


SECTION 2 • CHAPTER 6

Restore the housing cornerstone



Potential first-time home buyers Janet and Greg Schieber tour a home for sale in the Highland Park area of Los Angeles.

AP PHOTO/DAMIAN DOVARGANES



Housing represents one-fifth of the U.S. economy and is critical to many other areas of the economy—from finance to construction and manufacturing. Since the sluggish housing market remains one of the biggest drains on our economic recovery and a liquid, stable, and equitable market is critical to a long-term growth plan, digging a way out of the current crisis and charting a responsible path forward is a key piece of our economic-growth strategy.

The historic crisis in the housing market eviscerated \$7 trillion in home equity³ and left more than one in four homeowners owing more to the bank than their houses were worth.⁴ As families struggle through the ongoing crisis, the U.S. mortgage market remains on life support. The federal government—through Fannie Mae, Freddie Mac, and the Federal Housing Administration—backs more than 85 percent of new home loans made each year, as private capital has withdrawn from most parts of the market.⁵


Homeownership plays a central role for many in America's middle class as they build wealth and save for the future, capitalize small businesses, seek to pay for college, and look for economic security in challenging times, particularly the elderly. According to a 2012 Pew Research Center study, homeownership comes just behind job security and health care when it comes to people's perceptions of what it takes to be in the middle class.⁶ Policies for a strong and stable housing market are an important part of a long-term economic strategy.

Yet more than four years after Fannie and Freddie were placed under government conservatorship, policymakers have made little progress winding down the mortgage giants and establishing a sustainable system of U.S. housing finance. Meanwhile, lenders have significantly tightened credit standards, leaving many families ready to buy a home with no clear path to doing so.

clothes and health care and 40 percent less on food than families in affordable units.⁸

We therefore propose policies to:

- Provide access to sustainable homeownership or affordable rental housing for all eligible borrowers by developing a more responsible and sustainable housing-finance system that serves all communities and provides countercyclical capacity, along with striking the right regulatory balance and ensuring that high down payments are not a bar to sustainable homeownership
- Help underwater homeowners deleverage debt, avoid foreclosure, and lower their monthly housing costs by offering better solutions for delinquent homeowners and establishing more refinancing opportunities for current borrowers



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At the same time, more than 100 million Americans live in rental housing, and one in four renters pays more than half their monthly income on rent.⁷ High rents depress demand for other goods and services, which also hurts local communities. According to Harvard's Joint Center on Housing Studies, families in unaffordable housing units spend 50 percent less on

Policies to promote sustainable homeownership and affordable rental housing

Develop a more responsible and sustainable housing-finance system

Just about everyone agrees that the current level of government support to the housing market is too high and that private investors should assume more risk in the mortgage market. The question is how best to move in the right direction while still offering broad and consistent access to safe, affordable mortgage credit across all communities.

Housing

Problem: The national housing-finance system that has supported a key area of the U.S. economy since the Great Depression has broken down at huge personal cost to millions of Americans and to the country's broader economy. Private capital has fled the market, with the federal government now backing 90 percent of all home loans.¹ One in four renters pays more than half their monthly income on rent.²

Solution: Build a more responsible and sustainable housing-finance system that serves all communities, offering homeownership opportunities, as well as encouraging development of affordable rental housing.

Key policy ideas:

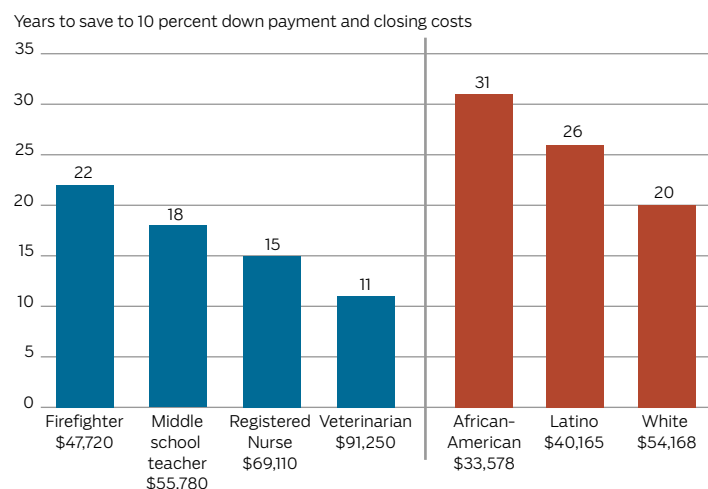
- Replace the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, also known as Fannie Mae and Freddie Mac, with government-chartered, privately funded entities that guarantee qualifying mortgage-backed securities and are backed by government reinsurance.
- Promote safe and sustainable lending by preventing predatory practices and aligning incentives among borrowers, mortgage originators, and securitizers, rather than by universally requiring a 20 percent down payment.
- Require lenders to forgive the underwater portion of mortgage balances when doing so would return more value to investors than allowing a home to go to foreclosure.

Other policies to strengthen the housing market and overall economy include refinancing underwater homeowners, providing government support for the development of affordable rental housing, and homeownership and rental strategies that can stabilize and revitalize the communities hardest hit by the financial crisis.

Outcomes: A stable and dynamic housing sector will allow access to safe, sustainable homeownership or affordable rental housing for all families. ■

FIGURE 11

The number of years it takes to save 10 percent of down-payment and closing costs



Source: Center for Responsible Lending calculations based on 2010 American Community Survey and Bureau of Labor Statistics Median Income data. Calculations based on a 2010 median priced house (\$158,100), an annual savings rate dedicated for down payment of 2% of income, and closing costs totaling 5% of home purchase price.

Two years ago, a group of housing-finance experts, affordable-housing advocates, and leading academics brought together by the Center for American Progress released a detailed plan for responsibly winding down the mortgage giants Fannie Mae and Freddie Mac and bringing private capital back into mortgages.⁹ Our plan calls for replacing Fannie and Freddie with several government-chartered, privately funded entities that guarantee qualifying mortgage-backed securities. These entities will price accurately for risk, enabling them to create a privately funded loss reserve. If one of the entities fails, the loss reserve will step in to back the securities it has issued. Government funds would only be tapped in the event of a catastrophic market downturn that wiped out all loss reserves, which is now significantly less likely given the

banking and mortgage reforms in the Dodd-Frank Act and related regulations.

Our plan also includes provisions to ensure that mortgage lenders and investors serve the entire mortgage market equally, and it establishes special funds—fully funded by market transactions—to responsibly expand affordable housing and promote access to mortgage credit for underserved populations. By maintaining an explicit and limited government guarantee on certain types of mortgage debt, our proposal preserves the 30-year fixed-rate mortgage, now a pillar of the U.S. mortgage market, and ensures that an appropriately broad range of families have access to home ownership. The plan also provides adequate liquidity for the multifamily market, which is crucial to enabling the creation of affordable rental housing.

Strike the right regulatory balance

As regulatory agencies seek to protect consumers and prevent future housing crises, they face the difficult task of striking the right balance among various considerations to ensure that lenders originate mortgages that are both safe and affordable. Agencies should not water down anti-predatory regulations aimed at ensuring proper underwriting, and they should align market incentives so that mortgage originators and securitizers succeed only if homeowners succeed. At the same time, regulators should not enshrine a requirement of 20 percent down payments, which is out of reach for the majority of American homeowners and prospective homebuyers.



Brandon Joyner, 8, right, bounds ahead of his mother Monica Spann, 37, at their new home in Capitol Heights, Maryland, Jan. 29, 2008.

AP PHOTO/JACQUELYN MARTIN

Additionally, the Consumer Financial Protection Bureau, or CFPB, and other regulators should ensure high-quality mortgage servicing and loss-mitigation options. One of the key reasons that the foreclosure crisis became so severe and has lasted so long was the belated and bungled response by mortgage servicers to the crisis. The CFPB has already issued a first set of rules that will improve servicing and provide homeowners with some ability to enforce the rules privately, but additional safeguards are necessary to ensure that safe, sustainable loan-modification options are available to all homeowners from all servicers.

Ensure that high down payments are not a bar to sustainable homeownership

Regardless of the outcome of the various rulemakings, down-payment requirements are likely to remain high for some time. These requirements will be especially onerous for lower-wealth families that may have the income to support successful homeownership but would have to save for many years for the down payment. Lack of savings for a down payment has long been recognized as a key barrier to homeownership for lower-wealth families.¹⁰



Amanda Hollander, left, and Katy McCormack
at their home in Portland, Maine, Feb. 28, 2013.
AP PHOTO/ELISE AMENDOLA

For this reason, we support efforts to provide down-payment assistance to those families, as long as the families are offered safe mortgage products, prepurchase counseling, and other supports ensuring successful homeownership.

Examples of these efforts include:

- **State housing-finance agency down-payment assistance programs:** These programs assist borrowers with down-payment and closing costs either through grants or loans. One successful model of such a program is Massachusetts'

SecondSoft Program.¹¹ The Center for American Progress has proposed a plan for bonds that can help support state housing-finance agencies so that they can offer programs of this nature.¹²

- **Shared-equity products:** In these programs, the government invests funds to provide lower-income buyers with down-payment assistance in exchange for a share in the appreciation when the home gets sold. Typically the homeowner still builds wealth as home values rise but does not walk away with a windfall. For details on how shared equity programs work, see the 2010 Center

for American Progress report, “A Path to Homeownership.”¹³

- **Matched-savings programs:** These programs encourage potential homeowners to save for a down payment by matching their own savings with private funds, government funding, or tax incentives. In 2007 the Aspen Institute developed a proposal for tax incentives in which a cumulative investment of \$28 billion in matching funds over 10 years would create 4 million new homeowners with incomes below \$50,000 for individuals and \$75,000 for households, and \$457 billion in new mortgages.¹⁴

Policies to help the housing-market recovery

The steep decline in housing prices that both triggered the financial crisis and were exacerbated by it have left more than one in four homeowners owing more to the banks than their homes are worth, which translates to nearly \$700 billion in “negative equity,” or the total amount that these homeowners are underwater.¹⁵ Many of these homeowners are already behind on their monthly payments or in foreclosure.

A housing recovery will eventually help some of these homeowners, but barring an ill-advised effort to reinflate a dangerous housing bubble, it is likely that we will need to

deal with the unique problems of underwater mortgages for some time to reduce the resulting drag on the market.

Deploy a principal-reduction program

Principal reduction—which means lowering the outstanding balance of an underwater loan to reflect current market value as part of a loan modification—can play a major role both in ensuring long-term success of loan modifications and in stabilizing the fundamentals of the nation’s hardest-hit housing markets. While many investors are already forgiving principal balances, Fannie Mae and Freddie Mac are still not permitted to do so by their regulator, the Federal Housing Finance Agency. That agency rejected an offer from the Treasury Department to pay a percentage of the principal forgiveness using Troubled Asset Relief Program, or TARP, dollars already earmarked for foreclosure prevention, although the agency’s own analytics demonstrate that permitting it would save money for Fannie Mae and Freddie Mac.

Allowing Fannie Mae and Freddie Mac to do principal forgiveness is sufficiently important that, if necessary, the Treasury Department should offer to pay the full cost using TARP funds rather than just a percentage.¹⁶ In addition to forgiving principal outright, investors could offer shared-appreciation loan modifications, where they write down some principal in exchange for a portion of the future appreciation on the home later.¹⁷



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The Center for American Progress also suggests that states follow the lead of the California, Nevada, and Arizona Hardest Hit Fund programs, which use federal TARP dollars to pay the full cost of principal-forgiveness reduction for current and delinquent homeowners with

Fannie and Freddie mortgages.¹⁸ For states without Hardest Hit Funds, such forgiveness could be paid for using funds from the National Mortgage Settlement or related settlements.

Give current borrowers more refinancing opportunities

Refinancing mortgages into rates that are now at historical lows is a great way to enable families to avoid default and put more money into their pockets that can be spent elsewhere in the economy.¹⁹

Families with little or no equity in their homes due to the steep declines in the housing market are, however, often unable to obtain refinancing. Additional steps should be taken to improve the Home Affordable Refinance Program, which helps homeowners whose mortgages are owned by Fannie Mae or Freddie Mac,²⁰ to help families with private mortgages refinance,²¹ and to use Hardest Hit Funds to promote refinancing.²² ■

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