiency in FHA underwriting, and mortgage discount incentives for borrowers that seek pre-purchase housing counseling.

Successful FHA lending demonstrates how flexible home loans that are underwritten according to borrower affordability can lay the foundation for sustainable homeownership. In particular, low down payment requirements and flexible underwriting criteria, such as the use of nontraditional credit,[4] have allowed millions of families to purchase a home and begin building wealth for their future. However, our NHN housing counselors are reporting difficulty securing such loans. Some lenders are not accepting any form of nontraditional credit, while others have confusing requirements that make their products difficult to use. FHA is experimenting with nontraditional credit by issuing guidance on acceptable forms of nontraditional credit, but lenders add an additional layer of requirements that makes it difficult for housing counselors to prepare borrowers.

In addition, inefficiencies in the FHA underwriting process are not allowing communities affected by the foreclosure crisis to recover quickly. NHN housing counselors report that the FHA underwriting process is taking an extended amount of time, which is affecting homebuyers' chances to purchase Real Estate Owned (REO) properties, homes for sale through short sale, and other properties. These inefficiencies also allow investors instead of first-time homebuyers to snatch up properties.

Finally, NCLR is disappointed that FHA did not take this opportunity to reinstate the pre-purchase housing counseling requirement for first-time homebuyers. In a shortsighted attempt to compete with the subprime market, administrators canceled the counseling requirement to streamline the underwriting process. Families that participate in pre-purchase counseling sessions are less likely to default on their mortgage, preventing foreclosures and future claims.

To effectively serve first-time homebuyers and other vulnerable borrowers, FHA must promote flexible lending models, increase efficiency in underwriting, and maximize its opportunities to reduce risk through homeownership counseling.

[4] Nontraditional credit can be used when a borrower does not have a credit score. A borrower should provide documentation to the lender of timely rental payments for the past 12–24 months, as well as other sources of on-time payments to creditors. Lenders have different requirements for what type of nontraditional credit is acceptable.

**More Needs to Be Done to Protect Future Homeowners**

NCLR supports the changes proposed in the "FHA Reform Act of 2010," which would boost FHA's ability to police lenders that originate loans with FHA backing. These changes include the expansion of indemnification provisions to all direct endorsement lenders and authority for FHA to withdraw originating and underwriting approval for a lender nationwide based on the performance of its regional branches. However, further improvements to transparency and enforcement in policing of unethical lenders are critical.

Much of the unexpected spikes in delinquencies can be attributed to imprudent or predatory 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 down payment assistance programs, known for being a haven for fraud and abuse, its capital reserve ratio would still be at the recommended 2%. Moreover, anecdotal reports from housing counselors raise concerns that dubious brokers and lenders who once peddled predatory subprime products have turned to FHA as their primary business vehicle.

While we are pleased that FHA has taken steps to make its lender enforcement more accountable through transparency, we are concerned this may not be enough. In an initial review of the Neighborhood Watch Early Warning System, the online tool was difficult to navigate and did not seem user-friendly. That said, we understand that the system is new. We hope to work with HUD to continue to expand and improve the site, including a portal for FHA borrowers to submit complaints and a place for the public to review these complaints.

FHA should provide strong protections for first-time homebuyers by increasing transparency and enforcement. These improvements will help screen out bad actors and give borrowers an opportunity to become first-time homebuyer.

**Boost Foreclosure Prevention Efforts to Stabilize Communities**

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 who fall through the cracks 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 (MHA), have not changed this dynamic. In fact, a recent survey completed by 13 national HUD-approved housing counseling intermediaries found that 76% of housing counselors rate the knowledge of mortgage servicers of FHA mortgage insurance loss mitigation tools as **fair or poor**.[5] Moreover,

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[5] Housing counseling survey conducted by NCLR in January 2010. Actual question: "Rate the performance of mortgage servicers participating in the MHA program on the following services. Knowledge of FHA mortgage insurance loss mitigation tools." **Excellent=1.6%, Good=21.9%, Fair=49.7%, and Poor=26.7%.**

counselors report mortgage servicers are initiating foreclosures prior to evaluating whether a borrower is eligible for MHA.[6]

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

We applaud FHA for fulfilling the demand for credit in underserved communities. Moreover, NCLR supports the changes proposed in the "FHA Reform Act of 2010" to provide future financial stability to the program. While economic conditions are presenting new challenges to the program, FHA administrators and policymakers cannot allow these pressures to jeopardize FHA's 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 recommendations to strengthen the FHA program, restore homeownership opportunities, and protect homeowners and taxpayers:

- **Increase transparency and enforcement in FHA lending.** 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 FHA develop a portal for complaints from FHA borrowers. This portal can be added as an enhancement to the existing FHA Neighborhood Watch Early Warning System. Complaints that are submitted should be investigated by FHA staff and made public.

- **Provide incentives to borrowers who seek homeownership counseling, and increase access to flexible lending models.** Congress has invested heavily in 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. NCLR recommends that FHA establish an incentive for borrowers who successfully complete homeownership counseling from a HUD-approved counseling agency before the closing of their mortgage. Incentives can include discounts on the up-front and annual mortgage insurance premiums and a lower down payment requirement. In addition, FHA can increase access to flexible lending products by providing clarification on what documentation is acceptable for nontraditional credit for all lenders so that housing counselors can prepare their borrowers. And finally, to boost the efficiency of the FHA underwriting process, FHA should implement a streamlined system for homebuyers interested in purchasing REO and short-sale properties. This will

[6] Housing counseling survey conducted by NCLR in January 2010. Actual question: "MHA guidelines require servicers to evaluate whether a borrower is eligible for MHA before initiating a foreclosure. In your experience, how consistently is this guideline followed?" **Always=3.1%, Usually=24.9%, Sometimes=28%, Rarely=36.8% and Never=7.3%.**

help get foreclosed homes off the market and to ensure that first-time homebuyers have access to properties before investors.

- **Increase funding for HUD-approved housing counseling agencies.** To ensure that reliable counseling services are available to meet demand, FHA should pay counselors directly for providing advice to FHA borrowers. Also, Congress should increase funding for housing counseling to $100 million, an increase of $13 million from last year, and $180 million for foreclosure prevention counseling, an increase of $67 million, and the original amount of funding that was allocated to address the foreclosure crisis. In addition, NCLR calls on industry leaders to support foreclosure intervention services through funding and partnerships.

- **Make loss mitigation accessible to all FHA borrowers, and enforce its proper use by servicers.** 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. Such duties are included in the "Foreclosure Mandatory Mediation Act of 2010" (H.R. 4635) and Chairwoman Waters's "Foreclosure Prevention and Sound Mortgage Servicing Act of 2009" (H.R. 3451).

## 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.