Creating a Durable Housing Finance System

The current system of housing finance is a temporary patchwork formed in the wake of the financial crisis. The series of fixes applied quickly in 2008 saved the country from a much worse fate, but it is time to rebalance the role of government and private, risk-bearing capital so that the housing finance system can finance the homes that people and our economy need. To help achieve the goal of a decent, affordable home for all in America, the federal government needs a durable system to assure the reliable flow of capital to housing. **It is time to move beyond the temporary measures so that credit can flow to create housing opportunity.**

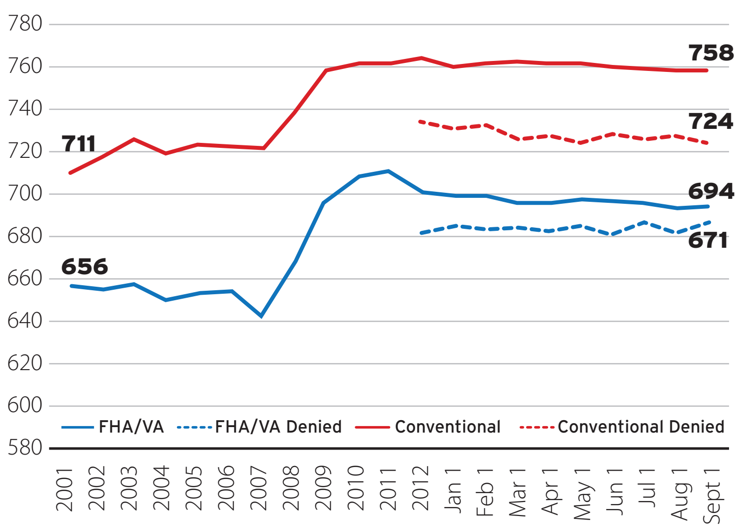
Despite low home prices and low mortgage rates, few can step into homeownership because of tight credit. Costs of rental housing are a growing burden for households of modest means, and the mismatch between housing costs and incomes burden working renters and homeowners across this country.

In both homeownership and rental housing, the current system is unsustainable due to the weaknesses revealed by the 2008 financial crisis and the choices being made now in the absence of Congressional action. Credit is too tight, the efficient securitization mechanisms built over many years are decaying, and the choices made by the Federal Housing Finance Agency (FHFA) are closing off options and reducing access to housing for Americans.

Tight Credit and Uncertainty Block Homeownership Opportunity

Lack of clear direction on reform and the current regulatory framework creates uncertainty for lenders, investors, developers, and homebuyers, who in turn do not lend, invest, build or buy as they otherwise would. The tight credit box created by lender and investor uncertainty prevents many low- and moderate-income

FIGURE 1 Average FICO Scores on Denied and Accepted Purchase Appplications Remain Elevated



Source: Amherst Securities, Corelogic, Ellie Mae

This period of affordability will eventually end as interest rates rise and housing prices rebound, and unless we act to expand the credit box, many households will miss an opportunity to rebuild wealth and stabilize their housing costs.

homebuyers from buying a home entirely and makes the process more difficult for many others. **For new home purchases, average FICO scores rose dramatically during the crisis and have not returned to sustainable levels.** For GSE purchase loans, scores rose from 711 in 2001 to 758 in 2013, and for FHA purchase loans, scores rose from 656 and have only dropped slightly from their peak to a current level of 694. The chart above, compiled by the National Association of Realtors, shows the trend.

At the same time, buying a house should be easier than in many years, due to lower house prices and historically low interest rates. NAR's housing affordability index, shown in Figure 2, illustrates that housing affordability is still better than in many past years (taller blue bar means better affordability). This period of affordability will eventually end as interest rates rise and housing prices rebound, and **unless we act to expand the credit box, many households will miss an opportunity to rebuild wealth and stabilize their housing costs.**

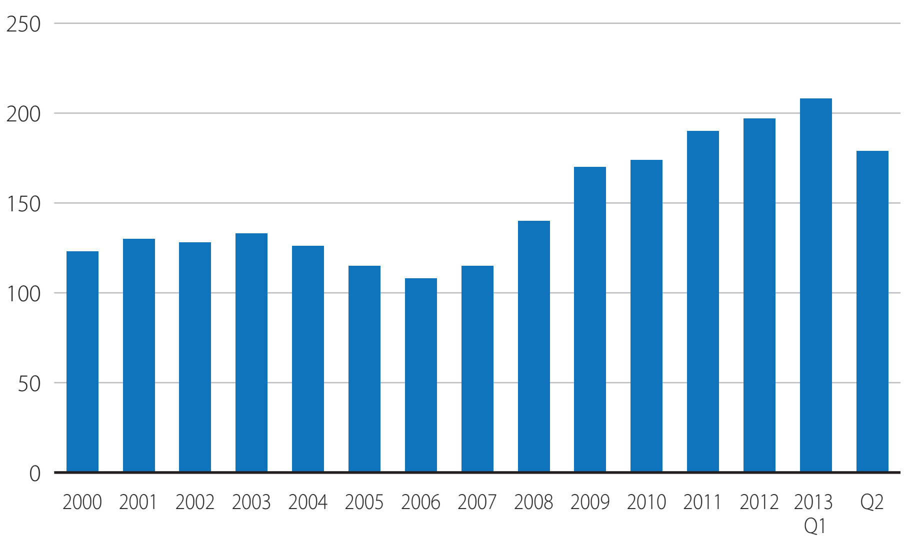
Rental Costs Are Burdening Households

Renters make up more than one third of the country, and their median income is approximately half that of owners.[1] **More than one in four working renter households (26.4 percent) spent more than half of their income on housing costs in 2011**, an increase of more than three percentage points since 2008, documented by NHC's Center for Housing Policy.[2] Demand for rental housing is increasing, and multifamily properties are an important component of meeting that demand. Ensuring a steady supply of capital to multifamily housing, therefore, is a necessary part of ensuring that Americans can afford a range of housing options.

In multifamily housing, we are only beginning to make up for the damage sustained during the financial crisis. Production of new multifamily housing lagged from 2008 to 2012. It has only just begun to return to normal levels and has not yet significantly filled in the hole that was left. The graph below, produced by the Mortgage Bankers Association from U.S. Census Data, illustrates how completions are still hundreds of thousands of units behind.[3] The stable, liquid capital provided by the GSEs in multifamily preserves existing properties through refinancing, provides the permanent financing for new properties, and ensures that multifamily properties can be created and sustained despite disruptions in the capital markets.

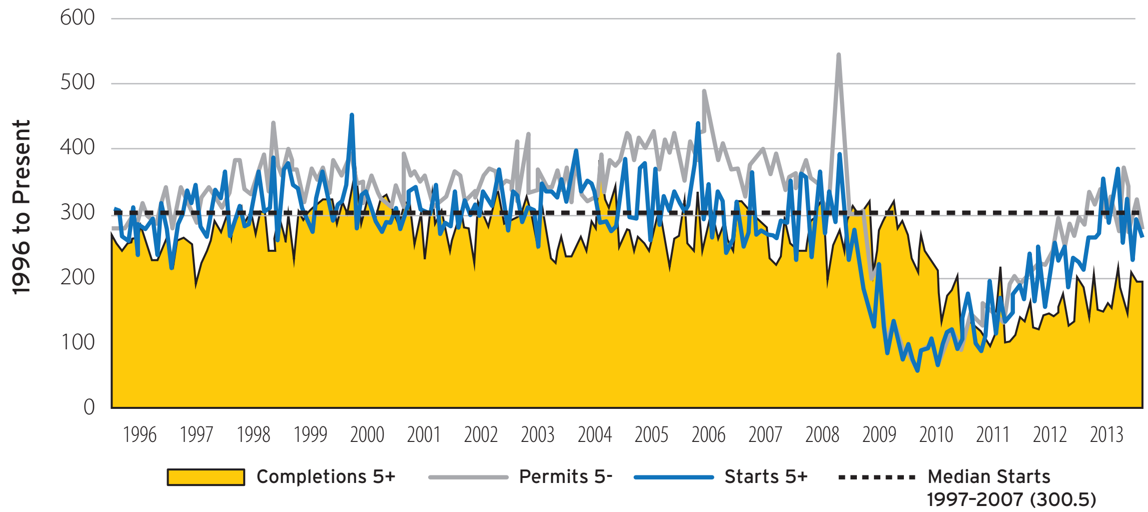
Lack of capital hampers efforts to restore damaged neighborhoods and create new rental housing where it is sorely needed. Until we return home finance markets to normal functioning, we cannot sustain a full economic recovery.

FIGURE 2 Housing Affordability Index



Source: NAR

FIGURE 3 Multifamily Starts, Permits, and Completions in Thousands of Units



Current Policy is Closing Off Options

Congressional inaction has left the Federal Housing Finance Agency (FHFA) to act alone. In many instances, FHFA has acted responsibly to conserve the assets of the GSEs and keep the secondary market functioning. In other instances, however, FHFA has acted in ways that close off options for future housing finance reform:

- **Raising guarantee fees** increases the cost of mortgage credit to consumers and improves the revenue earned by the GSEs, but under the current conservatorship, none of the increased revenue goes to capitalize entities that can absorb risk ahead of taxpayers, nor do we have new capital channels through which private risk-bearing capital can return.

- **Reducing multifamily loan production** by an arbitrary amount each year undermines the value of the stable and profitable GSE multifamily businesses while reducing the capital flowing to rental housing, particularly affordable housing and harder-to-serve communities that need capital the most.

- **Failing to fund the Capital Magnet Fund and the National Housing Trust Fund** from revenue now available prevents capital from reaching those most in need of affordable housing. Both programs should be getting up to speed now in preparation for their role as part of a changing housing finance system.

- **Refusing to allow new products by the GSEs** prevents attempts to better serve credit needs for rental or owned housing and stifles creativity. Government-backed channels are playing an outsize role in the market now yet cannot work to expand sustainable housing opportunities for Americans, particularly with restrictions on high-LTV lending in place.

FHFA's actions have increased market disruption in the short term and made Congress' job harder in the medium term. The appointment of Rep. Mel Watt to lead the FHFA may well lead to change in these policies, but the change in leadership does not obviate the need for Congressional action.

Meanwhile, **temporary controls erode the GSE's capacities.** The uncertainty of the two companies' future and the disruption of a long drawn out conservatorship are pushing skilled staff to migrate elsewhere and deterring new hires. Even updated systems cannot run well without knowledgeable staff to operate them. Housing practitioners feel the impact directly when particular GSE staff leave, causing closings to be delayed, workouts of distressed loans fail, and foreclosure management becomes more difficult. All of these challenges have direct impacts on neighborhoods and individual households.

It is Time to Move Forward on a Housing Finance System

Temporary measures cannot continue. Fannie Mae and Freddie Mac are in the sixth year of a conservatorship that many expected to end much sooner. The Federal Reserve, rather than private investors, is still buying most of the GSE's mortgage backed securities (MBS). FHA is carrying a disproportionate burden of financing new home purchases. In short, t**he full faith and credit of the federal government remains behind nearly the entire mortgage market without accumulating a protective fund, and yet credit for homebuyers is still far too tight.**

We do not need change for change's sake, but to make housing finance safer, more accessible and more sustainable. That will be easier while interest rates are still low. Right now, the federal government is still bearing risk on most new mortgages, without accumulating a protective fund. For that to change in a responsible way that protects taxpayers, the cost of credit will necessarily rise. If reform is done correctly, that increase will be small and gradual. Any increase will be easier to bear if underlying interest rates are low, like they still are. But rates have already begun to increase, and no one knows how much longer they will stay low.

What is needed now is a careful rebalancing of the roles of government and private risk-bearing capital to restore stability to housing finance system. There are many parts of the housing finance system that serve their purpose well: the 30-year fixed rate mortgage, liquidity from the To Be Announced market, FHA home loans and multifamily loans, the multifamily operations of the GSEs, and the basic system of mortgage securitization. Change requires a managed transition that allows public and private participants to adjust along the way as we measure the results from changes. Through careful action based on the principles this coalition has endorsed, we can bring private capital back into housing finance, protect taxpayers in the future, and improve access to affordable housing for all.

Endnotes

1. Harvard Joint Center for Housing Studies, State of the Nation's Housing 2013, p. 22, available at: http://www.jchs.harvard.edu/research/state_nations_housing

2. Center for Housing Policy, Housing Landscape 2013, May 2013, available at http://www.nhc.org/media/files/Landscape2013.pdf.

3. MBA Commercial Real Estate/Multifamily Finance Quarterly Data Book, Q2 2013, page 30. Data are in thousands of units in properties of 5 or more units, seasonally adjusted.