AFFORDABLE HOUSING CENTERS OF AMERICA
Every Family Deserves a Chance at the American Dream

Modernizing the Community Reinvestment Act

Draft Testimony of Lez Trujillo, Deputy Director
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I am Lez Trujillo, Deputy Director of the Affordable Housing Centers of America. Our mission is to empower low and moderate-income individuals, families, and communities to obtain and keep affordable, stable, safe, and decent housing. We accomplish this through public and private partnerships that support home-ownership counseling and education, access to suitable financing, housing development, and advocacy. Since our founding in 1985, more than 400,000 households have received homebuyer counseling from us, which has enabled over 106,000 families to acquire a home. In the face of the recent foreclosure crisis, we've provided assistance to more than 65,000 homeowners trying to save their homes from foreclosure. Headquartered in Chicago, we provide housing counseling services out of 17 branch offices, and nationwide through our call center. The families we help come from many walks of life—the young, seniors, families with children, working class, lower income or recently unemployed.

I appreciate the opportunity to speak to you today about reforming the regulations implementing the Community Reinvestment Act. There has already been much said about all the changes that have taken place in the credit markets and with financial service providers since the CRA was enacted in 1977, and so I won't spend time elaborating on those points. Instead, I wish to focus on the conditions found today, in 2010, in low and moderate income and minority neighborhoods throughout the country.

We believe that CRA modernization needs to be a critical part of the re-design of our nation's mortgage finance system, and that this re-design must be grounded in the harsh realities now found in most of America's low and moderate income communities in the aftermath of the financial meltdown and the great recession. Of particular relevance to this discussion is the impact of the recession on incomes, creditworthiness, and affordable housing stock. Hundreds of millions of Americans now derive income from sources that pay less and provide less stability. Tens of millions of former and current homeowners have had their credit profiles destroyed. Half a million homes sit empty, with large concentrations of single-family houses in lower income neighborhoods. Unfortunately, this is likely to be the "new normal" for years to come.

What will be the housing options for these tens of millions of Americans whose credit scores have been damaged? What is to become of the vast numbers of affordable single-family houses sitting empty in Englewood, K-Town, and underserved communities throughout the country? What is to become of the owners of occupied houses in these communities, if demand is undermined by one-size fits all mortgage underwriting standards that harken back to pre-CRA days of the early 1970's? How will the small businesses survive if lines of credit are revoked?

Its seems to us that the quest for answers to these difficult questions needs to be a primary driver of CRA reform and the creation of a new housing finance system. We suggest that certain sub-principles should help guide the quest, some of which illuminated the way for the passage of the original Act in 1977:

- Financial Institutions must not be allowed to write-off large segments of society or disinvest entire communities or types of housing.
- America's new housing finance system must offer paths for those who have lost homes or been damaged by the recession to (re) gain homeownership once they're ready.
- Responsibility for providing suitable financing for all types of affordable housing must be shared by all actors, at every level of the system, and not relegated to the exclusive responsibility of the government.
- America's new housing finance system must align the interests of homeowners and investors for sustainability at all levels—primary, secondary, and regulatory.
- As part of this alignment, America's new housing finance system should create funding streams that builds and sustains a robust, nationwide, nonprofit housing counseling infrastructure. For first time homebuyers with multiple risk factors, counseling should be a mandated condition for receiving financing.

The Need for Innovation

By 2005, rampant fraud and abuse was embedded into the DNA of the Private Label Security business model, often masquerading as innovation. Clearly the new housing finance system needs to prevent a reoccurrence of predatory lending, and several of our colleagues have suggested that the principle of ***sustainable*** mortgage and credit finance should be factored into CRA regulations, as should the concept of ***negative credit*** for institutions or their subsidiaries or affiliates that provide abusive loan products. We support those recommendations.

However, we fear that innovation has gotten a bad name at a time when we are going to need more genuine innovation than ever before to resolve the difficult housing questions facing us, in a way that is fair to the tens of millions of Americans damaged by the recession. In fact, since the housing bubble burst, many of the successful mortgage underwriting innovations that were adopted from 1985-2002 by CRA lenders have been eliminated. For example, virtually all of the largest banks have eliminated the use of letters of explanation and compensating factors for worthy borrowers that had experienced an unusual hardship, such as a medical emergency, and had their credit score reduced as a result. Such flexibilities were proven to be safe and sound alternatives to the old one-size fits all approach to underwriting, and led to sustainable housing loans for millions of first time homebuyers. But lenders have indiscriminately discarded these viable features as if they were no different than the riskiest features of subprime and Alt-A mortgages.

Going forward, innovation in determining creditworthiness is going to be more important than ever, and the CRA needs to provide incentives for lenders to undertake it. A recent report found that over 25% of all American households have sub-600 credit scores! We need to borrow from the religious concept of a jubilee by creating ways for damaged households to mitigate debt and credit history in a very short time so they can get a fresh start. The current, inadequate credit-score driven way of determining creditworthiness, with its simplistic mathematical approach of looking backwards at a few quantifiable factors for which data is available, will deny mortgages and other credit facilities for several years to millions of Americans hurt by the recession, even after they have stabilized income. For many, it will also severely limit their choices in the rental market, where landlords often use credit scores as a screening tool.

For a number of years we've witnessed a trend where our clients change jobs more frequently and have household incomes that are stagnant or declining. The boom in Alt A and subprime lending helped mask and delay the impact of this trend by enabling many families to cash-out home equity and use it to cover the gaps in household budgets. The popping of the housing bubble not only removed that crutch, but the ensuing great recession has made the problem of unstable and declining household incomes even deeper and more widespread. Unless we are prepared to say that the very large slice of the population that finds themselves in this situation can never buy or refinance a house, the new housing finance system is going to have to develop alternative ways for determining ability to pay, and new mechanisms for helping the homeowner sustain the ability to pay when hard times hit. A reformed CRA needs to provide incentives for lenders to attempt these innovations.

The housing finance system of the future must also facilitate innovation in other areas. Tens of millions of homes need to be retrofitted for energy efficiency. Low and moderate-income homeowners who have seen their equity vanish need access to affordable financing for this critically important work—as do owners of affordable rental units, who often face slim operating margins.

Millions of single family homes in distressed low income communities currently can't be sold because the only people willing to buy those homes can't qualify for a mortgage. We are going to need financing that enables this enormous pool of affordable housing stock to be preserved and re-occupied. In some cases this will require innovative approaches to fee-simple ownership; in other cases there will need to be financing that enables shared equity, mutual housing, and other non-traditional ownership models.

I've described just a few of the situations and conditions that are going to require innovation in housing finance if they are to be addressed. Taken together, these situations are the "new normal" in many low and moderate-income communities. They can't be seen as the tail on the dog of the new housing finance system. They are too large to be addressed only by the housing trust fund or by declining government grant dollars. Instead, ALL components of the housing finance system of the future, particularly the big banks, must be required to play a role. It will require innovation, mandates, and leveraging. As a start, the portfolio capacity and purpose of the largest lenders is going to have to be expanded and made available for CRA lending.

Michael Stegman, Director of Policy and Housing for the John D. and Catherine T. MacArthur Foundation and former HUD Secretary for Policy Development and Research, has suggested that the top tier of the nation's CRA-covered institutions should have a duty to serve as beacons of innovation and creativity in the development of innovative, affordable, and sustainable credit products for underserved markets. He suggests that their performance at meeting this obligation should be evaluated by regulators separately from their performance assessment on the existing lending, service, and investment tests. We could not agree more. The reason is the same given by Willy Sutton when asked why he robbed banks: "Cause thats where the money is." Since the financial meltdown, the big have only gotten bigger. Today, the 10 largest CRA-covered institutions together have deposits of more than $3.1 trillion, which translates to a combined market share of 45%. They have achieved that position in no small part due to the several subsidies they've been provided, and continue to receive, from the Federal Reserve and the Treasury. In return, they should have a duty to lead the financial services industry in the development and scale-up of innovative, affordable, and sustainable credit products and financial services for low and moderate-income families and communities.

<u>Creating Stability and Reducing Risk</u>

We have a few additional suggestions of ways that the CRA could be used to provide incentives to lenders for activity that would help stabilize low and moderate income communities. First, we believe that the CRA must provide incentives for the provision of innovative financing for rehab and retrofitting of low, moderate, and middle-income housing units. Particularly for homeowners with lower income and those on fixed incomes, we find that high utility bills are a major threat to their sustainability.

Second, we believe that rather than going back to the bad old days when households with multiple risk factors were simply eliminated from securing a mortgage to buy a house (as has happened since 2007), we believe that the CRA and other features of the new housing finance system be used to reduce risk and provide opportunity. For example, a reformed CRA could provide increased incentives for lenders to:

- Support a robust nonprofit housing counseling infrastructure that offers both pre and post-purchase programs for first time homebuyers. Even though the capacity is not there now, the new affordable mortgage system should make education and counseling a requirement for borrowers with multiple risk factors. To pay for it, counseling should be considered along with other closing costs on the HUD-1, and paid by the homebuyer, lender, or investor.

- Purchase insurance policies for each new homeowner. The insurance would cover the monthly PITI for a prescribed time if unemployment or another eligible event befell the homeowner.

Our colleagues in the affordable housing, civil rights, and progressive community have made a number of thoughtful, specific recommendations for modernizing and improving the CRA. We would like to highlight and endorse a few that we feel are most noteworthy:

- CRA examinations should be required to look at and evaluate the lending, investing, and service to minorities and communities of color. This should include loss mitigation and foreclosure activity by bank-owned mortgage servicers.
- Affiliates of CRA-covered institutions should be covered by the CRA and included in CRA exams.
- Assessment area definitions should be expanded so that the actual scope of a bank's activities are covered by the CRA and evaluated in the exam process.
- Any large bank found to have an inadequate performance in an MSA should be required to create and make public a corrective action plan for that MSA, even if the bank has an overall rating of satisfactory or higher.
- For the large banks,
  --A new test for innovation and creativity in the development of innovative, affordable, and sustainable credit products for underserved markets should be considered.
  --A new community development test for lending and investment should be created.
- Community involvement in the enforcement process should be strengthened by:
  --Creating a new process that allows organizations to review and challenge preliminary CRA ratings.
  --Considering verifiable Community Reinvestment Agreements in the CRA review and in any exams involving mergers or acquisitions.
  --Requiring any institution that receives an unsatisfactory rating to partner with local nonprofit community development and affordable housing organizations as part of the corrective plan.

One of the few silver linings of the busting of the housing bubble and the financial meltdown is that it has provided an opportunity for regulators to learn from past mistakes and to get it right in the future. I fervently hope that you seize the opportunity to reform and modernize the Community Reinvestment Act so that once again it can bring much needed private investment dollars back to our nation's underserved communities.

Thank you.