

CHALLENGES AND OPPORTUNITIES FOR HOMEOWNERSHIP IN A CHANGING FINANCIAL ENVIRONMENT

On May 6, 2009, the Federal Reserve Bank of San Francisco and the Greenlining Institute hosted a day-long symposium to look at the *challenges and opportunities for homeownership in a changing financial environment*. The symposium brought together bankers, representatives from the GSEs and government agencies, housing counselors, advocates, researchers and other categories of stakeholders interested in discussing the future of mortgage lending for low-mod-income and underrepresented borrowers and the impact that foreclosures have had on these communities.

Following a welcome by Scott Turner, director of community development at the Federal Reserve Bank of San Francisco, Orson Aguilar, executive director of the Greenlining Institute, kicked off the meeting with the question, “Why spend a day talking about housing?” This question was answered by an engaging lineup of speakers who shared their perspective on the critical role that housing plays in our lives and the extent to which its importance has been illuminated by the still unresolved foreclosure crisis.

This summary provides some of the key takeaways from the day that were revealed both in the presentations by the speakers and in the comments and questions from the attendees. Material from the event is posted on our website at <http://www.frbsf.org/community/resources/archive.html>. Ultimately, a day spent talking about housing uncovered additional topics for research as well as potential solutions that can increase our effectiveness in expanding and sustaining homeownership.

Below are some of the significant findings and recommendations:

African American and Latinos are significantly more likely to be seriously delinquent or in foreclosure than white borrowers, even after controlling for differences in credit score and income. Key factors in this outcome are related to where these borrowers obtained their loan, changes in housing and employment markets, the loan terms, and the credit and socio-economic characteristics of the borrower.

After statistically controlling for the likelihood of a high-cost loan and associated “unobservable” characteristics, the higher foreclosure rate for African Americans goes away while Latinos are still more likely to be in foreclosure. Key factors underlying this difference may be explained by language and seasonal employment. The question of undocumented borrowers using ITIN mortgages is unlikely to be significant given the very small volume of these mortgages.

A regulatory landscape that increases oversight at all levels will result in uniformly consistent underwriting practices and greatly ensure equal access to appropriate credit products for all borrowers. A majority of subprime lending was done by non-CRA regulated institutions and outside of CRA-designated assessment areas – even though some these were affiliated banking companies.

Intermediary organizations such as nonprofit housing agencies can help to close the gap in information for high minority communities and increase access to regulated financial institutions. Deceptive marketing by subprime lenders played into the fears of consumers and focused on negative issues in high-minority communities resulting in a greater likelihood that the borrowers would receive an inferior loan product even when borrowers qualified for prime lending products.

Borrowers that worked with nonprofits and received financial education and other high touch services have a higher success rate. However, the question of mandating financial education isn't clearly answered given the cost that it could add to the homeownership transaction and the capacity of nonprofit or government agencies to provide it. In California alone there are over 500 programs offering financial and homebuyer education. How do they get funded? Should financial education be mandated in school?

Creative and alternative assessment of risk can help to overcome the perceived credit risk between minorities and whites. For example, capturing an alternative debt repayment history may be more inclusive of currently marginalized communities.

Prudent underwriting clearly matters. Certain principles such as the borrower's ability to repay the mortgage as evidenced by current debt to income, credit history, and commitment to the transaction such as a down payment should underlie every loan transaction.

While securitization has been good for increasing liquidity and expanding credit, it has also contributed to a less regulated mortgage banking industry, which increasingly became broken over the past several years. Private capital was used to expand mortgage delivery among non-regulated lenders, many of whom offered products that went beyond the standards of bank lending guidelines. For banks, the objective is to not only originate a mortgage and make a profit, but to keep the customer for the lifetime and provide access to a full line of financial products.

Dr. Chris Herbert noted that a lack of savings for downpayment and closing costs is the most important barrier for low-income households and recommends that downpayment assistance be delivered through matched savings programs which can help to demonstrate buyers' ability to save and ensure that the buyer has personal equity invested. The big question again is how might these savings programs be funded?

Flexible underwriting can also successfully help to address the financial barriers to homeownership by low-income and minority households and does not necessarily lead to higher default rates. Government direct lending programs that serve riskier borrowers such as FHA and more flexible mortgage products developed by Fannie Mae and Freddie Mac during 1990s contributed to an increase in homeownership among low-income and minority households.

The full benefit of homeownership is only realized if homeownership is sustained over a number of years. Homeownership is most appropriate when households are able to handle both unexpected and general maintenance costs as well as income loss.

Homeownership must be viewed as a point along the continuum of asset building that prepares the purchaser to benefit fully from the experience. Some homeowners in heavily subsidized homeownership express feeling like “glorified renters.” Rent-to-own may be a scalable strategy for moving a person from renter to homeowner over time. Energy efficient mortgage is another innovation that has the potential to lower the carrying cost for homeowners, thereby increasing the sustainability of homeownership.

Loss mitigation and foreclosure prevention efforts still seen as inadequate and are essential to reducing the disproportionate impact that this crisis has had on historically disadvantaged homeowners and communities. Information about the quality and volume of loan modifications is opaque and does not clearly convey which servicers are working productively with borrowers and what kind of outcomes are being achieved. Data about loan modifications should be disaggregated by servicer. Additionally, the process for assisting borrowers could be improved simply by harmonizing the in-take forms among all of the major servicers.

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