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Latino Homeownership and Housing Counseling: An Alternative to FHA Policies

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Introduction

Latinos are the fastest growing group in the United States, with a current population of approximately 53 million. Between 1980 and 2010, the Latino population increased by approximately 35 million, and is projected to continue to increase. The U.S. Census Bureau projects that by 2060, there will be approximately 128.8 million Latinos in the U.S., or 31% of the total population. By 2020, Hispanics are expected to make up half of new homebuyers in the U.S.[1] As this population continues to increase, the demand for affordable housing will also increase.

Latinos tend to earn lower wages and work in lower skill level jobs than their White counterparts. Most of the jobs held by Latinos require little to no formal education. Per the 2010 Census, only 13% of Latinos have a college degree. Hispanics are also less likely than Whites and African Americans to have a bachelor's degree.[2] A higher percentage of Latinos work in the construction, agriculture and hospitality sectors than the general population.

Because they work low-paying jobs, Latinos are more likely to live in poverty. The census states that the Latino poverty rate was 26% in 2011 while the overall U.S. poverty rate was only 16%. Furthermore, Latino median incomes are only $39,000 per year, compared to the overall U.S. median income of $50,000. In 2012, 31% of Latino households had a median income of $25,000 or below. Latinos are also more likely to receive food stamps than other population groups. About 22% of Latinos receive food stamps while 13% of U.S. residents receive food stamps. The Bureau of Labor Statistics indicates that the Latino community is more likely to suffer from unemployment than non-Hispanic Whites.[3] Hispanics are also more likely to be married with children, creating an even greater demand for adequate housing.

Though they are more likely to earn low wages, to be unemployed, and to live in poverty, Latino purchasing power exceeds $1 trillion.[4] Such purchasing power can dramatically boost the nation's economy, especially in the housing sector. Between 2000 and 2010, Latino homeownership increased by 51%, and half of Latinos who bought homes were first-time homeowners. Though the number of Latino households increased, the rate remains relatively the same due to the influx of Latino immigrants to the U.S. Despite this recent growth in homeownership, fewer than half of Latino households currently own their homes. Only 46% of Latinos own their homes while 65% of all U.S. residents own their homes. Because of these trends, it is essential that policy reforms promote responsible and sustainable homeownership for Latinos and all Americans. Recently, however, policy changes made by the Federal Housing Administration (FHA) will create roadblocks for Hispanics who are interested in purchasing homes. The changes, which came into effect in 2013, scrutinize credit scores, increase insurance premiums, and ultimately make it extremely challenging for Latinos to purchase a home.

Latino Homeownership: Why Does it Matter?

Between 2010 and 2012, the Latino homeownership rate decreased from 47.5% to 46.1%.[5] In 2011, the national homeownership rate for Latinos was approximately 45%, while the homeownership rate for Whites was about 71%.[6] Latinos trail behind their counterparts because they experience unique challenges compared to other communities. These challenges include lower education and income levels, language barriers, poor credit or no credit, and immigration status. Latinos typically have lower credit scores compared to other communities, and many have no credit history at all. Often, they miss opportunities to build credit because they tend to make purchases in cash.

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Reducing costs of homes, lowering interest rates, assisting with down payments and reducing fees-especially those imposed by financial institutions-are positive changes for potential homebuyers.

Though they experience many barriers, more Latinos prioritize saving to purchase a home compared to the general population. A recent survey by Prudential indicates that 23% of Latinos consider saving for a home a top priority, compared to only 13% of the general population.[7] The report also states that, of participants surveyed, those born outside of the United States place more emphasis on saving for a home and their children's education, while higher income participants and those born in the United States place more emphasis on retirement.[8] A study by the Pew Hispanic Center shows that 87% of Latinos believe that owning a home is a symbol of the American Dream.[9] But homeownership is not only a metaphorical symbol of the American Dream. In actuality, home equity makes up 70% of the total wealth of low- and moderate-income families.[10]

This American Dream also manifests itself in other social aspects, and thus does not only benefit Latinos, but the greater population as well. Research shows that homeownership leads to a positive impact on communities in several ways. Aside from providing shelter and stability, homeownership can lead to lower crimes rates, fewer teenage pregnancies, higher civic engagement, improved health and greater academic achievement.[11]

The Federal Housing Administration

The Federal Housing Administration (FHA) is a division of the Department of Housing and Urban Development (HUD), and its purpose is to protect lenders from losses if a mortgage borrower defaults on a loan. FHA provides mortgage insurance to homebuyers who borrow from approved lenders, and has insured over 34 million properties since 1934. By serving as an insurer, FHA pays a claim to lenders when borrowers default on their loans. This means that ultimately, financial institutions bear less risk. Unlike other government agencies or departments, FHA is funded solely on revenue it generates from insurance premiums and fees charged to homebuyers. Though its insurance fund plummeted when the housing market crashed, FHA has $30 billion in cash and investments to pay potential claims.[12] By law, the fund is required to hold at least 2% of its outstanding insured loans.[13] Despite this amount of reserve funds, the FHA changed its policies in June 2013 to boost revenue. This change could prove detrimental to the economy, as the housing market is one of the most important drivers of U.S. wealth.[14] The change especially decreases accessibility for Latinos to qualify for FHA mortgage loans.

Federal Housing Administration loans were beneficial to Latinos because homebuyers with modest incomes or lower credit scores could qualify. Historically, a higher percentage of Latinos and younger, credit-constrained borrowers tended to borrow from FHA-approved institutions. In 2011, 49% of Latinos depended on the FHA to finance their homes. FHA was the primary lender to individuals with lower down payments and lower incomes. Instead of requiring a down payment of 10% or higher, FHA-backed loans only require a 3.5% down payment. Although the down payment requirement is more affordable than most lenders require, FHA's policies create barriers to homeownership by scrutinizing credit scores and debt-to-income ratios. Furthermore, borrowers who cannot afford a 20% down payment are required to pay mortgage insurance, and insurance premiums were raised. This could prove harmful to potential Latino homebuyers because many will not qualify for FHA-backed mortgages based on their credit scores and income. Those who do qualify will experience high mortgage payments that include a higher insurance premium.

Prior to June 2013, individuals with modest down payments and lower credit scores could qualify for FHA-backed mortgages. Though there were no income requirements for potential homebuyers, there were limits on how much one could borrow. Typically, loan amounts were approved for mortgages based on home prices in the area a buyer sought to purchase. Since there were no income requirements, the FHA did require that the buyer have a reasonable debt-to-income ratio. The minimum down payment was (and still is) 3.5% and there was no minimum credit score. Instead, the FHA took all aspects of a potential homebuyer's financial history into account when approving or disapproving a loan. One important benefit of having an FHA-backed loan was that there were no prepayment penalty fees. This is advantageous for Latinos because Latino homebuyers are more likely to borrow from the subprime market.[15] When they pay off their mortgage sooner, it saves them from having to pay high interest rates throughout the life of the loan.

Prior to June 2013, at the time of closing, an upfront premium of 1.75% of the total mortgage was due. This could be paid in one lump sum, or it could be financed into the loan. Borrowers were also required to pay a monthly insurance premium. In 2009, that premium was .55% of the loan amount. As of April 2013, the monthly insurance rate increased to 1.35% of the total loan. This means that homebuyers insured through FHA pay their regular mortgage payment as well as the monthly insurance premium. If the homebuyer did not pay the upfront mortgage premium, they would also include that in their monthly payment. The homebuyer would be responsible for the monthly insurance premium if the loan to mortgage value was greater than 78%. This meant that once the homebuyer has paid off at least 22% of the loan, they would no longer need to pay the monthly insurance premium.

Housing counseling reduces the risk of foreclosure for borrowers by making them more responsible homebuyers.

On June 3, 2013, FHA's policies changed. Though there are still no minimum credit score requirements, scores will be scrutinized, especially if the score is lower than 620. For example, if an applicant has a credit score of 620 and the Automated Underwriting System approves the application, HUD will require a manual underwriter review of the application. This could mean that the borrower would need to increase the down payment amount to be approved for the loan. A manual review of the application will also be required if an applicant's debt-to-income ratio is greater than 43% of the borrower's income, regardless of an approval from the Automated Underwriting System. Therefore, an application approval could be reversed if an underwriter reviews the data and decides that the application should be denied.

FHA now requires a monthly insurance premium payment throughout the life of the loan in some cases. The borrower still pays a monthly insurance premium of 1.35%, but in many cases this must be paid until the loan is paid in full. Previously, this was only required if the loan to value was greater than 78%. The changes require mortgages with a loan to mortgage value of less than 90% to pay a mortgage insurance premium for 11 years. If it is 90% or more, the mortgage insurance premium must be paid for the life of the loan.

The new policies imposed by the FHA will have serious consequences for the housing market and future homebuyers. An increase in the down payment will make it difficult for low-wage earning Latinos to afford the down payment as well as upfront insurance costs and closing fees. Saving for the down payment is very difficult for Latinos, and is usually the main deterrent preventing them from affording a home.

Monthly payments will be higher than usual because the mortgage insurance premium will be required for the duration of the loan in some cases. Additionally, closing costs have risen, and the fees may prevent potential homebuyers from purchasing because they cannot afford the fees and payments. If a homebuyer does not have a minimum credit score of 580, he/she will be required to pay a higher down payment. More importantly, individuals who would have qualified before may no longer be eligible for FHA insurance.

Housing Counseling

Unless a homeowner is refinancing into a high-cost loan or obtaining a reverse mortgage, housing counseling is not required by the FHA.[16] However, data shows that housing counseling can be extremely beneficial to homebuyers. Certified housing counselors provide homebuyers with essential tools and resources to guide them through the home buying process. Counselors provide financial literacy training, explain documents, assist with budgeting, and ultimately help determine if homeownership is a good option. Pre-purchase housing counseling reduces the delinquency rate of first-time homebuyers by 29%.[17] Case studies conducted by HUD's Office of Housing Counseling show that housing counseling leads to positive outcomes in homeownership. One report states that out of 574 homebuyers who received pre-purchase counseling, only one fell behind on mortgage payments after 12-18 months.[18] Additionally, homeowners who receive pre-purchase counseling are one third less likely to become over 90-days delinquent over two years when compared to homeowners who did not receive counseling.[19]

Housing counseling reduces the risk of foreclosure for borrowers by making them more responsible homebuyers, which benefits not only the borrower, but the lending institution and FHA as well. Research indicates that pre-purchase counseling is effective in preventing delinquency among first-time homeowners. The Bipartisan Policy Center Housing Commission states that "housing counseling can improve prospective borrowers' access to affordable, prudent mortgage loans, especially for families that otherwise might not qualify or who experience other barriers to mainstream lending."[20] In this way, borrowers who cannot afford a 20% down payment and high insurance premiums, or who do not have the best credit scores, can still qualify for an FHA-backed mortgage, ultimately boosting the mortgage market and ensuring Latinos and others have access to affordable homes.

Homeowners Armed With Knowledge (HAWK)

In May of 2014, HUD's Office of Housing Counseling announced a new initiative to make FHA loans more affordable. Homeowners Armed With Knowledge (HAWK) is a pilot program designed to integrate housing counseling into the home buying process. First time homebuyers who receive counseling from a HUD-approved agency receive discounts on their insurance premiums, thus lowering their monthly payments. Only first-time homebuyers qualify for the program, and homeowners wishing to refinance do not qualify.

The initiative offers homebuyers a reduction of .5 percent in their upfront mortgage insurance premium so long as they complete housing counseling before signing a contract to purchase a home, and then again pre-closing. Doing so would also decrease their annual mortgage insurance premium by .10 percent. Homeowners with no delinquencies after 2 years are eligible for an even greater discount- an additional .15 percent reduction to their annual premium. With this program, the average homebuyer could save roughly $325 per year.[22]

The HAWK program consists of a minimum 6-hour pre-purchase housing counseling session conducted by an approved agency. Upon completing the 6-hour course, homebuyers must allow a minimum of ten days to pass before signing a contract. If the homebuyer waits less than ten days before signing a contact, he or she will no longer qualify for the program. Two more counseling sessions are required after the first: a one-hour session right before closing on the home, and another one-hour post-closing session between 30 days and one year of closing.

Recommendations

FHA's decision to increase insurance premiums and scrutinize credit scores came as a direct response to the recent housing market crash. As the Bipartisan Policy Center notes, "The unprecedented collapse of the housing market that began in 2007 has undermined our confidence in the system built over the last 75 years."[22] It is not surprising that lenders and the FHA feel the need to protect themselves by making it more difficult for one to qualify for a mortgage. However, in doing so, they are excluding the population that could, in fact, save the market. With over $1 trillion in purchasing power, Latinos play a crucial role in advancing the U.S. economy. Though FHA launched the HAWK program, it is not enough. The program does not address inadequate credit scores amongst Latinos, nor does it create significant savings. Homeowners who participate in the program could save up to $325 per year, which is only about $27 per month. Despite the potential for decreased mortgage insurance premiums, $27 per month is not a significant savings. If the discount were higher, the program could be very appealing to Latino homebuyers.

Those seeking an FHA-backed mortgage are responsible for high costs during the home buying process. Homebuyers are required to pay a minimum 3.5% down payment, closing costs, appraisal costs, and the upfront mortgage insurance premium of 1.75%. For low- and moderate-income Latino families, this cost is astronomical. Even with the HAWK program, homeownership is nearly impossible for low-wage earning Latinos. Moreover, the program does not benefit homeowners seeking to refinance. Therefore, those who are already struggling with their monthly payments are excluded, and often, they are the ones who need the savings the most.

The HAWK program also does not improve access to credit for borrowers with lower FICO scores or no credit history. FHA must reduce the risk of default and foreclosure amongst the buyers it insures. However, often homebuyers are judged unfairly based on past financial mistakes, no credit history, or length of credit history. One alternative to improve credit scores and integrate potential homebuyers into the market, is for credit reporting agencies to examine alternative means of credit reporting. Alternative Credit Reporting is a viable and inclusionary option. In the United States, one needs credit to get credit, or to improve credit. Instead of reviewing a consumer's financial history, this type of reporting examines non-traditional data such as rent payments, educational background, or even remittances. Doing so allows credit bureaus to review an individual's risk beyond what is typically evaluated.

Conclusion

Federal and state regulators have addressed housing in different ways recently, and both levels have implemented policies or programs that affect homeowners and potential buyers in the Latino community by increasing barriers to homeownership. Though some policies are beneficial to homeowners and buyers, such as tax credits for first-time homebuyers, others are not. Affordable homeownership must be a legislative priority at the local and federal levels. Reducing costs of homes, lowering interest rates, assisting with down payments and reducing fees--those imposed by financial institutions and insurers--are positive changes for potential homebuyers.

Latinos deserve quality, safe and affordable housing options, and policymakers should strive to ensure that the housing needs of Latino community are met. That the FHA increased the minimum credit score and increased premiums could prove extremely detrimental for Latino families and many Latinos could be disqualified from securing FHA-backed loans. For Latinos, purchasing a home is already difficult. Therefore, scrutinizing credit scores and debt-to-income ratios makes the process even harder. Often, Latinos are lower-income and credit-constrained buyers who simply cannot qualify for or cannot afford a FHA mortgage. An affordable and accessible government guarantee is crucial for all homebuyers to ensure the American Dream is achieved.

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