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Title of proposal: Disrupting Financial Services' Structural Barriers to Credit Access Via a First Generation Homebuyer Special Purpose Credit Program

Program Objective and Focus

The homeownership gap between Black and White Americans is as large today as it was when redlining was legal. While the gap narrowed from 1970 to 2004, the Foreclosure Crisis, which hit the Black community in 2004[1]—long before the macroeconomic event struck in 2008– wiped out all gains and drove the gap wider. The homeownership gap is a major driver of the racial wealth gap since most people derive wealth from home equity. Homeownership remains elusive for far too many people of color because the financial services system was not constructed to serve communities of color; it was designed to exclude them.[2] Until we can completely dismantle unfair systems and replace them with equitable solutions, we must develop a credit program that can circumvent structural barriers and provide underserved groups with a direct path to quality, sustainable, and affordable financial services. A Special Purpose Credit Program (SPCP) designed to serve first-generation homebuyers can do just that. The Equal Credit Opportunity Act (ECOA) allows financial institutions and other entities to create SPCPs to expand fair access to credit, particularly for consumers and communities impacted by discrimination.[3]

Centuries of race-based laws and policies, including Jim Crow statutes, repatriation policies, racially restrictive covenants, and the Home Owners Loan Corporation Act—which systemized redlining and the association between race and risk in our financial markets–created structural barriers that served to deliberately lock consumers of color out of mainstream credit opportunities. Those structural barriers include residential segregation, the unbalanced distribution of resources, restrictive zoning ordinances, biased algorithmic-based systems, and the dual credit market in which mainstream financial services providers are concentrated in predominately White neighborhoods while high-cost and non-traditional financial services providers are hyper-concentrated in communities of color.[4]

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[1] Tami Luhby, Housing Crisis Hits Blacks Hardest, CNN (October 19, 2010). Available at http://www.cnn.com/2010/LIVING/10/19/inam.housing.foreclosure.money/index.html

[2] See Testimony of Lisa Rice before the Senate Committee on Banking, Housing, and Urban Affairs, *Separate and Unequal: The Legacy of Racial Discrimination in Housing*, National Fair Housing Alliance (April 13, 2021). Available at https://www.banking.senate.gov/imo/media/doc/Rice%20Testimony%204-13-21.pdf

[3] *Using Special Purpose Credit Programs to Expand Equality*, National Fair Housing Alliance (November, 2020). Available at https://nationalfairhousing.org/using-spcps-blog/

[4] Cheryl Young and Felipe Chacon, *50 Years After the Fair Housing Act - Inequality Lingers*, Trulia (April 19, 2018). Available at https://www.trulia.com/research/50-years-fair-housing/; Alexandra Lee, Where You Live Matters: Access to Key Amenities is Worse in Communities of Color, Zillow (June 23, 2021). Available at https://www.zillow.com/research/nfha-where-you-live-matters-29661/

Unfair policies also resulted in the structural racial wealth gap and the inability of people of color to pass on wealth to future generations. White families have 5 and 8 times the wealth of their Latino and Black counterparts respectively. One analysis found that if White wealth were to be held stagnant, fixed where it is today, it would take Latino households 84 years and Black households 228 years to reach parity.[5]

Structural inequities make it profoundly difficult for communities of color to access credit in the financial mainstream. This is because many of the impediments that were created using explicitly racial criteria are now embedded in the infrastructure and apparatuses upon which our financial services system is based. The dual credit market creates a structurally inequitable landscape, a series of physical barriers that stymie the ability of underserved groups who live in credit deserts to cross the banking divide. Credit deserts are communities that lack mainstream financial services providers like banks and credit unions but can often have a plethora of non-traditional financial entities like payday lenders, check cashers, and hard money lenders who typically do not report positive consumer behavior to credit repositories. It is important to note that banking deserts are not solely driven by economic factors. Banks are closing their branches in high-income, affluent Black neighborhoods at higher rates than they are closing branches in low-income non-Black areas.[6] People of color are more likely to live in credit deserts, use non-traditional financial services providers, be unbanked, credit invisible, and credit unscoreable.

Nontraditional credit providers typically do not report consumers' positive payments to credit repositories, but in a perverse arrangement negative behavior can often be reported. Moreover, nontraditional credit providers can often give consumers misinformation about how to handle their finances and manage debt, trapping consumers in predatory cycles. Additionally, consumers who access credit from finance companies that do report timely payments will be dinged by some credit scoring systems simply for having not accessed credit from a bank.

Technological systems used in the financial services space often perpetuate bias because they have picked up and reflect the inequities that are imbedded in our markets and they rely on tainted information. Much of the data used to build credit scoring, automated underwriting, digital marketing, and risk-based pricing systems is imbued with bias. One analysis found that people of color are paying $765 million each year in elevated costs due to unfair risk-based pricing systems.[7]

This all means that communities of color disproportionately lack the ability to save for a down payment and are more likely to be denied credit access due to high debt-to-income (DTI) and loan-to-value (LTV) ratios. A sufficient down payment would both reduce the consumer's DTI and LTV ratios. Inequities in the system also mean that Black and Latino borrowers will disproportionately have lower credit scores since most scoring systems, including the single score that is required by the government-sponsored enterprises (GSEs)[8], are more a measure of wealth than how well a

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[5] Chuck Collins, Dedrick Asante-Muhammad, Josh Hoxie, and Emanuel Nieves, *The Ever-Growing Gap: Failing to Address the Status Quo Will Drive the Racial Wealth Divide for Centuries to Come*, Institute for Policy Studies (August 8, 2016). Available at https://ips-dc.org/report-ever-growing-gap/

[6] Zach Fox, Zain Tariq, Liz Thomas, Ciaralou Palicpic, Bank Branch Closures Take Greatest Toll on Majority-Black Areas, S&P Global (July 25, 2019). Available at https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/bank-branch-closures-take-greatest-toll-on-majority-black-areas-52872925

[7] Robert Bartlett, Adair Morse, Richard Stanton, Nancy Wallace, Consumer Lending Discrimination in the FinTech Era, University of California, Berkeley (November 2019). Available at https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf

[8] Fannie Mae, Freddie Mac, and FHA require the use of the Classic FICO® score, which is an older model, even though both FICO and VantageScore have newer credit scoring systems, built on more contemporary data.

borrower pays their debt obligation. Many debts consumers pay, like rental housing payments and insurance premiums, are not reflected in most credit scoring systems.

The Proposal

This proposal, for a First-Generation Special Purpose Credit Program, combines two racial equity provisions to circumvent systemic impediments to enable consumers wrongly locked out of the financial mainstream to access quality, affordable, wealth-building financial services tools. The first racial equity provision incorporates an underutilized tool – SPCPs. The second fairness provision centers the SPCP around down payment assistance for first-generation homebuyers.

SPCPs can be game-changing pro-equity tools. They provide a tailored way for organizations to meet special social needs and benefit economically disadvantage groups, including groups that share a common trait, like race, ethnicity, national origin, or gender. If designed correctly, SPCPs can allow underserved consumers to bypass structural inequities—living in a credit desert or a neighborhood impacted by appraisal bias, being wealth-poor, having a deflated credit score, or being credit invisible–to obtain quality, affordable credit.

Implementing solutions with no concern for existing inequities in our systems will only mean that people who already have access will continue to have it and those who are hampered by impediments in the system will continue to be locked out. In fact, the Urban Institute projects that, without interventions, the Black-White homeownership gap will intensify.[9] We must have tailored solutions to drive equitable outcomes.

SPCPs provide a framework for creating credit products and services with intentionality and a deliberate resolve to serve borrowers of color. ECOA allows nonprofit and for-profit entities to use this tool if they determine a tailored program would "benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms."[10] For-profit financial institutions implementing SPCPs must follow several steps:[11]

1. Conduct an analysis using the organization's proprietary data and/or other resources to identify a class of economically disadvantaged groups who are being denied credit or receiving credit on unfavorable terms. The analysis should include an evaluation of whether these consumers could receive credit on the same favorable terms as other borrowers under the organization's normal credit standards.
2. Conduct research and analyses to identify barriers that are precluding the identified class of borrowers from favorably accessing credit under the organization's customary credit criteria.
3. Develop a program designed to provide credit, on favorable terms, to the identified class of borrowers and that mitigates identified barriers.

[9] Laurie Goodman and Jun Zhu, *By 2040, the US Will Experience Modest Homeownership Declines. But for Black Households, the Impact Will Be Dramatic*, Urban Institute (January 21, 2021). Available at https://www.urban.org/urban-wire/2040-us-will-experience-modest-homeownership-declines-black-households-impact-will-be-dramatic
[10] Susan M. Bernard and Patrice Alexander Ficklin, *Expanding Access to Credit to Underserved Communities*, Consumer Financial Protection Bureau (July 31, 2020). Available at https://www.consumerfinance.gov/about-us/blog/expanding-access-credit-underserved-communities/
[11] Nonprofit organizations offering SPCPs for their members or an economically disadvantaged class of persons are not required to follow all of these steps. Nevertheless, many of the proposed suggestions would greatly benefit non-profits who wish to develop and implement SPCPs.

4. Conduct rigorous fair housing and lending testing and analysis of the program to ensure compliance with civil rights laws and that the program will truly result in underserved borrowers being able to access credit in an equitable manner.
5. Develop a written plan that explains the class of persons the program will benefit and outlines standards and procedures for issuing credit under the program.
6. Engage with the Consumer Financial Protection Bureau (CFPB), and if applicable, prudential regulators, while the analyses, research and program design are being completed.
7. Engage with fair housing, civil rights, and consumer protection groups during the research, analysis, and program design phases to ensure program elements comply with civil rights and consumer protection laws and policies and will meet consumer needs.
8. Develop a fair marketing program to affirmatively promote the program to underserved and economically disadvantage groups to encourage them to apply for credit under the program.
9. Conduct regular monitoring and analysis to ensure viability and efficacy of the program.

NFHA has supported research to explore how SPCPs can be structured to advance racial equity and promote our nations' fair housing laws.[12] These programs, designed properly, can fulfill and advance the purposes of a bevy of civil rights statues and policies including the Civil Rights Act of 1866, the Fair Housing Act of 1968, the Equal Credit Opportunity Act of 1974, the Community Reinvestment Act of 1977, and several equity-based Presidential Executive Orders.

The second part of this proposal centers SPCPs around a down payment assistance program developed by the National Fair Housing Alliance and Center for Responsible Lending for First Generation Homebuyers.[13] The framework was developed based on extensive research undertaken by both organizations and the Urban Institute. Down payment programs are one of the most effective means of helping economically disadvantage borrowers access homeownership.

SPCPs can contain other program features. For example, they can be designed to eliminate credit scoring requirements or exempt borrowers from risk-based pricing restrictions, or credit overlays. While these types of provisions may be necessary to afford underserved consumers a real opportunity to access credit on favorable terms, down payment assistance helps close the racial wealth gap and addresses and mitigates several primary reasons people of color are denied credit, like high debt-to-income and loan-to-value ratios.

Down payment assistance to First Generation homebuyers is a proven strategy that can create 5 million new homebuyers—70 percent of which will be people of color–significantly closing the racial wealth and homeownership gaps[14]. Lack of down payment is a major barrier to homeownership for underserved groups.[15] Many Black and Brown consumers have sufficient income to pay a monthly

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[12] Steve Hayes, *Special Purpose Credit Programs: How a Powerful Tool for Addressing Lending Disparities Fits Within the Antidiscrimination Law Ecosystem*, National Fair Housing Alliance and Relman Colfax, PLLC (November, 2020). Available at https://nationalfairhousing.org/wp-content/uploads/2020/11/NFHA_Relman_SPCP_Article.pdf

[13] Nikitra Bailey, Tucker Bartlett, Mike Calhoun, Keith Corbett, Debby Goldberg, Deborah Momsen-Hudson, Lisa Rice, and Eric Stein, *First Generation: Criteria for a Targeted Down Payment Assistance Program*, Center for Responsible Lending and National Fair Housing Alliance (May 21, 2021). Available at https://nationalfairhousing.org/wp-content/uploads/2021/06/crl-nfha-first-generation-jun21.pdf

[14] Ibid.

[15] Christelle Bamona, *New Report Shows Saving for Mortgage Down Payment is a Substantial Barrier to Homeownership that Particularly Hits Communities of Color and Essential Workers*, Center for Responsible Lending (April 21, 2021). Available at https://www.responsiblelending.org/media/new-report-shows-saving-mortgage-down-payment-substantial-barrier-homeownership-particularly

mortgage obligation; in fact, many of them are currently paying rental housing payments. But these consumers disproportionately lack intergenerational wealth and sufficient down payments. Consumers who are the first in their generation of would-be homeowners face significant challenges because their families lack the wealth that homeownership can provide. These consumers also cannot as readily rely on guidance, networks, and assistance from family to navigate the homeownership process.

Drawing on a well-proven approach in the educational arena in which special funds are provided for first-generation college students, this approach targets funds to first-time homebuyers whose parents are not homeowners. It also targets first-generation consumers who earn at or below 120 percent of the Area Median Income. People who are first-generation homebuyers at this income level are disproportionately people of color. We strongly recommend eligible participants obtain pre-purchase counseling by a HUD-Approved agency, that home price limits follow GSE guidelines, and that loans eligible for the program be Qualified Mortgages.[16] We believe organizations can rely on the borrower's attestation that they are first-generation homebuyers[17] but other protocols would be put in place to guarantee income, housing cost limits, and other requirements are met.

We also recommend the down payment assistance to be substantial – at least $20,000. The minimum cash needed for a median-priced home is roughly $30,000. It would take nine years for a household earning the median income to save enough money to cover a 3 percent down payment and closing costs on a median-priced home.[18] Down payment assistance in the amount of $20,000 would go a long way to reducing the number of years families would need to save and give them an opportunity to gain housing stability faster. Down payment assistance should be stackable so it can be used with other programs.

Institutions offering the first-generation down payment assistance as a component of their SPCPs should exercise the affirmative marketing provisions championed by ECOA and directly partner with neighborhood development, fair housing, housing counseling, organizing, and other community-based groups to ensure eligible participants will learn about and can access the program.

While we urge for-profit entities, like banks and credit unions, to adopt this program, we also encourage nonprofit organizations, like Community Development Financial Institutions (CDFIs), to implement these solutions. CDFIs and other nonprofit entities are often deeply connected to local stakeholders and community-based groups and have existing relationships with underserved and economically disadvantaged populations. This can result in a robust and quick implementation of the program. Moreover, since nonprofits are often rooted in community, they may have an increased ability to capture critical qualitative feedback about the program. This feedback can be shared to facilitate deeper learning, improved efficiencies, and better access for underserved groups.

Program Achievement and Feasibility

A fully funded ($100 billion) SPCP that provides down payment assistance for first-generation homebuyers will go a long way to closing the racial homeownership and wealth gaps. It would increase the homeownership rate for Blacks, Latinos and Whites by roughly 5.6 percent, 4.2 percent, and 1 percent, respectively. It would also increase the homeownership rate for remaining categories of groups (ie. Asian, Native, Hawaiian, Pacific Islander and other groups) by about 3.3 percent.[19]

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[16] See https://www.consumerfinance.gov/ask-cfpb/what-is-a-qualified-mortgage-en-1789/
[17] Congresswoman Waters adopted this approach in her Down Payment Toward Equity Act, which was modeled after the NFHA/CRL First-Generation proposal.
[18] Bailey, *First Generation*
[19] Ibid.

One drawback to this proposal is SPCPs can often be implemented very clandestinely due to some concerns about the programs' potential for violating the Fair Housing Act. This is why NFHA is working closely with HUD and prudential regulators to urge the agencies to produce additional guidance to provide clarity about how these programs can comply with and advance the Act. NFHA collaborated with Relman, Colfax, PLLC, a leading civil rights law firm, to develop an expert paper that fully details how SPCPs fulfill the purpose of the Act.[20]

Homeownership is the primary way people build wealth, but legacy and current barriers and discrimination unnecessarily impede too many families who could sustain homeownership and build a solid financial foundation for their children. Financial institutions are increasingly enthusiastic about implementing SPCPs to address the stubborn challenges that face economically disadvantaged groups. This proposal provides a solid, feasible framework for mitigating stubborn credit access barriers and advancing on racial equity goals.

[20] See Hayes at https://nationalfairhousing.org/wp-content/uploads/2020/11/NFHA_Relman_SPCP_Article.pdf