AFFORDABLE HOUSING:
THE WAY FORWARD FROM HERE

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WHAT CAUSED THE CRISIS

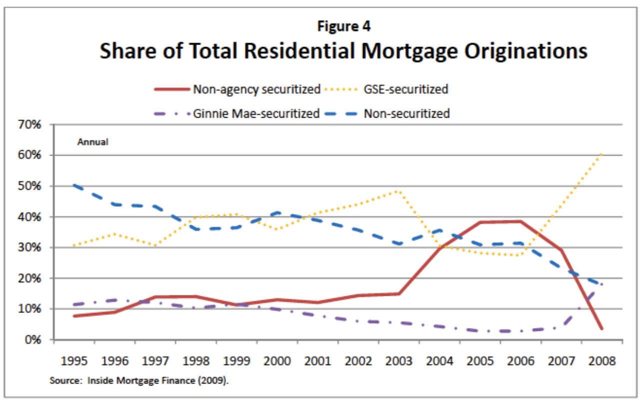
Pre-Depression Mortgage Finance

- Very limited and costly availability of mortgage credit
  - The typical mortgage was 50% down, 2-5 years in length and non-amortizing (interest-only).
  - Lender-friendly characteristics: no prepayment risk, limited interest rate risk, and large buffers against credit risk.
  - Homeownership rate around 40%, despite policies encouraging homesteading through cheap or free land grants. In DC and NY State, HO rate around 30%.
- Unstable financial system
  - Bubble-bust cycles every 5-10 years.
  - Large systemic costs in terms of economic and capital markets retardation.

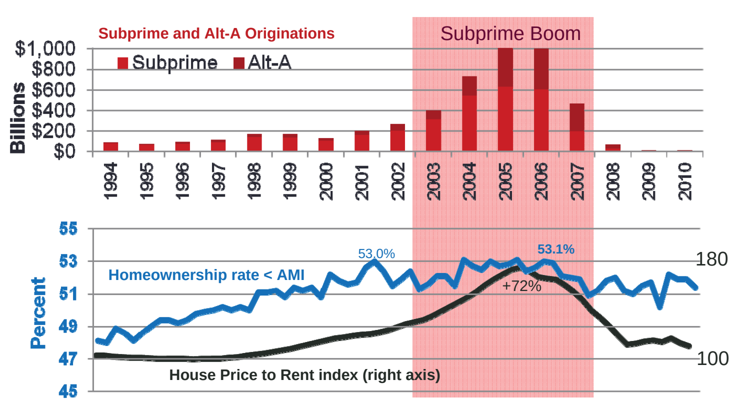
The Post-Depression Era of Mortgage Finance

- Introduction of govt support transformed mortgage finance
  - The establishment of the modern mortgage– high LTV, long-term, fixed-rate, fully self-amortizing.
  - Broad access– HO rate from 43.6% in 1940 to 64.4% in 1980.
  - Stability– The so-called "Quiet Period" in banking
- The transition from deposits to MBS
  - Interest rate shocks from the 1970s/80s
  - Deregulation/regulatory forbearance in the 1980s
- The transition from Agency MBS to private-label MBS

Private-Label Securitization Drove the Housing Bubble

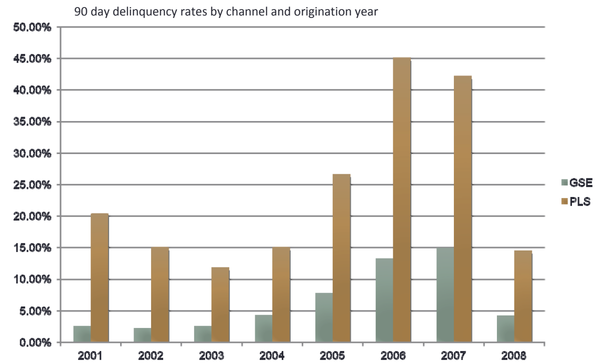


Crisis Caused by Products, not Homeownership



Source: *Inside Mortgage Finance; US Census Bureau*

PLS Loans Performed Significantly Worse

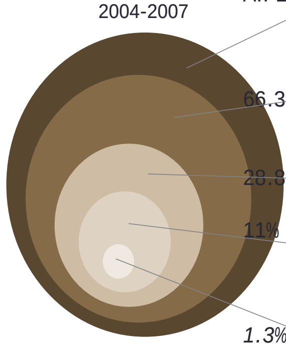


Source: Federal Housing Finance Agency (using data from Inside Mortgage Finance, Fannie Mae, Freddie Mac, and CoreLogic, Inc.)

WHAT DIDN'T

CRA Loans Did Not Cause the Crisis

2004-2007



All Loans (first-lien, 1-to-4 unit properties in metropolitan areas, home purchase or refinance)

66.3% Banks and Thrifts - CRA-regulated + their subsidiaries and affiliates

28.8% within CRA Assessment Areas

11% eligible for CRA credit (lower-income borrowers or neighborhoods)

1.3% Subprime CRA-eligible (only 5.9% of high-cost loans)

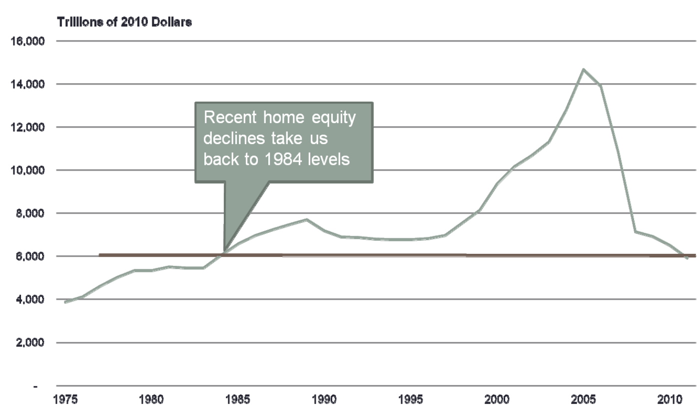
Note: Circles are drawn to scale.
Source: Home Mortgage Disclosure Act

CRA-type Lending Did Not Cause the Crisis

- The loans that caused the financial crisis -- subprime and Alt-A loans -- were overwhelmingly originated by non-CRA lenders
  - LMI borrowers who received loans through CRA lenders within their assessment area were significantly less likely to receive a subprime loan or loan with a risky feature, even after controlling for borrower and neighborhood risk characteristics
- CRA loans have performed better than non-CRA loans
  - CRA loans made in California were half as likely to go into foreclosure as loans to similar borrowers made by lenders not covered by CRA (*Lederman and Reid)*
  - CRA-motivated loans in CAP program, default risk was three times lower than subprime loans made to borrowers with similar risk profiles (*Ding, Quercia, Li, Ratcliffe)*

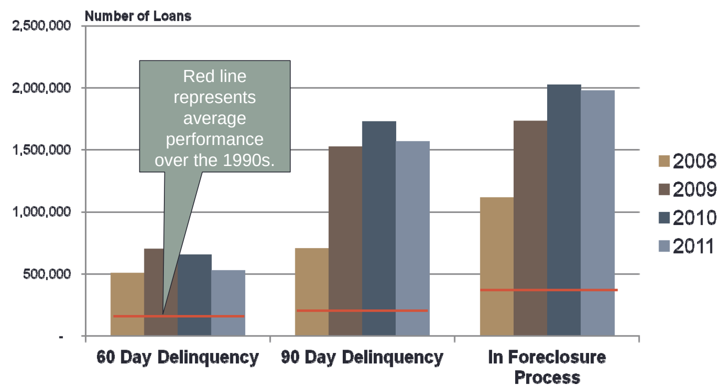
THE IMPACT OF THE CRISIS

Enormous Amounts of Home Equity Have Been Lost



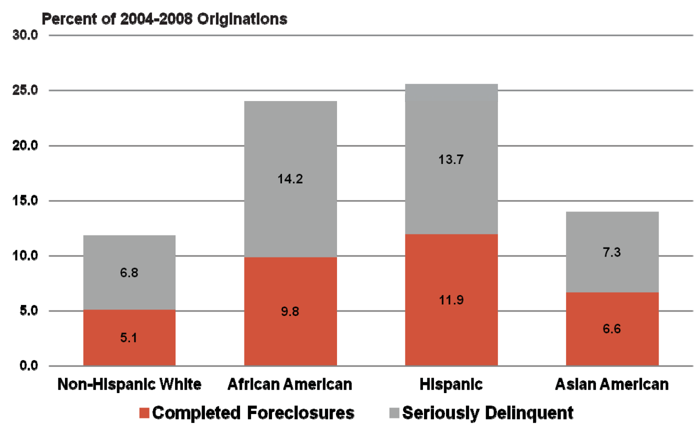
Source: Federal Reserve Board, Flow of Funds, Balance Sheet Tables. Dollar values are adjusted for inflation by the CPI-U for all items.

Delinquencies Falling, but Still Long Way From "Normal" Levels



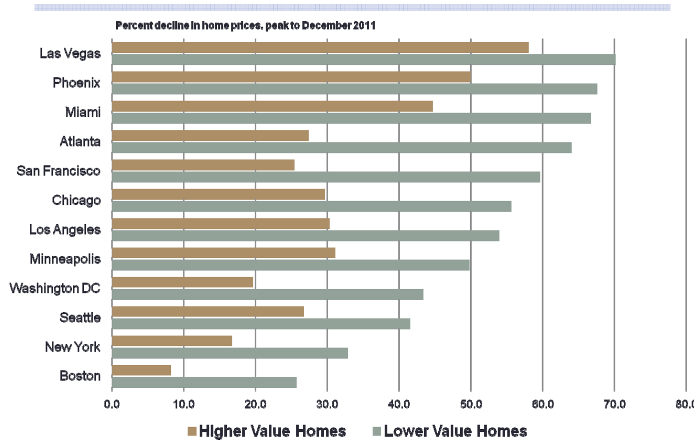
Source: Calculations of MBA National Delinquency Survey. Normal levels are calculated based on average performance for the 1990s.

Disproportionate Impact on Communities of Color



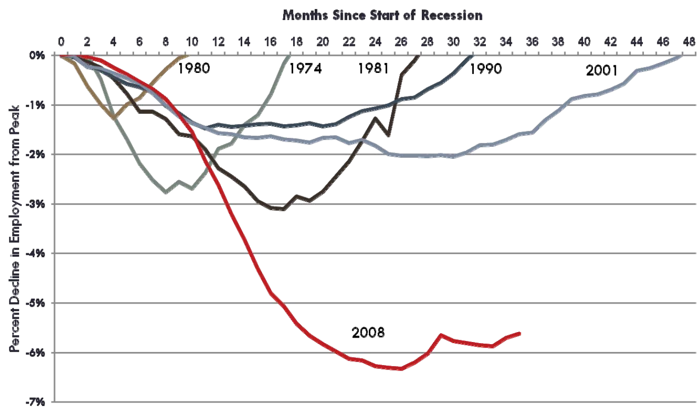
Source: Lost Ground, 2011. Center for Responsible Lending.

Lower-Priced Homes Have Been Hit Hardest by Price Declines



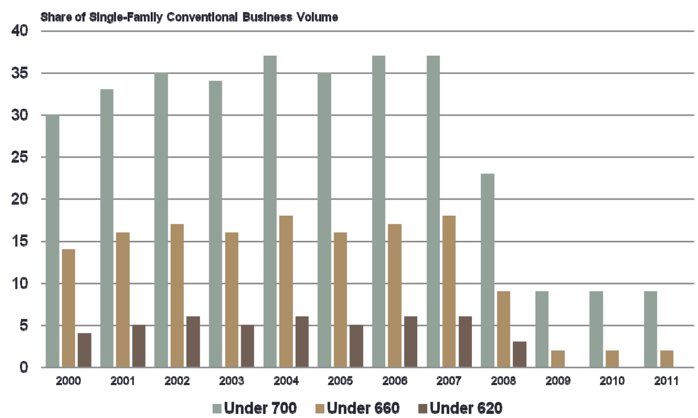
Source: Calculations based on Case Shiller MSA Level Tiered House Price Index.

Employment Has Started to Recover, but is Still in a Deep Hole



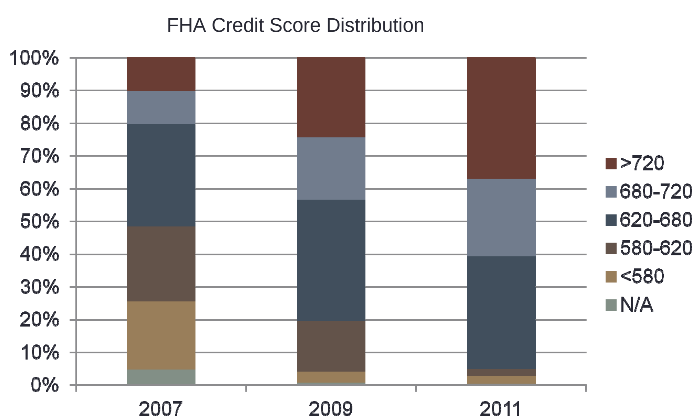
Source: Bureau of Labor Statistics, calculations by Federal Reserve Bank of San Francisco.

Credit Remains Extremely Tight



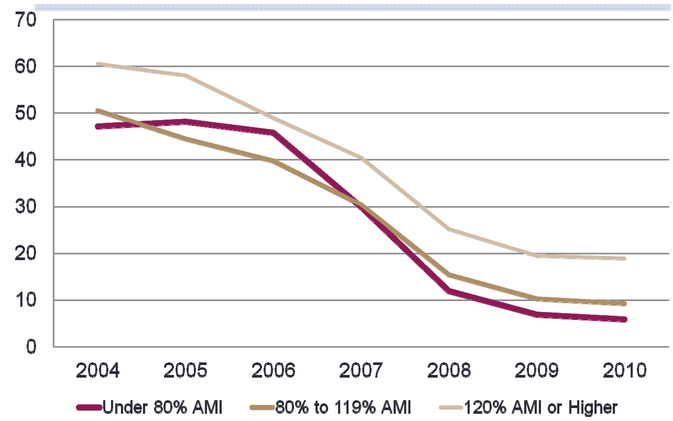
Source: Fannie Mae Annual 10K Reports.

FHA's Changing Risk Profile



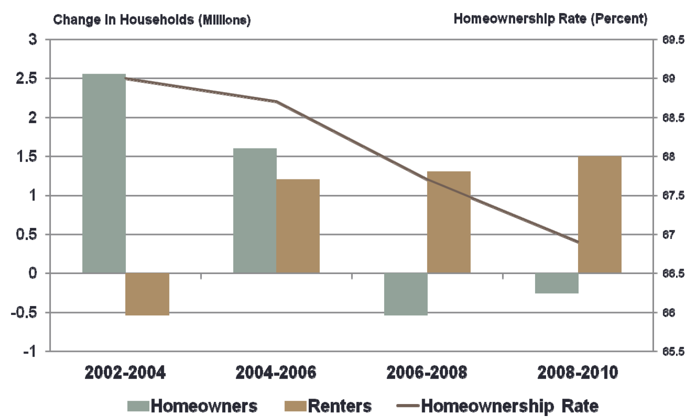
Source: MMIF FY2011 Q2 Report to Congress. Figures refer to data from 1st quarter of each year.

Lending in Low-Income Neighborhoods has Dropped Precipitously



Source: Home Mortgage Disclosure Act
Notes: Conventional first lien mortgage originations for purchase of owner-occupied 1-to-4 family and manufactured homes. Originations/1000 are median among census tracts, as percent of owner-occupied units.

Growing Demand for Rental Housing



Source: Joint Center for Housing Studies, State of the Nation's Housing 2011

Fiscal Environment Will Make Production of Affordable Housing Challenging

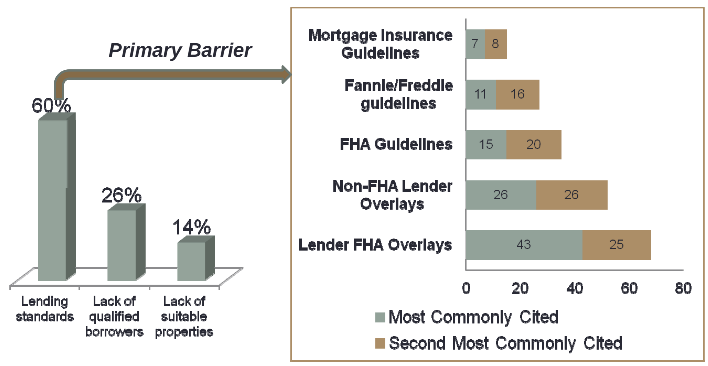
- HOME
  - President's FY13 Request: $1 billion
    - Level with FY12, 38 percent cut below FY11
    - Only currently funded HUD production program
- Low Income Housing Tax Credit
  - Cuts in annual funding to HOME and CDBG and redevelopment funds in CA will reduce "soft dollars" available to close funding gap for new LIHTC projects
  - 9% minimum credit rate set by ARRA is set to expire; applies to projects placed in service before Dec. 31, 2013
- State budgets not recovered from recession
  - 29 states have projected shortfalls totaling $47 billion
  - Revenues still well below pre-recession levels

THE FUTURE OF AFFORDABLE HOUSING

ACCESS TO CREDIT

The Impact of Tight Guidelines

84% of Prepurchase Housing Counselors surveyed report it is MUCH harder for reasonably qualified clients to get a mortgage.



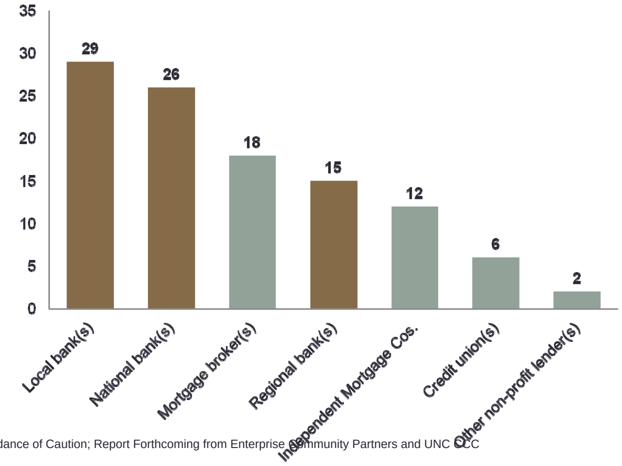
Source: Abundance of Caution; Report Forthcoming from Enterprise Community Partners and UNC CCC

Obstacles compounded in LMI communities

- Negative feedback loop in valuations, comparables.
- Mortgage barriers make cash buyers more attractive even at discounts.
- Harder hit communities can't compete with newly affordable, more attractive neighborhoods.
- Demand-side weakness: New buyer caution, low household formation.
- Over-reliance on bright-line, conservative rules instead of common sense underwriting.

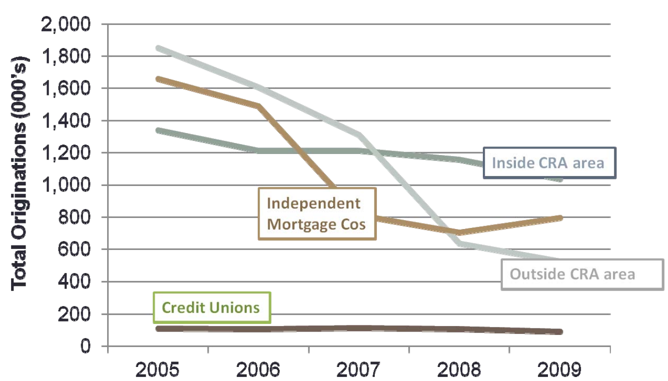
Source: Abundance of Caution; Report Forthcoming from Enterprise Community Partners and UNC CCC

Return to Bank, Retail, Local Lending



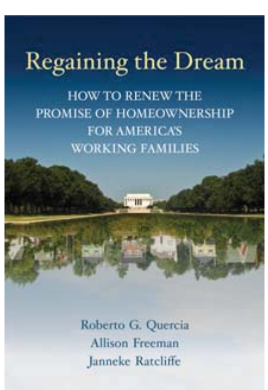
Source: Abundance of Caution; Report Forthcoming from Enterprise Community Partners and UNC CCC

Return to Bank, Retail, Local Lending



Source: HMDA

What CRA Lending Can Teach Us



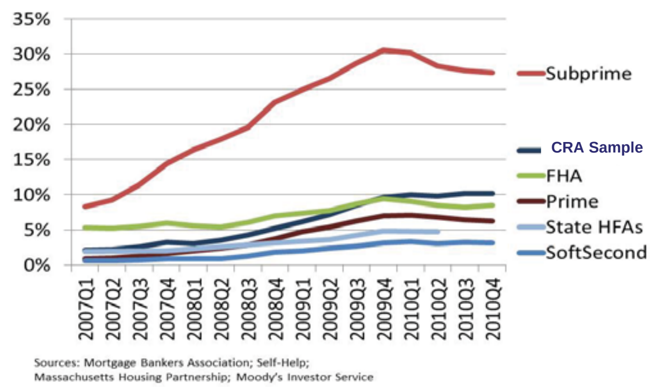
A study of 46,000 working families who became homeowners in the decade leading to the crisis.

Their success in remaining homeowners points to a way out of the housing crisis and toward a stronger economy.

By expanding opportunities for sustainable homeownership, working families can move up the economic ladder, create mobility in the housing market and provide jobs and economic growth.

Published by Brookings Institution Press

Evidence of Homeownership Done Right



What are the Hallmarks of Sustainable Homeownership?

- Safe product – fixed rate, long-term amortizing loan
- Fairly priced with no hidden fees and/or costs
  - E.g. no prepayment penalties, yield spread premiums, teaser rates
- Underwritten for ability to repay
- Responsible servicing
- Additional supports where needed (e.g. downpayment assistance, counseling)

QRM: The Wrong Answer

7.9 Million loans, 2004-2008, Conventional Prime, FHA, Subprime, Alt-A

	Good LI Loans Prevented	Good MI Loans Prevented	Bad Loans (Defaults) Avoided vs QM (5.8%)	Good Loans Prevented/Default Avoided
20% Down	62%	66%	-1.8% (4%)	10
FICO 690	39%	30%	-2.3% (3.5%)	7
30% DTI	80%	73%	-1.6% (3.2 %)	11
All 3	85% of all performing loans			12

Source: Balancing Risk And Access, Quercia, Ding and Reid. UNC Center for Community Capital, Jan. 2012

THE FUTURE OF AFFORDABLE HOUSING

REBUILDING THE HOUSING FINANCE MARKET

Long-Term Issues (Mortgage Finance Reform)

- Options 1, 2, and 3
- Continued govt guarantee?
- Alternatives to the status quo
- Political risk

The Debate Over the Government Guarantee

- Pros: Broad, consistent, and affordable mortgage finance
- Cons:
  - The benefits of the guarantee are overstated
  - The guarantee distorts markets
  - The guarantee exposes taxpayers to too much risk
- The importance of the guarantee for market stability

Do We Need a Government Guarantee?

- Argument: Jumbo markets (pricing and products) prove that the guarantee is unnecessary

- Response:
  - Where will the liquidity come from?
  - Will the private sector continue to emphasize low-cost and consumer-friendly products in the absence of market pressure?
  - Will the private sector be able to provide low-cost and consumer-friendly products in the absence of Agency markets?

- Understanding the difference between credit risk investors and interest rate risk investors

Alternatives to the Status Quo

- Option 1
  - Rep. Hensarling, Rep. Garrett, Sen. Corker, American Enterprise Institute
  - Key questions: Whither the 30-year FRM? How can liquidity be replaced?
- Option 2
  - David Scharfstein
- Option 3
  - Reps. Campbell/Peters, Rep. Miller, Center for American Progress's Mortgage Finance Working Group, Mortgage Bankers Association, Nat' Ass'n of Homebuilders, Credit Suisse, FS Roundtable, Marron/Swagel, Passmore/Hancock, Mark Zandi.

- Key questions: How to deal with the public/private conflict inherent in GSEs? Is there political will to propose something that looks like GSEs? How do we ensure affordable housing finance?

Questions and Discussion