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DEVELOPING THE NEXT GENERATION OF LATINO LEADERS®

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Recovering the American Dream for Latino Families:

Expanding Affordable Homeownership through Public Private Partnerships

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For most Americans, owning a home symbolizes stability, success, and something to buffer against hard times. Homeownership also represents an important asset on the path to achieving economic security. Sadly, despite dramatic growth in population, Latinos have trailed other American communities in attaining and benefitting from homeownership.

This brief will explore strategies to expand safe and affordable homeownership for low-income families, especially Latinos and other communities of color. Specifically, the brief will review how a program similar to the Low Income Housing Tax Credit program (LIHTC) could be used to expand targeted homeownership for low-income families throughout the US.

Family Wealth

According to the 2010 Census, Latinos make up 16 percent of the country, a 43 percent increase since 2000. (Pew 2011) By the year 2050, Latinos are projected to become the majority ethnic group in the United States at 29 percent of the population. (Pew Hispanic) This explosive growth in population has not been matched by a growth in economic assets and family wealth.

While income measures the amount of take home pay a person receives, wealth is a measure of an individual or family's economic assets minus its debts. (Kochkar) Wealth can be used to finance a family member's education or business endeavor and acts as a cushion to financial hardship such as loss of a job, sickness, and other types of situations that bring economic distress. (Carasso) While income inequality is often mentioned in the news media, the disparity between white and non-white family wealth in the US is extremely striking. For instance, Latino households have less than $0.16 in wealth for every $1 held by white families. (Pew)

Homeownership, Redlining and the Foreclosure Crisis

Disparities in wealth can be blamed at least in part for large disparities in homeownership. A family's home usually represents a large portion of a family's economic assets, and for those making less than $50,000 annually, a home accounts for more than half. (HUD iii) Sadly, Latinos and other communities of color have faced historic discrimination in access to homeownership and own their homes at a much lower rate than white families. While the white homeownership rate is 73 percent, Latino homeownership rates are closer to 46 percent. (HUD)

Historic discrimination in homeownership for Latinos and African-Americans emerged from both the public and private sectors. The GI Bill of 1944, which helped 2.5 million veterans do everything from buy their first homes to pay for college, was generally unavailable to non-white Americans. (De Lweeuw 10) Until 1968, the Federal Housing Administration denied loan guarantees based on race. (Urban Institute 5) Redlining—the practice of illegally denying lending loans and insurance to specific communities based on race—was a common practice at banks and insurance companies until the late 1960s and early 1970's. This overt practice was ended by the Fair Housing Act of 1966 and the Home Mortgage Data Act of 1975. In the following decades, homeownership in Latino communities improved but, due to historic discrimination, consistently trailed average American homeownership rates.

More recently, the foreclosure crises of 2006 and 2008 has taken an especially severe toll on Latinos and other communities of color. Due to predatory lending and mortgage steering, or steering prime-rate borrowers into subprime loans, Latinos were much more likely than white borrowers to be the recipients of subprime loans during the early 2000s housing boom. (Borcian 5) According to a study by the Center for Responsible Lending, African-Americans and Latinos with excellent credit scores (660 FICO scores and higher) were three times more likely to take out a high-cost mortgage as compared to whites. (Borcian 5). In 2012, Wells Fargo agreed to pay $175 million to settle claims that its

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mortgage brokers had unfairly steered Black and Latino borrowers into subprime mortgages when they qualified for less costly prime rate mortgages. (Savage)

These unfair lending practices cost the Latino community two-thirds of the home equity built during the preceding decade. According to a report by the Pew Research Institute, "the net worth of Hispanic households decreased from $18,359 in 2005 to $6,325 in 2009. The percentage drop—66 percent—was the largest among all groups." A report by the National Community Reinvestment Coalition found that, among recent borrowers, Latinos and African-Americans were almost twice as likely to face foreclosure as white borrowers. (Carr 5) The report also found that foreclosures were likely made worse by the specific geographic concentration in areas hit hardest by foreclosures (California, Florida, and Nevada). (Pew 5)

Expand Low-Income Homeownership through a new Homeownership Tax Credit

Despite the need for homeownership at all levels of society, the majority of government subsidy flows to wealthier families in the form of the Mortgage Interest Deduction. (Belsky 4) In light of both historic discrimination in homeownership and more recent predatory lending practices, there should be a concerted effort at the Federal level to address the homeownership gap currently plaguing Latinos and other communities of color.

One innovative way to expand homeownership among low-income families is to create a tax program modeled on the successful Low-Income Housing Tax Credit program (LIHTC). The LIHTC program, created as a part of the Tax Reform Act of 1986 and based on Section 42 of the Internal Revenue Code, is the primary way in which most new and rehabilitated affordable rental housing is created. Amongst housing subsidy programs, this program is unique in its overt reliance on private-sector capital to enable the creation of low-income housing. While the LIHTC program can be used to finance homeownership opportunities for low-income families, the program's regulatory structure makes this cumbersome and difficult for most developers. Following the original intent of the program, the vast majority of program financing is directed towards the creation of new and substantially rehabilitated rental housing.

The LIHTC program as it currently exists may not be the ideal way for the federal government to support low-income homeownership, but a new program utilizing the tax credit concept could be successful. First, the program's focus on incentivizing private sector capital for affordable housing directly leverages the expertise and knowledge of the real estate field specifically for low-income families. Second, the program only pays for success. Investors in the program receive the full value of the tax credits over a ten-year period, but face a fifteen-year period in which they are responsible for ensuring that the property is successful. During that time if the property does not meet program standards, the credits can be or taken back. (Joint Center 6) Third, because it produces a fair return for participant investors and developers, a broad constituency has developed that is willing to advocate on its behalf to policymakers.

Versions of this idea have occurred in previous, bi-partisan forms. Some earlier iterations include the Home Ownership Tax Credit Act of 2001 (H.R. 2033) introduced by Congresswoman Roybal-Allard, the Renewing the Dream Tax Credit which was proposed by the Bush Administration in 2002, and the Community Development Homeownership Tax Credit Act of 2002 (S. 859) introduced by Senator Kerry. While there were differences in each of these proposals, the bi-partisan nature and recurrence of a tax-credit for homeownership show this is a viable idea whose time has come.

How Does the Low Income Housing Tax Credit program work?

The LIHTC program is generally known, and rightly so, as a complicated program. While there are many nuances to it, the basic structure of the program is as follows:

- The Department of the Treasury oversees the LIHTC program; however, state housing finance agencies administer the program at the state level.
- The Treasury provides two dollars worth of tax credits per citizen; state administrators, such as the Tax Credit Allocation Committee (TCAC) in California, subsequently disperse these credits.
- State housing finance agencies use an application process called the "Qualified Application Process" to determine the allocation of these credits to affordable housing developers.
- Housing developers sell these tax credits to large institutions that buy the credits and use them to offset their tax burden on a one-dollar-per-one-credit basis. The credit price is set at a market price and fluctuates based on project, geography, and developer.
- Investors in the program use the credits to offset their tax liability and see the full value over a ten-year period.

In its current form the LIHTC program allows for homeownership uses but is not feasible in the vast majority of projects. A new tax credit program, based on LIHTC, could focus exclusively on the needs of low-income homeowners.

How Would a Homeownership Tax Credit Program Work?

In its current form, the LIHTC program allows for homeownership uses but is not feasible in the vast majority of projects. A new tax credit program, based on LIHTC, could focus exclusively on the needs of low-income homeowners. Instituting a few basic changes would greatly enhance the new tax credit's ability to serve the goal of expanding homeownership in these communities.

Initially, any new homeownership program would have to address the major barriers to homeownership low-income families face. These barriers include a lack of wealth, a lack of income, and a lack of credit. (Khadduri 4) In addition, the program would have to take the existing LIHTC format and make it applicable to the unique needs of a homeownership subsidy program. It would also need to ensure that homeowners are actually gaining the benefit of homeownership (i.e. asset accumulation) while still ensuring the public subsidy makes a lasting difference for more than one family. The following changes should be made accordingly:

1. Homeownership tax credits should be modeled on the existing mortgage market and the subsidy should come from the mortgage lender. The developer based model works well for the LIHTC program due to the special needs of certain low-income populations, however, a lender-based subsidy that allows prospective homebuyers to find their own homes would be more economically efficient. (Belski 20)
2. The subsidy should come in the form of a mortgage rather than the LIHTC's construction equity, similar to the legislation put forth by Congresswoman Roybal-Allard. Congresswoman Roybal Allard's proposal called for a below-market rate second mortgage of approximately 20 percent of the homes' appraised value that would cover closing and down payment costs. (Belski 18) This situation would allow a family to effectively close the gap between what a home costs and what they qualify for based on income and credit.
3. While the LIHTC program targets families making less than 60 percent of AMI, a mortgage tax credit could target families making less than 80 percent of AMI. This situation would allow states to target families who would not be able to buy a home without the tax credit but who are not too low-income to afford a monthly mortgage.
4. The new tax credit should change LIHTC's 15-year investor liability period to 10 years. This situation would protect homeowners who wish to move after 10 years in the home as well as increase the value of the credit by decreasing investor liability. The liability period could require that any home going into foreclosure within the first ten years would have to give their credits back. This situation would provide a large incentive for investors to ensure that struggling homeowners' needs are addressed quickly and effectively. Any homeowner who sells their home within the first ten years would receive their home's equity on a graduated schedule, 10 percent for every year of ownership. This condition will help incentivize neighborhood stability.
5. Homeownership counseling should be included to ensure that families know exactly what the costs and benefits of homeownership are. While there is no need for this type of service for the rental focus of the LIHTC program, instituting pre- and post homeownership counseling for families receiving below market mortgages has been shown to significantly reduce the likelihood of foreclosures for homeowners.

Funding Source

To create a new affordable homeownership tax credit, Congress will need to amend the Internal Revenue Code's Section 42 as well as identify a way to fund the new tax credit. While a portion of existing LIHTC funds could be used, this option is less than ideal since it will mean a reduction in funding for affordable rental housing, the primary goal behind the LIHTC. A preferable option is to create an entirely new stream of funding.

One possible way to create that new stream of funding is to address the lopsided Mortgage Interest Deduction program, which currently benefits mostly upper income homeowners. The National Low Income Housing Coalition has proposed to eliminate the deduction and replace it with a 15 to 20 percent tax credit for home up to $500,000 in value. Their proposal would use the extra revenue to fund the National Housing Trust Fund, but the savings could easily go towards a housing tax credit. The NLIHC approach would generate between $20 and $40 billion dollars a year and could substantially support low-income homeownership.

Conclusion

The benefits of a new homeownership tax credit would be numerous and straightforward for both Latinos and our economy. Latinos, who are more likely to be low-income, will have better access to homeownership and asset building. This increase in assets and wealth will mean greater economic security and activity in the Latino community. Second, an increase in demand for moderately priced homes will help to remove a portion of the more than 13 million vacant single family homes that are depressing home prices throughout the country. (McBride) These actions will in turn benefit surrounding neighborhoods and home values.

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