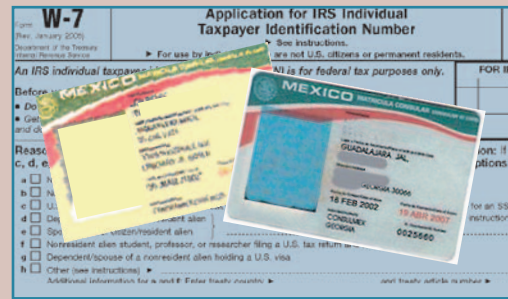


Alternative IDs, ITIN Mortgages, and Emerging Latino Markets



By Mari Gallagher

The author gratefully acknowledges and thanks Mark Doyle of Second Federal Savings Bank, Michael Frias of the FDIC, Rob Paral of Rob Paral and Associates, Harry Pestine and Kathleen Toledano of the Federal Reserve Bank of Chicago, Jeanne Hogarth and Marianne Hilgert of the Board of Governors of the Federal Reserve System, and the author's many colleagues at MCIC for their many contributions to this emerging body of work.

Overview

Mainstream financial institutions – banks, savings and loans, and credit unions – create and allocate capital and economic opportunities through their central and defining function of taking in deposits and making loans. This process determines where credit and capital will flow.¹ As such, it shapes nearly every aspect of our social, economic, and built environment. Market forces and regulatory structures behind this flow are powerful and, at times, contentious. Banking practices and public policy influence one another continually, but are continually impacted most by emerging market conditions.

It is significant that the last five years have seen proliferation in: 1) local bank branches, particularly in Latino markets; 2) transnational cooperation among governments, regulators, and corporations, as well as new technologies that together have encouraged the use of mainstream financial products among Latino immigrants living in the U.S. and family members in the home country receiving remittances; 3) alternative banking products and credit scoring; 4) free checking and other incentives to respond to the competitive marketplace; 5) public and private sector programs and partnerships to reach the unbanked; and 6) the view that “banking” the “unbanked” Latino customer is an attractive pursuit.

It is also significant that banks are now making loans to undocumented Latinos – primarily Mexicans – in increasing numbers. For many large financial institutions,

the silos of compliance, with respect to documentation, and new markets have intersected for the first time.

The banking industry finds the Latino market valuable because of its size, rate of growth, cross-selling opportunities, and customer referrals (friends and family members) further up the economic ladder. Consumer and community advocates find banking relationships valuable because they mitigate the expenditure of resources associated with other financial transactions (time, effort, and money), leaving more disposable income, energy, and purchasing power. Depository accounts eliminate the need to carry or store large amounts of cash “under the mattress,” reducing incidence of theft. Consistent account usage – deposits and withdrawals – encourages savings and can help to establish a credit history. Bank usage, in turn, facilitates upward economic mobility through the acquisition of other mainstream financial products: certificates of deposits, credit cards, individual retirement accounts, and loans for education, small businesses, and housing.² In other words, market decisions within the banking industry shape the ability to build assets and create wealth in ways that affect individuals and their households, and investments and growth patterns in local and regional economies.

Regulators have consistently promoted mainstream banking access and use for low-income individuals and other marginalized groups as part of Community Reinvestment Act compliance, though not at the expense of safe and sound business practices.

Ninety-three percent of non-Hispanic Whites have bank accounts, compared to only 63 percent of African Americans, 43 percent of all Latinos, and 25 percent of Mexican immigrants. How can Latino immigrants – particularly Mexicans – be encouraged to enter the mainstream banking system? One strategy has been the development and acceptance of alternative identification, such as the Matricula Consular Card (now called the High

Security Consular Registration Card or, in the remaining portion of this article, the Consular Card) and the Individual Tax Identification Number (ITIN). Foreign or U.S. government-issued cards such as these are acceptable forms of identification under Section 326 of the USA PATRIOT Act.

Electronic methods are an increasingly popular method for sending remittances. During the past three years, electronic transfers increased 145 percent. Industry observers suggest that this increase is partly due to U.S. and Mexican alliances to allow Mexican citizens living in the United States, documented and undocumented, to open accounts through the use of alternative identification cards.³ In 2003, the Partnership for Prosperity report addressed to President Vicente Fox and President George W. Bush also cited alternative IDs as a major contributor to this upward trend.

The market response by financial institutions has in many cases gotten ahead of the varying state laws regarding alternative identification for undocumented immigrants. This has led to some political challenges for banks, and misunderstanding among undocumented customers and potential customers.

The purpose of this article is to share research on the use of these alternative identification cards in the banking industry and new information on the rise of the ITIN mortgage market.

Background on Consular and ITIN Cards

MCIC and the Federal Reserve Bank of Chicago cosponsored a forum in February 2004 that focused on the increasing use of Consular Cards and ITINs at financial institutions throughout the United States. Approximately 200 people attended. Represented were 12 foreign consulates, 36 banking institutions, and 14 government offices. Nonprofit service agencies, alternative lenders, regulators, and research organizations also attended. Over two dozen participants came from other states specifically to attend the forum, and three came from other countries. The panel discussion included representatives of the Federal Reserve Bank of Chicago, the IRS, Freddie Mac, Second Federal Savings Bank, Latinos United, and the Illinois Coalition for Immigrants and Refugee Rights. Following are the “lessons learned” from the forum and related research findings.

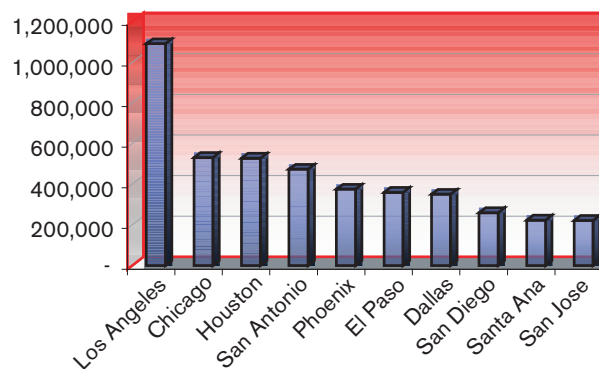
The **Consular Card** is an alternative form of identification issued by the Mexican Consulate since the 1870s to Mexican nationals, regardless of their legal status, living in the U.S. To obtain a card, an individual needs to present a Mexican birth certificate, another official identity document such as a Mexican voter’s registration card or driver’s license, and documentation that attests to that person’s address in the U.S., such as a utility bill. The card

bears the individual’s photograph and U.S. address. In response to the terrorist attacks of September 11, 2001, this photo ID was enhanced with 13 security features.

The ITIN, a nine-digit number that begins with the number 9, was created for taxpayers who do not qualify for a Social Security number. The IRS has issued more than 7 million ITINs since 1996, when the policy was enacted. Many undocumented immigrants living in the United States pay taxes (such as payroll taxes) and need ITINs for that purpose. One also needs an ITIN to open an interest-bearing account if a Social Security number is not obtainable.

Consular Cards and ITINs have opened a new door of opportunity to previously unbanked immigrants. Once they establish credit in the U.S., they may be offered credit cards, home and business loans, investment advice, and other bank services. In the absence of a Social Security number, ITINs are acceptable forms of ID for mortgage applications, although to date the formal secondary mortgage market is not buying and securitizing the loans. This means that banks must portfolio them, self-insure them, and pass on these extra costs to the ITIN bearing customer. As of September 2004, there were 18 banks and one credit union that accept ITINs for mortgage underwriting; TCF Bank and Fifth Third Bank are the largest institutions. TCF made a public announcement citing the size and attractiveness of the market. The Minnesota-based bank has \$11.7 billion in assets nationwide and more than 190 branches in Illinois. Most of the financial institutions engaged in the ITIN mortgage market are small community lenders, such as Second Federal Bank, which serves the Chicago metro area, and Mitchell Bank, which serves the Milwaukee area. Three private mortgage insurers are providing Private Mortgage Insurance (PMI) to ITIN mortgages. Several banks report excellent repayment performance – no “late pay” histories and no defaults – although industry data is not centralized,

Chart 1: Top 10 Cities with Mexican Ancestry Population



and institutions are in the early stages of performance tracking.

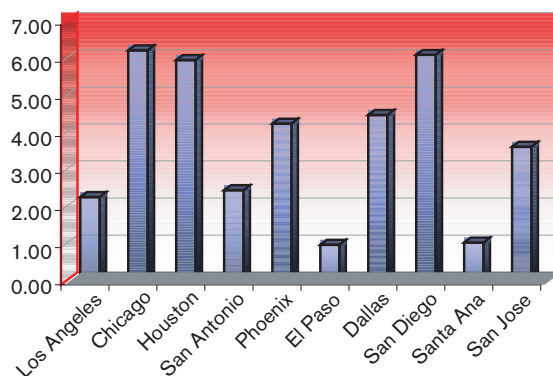
National Practices

Today, approximately 30,000 out of roughly 88,000 total bank offices across the country accept Consular and/or ITIN cards, and Chicago leads the nation with respect to its proportion of banks that accept these alternate forms of identification to Mexican ancestry population.⁴

We can also see Chicago's dominance by comparing it to the Los Angeles experience. Chicago has 2.9 million total residents, of which 530,000 (18 percent) are of Mexican ancestry, not including those that are undocumented. Los Angeles has 3.7 million total residents with more than 1 million people (30 percent) of Mexican ancestry. In other words, Los Angeles has twice the Mexican ancestry population of Chicago, a longer history of Mexican ancestry residents, and a much higher ratio of Mexican ancestry population to the total population.

Yet the Chicagoland banking industry appears to be pursuing the Mexican American market more aggressively. In Los Angeles, there are 2.3 banks that accept the Consular Cards as identification per 10,000 Mexican ancestry population compared to 6.2 banks in Chicago.

Chart 2: Accepting Bank Offices Per 10,000: Mexican Ancestry Population



Chicago has more total bank branches than Los Angeles, but Illinois has fewer bank branches than California. How do these two states compare in terms of banks and branches that accept alternative IDs? Illinois has approximately 14 accepting branches compared to California's approximately four accepting branches per 10,000 Mexican ancestry population.

Free maps and other information on these patterns can be found at www.mccic.org.

Understanding Latino Market Dynamics

One cannot understand the opportunities of the undocumented immigrant financial services market in the Chicago region without placing it in context of larger Latino market dynamics. In 2000, there were 281.4 million residents in the United States. Of those, 35.3 million, or 12.5 percent, were Hispanic, meaning that one person in eight was of Hispanic origin. This number includes people from Cuba, Central or South America, Mexico, Puerto Rico or some other Latino origin, and Hispanic Americans as well as immigrants.

The Hispanic population is the fastest growing segment of the U.S. population. Between 1990 and 2000, the nation's Hispanic population grew by 57.9 percent, from 22.4 million to 35.4 million. This compares to a 13.2 percent increase for the total U.S. population. More than half of the Hispanic population is of Mexican ancestry (58.5 percent). According to the U.S. Census Bureau, if this trend continues, by 2020 there will be over 82 million Hispanics in the U.S. – one out of every three U.S. residents. Slightly less than half of all Hispanics lived in central cities within a metropolitan area (45.6 percent) compared with slightly more than one-fifth of non-Hispanic Whites (21.1 percent).

Although the Mexican population in Chicago is smaller than that of Los Angeles, Mexicans represent a much larger percentage of the total Hispanic population. In Chicago, of the 753,000 Hispanics, 70 percent are of Mexican origin. This includes both documented Mexican immigrants and the native-born population who claimed Mexican ancestry on their Census form.

Homeownership Opportunities and Challenges Among Immigrant Populations

Homeownership is the number one way that Americans build assets for a secure future, and improve their overall quality of life. A home is an investment that usually appreciates in value and whose equity can be accessed for important financial needs, such as starting a business or sending a child to college. Homeownership correlates with community investment and revitalization, as homeowners are more apt to protect and invest in their surroundings. Homeownership also contributes to local and national economies.

Immigrants also use homeownership to build a secure future, though not with the same frequency as native born. Immigrant homeownership rates lag the rate of the general population, and many programs and lending products have been geared to the special needs of immigrants in an attempt to reverse this trend. Immigrant homeownership challenges and opportunities are likely to accelerate in this decade, in part due to the sheer numbers of new immigrants entering the country. For

Table 1: Chicago's Immigration Patterns: 1990-2000

	1990 Population	% of 1990 Total	2000 Population	% of 2000 Total	% Change
Total foreign born	469,117	17%	628,708	22%	34%
Naturalized citizen	177,398	6%	223,942	8%	26%
Not a citizen	291,719	10%	404,766	14%	39%

example, the number of foreign-born households in the United States increased by 4.3 million during the 1990s, more than double the increase in the previous decade. A study conducted by Analysis and Forecasting Incorporated revealed that immigrants accounted for 31 percent of total household growth in the 1990s. The number of foreign-born homeowners grew by 2.2 million last decade, triple the increase in foreign-born owners during the 1980s.

Between 1990 and 2000, the foreign-born population in Chicago also increased substantially. Currently, 22 percent of the residents of the city are foreign born – a level of immigrant population that has not been seen since the early twentieth century.

Immigration has become a suburban, statewide, and regional phenomenon. Local economies on the upswing – whether dominated by textiles, services, or agriculture – will likely continue to attract both documented and undocumented immigrants. New destination states, such as Georgia and Tennessee, are seeing the most dramatic increases. For example, in Dalton, Georgia (the self-described rug capital of the world), the local school population is now dominated by children of Mexican nationals. In Nashville, Tennessee, the local immigrant and refugee population (Mexicans and all nationalities) climbed 68 percent, from 1990 to 2000, to 39,596 people, yet these figures are well below state-wide increases: Georgia's foreign-born population increased 233 percent this past decade and Tennessee's increased 169 percent.

Industry Pressure Points

Currently, the secondary market is not active in buying ITIN mortgages, yet the primary market is active, particularly in the larger Chicago area.

Despite the growing interest in ITINs and recent press on new trends (see Crain's articles of April and July 2004, and the Chicago Tribune article of December 2004, which cites MCIC analysis), new data, information, and projections are needed to fully size the undocumented Mexican market. Even in the absence of branded information sets, niche community banks such as Second

Federal Savings are already making these loans and holding them in their portfolios. Anecdotal accounts on the performance of these loans are positive, but, again, there is no commonly available industry documentation quantifying performance.

Large financial institutions are privately assessing the ITIN mortgage market. This presents an opportunity for the larger market, but also a threat to small, niche lenders who are already testing the market at their own risk. In short, the niche players are creating the market, but they can easily lose it to the bigger players that come in once the pioneering work is done.

The regulatory community cites language in Section 326 of the PATRIOT Act in explaining that Consular and ITIN cards are acceptable forms of IDs. Nonetheless, the small players making these loans might feel pressure to demonstrate their safety and soundness compliance. This takes a commitment of time and resources, the cost of which is often harder for smaller institutions to absorb. The market is new and exploratory. While it is each institution's responsibility to demonstrate the performance of their own portfolio, it is difficult to draw conclusions about the viability of the ITIN mortgage market overall.

Pressure is mounting for government-sponsored entities such as Freddie Mac, Fannie Mae, the Federal Home Loan Bank System, and other actors, to quantify the risks and benefits of buying, funding, and/or insuring ITIN mortgages. Inconsistent state laws regarding acceptable forms of identification for obtaining driver's licenses and other benefits and services potentially complicate this task.

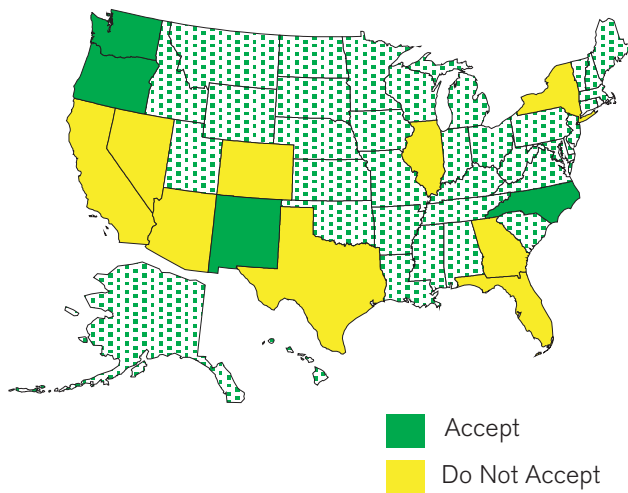
For example, regarding driver's license acquisition:

- 10 states accept the Consular Card
- 5 states accept the ITIN
- 22 states have state laws that require the license to expire concurrently with an immigrant's visa
- 23 states have lawful presence laws, meaning that it is written into the law that only legal residents can obtain a driver's license
- In some cases, states have policies or practices that allow a temporary or specific-use license regardless of immigration status

Policy to accept alternative identification does not correlate with the sitting governor's party or the number or proportion of Mexicans in that state. Of the 10 states where state policy is to accept the Consular Card as documentation to obtain a license, six have Democratic governors and four have Republican governors.

Map 1 shows all states with at least 100,000 or more Mexican immigrants and their state (driver's license)

Map 1: States That Have 100,000 or More Mexican Immigrants by Consular Card Policy



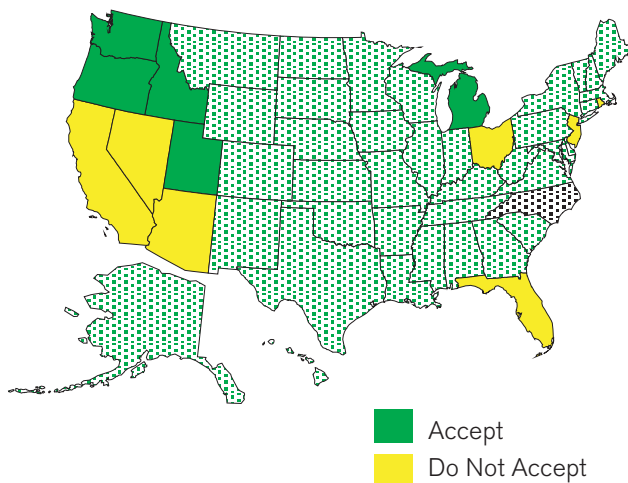
policies on Consular Cards. Those shaded in green accept the card; those shaded in yellow do not.

Of the states where at least 40 percent of all bank branches accept alternative identification cards:

- 7 have Republican governors
- 7 do not accept Consular Cards
- 8 have lawful presence laws related to obtaining a driver's license
- 11 do not accept the ITIN⁵

Map 2 shows all of the states where at least 40 percent of bank branches accept alternative identification cards by state policy regarding Consular Cards for obtaining a driver's license. Those shaded in green accept the cards; those shaded in yellow do not. This variation has led to some political challenges for banks, which are pursuing

Map 2: States Where at Least 40 Percent of Bank Branches Accept Alternative IDs by Consular Card Policy



the market most aggressively in states with high Mexican concentrations, and to some confusion and mistrust among documented and undocumented customers and potential customers, particularly migrants who routinely live in several states each year and have difficulty keeping up with each state's practices.

ITIN Mortgage Case Study: Second Federal Savings of Chicago

The undocumented Mexican population living in the United States poses unique underwriting challenges. Many have been in this country for many years – some even decades. Anecdotes from immigrant advocacy groups and others suggest that a substantial number have achieved economic and social stability and some have achieved a fair measure of professional and personal success. However, their lack of official status has historically restricted or discouraged participation in mainstream financial activities, such as opening a checking or savings account, paying bills and rent by check or electronic means that can be easily traced, and receiving income that can be verified through conventional methods. Mexican immigrants in particular tend to be “under-banked” and have established few formal ties – and in many cases no ties – to credit channels typically assessed by underwriters. Many fear that they will lose money placed in banks if they ever are deported.

Under the Equal Credit Opportunity Act, a bank may consider the applicant's residency status in the U.S., the applicant's immigration status, and any other information necessary to determine the creditor's rights and remedies in case of default. For example, a bank can distinguish between a noncitizen who is a long-time resident with permanent resident status and a noncitizen who is temporarily in this country on a student visa.

Community banks – often understaffed and besieged by eager brokers with mortgage deals in hand – need to ensure proper screening and documentation. Dual identity issues are likely to be challenges for all institutions engaged in ITIN mortgages, as some applicants are likely to have an ITIN and an invalid Social Security number.

Second Federal Savings has developed alternative underwriting criteria and methods in an effort to respond to the needs of the market and to meet safety and soundness. The underwriting process for ITIN mortgages primarily focuses on establishing true customer identity, credit worthiness, and income verification.

Many Mexican families in Second Federal's market rely on extended family members, friends, and networks to carry out shared domestic, social, and economic functions of the household. The family unit is often comprised of mixed status residents, some with legal residence status and some with undocumented status.

Table 2: A Summary of Second Federal’s Underwriting Criteria Compared to the Mainstream Market

Mainstream Market	Second Federal ITIN Market
Income	
24 months employment in same type of work	12 months employment in same type of work
Cash income not allowed	Some cash with employer letter allowed
2 years tax returns and W-2s, pay stubs/VOE ^a	Pay stubs and VOE in lieu of W-2s/tax returns
75% of verifiable border income	75% of verifiable border income
75% rental credit added to income	75% of rental credit deducted from PITI ^b
Debt-to-income ^c ratios 41/45 with DU ^d	
Debt-to-income ratios 28/36 without DU	Debt-to-income ratios 45/45 without DU
Automated underwriting by Fannie Mae	
Credit	
24 months – 4 trade lines	12 months – 3 trade lines/alternative sources
Credit score driven	Credit score weak tool/tends to be inaccurate
Credit verified by Social Security number	Credit verified by SSNs used and ITINs
Collections over \$250 must be paid	All collections must be paid
Collateral	
1-2 Units – LTV ^e 95% with PMI	1-2 Units – LTV 95% without PMI
3-4 Units – LTV 80%	3-4 Units – LTV 90% without PMI
Down payment funds – 3% from borrower	Down payment funds – 3% from borrower
Down payment funds must be seasoned	Seasoning of down payment funds not required
Seller contribution – maximum 3%	Seller contribution – 1-2 no max. 3-4 6%
Appraisal – can be exterior only in some cases	Appraisal – always interior and exterior
Identity	
U.S. Citizen or Permanent Resident Alien	Must have an ITIN # or completed W-7 at SFS
State issued picture ID	National picture ID (e.g., Consular Cards, passport)
Depository Account	
Must show at least 2 months PITI reserve	Account at SFS/monthly payment auto drafted
Other	
Homebuyer counseling – 95% LTV	Homebuyer counseling – 90% LTV
Standard process for applicants	Hands-on process, additional documentation

a VOE – verification of employment form.

b PITI – the total housing monthly cost of principal, interest, taxes, and insurance.

c Debt-to-income ratio – $\text{PITI} \div \text{gross monthly income} / \text{total monthly debt payments} \div \text{gross monthly income}$.

d DU – Desktop Underwriter – Fannie Mae’s proprietary underwriting tool for approved mortgage seller/servicers.

e LTV – loan-to-value ratio, or the total mortgage amount divided by appraised value of home.

ITIN mortgages in Second Federal's portfolio typically have multiple contributors listed as part of the borrower team. Second Federal allows multiple wage earners who plan to continue cohabitating to coqualify for the mortgage as a household. Furthermore, borrowers can have a coborrower who does not occupy the mortgaged unit. However, when processing a loan with a nonoccupant coborrower, the applicant that intends to reside in the property must use 5 percent of their own funds for down payment and closing costs if the loan-to-value ratio is greater than 80 percent.

Boarder income is allowed if there is reasonable assurance that it will continue for at least one year after purchase. Boarders can include extended family members, such as a cousin, or more formal arrangements.

Applicants are required to complete a home buyer education program if they are first-time homebuyers. Training options are reviewed and approved by Second Federal Savings. Second Federal partners with local organizations, such as the Resurrection Project, to provide the training, but other providers are also allowed.

Industry experts speculate that, over the years, some undocumented residents (Mexicans and other nationals) have obtained mortgages with invalid Social Security numbers. The secondary market has likely purchased some of these mortgages. These mortgages are thought to be a very small share of total mortgages. However, on occasion, ITIN mortgage applicants are not first-time homebuyers. Documenting the true identity of each applicant and past identity paths and actions, then assessing their credit worthiness is time-consuming work, which might explain why, to date, smaller banks are more active than larger banks. Table 2 is a summary of Second Federal's underwriting criteria compared to the mainstream market.

Latinos generally, and Mexican documented and undocumented residents specifically, will likely provide a key growth area for the mortgage market. Investor interest in this market will take hold if data, trend analysis, and new information developed through pilot programs indicate that performance falls within the industry's risk tolerances.

The community development impact of increased homeownership among undocumented populations has the potential to transform communities. As a follow-up to the forum cosponsored by the Federal Reserve Bank of Chicago, MCIC received e-mail correspondence from over 100 service providers, community development coalitions, and lenders from across the country who were seeking more information, underwriting guidance, and best practices.

MCIC's projections suggest that the ITIN mortgage market for undocumented Mexicans is huge, untapped, and growing. Recently, MCIC projected the size of the market

by Illinois county, by specific towns and suburbs of the Chicago metro area, and by Chicago community area. These maps are now available at no cost on MCIC's Web site. Visit www.mcic.org to view the maps and to subscribe to the E-list (free of charge) to ensure that you receive future maps and publications.

Notes

1 Hoffmann, Susan, *Politics and Banking*, The John Hopkins University Press, 2001.

2 Federal Reserve Board "The Unbanked—Who Are They?" *Capital Connections* 3:2 (Spring 2001).

3 2003 data collected by MCIC.

4 Cited in the *Partnership for Prosperity Report* to President Vicente Fox and President George Bush in 2002, a forum cosponsored by the Federal Reserve Bank of Chicago and MCIC in 2004, a Federal Reserve Bank of Dallas publication in 2004, and an Office of the Comptroller of the Currency publication in 2004.

5 Only five states in total accept the ITIN.

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