Could Overhaul of Big Bank Capital Rules Spark a Housing Fight?

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For months, banks have struggled to make headway in their battle with regulators seeking to impose a tougher capital regime. But the industry may soon gain some surprising (and valuable) allies: liberal housing advocates.

While few would expect the left to argue against new rules that handcuff big banks, one aspect of the impending capital proposal has caught the attention of housing groups because it could end up making mortgages more expensive for lower-income people. That could also stir up trouble with influential Democratic lawmakers who are strong proponents of boosting homeownership.

The provision, part of a plan being released next week by the Fed, OCC and FDIC, is expected to call for banks to hold more capital against mortgages that come with a low down payment – the types of loans typically used by minorities and first-time home buyers. That isn’t sitting well with some housing groups.

“What happens when you raise the capital costs? You make more affordable loans less economic for lenders, which means they will make fewer of them,” notes David Dworkin, the president and CEO of the National Housing Conference. “There may be no more effective way for regulators to undercut efforts to close the racial homeownership gap than by this capital proposal.”

Such critiques could cause some heartburn in the Biden administration, which has made it a priority to expand homeownership for people of color and other underserved communities. The White House’s progressive allies have also focused a lot of their attention on housing, especially as skyrocketing prices and rising interest rates have made it more and more difficult for average Americans to buy houses. (The U.S. median home price is now $436,800, making a 20 percent down payment more than $87,000.)

The Fed declined to comment on the expected mortgage capital change. Though it is a bit technical, the plan tinkers with the so-called risk weights (calculations that determine the amount of capital needed) for mortgages that banks hold. The risk weights for mortgages with a 20 percent to 40 percent down payment – loans that are typically marketed to middle-income borrowers – are likely to remain unchanged, sources said. But they will rise for loans with less than 20 percent down.

One thing that may allay some concerns about the mortgage capital charges: banks have already been moving away from making home loans in recent years. Non-bank lenders now handle around three-quarters of the volume.

During JPMorgan’s earning call last week Chief Financial Officer Jeremy Barnum predicted that the capital proposals being readied could prompt banks to further retrench from mortgage lending. “You're once again making that product even harder to offer to homeowners,” he said.

Housing advocates point out that unlike non-bank mortgage companies, banks have to comply with the Community Reinvestment Act that seeks to spur lending in low-income neighborhoods. They also face a variety of political pressures to lend to underserved borrowers. After the murder of George Floyd, for instance, several large banks made commitments to expand homeownership for Black Americans. That included programs by Bank of America and TD Bank that offer no-down-payment mortgages or credits towards closing costs to low-income people.

At the end of the first quarter this year, large banks held about $1.36 trillion in mortgages, according to data from the Philadelphia Fed. One out of every 10 outstanding home loans had an original down payment of 10 percent or less – meaning the new higher capital standards would apply.

"Almost every first generation home buyer does not have a 20 percent down payment, so any additional capital requirement would cause downward pressure on that activity," says Gabe Del Rio, president and CEO of the Homeownership Council of America. "This is just another blow for making homeownership available to ordinary people in America."