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The Role of the 30-Year Fixed-Rate Mortgage in Maintaining the Pathway to Sustainable Homeownership for Hispanic Families

Presented at

Housing Finance Reform: Continuation of the 30-Year Fixed-Rate Mortgage

Submitted to
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Submitted by
Janis Bowdler
Director, Wealth-Building Policy Project
Office of Research, Advocacy, and Legislation
National Council of La Raza

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Raul Yzaguirre Building
1126 16th Street, NW
Washington, DC 20036

www.nclr.org

Good morning. My name is Janis Bowdler. I am the 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 that are critical to building financial security in Latino communities, such as homeownership, consumer credit, auto lending, and financial planning. In this capacity I have produced a number of publications on related issues, including *The Foreclosure Generation: Long-Term Impact of the Housing Crisis on Latino Families and Children*; *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*.

The NCLR Wealth-Building Policy Project promotes fair and accessible financial markets where Latino families have the opportunity to obtain assets and build wealth in a manner that will last a lifetime and can be shared with the next generation. NCLR conducts research and analysis on public policy affecting the financial security of Latino families, such as threats to sustainable Hispanic homeownership, access to affordable financial services, and access to affordable credit. The NCLR Homeownership Network (NHN) provides financial, homebuyer and foreclosure prevention counseling to more than 65,000 families annually. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic community development financial institution (CDFI). Since 1999, RDF has leveraged more than $680 million in financing for local development projects throughout the country. This work has increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation on financial services markets.

I hope that today's hearing will shed light on a critical issue—the viability and advantages of the 30-year fixed-rate mortgage. For nearly eight decades, 30-year fixed-rate mortgages have put homeownership within reach of America's middle class and first-time homebuyers. Long-term financing allows credit to be extended at a price that is affordable to middle-income families, and the fixed rate provides certainty around housing costs. Without this flexible financing tool, homeownership will become a luxury reserved for the affluent, and the majority of families will be left without the appreciable asset that has long been the cornerstone of middle class wealth.

In my testimony today I will discuss the role of the 30-year fixed-rate mortgage and explain its advantages for homeowners. I will also share our perspective on how to maintain a viable path to homeownership for future generations of homebuyers.

Advantages of a 30-Year Fixed-Rate Mortgage

The 30-year fixed-rate mortgage has become so ubiquitous that some have taken its benefits for granted. However, such financing has not always been available. Prior to the creation of the Federal Housing Administration (FHA) in 1934, most loans were limited to 50% of the home value, which means that a family would have to pay the other 50% in cash to purchase a new home. Such loans were often short-term notes where a family would have to refinance every few years to cover the final balloon payment. Even this payment schedule could not be counted on. In the lead-up to the Great Depression, cash-strapped banks could "call" the note for immediate replayment, forcing many into foreclosure.[1] President Franklin D. Roosevelt and Congress responded by creating FHA mortgage insurance to reduce barriers to purchasing a home and provide banks and consumers with certainty and predictability in the transaction. This, along with the introduction in 1938 of the Federal National Mortgage Association, popularly known as Fannie Mae, standardized the 30-year fixed loan and made it available nationwide.

The 30-year fixed-rate mortgage remains an essential financing tool for homebuyers in the modern mortgage market. By spreading the cost of the home purchase over a 30-year term, the asset becomes more affordable. The fixed interest rate provides certainty, allowing a family to budget their housing costs and make long-term financial plans. Modest downpayment requirements have opened the doors of homeownership to families with incomes sufficient to cover monthly mortgage payments and maintenance costs but who lack the family wealth for a high downpayment. The amortization feature of the 30-year fixed-rate loan means the borrower knows when the final payment will be due and their family wealth grows as principle is repaid. Finally, most prime 30-year fixed-rate notes are prepayable, which means the homeowner can refinance their loan or sell without penalty.

The standard structure of the 30-year mortgage has opened homeownership to millions of families over the last seven decades. As a result of this financing tool, two out of three Americans own their own home today, the vast majority of whom relied on some type of mortgage to finance their purchase. Building wealth through home equity can fuel retirements, business ownership, and the advanced education of one's children. Those fortunate enough to own their home or land are able to pass their wealth to their children, a practice that has helped expand America's middle class.[2] Even without dramatic increases in home values, the home acts as a forced savings account that captures some of the income put toward house payments, which is unavailable for individuals who do not own their homes. Over the last 50 years until the most recent recession, wealth among American households grew steadily, peaking at $65 trillion in 2007.[3] While home equity does not account for the entirety of that wealth, a home is still the highest valued asset for most Americans. This is especially true for Hispanic and Black homeowners, for whom home equity makes up 65% and 59% of household wealth, respectively. For Hispanic households, no other asset type besides a home—e.g., interest-earning assets at financial institutions—constituted more than 10% of total net worth in 2005.[4]

Unfortunately, the benefits of homeownership have not been equally available to all. Historical discrimination in the distribution of land, unfair restrictions on FHA mortgage insurance and redlining, and exploitation by predatory subprime lenders has left communities of color with

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[1] Jacob Gaffney, "This housing crisis is the not the Great Depression," *HousingWire*, June 16, 2011, http://www.housingwire.com/2011/06/16/this-housing-crisis-is-not-the-great-depression (accessed October 16, 2011).

[2] Melvin Oliver and Thomas Shapiro, *Black Wealth, White Wealth: A New Perspective on Racial Inequality* (New York: Routledge, Taylor & Francis Group, 2006).

[3] Chris Isidore, "America's lost trillions," *CNN Money*, June 9, 2011, http://money.cnn.com/2011/06/09/news/economy/household_wealth/index.htm (accessed October 17, 2011).

[4] Paul Taylor, Richard Fry, and Rakesh Kochhar, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics* (Washington, DC: Pew Research Center, 2011).

lower homeownership and wealth rates.[5] Latino and Black homeowners were more likely to receive exotic mortgage products, even when they had solid credit that warranted a sustainable 30-year fixed loan.[6] When the toxic mortgages began to reset and brokers and lenders could no longer maintain their refinance schemes, a recession ushered in record-high foreclosure rates. Since the dawn of the crisis in 2007, more than six million homeowners have lost their home to foreclosure.[7] The foreclosure crisis has been particularly acute among Latino homeowners. For example, nearly half of foreclosures in California have been on Latino families.[8] In fact, recent research revealed that wealth in White households exceeds that of Hispanic households by a staggering 18-to-one ratio and by 20-to-one for Black households—a gap that is attributable largely to differences in home equity and the loss of homes through foreclosure.[9]

Our present foreclosure crisis demonstrates the importance of preserving the standard 30-year fixed-rate mortgage. Critics of the 30-year fixed note argue that families pay a premium in their interest rates for the benefit of extending the term. However, most families do not view their home as a strict financial transaction or a get-rich-quick scheme. Rather, they are investing in a nest egg and a community with the anticipation of long-term returns. Most homeowners are not in the position to play the markets or hedge interest rate risk. The predictability and security of a 30-year fixed-rate mortgage is worth a modest premium in the interest rate.

Paving the Way for Sustainable Homeownership

Research shows that families who lack the cash for high downpayments can be successful in a well-underwritten prime mortgage.[10] The Center for Community Capital compared low-income homebuyers who received flexible but responsible conventional prime mortgages with similarly situated borrowers who received subprime mortgages. Those with subprime loans have suffered foreclosure at a rate three to five times that of borrowers who received flexible yet responsibly underwritten 30-year fixed loans. In fact, not only were the borrowers with the responsible loans less likely to foreclose, they also gained an average of $20,000 in home equity as of 2009. NCLR's experience with Latino first-time homebuyers tells a similar story. Over the last 13 years, NHN counselors have helped more than 25,000 moderate-income families purchase a home with prime mortgages. Counselors overwhelmingly report that few, if any, of their clients

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[5] Meizhu Lui et al., *The Color of Wealth: The Story behind the U.S. Racial Wealth Divide* (New York: The New Press, 2006).
[6] Robert B. Avery, Kenneth P. Brevoort, and Glen Canner, "The 2007 HMDA Data," *Federal Reserve Bulletin* 94 (December 23, 2008); and Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (Durham, NC: Center for Responsible Lending, 2006). For a review of predatory practices aimed at Hispanic families see Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market* (Washington, DC: National Council of La Raza, 2005).
[7] Center for Responsible Lending, "Snapshot of a Foreclosure Crisis," 2010, http://www.responsiblelending.org/mortgage-lending/research-analysis/snapshot-of-a-foreclosure-crisis.html (accessed October 17, 2011).
[8] Debbie Gruenstein Bocian et al., *Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis* (Oakland, CA: Center for Responsible Lending, 2010).
[9] *Wealth Gaps Rise to Record Highs.*
[10] Lei Ding et al., *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, working paper (Chapel Hill, NC: UNC Center for Community Capital, 2010), http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf (accessed October 17, 2011).

who received counseling before they bought their home returned for foreclosure prevention counseling. This evidence shows that when families receive the right loan with the right support, they can be successful and sustainable homeowners and build wealth—even with modest incomes and low downpayments.

Several decades of innovative affordable lending have taught us how to mitigate the risk of extending credit to first-time homebuyers, low-wealth borrowers, and underserved communities. For example, mortgage insurance—a longstanding requirement by lenders and investors on home loans where the loan-to-value (LTV) ratios exceed 80%—allows banks and credit unions to lend safely and responsibly to qualified families with higher LTVs. Analysis conducted on behalf of Mortgage Insurance Companies of America (MICA) of 43 million loans made between 2001 and 2008 with LTVs up to 97% found that those with mortgage insurance outperformed noninsured loans, and performed well considering the economic downturn.[11] Housing counseling is another excellent risk way to mitigate risk. Research shows that objective advice from an independent, trained housing counselor prior to purchase effectively reduces the likelihood of default.[12] Similarly, recent research has shown that counseling during a delinquency improves cure rates and lowers rates of redefault.[13] Finally, a homeowner's own savings can provide a cushion in times of unexpected financial distress. Modest-income borrowers would better positioned to manage unexpected expenses if they have some cash liquidity, rather than storing all of their cash savings in their home via a large downpayment.

Moreover, the affordable housing market continues to innovate with the 30-year fixed loan as a foundation. New tenure forms, such as community land trusts, lease-purchase, and shared equity mortgages, can help families take important steps toward ownership with far less risk overall to the lender, consumer, and the market. Affordability tools such as "soft second" loans and mortgage revenue bonds often used by housing finance agencies can reduce the upfront cost of realizing homeownership.[14] To achieve scale that is sufficient to move such options into the mainstream housing market, these innovative approaches require the same ingredients that made the affordable 30-year fixed mortgage a market standard: secondary market liquidity, credit enhancements, and a stable, competitive marketplace. Of course, deciding to buy a home is a major family decision and must come at a time when a family is financially prepared. Therefore, policymakers must also support a robust rental market that provides affordable options for future buyers and families for whom homeownership is not desirable or possible.

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[11] MICA regulatory comment letter on credit risk retention, August 1, 2011, http://www.privatemi.com/news/pressreleases/attachments/MICA_QRM_Letter.pdf (accessed October 17, 2011). Specifically, see attached analysis: Kenneth Bjurstrom, Johnathan Glowacki, and Tanya Havlicek, *Mortgage Insurance Loan Performance Analysis as of March 31, 2011*, July 28.

[12] Abdighani Hirad and Peter M. Zorn, "A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling" (Joint Center for Housing Studies, Low-Income Homeownership Working Paper Series, Boston, 2001).

[13] Neil Mayer et al., *National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects September 2010 Update* (Washington, DC: The Urban Institute, 2010).

[14] For a review of five successful examples, see David Abromowitz and Janneke Ratcliff, *Homeownership Done Right: What Experience and Research Teach Us* (Washington, DC: Center for American Progress 2010), http://www.americanprogress.org/issues/2010/04/pdf/homeownership_done_right.pdf (accessed October 17, 2011).

Despite all of the evidence demonstrating the importance and viability of affordable 30-year fixed-rate mortgages, this market staple is restricted in the current credit environment. The January 2008 Federal Reserve Senior Loan Officer Opinion Survey revealed that a significant number of prime lenders had tightened their credit standards, and subsequent surveys show that little change has occurred over the last three years. The Community Reinvestment Association of North Carolina found that loan-level pricing adjustments (LLPAs) imposed by Fannie Mae and Freddie Mac add significant costs to loans and reduce access to credit, particularly for Latino and Black homebuyers.[15] Furthermore, challenges have surfaced among FHA loans, which have been the primary financing tool available to borrowers of color since the collapse of the mortgage market. The National Community Reinvestment Coalition revealed that national lenders were layering additional credit criteria on FHA mortgages, thereby restricting their availability.[16] Consequently, despite the average 30-year mortgage rate having dropped to below 4%, fewer borrowers are able to take advantage of the low rates and lower home prices.

The threats to affordable, long-term housing financing are not limited to today's credit crunch. Unfortunately, the future availability of affordable 30-year fixed loans for working families is in question. Earlier this year federal bank regulators promoted the idea of a wealth standard in their proposed risk retention rule, which would unnecessarily cement high downpayment requirements in regulations. The idea of requiring a high downpayment for loans secured by Fannie Mae and Freddie Mac and those insured by FHA was also introduced by the Department of Housing and Urban Development and the Department of the Treasury in a white paper sent to Congress.[17] Such strict regulatory requirements will decrease the availability of responsible and affordable credit to qualified families. Critics of Fannie Mae and Freddie Mac are going further by pushing for a complete dismantling of our current secondary market system through privatization, even though lenders—especially small community lenders—say that they would not be able to offer fully amortizing 30-year notes in a completely private system.[18]

Recommendations

Rather than dismiss a proven finance tool such as the 30-year fixed-rate mortgage and affordability features such as low downpayments, policymakers should be exploring those factors that set families up for success. The conservatorship of Fannie Mae and Freddie Mac is

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[15] Adam Rust, *The New Hurdle to Homeownership: How Loan Level Pricing Changes the Cost and Access to Credit* (Durham, NC: Community Reinvestment Association of North Carolina, 2011), http://cra-nc.org/sites/cra-nc.org/files/pdf/The%20New%20Hurdle%20to%20Home%20Ownership.pdf (accessed October 16, 2011).

[16] National Community Reinvestment Coalition, *Working-Class Families Arbitrarily Blocked from Accessing Credit* (Washington, DC: National Community Reinvestment Coalition, 2010), http://www.ncrc.org/images/stories/mediaCenter_reports/fha%20white%20paper-120810-final.pdf (accessed October 17, 2011).

[17] U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, *Reforming America's Housing Finance Market*. Washington, DC, 2011, http://portal.hud.gov/hudportal/documents/huddoc?id=housingfinmarketreform.pdf (accessed October 18, 2011).

[18] See: Lew Sichelman, "The End of the 30-Year Fixed Rate Mortgage?" *Urban Land*, June 22, 2011, http://urbanland.uli.org/Articles/2011/June/Sichelman30yr (accessed October 17, 2011). In this article, Sichelman quotes members of the mortgage industry asserting that the 30-year fixed-rate mortgage would become either extremely expensive or disappear altogether without the secondary market liquidity provided by Fannie Mae and Freddie Mac. Sichelman also quotes critics who question the benefits of fixed-rate financing and argue for a fully privatized housing finance system.

neither desirable nor sustainable from a public policy or market perspective. However, we caution against throwing away portions of our housing finance system that work well. In a letter to President Obama, NCLR and 16 other civil rights organizations outlined a set of principles to guide housing finance reform in a manner that ensures equitable and sustained access to credit for all qualified homebuyers. I have attached a copy of this letter for the record.

Without the advantages of long-term fixed-rate financing, many qualified, middle-income families will be shut out of homeownership opportunities, particularly Hispanic and Black borrowers and other low-wealth households. Policymakers should take steps to strengthen the role of the classic, 30-year fixed-rate mortgage and other market innovations that build off its success. In addition to the principles outlined in the attached letter, NCLR offers three specific recommendations to the committee:

- **Maintain secondary market liquidity for affordable 30-year fixed-rate loans that are made equally available to all qualified families.** The 30-year fixed mortgage is the foundation of affordable homeownership. A robust secondary market that provides liquidity throughout the nation is critical to keeping this popular home financing tool broadly available to working families. The federal government must 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 parity between communities of color and Whites. Families should not be relegated to substandard mortgage products because a bank refuses to lend in their neighborhood or employs discriminatory practices. Such policy implementation should be further bolstered by support for a robust, integrated, and affordable rental market.

- **Support prepurchase housing counseling and other credit enhancements.** Prepurchase counseling has been shown to serve as a credit enhancement by reducing the likelihood of default. Yet funding for this proven method of reducing risk was eliminated by Congress and the administration for fiscal year 2011. Recently, the Senate Appropriations Committee passed the Transportation and Department of Housing and Urban Development appropriations bill with $60 million allotted for housing counseling. While this represents a serious cut from the industry high of $87.5 million in fiscal year 2010, it is a critical step in restoring the program. NCLR also calls on the private mortgage industry to step up its support for housing counseling. Lenders, investors, and mortgage insurers benefit from a well-educated consumer. The industry has long viewed housing counseling as a philanthropic endeavor, but we encourage financial institutions to create business partnerships with nonprofit counseling providers. Finally, credit enhancements such as housing counseling, mortgage insurance and shared equity models require the support of Fannie Mae and Freddie Mac to achieve scale. The entities should leverage proven and promising approaches in their current lending, and policymakers must ensure that this element is maintained as we reform our housing finance system.

- **Reduce barriers to financing experienced by today's borrowers.** Rigid credit markets are making it difficult for working families to obtain mortgages. This slows the recovery of the housing market and leaves neighborhoods at the mercy of absentee investors with little interest in the up-keep of the property or its impact on the surrounding community.

These burdens could be reduced with the elimination of LLPAs and the use of proven underwriting criteria such as modest downpayments for counseled borrowers.

Thank you. I would be happy to answer any questions.