

Affirmatively Furthering Fair Housing and Secondary Mortgage Market Reform: Making the Connection

By Philip Tegeler and Henry Korman¹

The ongoing debate over reform of the residential mortgage system has significant implications for borrowers of color, who were disproportionately affected by the foreclosure crisis. One aspect of the financial reform debate, highlighted in the Obama Administration's 2011 Report to Congress,² involves the development of a new entity or entities to assure liquidity and stability in the mortgage market by purchasing and reselling mortgages in the securities market.³ A number of civil rights groups have assessed the potential racial impacts of these proposals, and urged the Administration to back a system that encourages fair access to credit for underserved communities.⁴ This Policy Brief addresses one aspect of this larger civil rights analysis – the interplay between housing finance reform and the Fair Housing Act's racial integration mandate.

The Fair Housing Act's requirement that all federal financial programs affecting housing must "affirmatively further fair housing" applies to HUD, the Department of Treasury, the Federal Housing Finance Agency, the Securities and Exchange Commission, and other agencies with supervisory authority over the housing finance system. This "AFFH" provision requires the agencies to avoid policies that encourage residential segregation and to develop policies that affirmatively promote residential integration.⁵ In the context

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² *Reforming America's Housing Finance Market: A Report to Congress* (February 2011), available at <http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf>

³ Prior to their collapse, the largest of these "Government Sponsored Enterprises" (GSEs) were Fannie Mae and Freddie Mac, both currently functioning under government receivership while a new system is being debated.

⁴ The key civil rights issues underlying housing finance reform are summarized in a *Civil Rights Statement of Principles for Secondary Mortgage Market Reform* (October 2010) developed by the Center for Responsible Lending, the National Fair Housing Alliance, the National Council of La Raza, and other groups. See http://www.prrac.org/pdf/civil_rights_%20and_secondary_market_reform.pdf

⁵ This specific civil rights requirement, which derives from 42 U.S.C. §3608, goes beyond the broader duty to avoid discrimination in access to credit for all families, which is addressed in the other policy briefs in this series.

of reforming the secondary mortgage market, this obligation is more complex than in the implementation of ordinary federal housing programs, but it is still important to get right, especially since our prior system has served primarily to increase residential segregation.⁶

The Obama Administration's 2011 report to Congress strikes some of the right notes on AFFH, but is short on details. The Report notes that families who purchase homes should "have choices in housing that make sense for them and for their families,"⁷ and that, with respect to rental housing:

"Promoting a housing finance market that provides liquidity and capital to support affordable rental options can alleviate the high rental burdens that many low-income households face. It can also expand rental options for low-income households in urban, suburban, and rural communities of opportunity, with good jobs for parents and quality schools for children."⁸

Unfortunately, the Administration's Report to Congress does not explain how to achieve these goals in a reformed housing finance system. This Policy Brief will offer some more detailed principles and specific proposals on how the AFFH duty might be included in the Administration's final plan.

Affirmatively furthering fair housing in the single family home market

The key AFFH objective in the single family home market is to avoid mortgage incentives that steer moderate income families of color into segregated neighborhoods, and to promote mortgage products that encourage a range of integrated housing choices throughout the metropolitan area. In our view, there are several key policies to achieve this result:

First, based on prior research, policies that expand home mortgage access for low and moderate income families of color should naturally lead to expanded housing choice for these families in a wider range of communities.⁹

Second, it is essential that there is no geographic restriction on the neighborhoods in which these specialized products can be used – and no incentives to encourage home mortgages in low income or predominantly minority communities.

⁶ For a brief history of the federal government's role in creating the secondary mortgage market, and the system's role in driving metropolitan segregation, see David Freund, "Democracy's Unfinished Business: Federal Policy and the Search for Fair Housing, 1961-68," (PRRAC, 2004) at pp 7-28 (explaining the origin and development of the Federal Home Loan bank Board, FHA, and Fannie Mae in the 1930s, 40s and 50s) www.prrac.org/pdf/freund.pdf

⁷ *Report to Congress*, at p.1.

⁸ *Id.* at p.20.

⁹ Friedman, Samantha and Squires, Gregory D., "Does the Community Reinvestment Act Help Minorities Access Traditionally Inaccessible Neighborhoods?" *Social Problems*, Vol. 52, Issue 2, pp. 209-231 (2005)

Third, while it is important that secondary mortgage market reform more rigorous underwriting standards for home mortgage loans, it is also important not to create standards that limit the availability of special mortgage products to encourage homeownership for underserved families – and access to neighborhoods that have traditionally not been open to these families. The single family home price structure in many metropolitan areas is partly a function of segregation, and a reformed housing finance system should give families access to a reasonable range of neighborhoods and communities.

Fourth, housing counseling agencies that assist first time homebuyers should include housing mobility counseling in the required services provided, to assist families in learning about the full range of neighborhoods and schools available in the regions they work in.

Affirmatively furthering fair housing in the multifamily rental market

In the past, Fannie Mae and Freddie Mac have played several important roles in the multifamily rental market, including through the purchase of non-conventional loans for affordable multifamily rental housing, the acquisition of Low-Income Housing Tax Credit investments, purchases of tax exempt multifamily bonds, and other activities¹⁰. These functions are important to retain in the upcoming reform of the housing finance system, but in order to truly “affirmatively further fair housing,” multifamily mortgage products should be developed that encourage more integrated outcomes.

One important way to accomplish the AFFH goal for multifamily housing finance is to eliminate the federal government’s financial support for economically segregated developments that are “all market rate” or “all poor”. Thus, private market rate multifamily mortgage products backed by the federal government should be developed with minimum inclusionary requirements (at least 10%) for low income families. Likewise, the federal government should stop providing secondary mortgage financing for rental housing that is designed only for poor families. By developing mortgage products for low income housing development that include some mixed income market rate housing, the federal government will be incentivizing both more integration within a development and encouraging more integrated project locations outside of high-poverty neighborhoods. Federal support in the secondary mortgage market must also utilize underwriting standards that consciously create incentives for locating affordable housing in “high opportunity” neighborhoods outside racially identified, high poverty areas.

¹⁰ See Henry Korman, "Furthering Fair Housing, the Housing Finance System, and the Government Sponsored Enterprises" (Kirwan Institute, April 2010) www.prrac.org/pdf/HenryKorman-FairHousing&GSEs.pdf

Fair Housing Data Collection and Enforcement

A crucial element of the obligation to further fair housing is the duty of federal supervisory agencies to refrain from engaging in discrimination *and* the duty to assure that the private, public, and quasi-public entities under agency supervision do not engage in discrimination. In a reformed housing finance system, these principals mean that there must be requirements for data collection that report on the fair housing and fair lending characteristics of borrowers whose loans are securitized, and *there must also be detailed demographic information about the location of single family and multifamily loans with respect to race, ethnicity, and poverty*. Data collection alone is insufficient to assure a housing finance market that does not discriminate. Reform of the housing finance system must include a commitment of resources to both public sector and private non-profit enforcement of fair lending laws.

Securitization and Fair Housing Enforcement

The Fair Housing Act separately forbids discrimination in the “making or purchasing of loans or providing other financial assistance (A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or (B) secured by residential real estate.”¹¹ The obligation to further fair housing codified elsewhere in Title VIII therefore imposes a duty directly on the SEC to take steps to assure that issuers of mortgage-backed securities do not improperly exclude loans for purchase based on the characteristics of the borrowers or the demographics of the location of the loans. It also requires the SEC to actively assure that issuers of mortgage-backed securities take affirmative steps to buy and securitize loans made to borrowers of color.

It will also be important to coordinate policy-making for affirmatively furthering fair housing in reform of the housing finance system with other related areas of government regulation. For example, the proposed definition of “qualified residential mortgage” in the recently proposed interagency credit risk retention rule for asset-based securities could have the effect of curtailing CRA lending by private lenders who might otherwise be willing to offer alternative loan products to borrowers of color often left out of prime credit markets. In addition, the SEC’s proposed rule for issuer data collection and disclosure of the underlying assets in asset-backed securities would rule out collection of racial, ethnic, and locational characteristics associated with home mortgage loans. Failure to collect this type of information will make enforcement of the Title VIII prohibitions on discrimination in the secondary mortgage market difficult, if not impossible (racial demographic data is currently part of Home Mortgage Disclosure Act data and other data collected by the GSEs).

¹¹ 42 U.S.C. §3605(b)(1),