



Re-examining Efforts to Promote Homeownership: What Have We Learned from the Foreclosure Crisis?

Presented at: Challenges and Opportunities for Homeownership in a New Banking Era
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May 6, 2009



Solving problems, guiding decisions – worldwide



Summary of Key Points

- Promoting sustainable homeownership an important public policy goal
- Substantial gains in homeownership from 1994 to 2004 occurred before subprime and non-traditional mortgage lending exploded
- Available evidence suggests government efforts to promote homeownership did not contribute substantially to the foreclosure crisis
- Going forward, we should avoid rolling back underwriting standards too far, while also pursuing policies that better ensure homebuyers can sustain homeownership

Topics to be Covered

- Why should public policy support homeownership?
- How successful have efforts been to increase homeownership?
- What have been principle policies to promote homeownership and what do we know about how effective they have been?
- What role did efforts to promote homeownership have in producing the foreclosure crisis?
- What are lessons of the foreclosure crisis for future efforts to promote homeownership?

Why Should Public Policy Support Homeownership?

- Support for homeownership generally based on belief that it brings important financial, social and other benefits
- But arguments about how homeownership benefits low- and moderate-income households are not a slam dunk
- Financial Benefits Often the Principal Rationale
 - Complex to estimate and difficult to prove
 - Clearly a risky investment that ties up large share of wealth
 - **But** homeownership is the primary form of wealth accumulation for low- and moderate-income households
 - May primarily result from forced savings aspect of paying a mortgage along with nominal appreciation

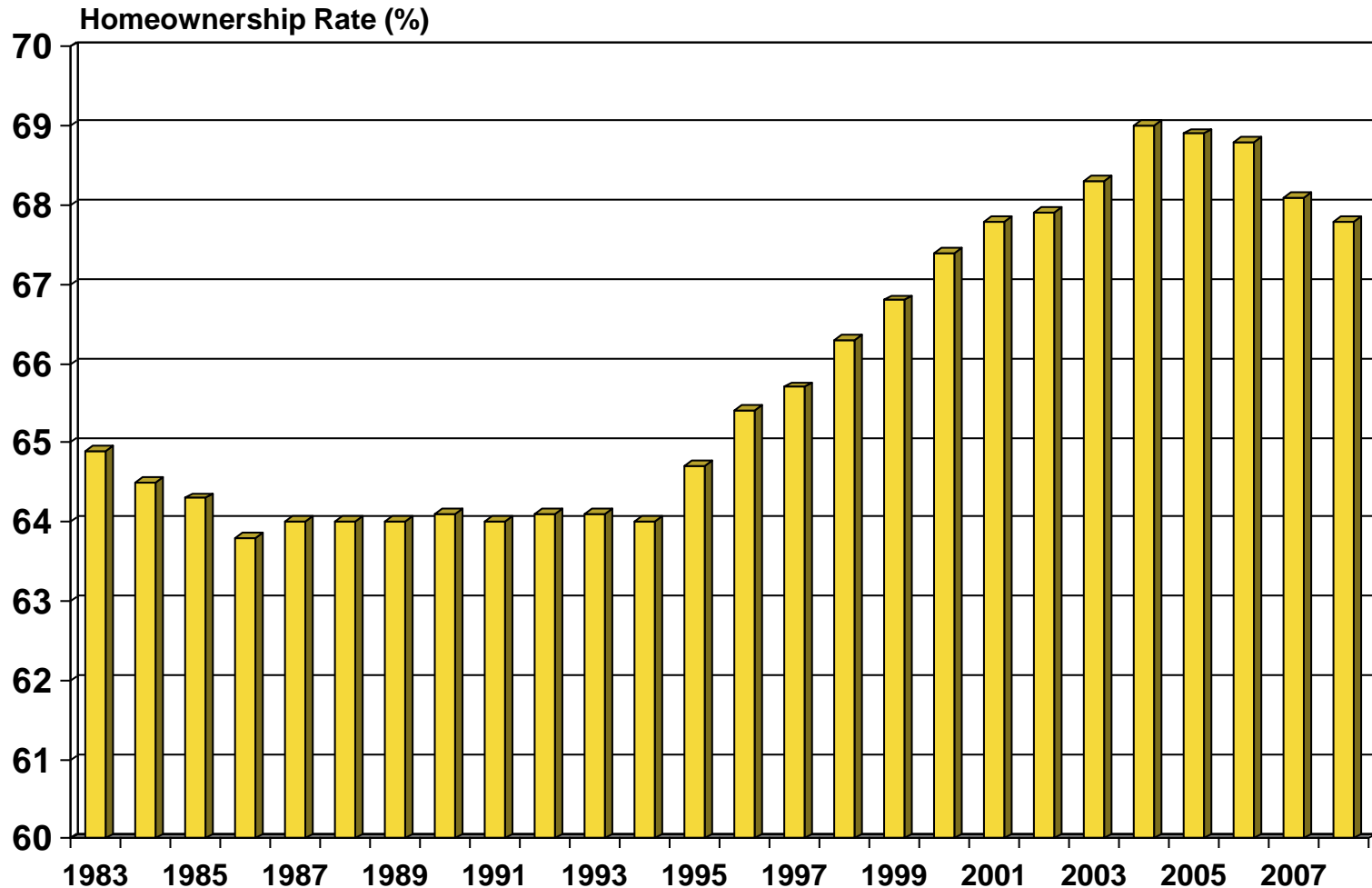
Why Should Public Policy Support Homeownership?

- Evidence for Social and Other Benefits Less Compelling
 - Only weak support for homeowners being more engaged in their communities
 - Fairly consistent support for positive outcomes for children, including better educational achievement and higher homeownership rates as adults
 - Little evidence of owners having better physical and psychological health
- Perhaps one of strongest rationales for supporting homeownership is the simplest—most households have a strong preference for owning a home

Important to Recognize that Homeownership is Not Always Appropriate

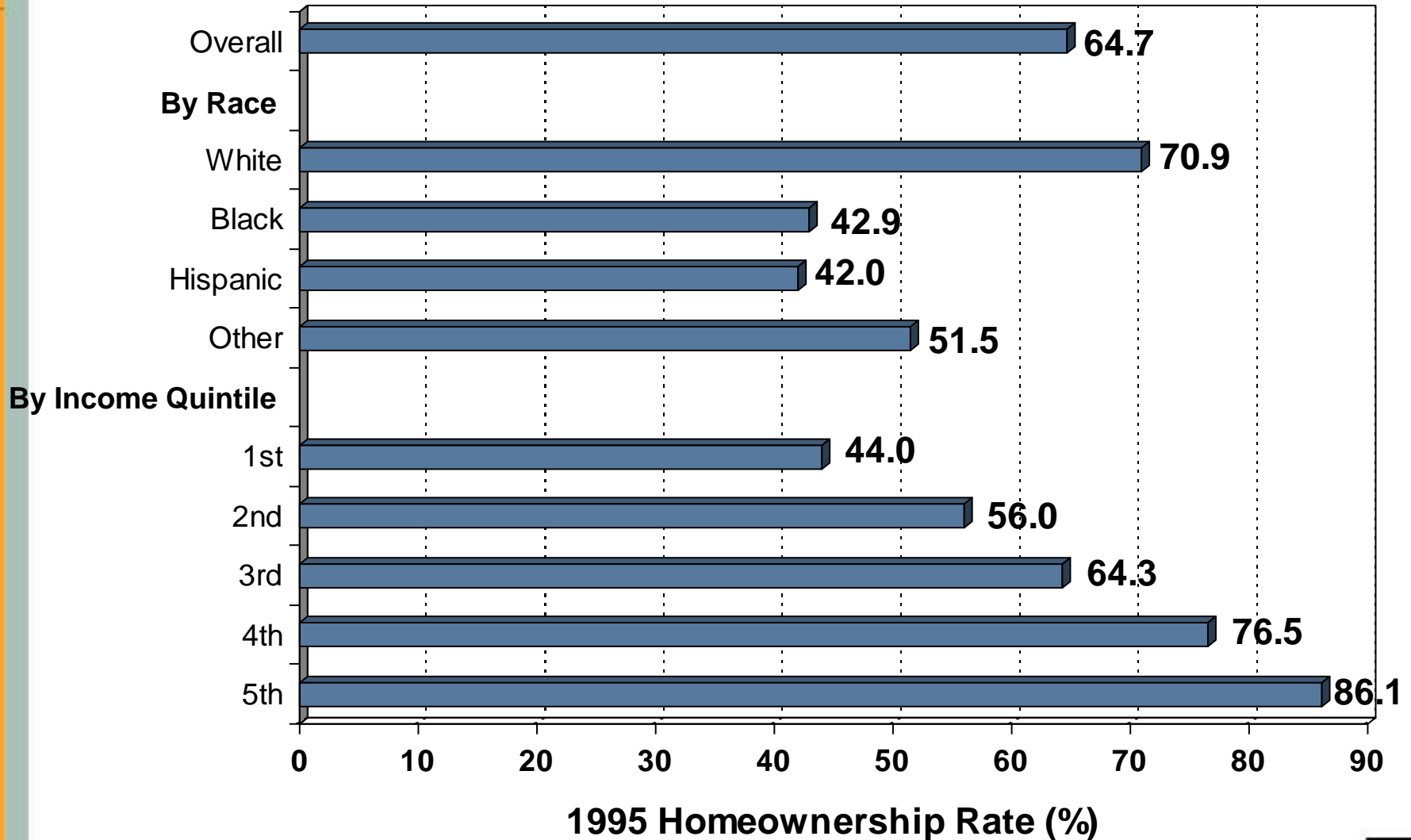
- Financial, Social and Other Benefits only realized if homeownership is sustained over a number of years
 - About half of low-income homeowners in 1980s and 1990s did not maintain homeownership for more than five years
- Homeownership appropriate *when* households:
 - Have financial ability to withstand unexpected costs and loss of income
 - Have ability to handle home maintenance needs
 - Are unlikely to need to move in next few years

Increase in Homeownership Rates From Mid 1990s Through 2004 was Significant



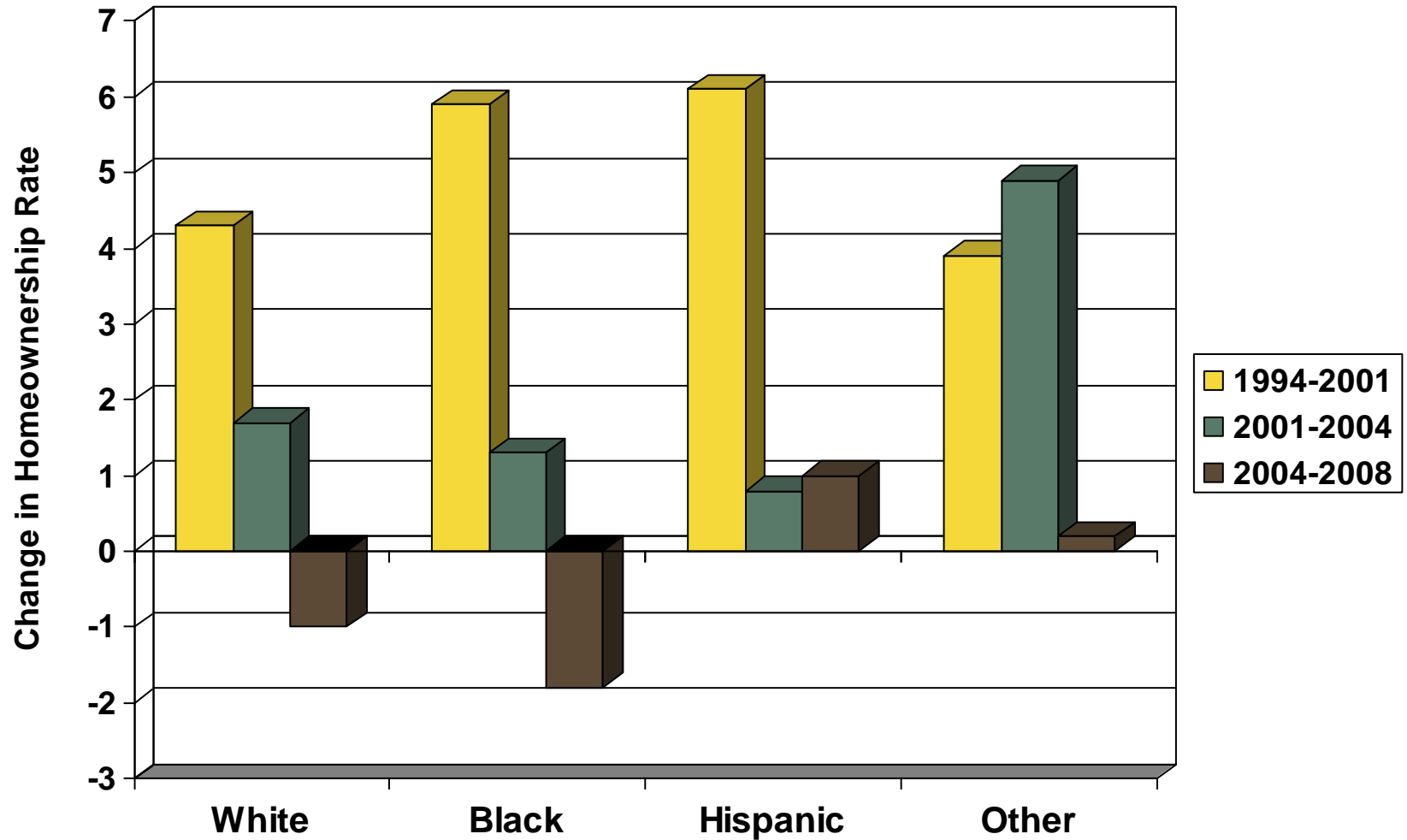
Source: Current Population Survey

Focus on Increasing Homeownership Rates Motivated by Significant Differences in Rates by Race and Income



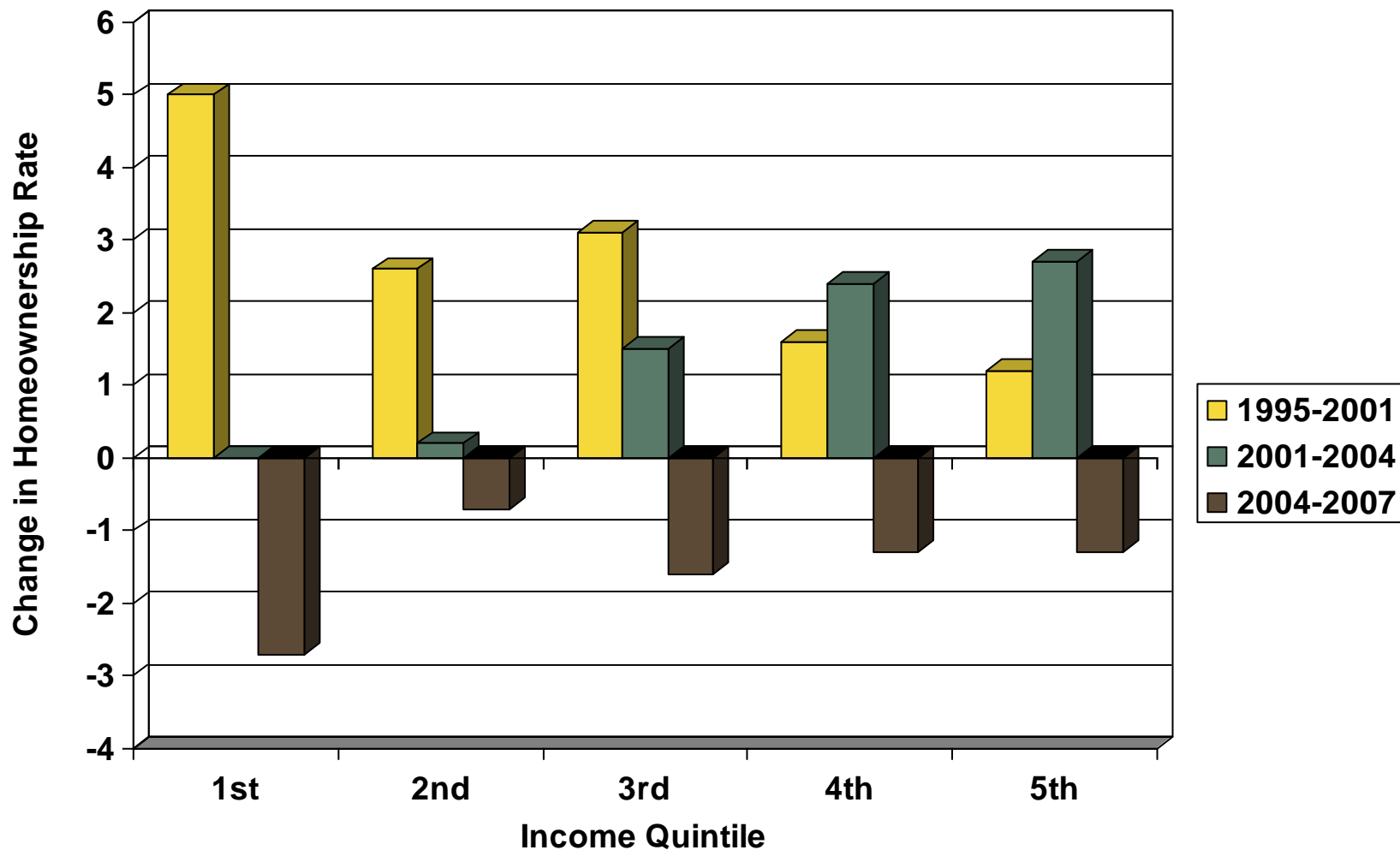
Source: Current Population Survey

Homeownership Gains Were Larger for Blacks and Hispanics Up Until 2001



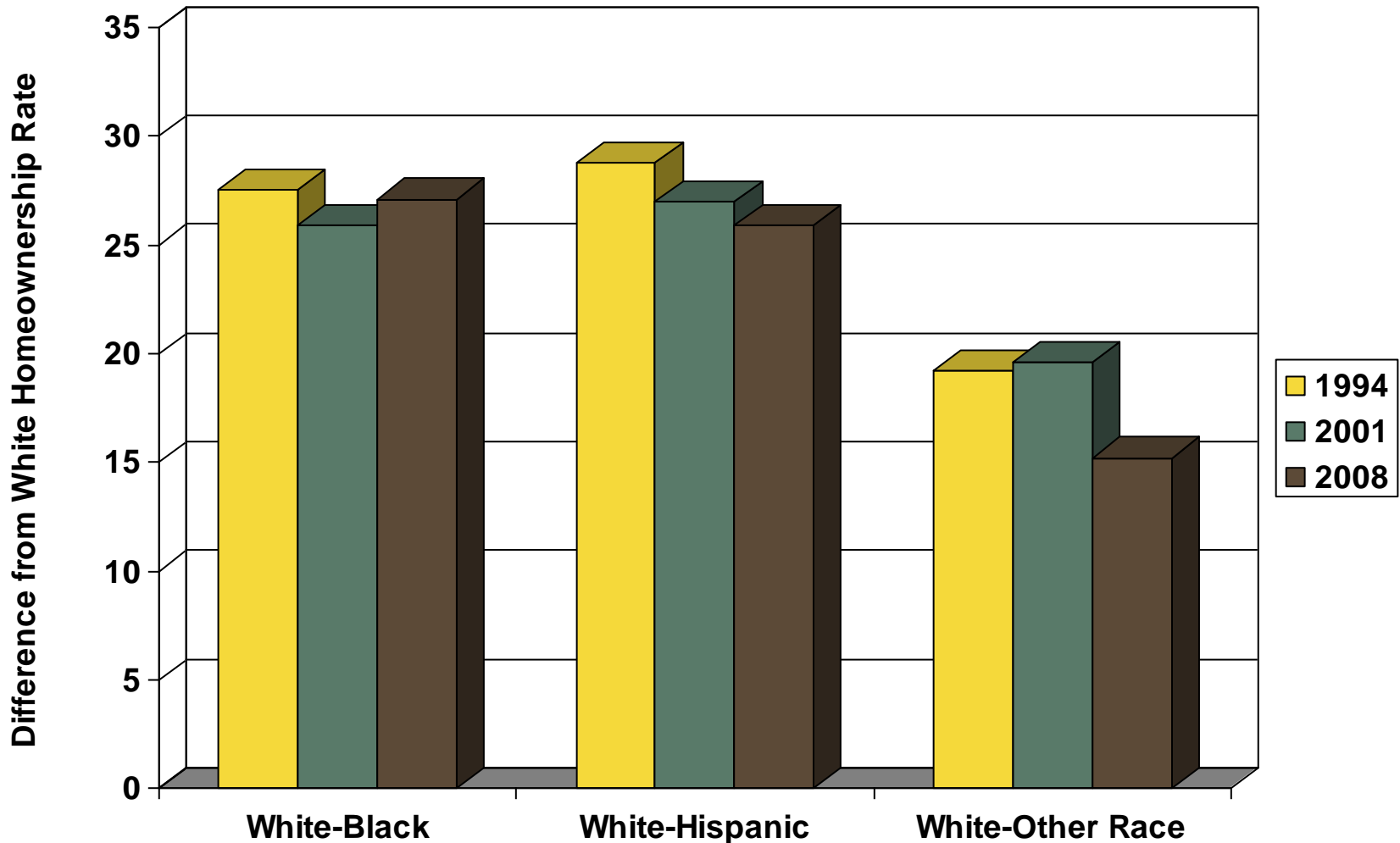
Source: Current Population Survey

Homeownership Gains Also Larger for Lower Income Households Through 2001



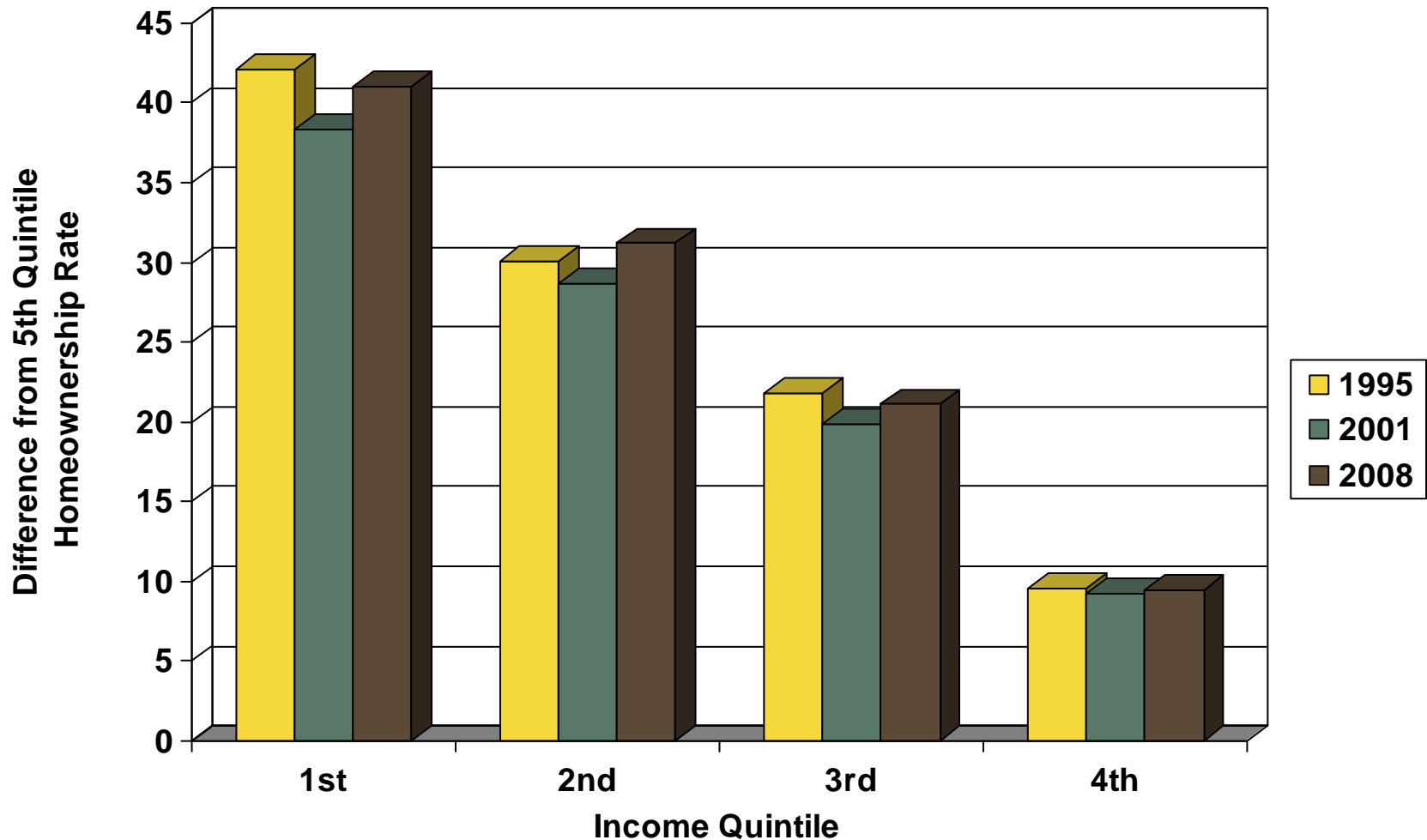
Source: Current Population Survey (reported in Calem, Courchane, and Wachter, 2009)

While Minority Homeownership Rates Are Higher than in Early 1990s, Gaps Have Hardly Changed



Source: Current Population Survey

Homeownership Gaps by Income Also Largely Unchanged Since 1994

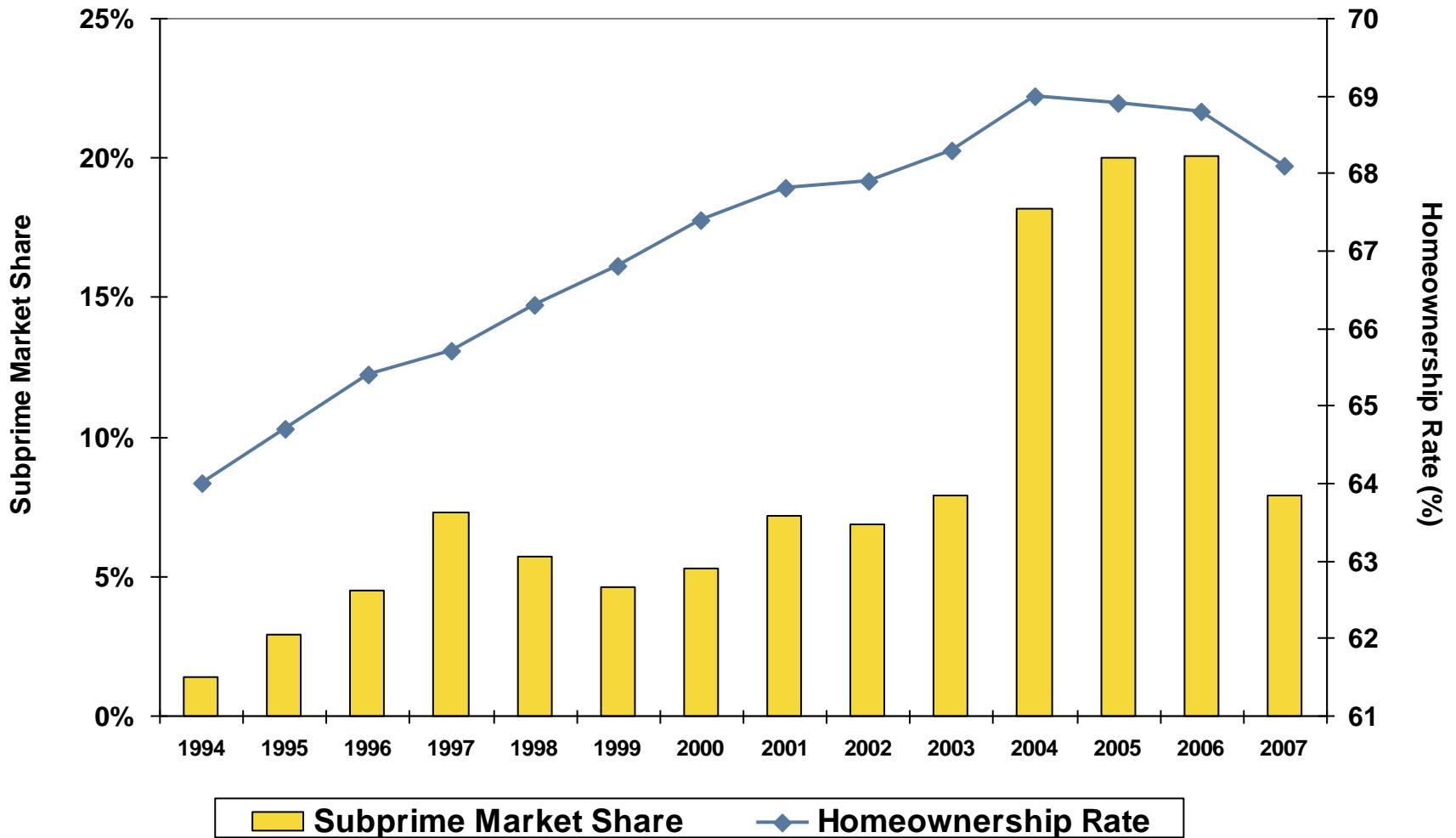


Source: Current Population Survey (reported in Calem, Courchane, and Wachter, 2009)

What Do We Know About Causes of Increased Homeownership Rates?

- Increases generally believed to be due to combination of:
 - Favorable demographics
 - Strong economic conditions including employment growth, low interest rates, and steady but not crazy house price growth
 - Innovations in mortgage markets—better estimation of risk, more relaxed underwriting terms, and lower transaction costs
 - Increase in homeownership programs and regulations promoting homeownership
- Disentangling how much each factor contributed is hard
 - Studies have found that demographic trends only account for about a third of the increase
 - Remaining increase attributed to other three factors combined

Significant Expansion of Subprime Lending Largely Occurred After Homeownership Rates Peaked



Source: Current Population Survey and Inside Mortgage Finance (from Joint Center for Housing Studies, 2008)

Main Government Efforts to Promote Homeownership

- Impression that there has been substantial effort by the government to promote homeownership since early 1990s
- But actually few new programs and most are small scale
- Largest government efforts are programs that are not new—with the exception of GSE housing goals
- Efforts can be grouped into four main categories:
 - Downpayment assistance
 - Direct lending programs
 - Regulatory mandates on financial institutions
 - Housing counseling

Most Important Barrier for Lower-Income Households is Lack of Savings for Downpayment and Closing Costs

- Several downpayment programs initiated in the 1990s, but most are not large:
 - HOME Program – assists 20,000 to 30,000 per year
 - Federal Home Loan Bank Affordable Housing Program – assists about 15,000 per year
 - NeighborWorks America – assists 8,000 per year
- Seller funded downpayment assistance channeled through non-profits had much higher volumes – 100,000 to 200,000 per year since early 2000s
 - Enabled by availability of FHA insurance
 - But FHA no longer will finance these purchases due to high defaults

Long-Standing Government Lending Programs Serve More Homebuyers, But Offer Limited or No Subsidy

- FHA mortgage insurance program has been single largest program
 - Makes credit available to riskier borrowers but does not offer a subsidy
 - Until foreclosure crisis, experienced substantial loss in market share to subprime lenders and GSEs
- Mortgage revenue bonds allow state housing finance agencies to provide interest rate subsidy of about 1.5 pp to about 125,000 homebuyers a year
- Rural Housing Service Section 502 provides deeper interest rate subsidy but only assists about 15,000 buyers a year

Regulation of Financial Institutions Also A Key Component of Government Efforts

- During 1990s federal Housing Goals led Fannie Mae and Freddie Mac to develop mortgage products with more flexible underwriting
 - GSE lending to low- and moderate-income borrowers increased substantially—from about a third of all GSE loans in 1993 to more than half in recent years
- Since 1977 Community Reinvestment Act has encouraged federally-insured banks and thrifts to meet the credit needs of the geographic areas where they accept deposits
 - In 1990s many lenders also created special lending programs that provide relaxed underwriting and below market interest rates to low-income borrowers
 - Best information available suggests these special programs originated about 20,000 to 30,000 loans per year

Homeownership Education and Counseling One of the Most Widespread Efforts to Support Homeownership

- Counseling viewed as both helping to overcome informational barriers and to mitigate default risk
- Beginning in 1990s, many affordable lending programs required counseling to prepare low-income buyers for homeownership
- From 1994 to 2005 the number of pre-purchase counseling clients assisted by HUD-approved agencies increased from 25,000 to more than 500,000
- Sharp decline in counseling volumes after 2005 as subprime purchase lending took off

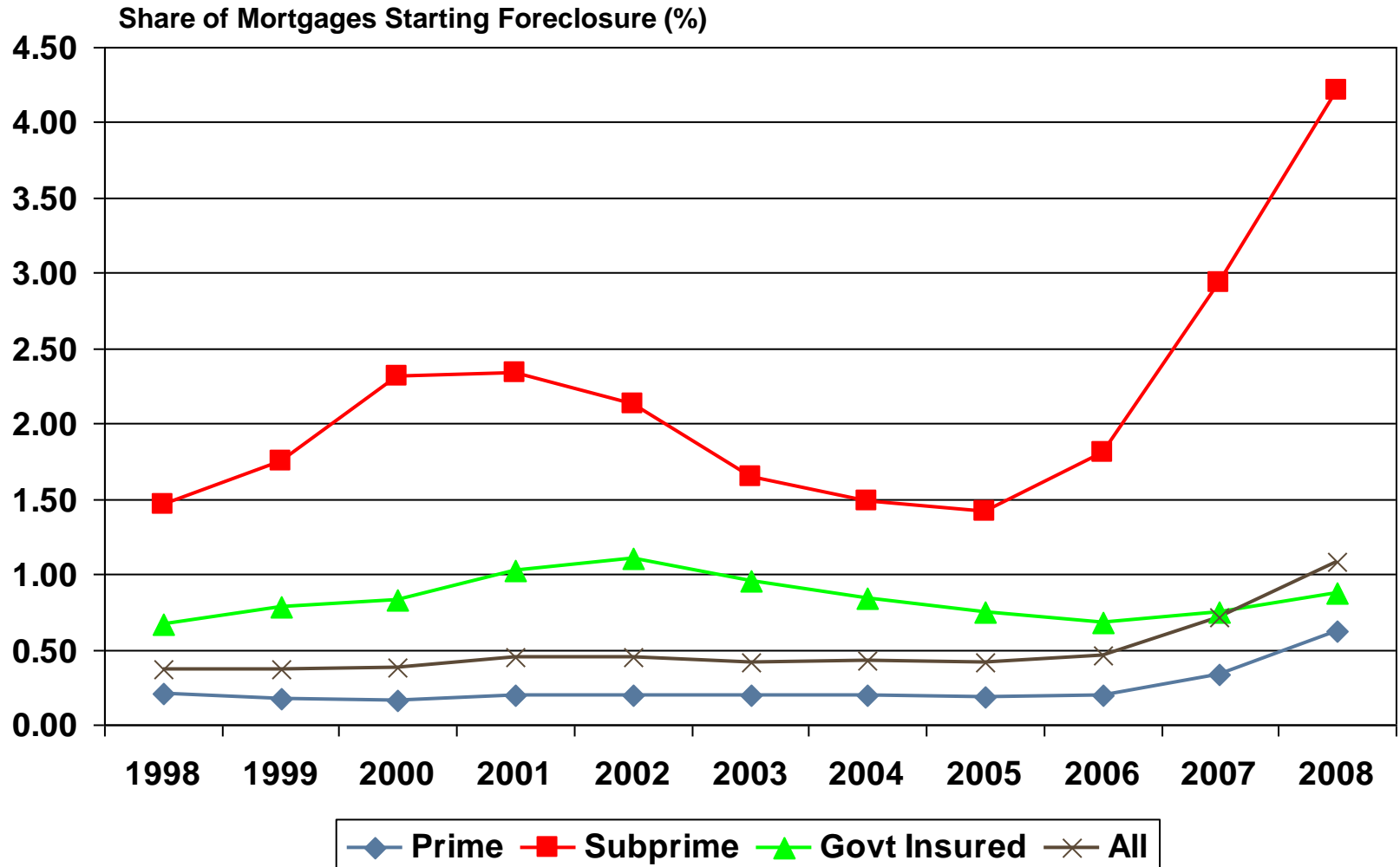
How Much Did these Efforts Help to Increase Homeownership? It's Not Clear

- No evaluations of downpayment assistance programs, but financial simulations suggest they have greatest potential impact
- Assessments of FHA's impact find at best it increases homeownership by less than 2 percentage points
- CRA has been found to increase lending volumes in low-income areas, although impact on homeownership rates is unclear
- Studies generally find less positive impacts of GSE lending on either mortgage volumes or homeownership rates
- A few studies have found that counseling associated with reduced default rates, but studies are not definitive
- But taken as a whole, all of these efforts likely contributed some to gains—along with favorable economic conditions

How Much Did Government Efforts Contribute to Foreclosure Crisis?

- Overall, available evidence suggests government efforts were not a significant factor producing the crisis
- Subprime and Alt-A lending were the main cause—and much of this lending occurred outside of federal regulatory framework
- CRA loans have performed better than comparable loans through other channels
- Little information on recent performance of GSE affordable loan programs, but public testimony indicates their financial problems stemmed mostly from Alt-A loans made to retain market share
- With notable exception of seller-funded downpayment assistance, some evidence that federal downpayment programs have had low foreclosure rates

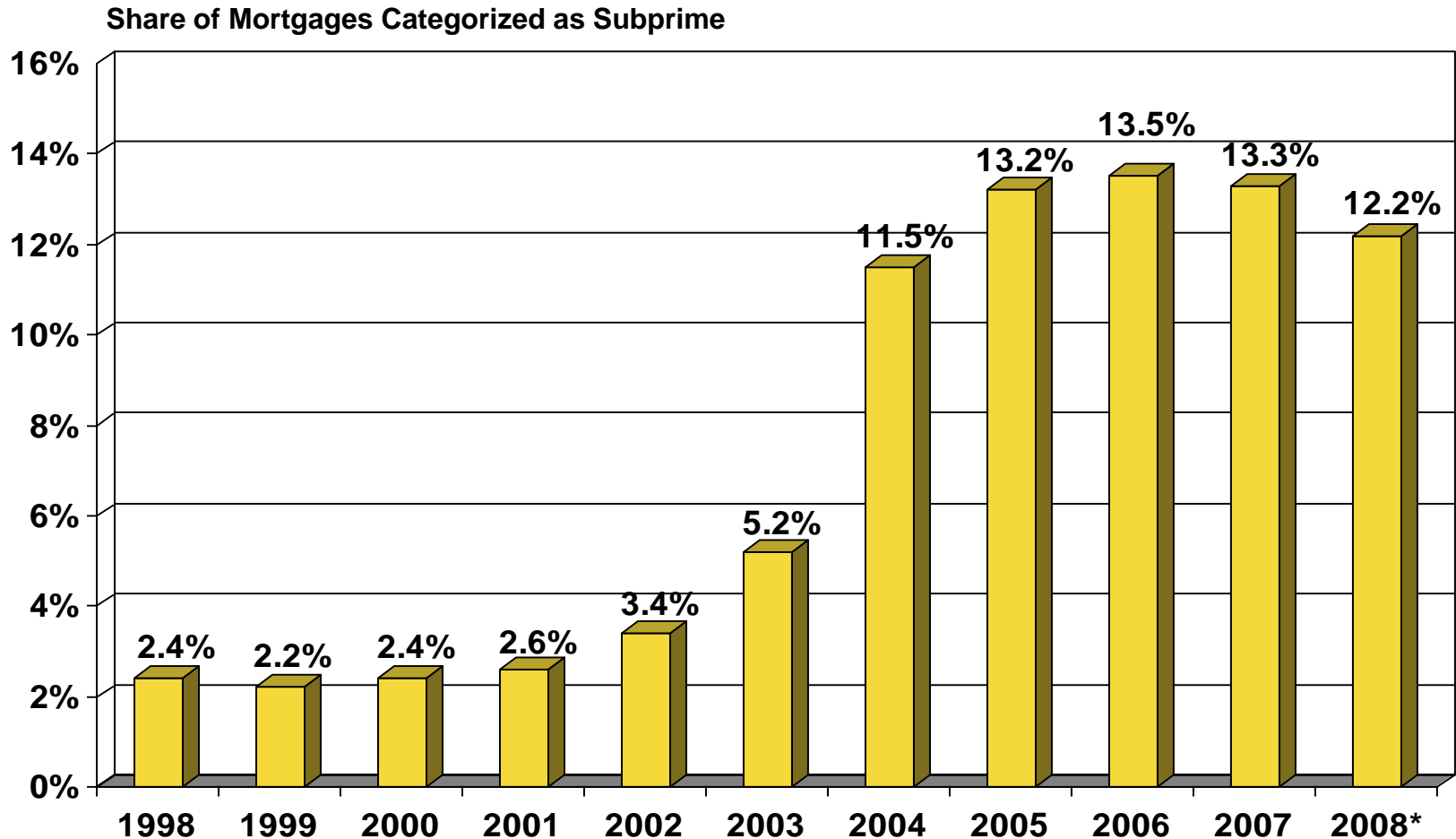
Subprime Loans Clearly the Root Cause of the Foreclosure Crisis



Source: Mortgage Bankers Association, National Delinquency Survey.

Note: Annual figures are average of quarterly data; 2008 only includes first three quarters.

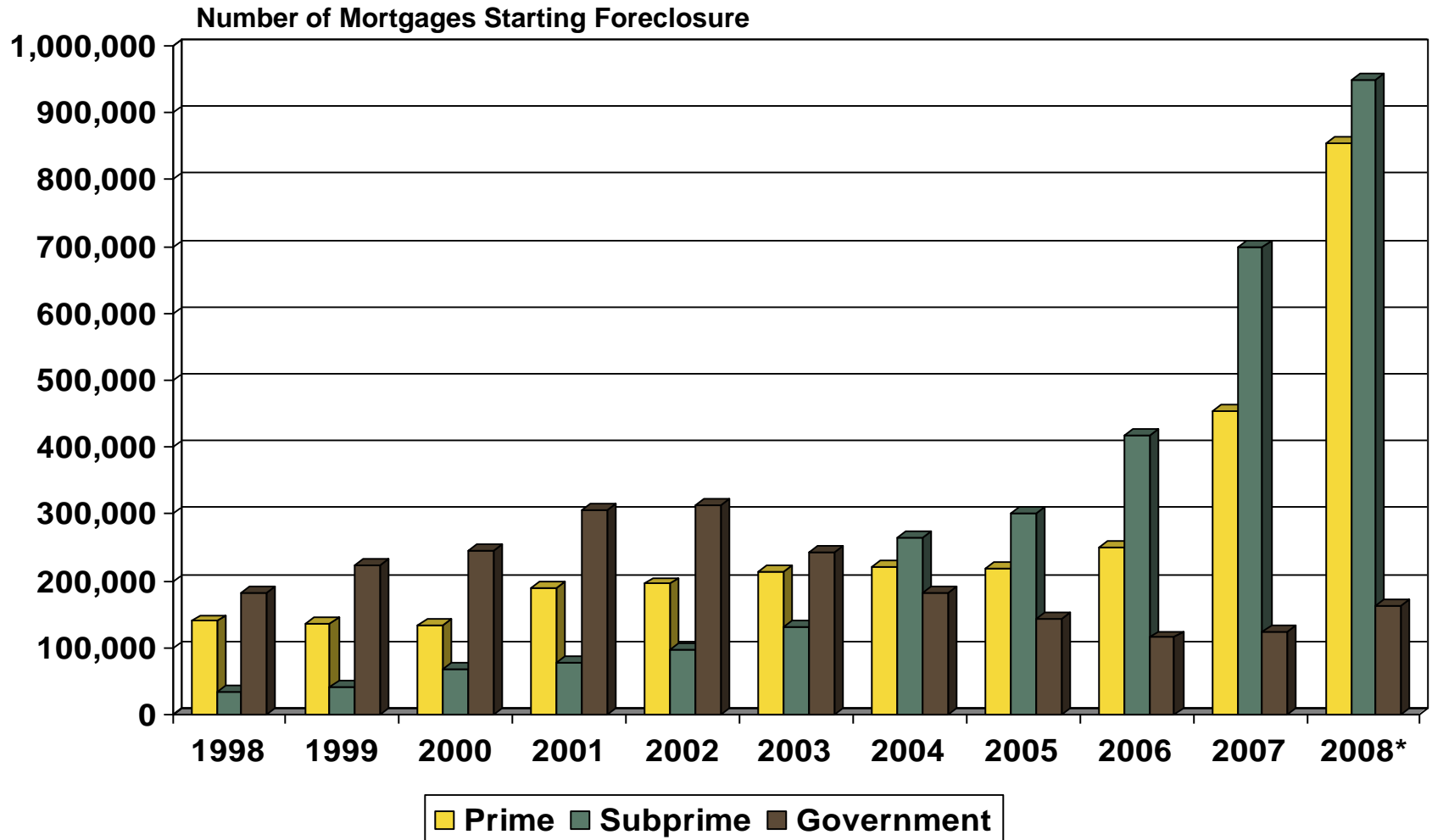
Increase in Overall Foreclosure Rates Due to Rise in Both Subprime Foreclosure Rate and Market Share



Source: Mortgage Bankers Association, National Delinquency Survey.

Note: Annual figures are average of quarterly data; 2008 only includes first three quarters.

As Economy Worsens, Prime Foreclosures Starting to Catch Up with Subprime



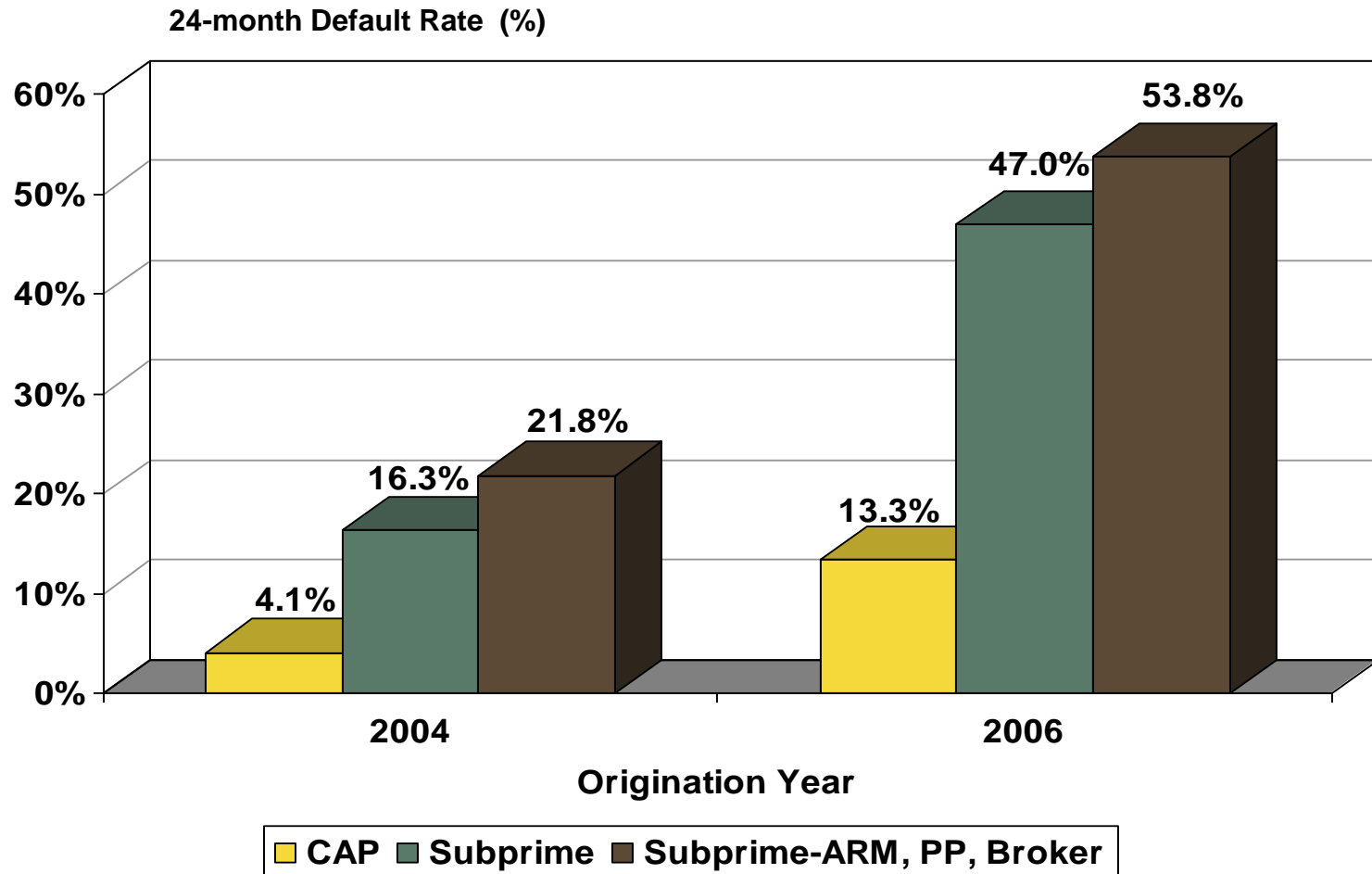
Source: Mortgage Bankers Association, National Delinquency Survey.

Note: Annual figures are average of quarterly data; 2008 only includes first three quarters.

Recent Studies Have Found that Loans Made Under CRA Have Relatively Lower Foreclosure Risk

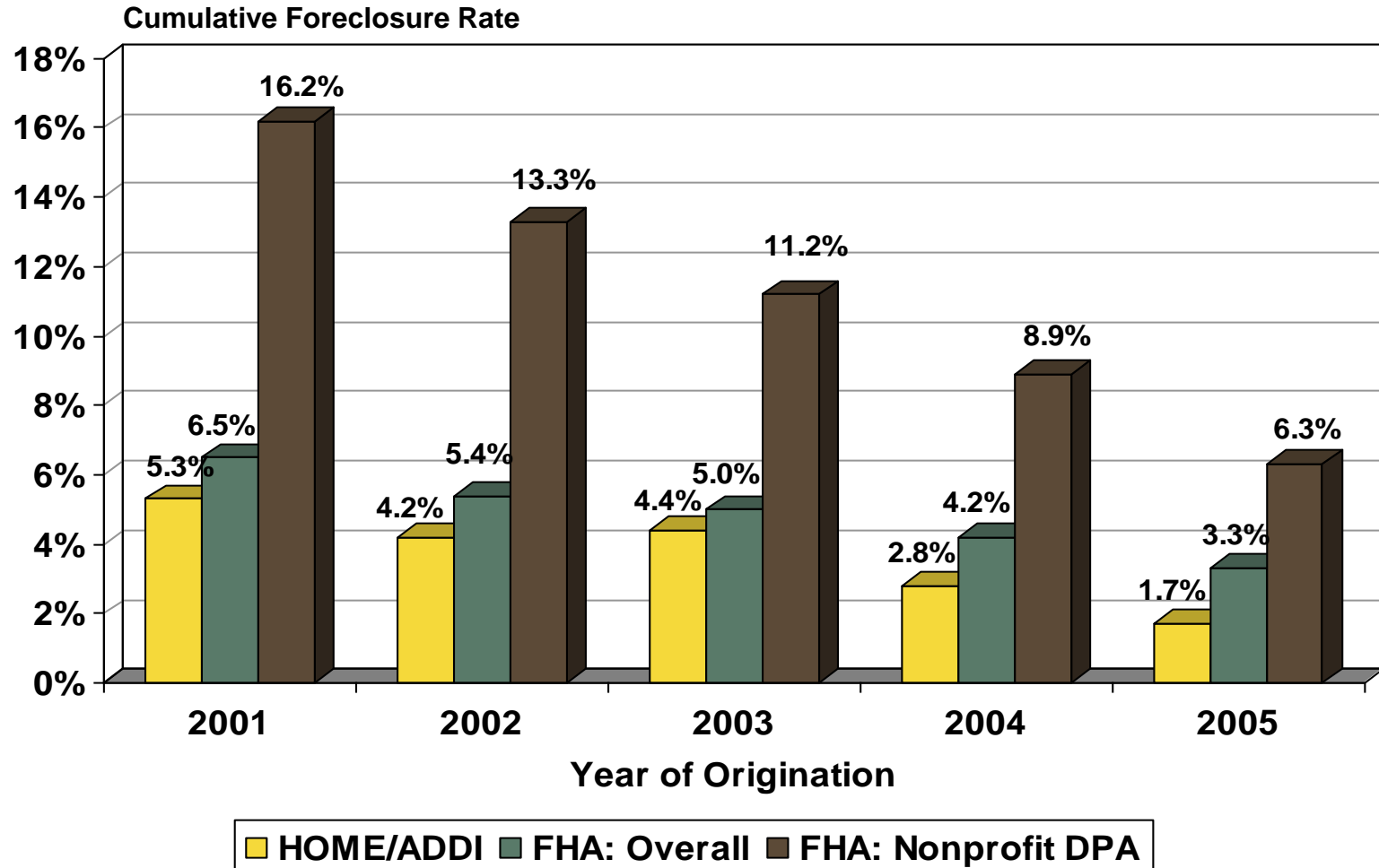
- Laderman and Reid of SF Fed find that loans made by CRA lenders in their assessment areas were ***half as likely to go into foreclosure*** as similar loans made by independent mortgage companies
- UNC researchers find that loans made under CRA special lending programs had ***default rates that were only one-quarter the rate of comparable subprime borrowers***
 - Default risk of subprime loans further exacerbated by common characteristics of ARM, broker-originated, and prepayment penalties

Special CRA Lending Program (CAP) Had Much Lower Default Rates than Comparable Subprime Loans



Sources: Ding, Quercia, Ratcliffe, and Li, 2008.

Some Evidence That Government Downpayment Programs Have Supported Sustainable Homeownership



Sources: HOME/ADDI Foreclosure Rate from forthcoming HUD study; FHA foreclosure rates from Federal Register, Vol. 73, No. 116, pages 33941-33955, June

Primary Failures of Mortgage Underwriting During the Foreclosure Crisis Not Needed for Affordable Lending

- Failure to document borrower income and assets which encouraged “liar” loans
- Allowing excessive housing costs to income ratios
- Originating loans that will almost certainly be unaffordable when interest rates adjust
- Counting on increases in house prices to mitigate foreclosure risks
- Counting on high credit scores to offset other indicators of default risk
- Making loans to investors motivated by speculative profits

Lessons for Future Efforts to Support Homeownership

- There are substantial financial barriers to homeownership for low-income and minority households
- Homeownership gains of the 1990s associated with period of more flexible underwriting that helped address these barriers
- As the market returns to more prudent lending need to be careful to not “throw the baby out with the bathwater”
 - Experience of 1990s suggests that lending with higher LTVs and debt to income ratios and lower credit scores does not have to lead to unacceptable default rates
 - *If* borrowers are adequately prepared and mortgage products are appropriate

Potential Approaches to Ensuring the Sustainability of Homeownership

- FHA to undertake a demonstration of pre-closing counseling for high LTV loans as a check on borrower's ability to take on this risk—could have lessons for other market segments
- Several important constraints in making this work:
 - Has to be timely—coming as part of mortgage application process it will be important that counseling can be delivered quickly
 - Has to be paid for—in order for counseling to be available and of high quality it will need steady revenue source
 - Has to serve as legitimate check on purchase decision—could easily become a “check the box” step in the process

Potential Approaches to Ensuring the Sustainability of Homeownership

- To ensure that homebuyers are prepared to meet financial challenges of homeownership, deliver downpayment assistance through matched savings programs
- Addresses most important financial barrier to homeownership
- Will help ensure that buyers have the ability to budget and save, which will be needed to sustain homeownership
- Borrowers will also have more of their own equity invested, which is a strong predictor of whether they are likely to default

In Conclusion

- Supporting low-income and minority homeownership remains an important public policy goal
- The foreclosure crisis should not be attributed to government efforts to promote homeownership
- Many of the innovations and approaches developed during the 1990s are still valid
- But we should pursue approaches that help improve the sustainability of homeownership



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