

2008 National Interagency Community Reinvestment Conference
San Francisco, California
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**Opening Remarks to the 2008 National Interagency
Community Reinvestment Conference**

Good morning. On behalf of the San Francisco Fed and our co-hosts, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, I'm delighted to welcome you to San Francisco and to the 2008 National Interagency Community Reinvestment Conference.

This year's event marks the 13th time that the regulators have jointly sponsored a conference on the Community Reinvestment Act. As in past years, one of the goals of this year's conference is to help you to understand the regulations and provide you with information on how to meet your CRA obligations. But even more, the conference is designed to keep you informed of the most important developments in the field and to give you the opportunity to share emerging challenges and best practices with your colleagues. And there are always many emerging issues to highlight. Indeed, since the first conference back in 1991, the field has evolved considerably—the CRA itself has undergone significant revisions, New Markets Tax Credits have replaced Low Income Housing Tax Credits as the complicated investment instrument of the day, and financial products and services are increasingly being targeted to meet the financial services needs of the unbanked.

Perhaps the most notable change, however, is that in the last 25 years, consumer credit markets have shifted dramatically, moving from a credit rationing approach to a risk-based pricing system. In other words, today, far fewer applicants are denied credit—rather, they are offered credit at higher prices intended to reflect the greater risk posed by these loans.¹ This shift, coupled with other innovations in the financial markets, has significantly increased access to credit, with both positive and negative effects.

On the positive side, expanded access to credit has greatly increased the ability of low- and moderate-income households of all races and ethnicities to become homeowners.² None of us would want to turn back the clock to the days when the prospects of being approved for a loan were more limited in certain neighborhoods and for certain classes of borrowers. But, as has become apparent over the past year with the rise in mortgage delinquencies and foreclosures, the risks associated with the changes in the consumer credit markets were greatly underestimated, and we are now grappling with the consequences.

My colleagues and I have been deeply involved in assessing the impact of rising foreclosures on the financial markets and the U.S. economy, and in developing the Fed's policy response.³ On the monetary policy front, we have undertaken several actions designed to stimulate demand in the face of contractions in the housing market and the tightening of credit. We have also sought to bolster market liquidity and promote orderly market functioning through several new lending facilities. We continue to carefully monitor trends in the financial markets and the economy, and we are committed to acting in a timely manner to address new developments.

In my remarks today, however, I would like to focus on the implications of the trends in the consumer credit markets—particularly in the area of subprime mortgage lending—for all of you here working in the field of community development. Personally, one of my greatest concerns is how the rise in foreclosures is affecting low-income families and communities. As I think many of you in this room have seen firsthand, the impact of foreclosures has been felt most acutely in people's homes and neighborhoods. Losing one's home—from having to pack up boxes and face the uncertainty of "what's next" to the long-term financial consequences—is not the dream anyone imagines for themselves when they pick up the keys to their first house.

For these reasons, I believe it is incredibly important to develop and share innovative solutions that can help to prevent foreclosures as well as mitigate the negative impact of foreclosures on borrowers and communities. In the words of the late Federal Reserve Board Governor Ned Gramlich, who had the foresight to see the risks in the credit market well before many of us, "...one of the nation's primary goals over the next few years should be the avoidance of a

domino effect that forces large and unnecessary losses on households through unnecessary or premature foreclosures.”⁴ It is in pursuit of this goal that I offer my remarks today.

Foreclosure Trends and their Impact on Low-Income Communities

To begin the discussion, let me just quickly provide some context about the current scale of delinquencies and foreclosures. While some communities have been struggling with high rates of foreclosure for a much longer time,⁵ the recent national rise in delinquencies and foreclosures has been sudden and substantial. By one estimate, in 2007, more than 1.25 million homes entered foreclosure, and more than twice as many (2.6 million) were at least 30 days past due on their mortgage payments as of the fourth quarter of last year.⁶

Most of the problems have been concentrated in the subprime market, and in particular, among subprime adjustable-rate mortgages, although more recently we’ve begun to see increases in foreclosures on subprime fixed-rate mortgages and even on prime adjustable rate mortgages.⁷

The reasons for the current crisis are complex and intertwined. Perhaps the most significant factor driving the current rise in delinquency and foreclosures is declining house values. Economic research has shown that downward changes in house prices are strongly associated with subprime delinquency “hotspots.”⁸ Of particular concern, however, is how relaxed underwriting standards and abusive lending practices have increased the risk of delinquency and foreclosure. As Chairman Bernanke recently noted, “far too much of the lending in recent years was neither responsible nor prudent.”⁹ Between 2001 and 2006—right when we saw the largest growth in subprime lending—the quality of loans deteriorated fairly steadily as underwriting criteria eased.¹⁰ Many subprime loans included additional risk factors, such as a lack of full documentation, high combined loan-to-values, and high debt-to-income ratios.

While much attention has focused on interest rate resets as a trigger for delinquencies and defaults—particularly on loans with artificially low introductory rates—so far they have not played a significant role.¹¹ This is not to say, however, that resets *won’t* matter. In 2008, about 1.5 million loans are scheduled to reset. The Federal Reserve Board estimates that for the

average subprime borrower, this could lead to a 10 percent increase in their monthly mortgage payments.¹² Especially for borrowers already stretched to the limit, these resets may significantly increase the likelihood of delinquency.

The mortgage crisis has serious implications for the people and communities that all of us serve. For instance, data collected under the Home Mortgage Disclosure Act show that minorities are more likely to receive higher-priced loans than non-Hispanic whites, and that an increase in the incidence of higher-priced lending is associated with an increase in serious mortgage delinquency rates.¹³ In addition, studies of cities like Baltimore, Chicago, and Cleveland have found that low-income and minority communities have been the hardest hit by concentrations of foreclosures.¹⁴ The rise in foreclosures may have other negative implications as well, such as reducing neighborhood property values and increasing crime.¹⁵ Furthermore, as declining property taxes and transfer fees shrink local government revenues, vital services to low- and moderate-income families may also suffer. What this means is that the foreclosure crisis is likely to have a profound impact on the communities you work in, with effects that go well beyond the housing sector.

Before I turn to potential interventions, I want to make one final point. There has been a tendency to conflate the current problems in the subprime market with CRA-motivated lending, or with lending to low-income families in general. I believe it is very important to make a distinction between the two. Most of the loans made by depository institutions examined under the CRA have not been higher-priced loans,¹⁶ and studies have shown that the CRA has increased the volume of responsible lending to low- and moderate-income households.¹⁷ We should not view the current foreclosure trends as justification to abandon the goal of expanding access to credit among low-income households, since access to credit, and the subsequent ability to buy a home, remains one of the most important mechanisms we have to help low-income families build wealth over the long term.¹⁸

Building a Foundation for Sustainable Homeownership

With that in mind, the current foreclosure crisis suggests to me the need to craft responses that will mitigate the negative impacts of foreclosure, and compels us to revisit the question of how

to ensure that the tools that enable homeownership create *sustainable* benefits, both for families and for the communities in which they live.

As a first step, it is clear that avoiding preventable foreclosures should be a key priority for both the private and public sectors. Many important initiatives are already underway, including efforts to improve borrower outreach through public service announcements and community events, to develop a systematic and streamlined approach to restructuring adjustable rate loans, and to create new refinance options to help borrowers shift into more sustainable loan products. I support these efforts, as well as the collection of data that can help us to ascertain their effectiveness. I am particularly encouraged that efforts such as the HOPE NOW Alliance and the Mortgage Relief Fund supported by the Federal Reserve Bank of Boston are the result of collaborative agreements among government agencies, regulators, lenders, investors, servicers and nonprofits. The complexity and seriousness of the foreclosure issue, and its deep impact on borrowers, neighborhoods, and the economy, call for these kinds of cross-sector partnerships, both locally and nationally.

There are some signs that these efforts are working, and that the number of loan modifications is growing.¹⁹ In addition, the FHA Secure plan and the increase in the FHA conforming loan limits should enable more borrowers to refinance into an FHA-insured mortgage.²⁰ The recent announcement by Fannie Mae and Freddie Mac on plans to increase liquidity in the mortgage markets is also promising.²¹ Still, the scale and impact of these efforts to date are small compared to the volume of loans that are delinquent, and many counselors and servicers lack the capacity to respond effectively to demand. In addition, as home prices decline, many borrowers are finding themselves with loan amounts that are higher than their home values, limiting their refinance options. It is critical that we continue to explore the possibility of a broader range of interventions that would help keep families in their homes.

But, I think it is equally important to begin thinking *now* about how to ensure that access to credit and homeownership provides a long-term benefit for low-income households and communities.

As a first step, there is a need to develop new strategies that help low-income borrowers—particularly those that may not have extensive financial knowledge—make better and more informed credit choices. Additional investments in financial education and homeownership counseling must be a key component of this strategy. Financial education has been shown to help households manage their finances more prudently, especially in decisions concerning credit, saving, and investment, and it has been shown to reduce the likelihood of default.²² Calling for more financial education is not a new idea, but challenges remain in funding educational programs and developing appropriate curricula and delivery channels for diverse audiences. Later this morning, you will have a chance to see one new fun approach to teaching children about financial management skills.

Second, we need to expand access to affordable homeownership opportunities. The gap in homeownership affordability—especially in states like California—is as high as it has ever been.²³ As long as an adjustable rate, interest-only or high LTV subprime loan is the only way to afford a house, low-income families will continue to take on loans that they cannot sustain over the long term, and may be at greater risk of falling prey to unscrupulous lending practices. In stark contrast to the results we are seeing in the subprime market, the vast majority of new homeowners who have gone through affordable homeownership programs—which often involve pre- and post-purchase counseling and support as well as a savings component such as an Individual Development Account—have not defaulted on their loans.

This evidence also speaks to a much greater need for savings options for low-income families, both owners and renters.²⁴ Helping families save for a downpayment, and ensuring that they have a savings buffer to help them weather adverse economic times or life events, may lead to better outcomes overall than mortgages that make homeownership affordable only through risky loan terms.²⁵

In addition, strategies to increase the supply of affordable homes are also needed. For example, I know many of you in this room have been extremely proactive in thinking about innovative ways to convert foreclosed properties into affordable rental or homeownership opportunities.²⁶ These

efforts, as well as other potential strategies, such as the establishment of housing trust funds and community land trusts, can serve as mechanisms for creating long-term housing affordability.

Third, to be successful, policies that help low-income and minority households enter homeownership must be linked with broader community development strategies. Low-income households, and particularly low-income minority households, may be especially vulnerable to buying homes in disadvantaged neighborhoods, where job opportunities are limited, schools are often subpar, and the financial benefits of homeownership may be more limited.²⁷ Much of the work that you already do to stimulate neighborhood economic development, increase local employment opportunities and wages, and improve neighborhood-linked amenities such as schools and transportation options, are critical in transforming the opportunities available to low-income households.

Last, but certainly not least, we need to think more broadly about how homeownership fits into the overall asset-building picture for low-income households, and what other programs or policies are necessary to ensure that homeownership is sustainable. In one study of low-income homeowners, researchers found that two-thirds of households that refinanced their homes did so to pay down other debt, including higher cost credit card debt. Others borrowed against the equity in their homes to pay for medical and educational expenses.²⁸ It is troubling that so many low-income families have had to use home equity to help manage their overall debt load, or to bridge a gap in health care insurance. We need to help households learn how to manage their finances and to create safety nets that offer protection against economic shocks, so that low-income families are less vulnerable to losing their homes.

Conclusion

To conclude, I would like to note some of the ways the Federal Reserve is responding to this crisis, even beyond the steps designed to stabilize the financial markets. These efforts are taking place across the System, and are built on our strengths in research and data analysis and on our regional presence.

At the San Francisco Fed, this work has included providing research, data and maps to community groups and local governments on neighborhood hotspots as well as establishing local task forces that can leverage local resources and stakeholders to respond to local needs. Through our convenings, we are working to improve communication between borrowers, counselors, and servicers to put a human face on what is often a distant, lengthy, and bureaucratic process. And, as always, we are committed to sharing best practices in foreclosure mitigation, both through our publications and through our convenings. Three of the panels at this year's conference address this topic, and will present strategies for preventing foreclosure and for mitigating the negative impact on neighborhoods. In addition, the San Francisco Fed will be sponsoring a national conference specifically on how to address REO property issues in high-cost markets later this year.

Finally, while the issues of foreclosure are certainly capturing center stage, it is important not to forget all of the other aspects of the work you do in low- and moderate-income communities. Over the next two and a half days, whether you're immersed in the CRA regulations, learning the basics of underwriting multi-family rental properties, or exploring emerging topics in community development, I'm confident that you will return to your own communities with new ideas and contacts. I applaud the dedication of each and every one of you to improving the lives of low-income families, and I know that working together, you will continue to help lay the foundation for sustainable and vibrant communities.

Thank you. I hope you enjoy the conference.

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¹ Eric S. Belsky and Ren S. Essene, "Consumer and Mortgage Credit at a Crossroads: Preserving Expanded Access while Informing Choices and Protecting Consumers" (Working Paper UCC08-1, Joint Center for Housing Studies, Harvard University, Cambridge, MA, 2008), p. 16.

² Between 1993 and 2000, home purchase lending to low- and moderate-income people living in low- and moderate-income neighborhoods grew by 94 percent—more than in any of the other income categories. See *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System* (Joint Center for Housing Studies, Harvard University, Cambridge, MA, March 2002), p.4.

³ Eric S. Rosengren, "Early Lessons from Recent Financial Turmoil," remarks by President and Chief Executive Officer of the Federal Reserve Bank of Boston, presented at the South Shore Chamber of Commerce, Quincy, Massachusetts, March 6, 2008.

⁴ Edward M. Gramlich, *Subprime Mortgages: America's Latest Boom and Bust* (Washington, D.C., The Urban Institute, 2007), p. 79.

⁵ For example, cities such as Chicago and Minneapolis were experiencing high levels of foreclosure well before the current national increase in foreclosure rates.

⁶ Mortgage Bankers Association (MBA), National Delinquency Survey, 4th Quarter 2007. Figures U.S. Total, seasonally adjusted. RealtyTrac reported that in 2007, more than 2.2 million foreclosure filings were logged against 1.3 million properties nationwide. MBA data also likely underestimate the absolute number of delinquencies.

⁷ Janet L. Yellen, “Prospects for the U.S. Economy in 2008,” speech by President and Chief Executive Officer of the Federal Reserve Bank of San Francisco to the San Francisco Planning and Urban Research Group, San Francisco, February 12, 2008. (Note: Research suggests that risk of fixed rate subprime loans compared to ARMs in part reflects selection bias, with riskier borrowers opting for ARMs. Some research also shows that adjusted for the vintages of loans, the performances of subprime fixed-rate and adjustable-rate loans are more similar. See Yuliya Demyanyk and Otto van Hemert, “Understanding the Subprime Mortgage Crisis” (Federal Reserve Bank of St. Louis, February 4, 2008).)

⁸ Mark Doms, Frederick Furlong, and John Krainer, “Subprime Mortgage Delinquency Rates” (Working Paper 2007-33, Federal Reserve Bank of San Francisco, 2007).

⁹ Ben S. Bernanke, “Fostering Sustainable Homeownership,” remarks presented by Federal Reserve Chairman Ben S. Bernanke at the National Community Reinvestment Coalition Annual Meeting, Washington, D.C., March 14, 2008.

¹⁰ Yuliya Demyanyk and Otto van Hemert, “Understanding the Subprime Mortgage Crisis” (Federal Reserve Bank of St. Louis, February 4, 2008).

¹¹ Kristopher Gerardi, Adam Hale Shapiro, and Paul S. Willen, “Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures” (Working Paper 07-15, Federal Reserve Bank of Boston, 2007).

¹² Ben S. Bernanke, “Reducing Preventable Mortgage Foreclosures,” remarks presented by Federal Reserve Chairman Ben S. Bernanke at the Independent Community Bankers of America Annual Convention, Orlando, Florida, March 4, 2008.

¹³ For home-purchase loans in 2006, the gross mean incidence of higher-priced lending was 53.7 percent for blacks and 17.7 percent for non-Hispanic whites, a difference of 36.0 percentage points. See Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, “The 2006 HMDA Data,” *Federal Reserve Bulletin*, Volume 94 (2007), p. A95 and p. A107. Areas of substantial new construction and higher house price appreciation have also been linked to concentrations of subprime lending. See Chris Mayer and Karen Pence “Subprime Mortgages: What, Where, and to Whom?” (Federal Reserve Board of Governors, Washington, D.C. 2008).

¹⁴ See, for example, William C. Apgar, and Mark Duda, *Collateral Damage: The Municipal Impact of Today’s Mortgage Foreclosure Boom* (Homeownership Preservation Foundation, Minneapolis, MN, 2005) and Ira Goldstein and Richard Voith, “One Industry’s Risk is Another Community’s Loss: The Impact of Clustered Mortgage Foreclosures on Neighborhood Property Values in Philadelphia,” paper presented at the Federal Reserve Bank of Philadelphia, *Reinventing Older Communities*, April 2006.

¹⁵ See, for example, Dan Immergluck and Geoff Smith, “The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime,” *Housing Studies* 21, no. 6 (2006): 851-866. Dan Immergluck and Geoff Smith, “The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values,” *Housing Policy Debate* 17, no. 1 (2006): 57-79. Vicki Been, Solomon Greene and Jenny Schuetz, “Spillover Effects of Foreclosures on Property Values in New York,” paper presented at the New York City Subprime Lending and Foreclosure Summit, December 12, 2007.

¹⁶ According to the 2006 HMDA data, 19 percent of the conventional first lien mortgage loans originated by depository institutions were higher-priced, compared to 23 percent by bank subsidiaries, 38 percent by other bank affiliates, and more than 40 percent by independent mortgage companies. Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, “The 2006 HMDA Data,” *Federal Reserve Bulletin*, Volume 94 (2007), p. A89.

¹⁷ *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System* (Joint Center for Housing Studies, Harvard University, Cambridge, MA, March 2002).

¹⁸ This assumes responsible lending and that homeownership is sustainable. Research has shown that low-income homeowners build more wealth than low-income renters, both through accumulated equity in the home as well as a greater propensity to save. See Edward M. Gramlich, *Subprime Mortgages: America’s Latest Boom and Bust* (Washington, D.C., The Urban Institute, 2007), pp. 70 – 77 for an analysis of the 2004 data from the Survey of Consumer Finances on this topic.

¹⁹ Hope Now Alliance Servicers, “Prime and Subprime Residential Mortgages: 2007 Loss Mitigation Activity” (Financial Services Roundtable, Washington, D.C., 2008).

²⁰ Ben S. Bernanke (2008). “Fostering Sustainable Homeownership,” remarks presented by Federal Reserve Chairman Ben S. Bernanke at the National Community Reinvestment Coalition Annual Meeting, Washington, D.C., March 14, 2008.

²¹ Office of Federal Housing Enterprise Oversight (OFHEO), “OFHEO, Fannie Mae and Freddie Mac Announce Initiative to Increase Mortgage Market Liquidity,” News Release, March 19, 2008. Available online at: http://www.fanniemae.com/media/pdf/liquidity_announce031908.pdf;jsessionid=PM0PP1LHK0VCZJ2FQSHSFGI

²² Marianne A. Hilgert, Jeanne M. Hogarth, and Sondra G. Beverly, “Household Financial Management: The Connection between Knowledge and Behavior,” *Federal Reserve Bulletin* (July 2003): 309-322. Lei Ding, Roberto Quercia, and Janneke Ratcliffe, “Postpurchase Counseling and Default Resolutions among Low- and Moderate-income Borrowers” (Center for Community Capitalism Working Paper, University of North Carolina, 2007).

²³ *The State of the Nation’s Housing 2007* (Joint Center for Housing Studies, Harvard University, Cambridge, MA, 2007).

²⁴ Policies and programs that aim to increase the savings of low-income households are part of a growing “asset building” field, and include initiatives such as Individual Development and Children’s Savings Accounts, as well as efforts to promote savings behavior by allowing families to split tax refunds. For more information and research on asset building topics, see <http://www.assetbuilding.org/>.

²⁵ Michael A. Stegman, “An Affordable Homeownership Strategy that Promotes Savings rather than Risks,” in *Ending Poverty in America: How to Restore the American Dream*, ed. John Edwards, Marion Crain, and Arne L. Kalleberg, 165-178 (New York: New Press, 2007).

²⁶ Some promising examples of programs to address vacancies already exist. For example, the Neighborhood Housing Services Redevelopment Corporation in Chicago has acquired hundreds of abandoned properties from such sources as the Department of Housing and Urban Development, the City of Chicago, REO properties, and private owners. The properties are then rehabilitated and sold to owner-occupants.

²⁷ For a review of the literature, see Carolina Reid, “Locating the American Dream: Assessing the Neighborhood Benefits of Homeownership,” in *Chasing the American Dream: New Perspectives on Affordable Homeownership*, ed. William M. Rohe and Harry L. Watson (Ithaca and London: Cornell University Press, 2007).

²⁸ The analysis reveals that among a panel of low-income homeowners, one-third borrowed against their home equity (by using a cash-out refinancing, second mortgage, or home equity line of credit), and that 64 percent of those used the funds to pay down other debt. Michael A. Stegman, Allison Freeman, and Jong-Gyu Paik, “The Portfolios and Wealth of Low-Income Homeowners and Renters: Findings from an Evaluation of Self-Help Ventures Fund’s Community Advantage Program” (Community Development Working Paper 2007-02, Federal Reserve Bank of San Francisco, 2007), p. 29-30.