- 2008: GSE affordable housing goals tightened, addition of duty-to-serve

The Senate draft is no different--to promote and ensure access to affordable mortgage credit and affordable housing, including to underserved borrowers and concepts such as the "Market Access Fund", "Market Access Plan", "Market Access Agreement".

All such mandates seek a "free lunch", but ignore the fact that the marginal buyer determines not only price levels, but also their degree of stability, because price does not necessarily equal value.

Today, FHA's pro-cyclical underwriting policies are fueling a home price boom which occurs during extended periods of a seller's market. FHA, as the largest provider of credit to highly leveraged buyers, has a responsibility to take counter-cyclical action now. It should eliminate the riskiest portions of the FHA credit box, crowd out the 30-year mortgage, and crowd in the 20 year mortgage. Eliminating Fannie Mae and Freddie Mac without legislation

Ellen Seidman
Non-Resident Fellow, Urban Institute
said at 10:54 am on March 15th, 2018:

Most of you are aware that I am not an economist. But I know that there are several in the Policy Debate group. Ed's argument about sellers' markets and affordability subsidies being priced into house prices is interesting. Any comments from the economists?

Mark Zandi
Chief Economist, Moody's Analytics
said at 6:48 pm on March 15th, 2018:

Ed's argument that the affordability subsidies result in higher house prices, washing out any benefit to the underserved presupposes that there is *no* housing supply response to the increase in housing demand. That may or may not be the case in the short-run in some communities, but it isn't the case in the longer-run. And specifically with regard to the affordable goals, it isn't clear they are effective in supporting housing demand, and thus likely have had little impact on house prices even in the short-run. Ed's concern that the FHA is currently promoting a "housing price boom" appears overdone. House prices are consistent with household incomes and rents in most communities; the exception being in markets impacted by strong global investor demand in global gateway cities.

Ed Pinto

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Codirector, AEI Center on Housing Markets and Finance
said at 9:45 am on March 16th, 2018:

Federal housing policy promotes homeownership by subsidizing mortgage debt for many households with few assets and low credit scores. Empirical work by AEI's Housing Center exploited the Federal Housing Administration's (FHA's) surprise 50 basis point cut to its annual mortgage insurance premium in January 2015 to study the impact of federal housing policy and interest rates on housing demand for a population of households likely to be influenced by changes to policy. The premium cut, which reduced monthly payments the same amount as a three-quarter percentage point drop in the mortgage rate, increased the purchasing power of the typical FHA borrower by 6 percent. Our analysis suggests FHA borrowers increased the value of the housing they purchased by 2.5 percentage points relative to a control group of borrowers in areas with minimal FHA presence. The rise in spending reflected an increase in constant-quality home prices, with no significant change in the quality of housing purchased by FHA buyers. We also estimate that the premium cut induced approximately 17,000 households to become first-time homebuyers in the initial year after the cut, an increase that fell far short of the FHA's projection. Because the rise in constant-quality house prices affected both FHA and other buyers in areas with substantial FHA lending, non-FHA first-time buyers as a group incurred a cost of $180,000 for each of the 17,000 new first-time FHA buyers. The big winners were the Realtors, which had lobbied hard for the premium cut--some $400 million/year in additional commissions. Not bad for maybe a couple of million spent on lobbying for the cut. The Impact of Federal Housing Policy on Housing Demand and Homeownership: Evidence from a Quasi-Experiment

Tim Howard
Former Vice Chairman and CFO of Fannie Mae
said at 10:42 am on March 15th, 2018:

My framework for government involvement in housing has two components: an effective direct subsidy program, and a mortgage credit guaranty system whose structure and operation facilitate cross-subsidies that hold down guaranty fees for affordable housing borrowers.

The Senate draft bill misses badly on both. Its proposed reform of the secondary market credit guaranty system is almost completely devoid of details, making it impossible to assess how guaranty fees would be affected under the bill. The draft is silent on credit guarantor capital requirements—the most important determinant of guaranty fees—and leaves nearly all of the difficult challenges of replacing the existing system based on Fannie and Freddie with a new multi-guarantor system to be figured out by the regulator after the bill has passed. That is extremely risky.

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The Senate draft compounds this error by pretending that having an effective direct subsidy program is conditional upon secondary market reform. It is not. To the contrary, the "market access fee" proposed in the Senate bill would collect much more revenue, and provide support for many more affordable housing programs, if were levied on all newly originated mortgages, not just those financed by secondary market credit guarantors.

Shekar Narasimhan
Managing Partner, Beekman Advisors
said at 12:47 pm on March 15th, 2018:

Speaking from a multifamily perspective. The simplest reason for government engagement in rental housing is that it is where most lower-income Americans live and we must ensure safe, decent and sanitary housing for *all* Americans. The leaked Senate bill has 5 important elements for the multifamily sector: 1. Ensures liquidity at all times with the government back-stop- critical given balloon mortgages and the need for regular property upgrading. 2. Does not interrupt the flow of capital as it utilizes current systems to create the new one (Fannie & Freddie MF businesses are spun-out) and Ginnie Mae becomes government back-stop. 3. Puts private capital at risk first and removes any back-stop for the corporate entity. 4. Keeps GSE multifamily lending in the affordability fairway with requirement that at least 60% of all units financed must serve 80% of area median income and 5. Encourages serving under-served markets through the market access fee and risk-taking with credit enhancement. All-in-all, an improvement on the current system with clearer rules of the road.

Laurie Goodman
Director, Housing Finance Policy Center
said at 2:36 pm on March 15th, 2018:

The really problematic issue with access and affordability in the single family market that neither the current system nor the leaked Senate bill solves for is the fact that lender often avoid making loans to LMI borrowers, because of the lower profits both at the point of origination and for on-going servicing. Lenders tend to charge the same percentage for originating and servicing all the loans they handle. Yet on average LMI borrower take out smaller loans and are move likely to go into default, making them less profitable to originate and service. While I believe paying lenders for servicing these loans, is proposed in the Senate bill would likely take up the lion's share of the borrower subsidy, with no direct borrower benefit, the bill does make an attempt to address this issue.

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Barry Zigas
Director of Housing Policy, Consumer Federation of America
said at 3:34 pm on March 15th, 2018:

Laurie's hit on an important point -- the secondary market doesn't originate loans. It can make certain loans more attractive for primary market lenders through concessionary pricing, underwriting approaches or other features. Conversely, it can chill the market for responsible innovation to reach more borrowers by declining to provide a liquidity outlet for such loans. If there isn't coordination in carrots and sticks in both the primary and secondary markets access will suffer. The Community Reinvestment Act has spurred such innovation in the past. But its "sticks" are weak, and more and more of the mortgage industry falls outside of its coverage.

Barry Zigas
Director of Housing Policy, Consumer Federation of America
said at 3:21 pm on March 15th, 2018:

The leaked Senate draft recognizes the quandary of its basic design – by relying on privately capitalized guarantors with no constraints on return, no requirement to accept lower returns for some credit risk as part of a broadly cross subsidized book, and no enforceable obligation to fully meet credit needs in the market, it would leave assurance of broad service to goodwill and chance, an unpalatable option. The drafters attempt to remedy this by redirecting the revenues from a 10 basis point strip on guaranteed securities to a system of direct subsidies to LMI borrowers as a discounted guarantee fee or cash assistance for down payments.

I've written here about why this approach falls short, and here and here on how FHA and other government mortgage credit insurance offers a means to provide full spectrum lending across risk profiles. The Center for Responsible Lending and National Urban League have published an extensive critique of the draft that raises significant additional issues.

Recent work from the Terner Center at UC Berkeley, whose recommendations echo those in the 2002 Millennial Housing Commission report, recommends comprehensive FHA changes. But FHA (and other similar programs) will continue to play a major role no matter what successor model is adopted, from recap and release to something like the leaked draft. Full scale reform and reorganization might be a long-game objective for FHA. But it can't be suspended or frozen while we wait; for now Congress and the Administration should focus on more immediate issues, particularly in resolving lenders' concerns about False Claim Act prosecutions, providing

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significant separate funding for infrastructure upgrades and support, and confirming an FHA Commissioner.

Mike Calhoun
President, Center for Responsible Lending
said at 3:29 pm on March 15th, 2018:

The Senate draft offers a weak tea substitute for the robust affordable housing infrastructure in the current system. It rids the system of its public interest mandate and is built on a set of overly optimistic assumptions. It focuses on a proposed $4 billion direct subsidy that lacks the enforceability of current duty-to-serve obligations, including affordable housing goals. It weakens fair lending with business judgment protection for the guarantors' market access plans. The proposal is not only a blow to affordable housing, it harms the overall housing market.

The proposed system will increase costs by: providing less cross-subsidy to underserved borrowers than the current system; increasing G-fees, after correcting assumptions about the current and proposed system; and increasing, not decreasing, the average mortgage interest rate.

Congress has already taken on bipartisan reform with the Housing and Economic Recovery Act of 2008 (HERA). Now, we should shift focus to ensuring that the system meets its access and affordability requirements.

A more robust discussion of our views can be found in a report that we co-authored with Marc Morial, president of the National Urban League and Mike Molesky, a senior financial economist and leading expert on mortgage default risk and insurance regulation.

Mark Zandi
Chief Economist, Moody's Analytics
said at 6:17 pm on March 15th, 2018:

The future housing finance system envisaged in the Senate draft legislation would at the very least maintain the GSEs' current credit box, and more effectively target support to low and moderate income households.

It does this through a market access fee charged on all single and multifamily mortgages insured by the multiple guarantors in the future system. Assuming a 10 basis point fee, this would translate into over $5 billion in funds per annum to finance cross-subsidization in the system. This compares to cross-subsidization in the current system of closer to $4 billion per annum.

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The cross-subsidization in the future system would be targeted at low and moderate income households, instead of the high-risk borrowers receiving a cross-subsidy in the current system. These aren't necessarily the same groups, and indeed in the current system some high-income, but high-risk borrowers receive a cross-subsidy.

It is important to note that this can be accomplished at the same time as providing taxpayers with more protection and allowing the future guarantors to risk-based price.

Having said this, the Senate draft legislation could be improved with regard to access and affordability by requiring that all of the future guarantors in the system have a national footprint. That is, they must serve the entire market in all market conditions. A somewhat higher market access fee is also possible, to generate more revenue for even more cross-subsidization without reducing the market share of the future guarantor system.

This paper provides a detailed description of how the cross-subsidization to assure access and affordability in the future system envisaged in the Senate draft legislation would work.

Ellen Seidman
Non-Resident Fellow, Urban Institute
said at 10:17 pm on March 15th, 2018:

Thanks, Debaters, for your thoughtful responses, and your interactions with each other.

For our final question, please consider what could and likely will happen over the next 3-5 years (go out to 10 if you dare), first, if there is no legislation and second, if legislation similar to the Senate draft bill is enacted. In your responses, consider (i) what the Treasury and FHFA have the authority to do, alone or together; (ii) the likely impact of any decision and/or settlement of the shareholder litigation; and (iii) likely budgetary action by Congress relating to HUD and the FHA. Remember that the focus of this debate is on access and affordability—in a world in which the vast majority of new households will be headed by non-whites.

Mark Zandi
Chief Economist, Moody's Analytics
said at 8:33 am on March 16th, 2018:

Fannie Mae and Freddie Mac will likely remain in conservatorship for the foreseeable future, as finding consensus for legislative GSE reform remains vexed. That doesn't mean the GSEs will stand still, particularly with a Trump appointee running the FHFA.

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The credit risk transfer process will continue to evolve and expand. The CRTs began nearly 5 years ago, and are now transferring more than half of the credit risk taken on by the GSEs. The process will surely be tested by recession and financial market volatility, but it will successfully adapt to these challenges.

The common securitization platform will come to full fruition. Despite some handwringing, it too has made significant progress. The CSP and a single security are important to any future housing finance system.

It is also likely that the size of the GSEs' credit box will be reduced. Lower loan limits seem a likely approach to reduce the GSEs' footprint to allow private portfolio lenders to take on more credit risk. The cross-subsidy in the current system may also be reduced.

The longer the GSEs remain in conservatorship, the harder it will be to get them out. That they will likely soon be scored by the CBO as providing a negative subsidy and thus providing revenues to the Treasury for other government needs will make it doubly hard politically to change the status quo.

This is unfortunate, as the GSEs in conservatorship will not be able to keep up with the changing demographic and technological needs of the nation's underserved mortgage borrowers.

Tim Howard
Former Vice Chairman and CFO of Fannie Mae
said at 11:25 am on March 16th, 2018:

I have been a critic of credit risk transfer (CRT) securities as a substitute for equity capital in a reformed secondary market credit guaranty system, because I strongly believe that programmatic CRT issuance will make guarantors less able to absorb the credit losses they retain.

My argument is a simple one. Investors price CRT securities with the objective of earning a competitive risk-adjusted return (that is, so that the interest income and principal repayments they receive will comfortably exceed expected credit loss transfers). If they believe there is a significant chance of losing money on a CRT investment, they either will raise their yield requirement or (more likely) decline to purchase new CRT issues. The inevitable result of this entirely predictable behavior by CRT buyers is that the issuer will end up paying more (and likely far more) in interest on the CRTs it issues than it receives in credit loss transfers, weakening its ability to bear losses itself during times of stress.

In the spirit of debate, I would like to ask supporters of programmatic CRT issuance: "Am I getting anything wrong in my analysis, and if not, what is the counter-argument for supporting a 'reform' element that is bad both for the stability of the housing finance system and for homebuyers, who will have to bear the cost of this program?"

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Ed Pinto
Codirector, AEI Center on Housing Markets and Finance
said at 8:37 am on March 16th, 2018:

Legislatively reforming or eliminating the GSEs and decreasing the risk of taxpayer-funded bailouts will be difficult. Policy disagreements in the Senate, and between the Senate and the House, make it unlikely to accomplish in 2018.

An administrative solution to eliminate the GSEs and reform the FHA could be implemented over 5+ years (Eliminating Fannie Mae and Freddie Mac without legislation). This would create a stable housing finance market by turning the government-dominated US housing finance system into a predominantly private-sector system based on free market principles, get the taxpayers off the hook, help Treasury reduce the debt by billions of dollars annually, and slow home price growth thereby making homes more affordable for first-time LMI buyers.

Make reliable wealth building the goal of federal homeownership policy:

- Focus FHA exclusively on first-time, LMI homebuyers by crowding out the risky 30-year loans and crowding in 20-year wealth building loans by administrative action.
- Congress could create the Low-Income, First-Time Homebuyer (LIFT Home) Tax Credit, a transparent, targeted, on-budget, upfront tax-credit more replacing today's system using opaque subsidies on high risk lending to marginal buyers.
- Over 10 years, 4 million buyers placed on the path to wealth building, with a 50% reduction in default risk, and freeing up an estimated 1.2 million low-income rentals, allowing the expensive LIHTC program to be phased out.

Tim Howard
Former Vice Chairman and CFO of Fannie Mae
said at 10:03 am on March 16th, 2018:

I don't believe there is any way to predict what will happen if the Senate bill passes, since it's virtually devoid of operational details. It is analogous to having a group of auto critics design a car as it's being built on the assembly line; it's anybody's guess as to what it will look like when it rolls off, let alone whether it will run.

A non-legislative outcome is far more likely in any case, due to the complexity of the problem and the dysfunction in Congress. Even here, however, prediction is very difficult. It's more a case of what's most probable, and here is my assessment of that:

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- Fannie and Freddie will remain in conservatorship until some triggering event—most likely an adverse ruling in one of the court cases challenging the net worth sweep—occurs to prod (or force) administrative action by Treasury.

- Treasury's reform initiative will follow the model put forth by Moelis & Company last June. This is a "turnkey" solution, with support of the investment bankers who will need to raise the capital for it, and it also will yield upwards of $100 billion for Treasury through conversion of warrants for Fannie and Freddie common stock.

- Affordable housing groups will succeed in getting legislation, not tied to secondary mortgage market reform, that imposes a small fee on all new mortgage originations, with the proceeds used for targeted subsidy programs.

Laurie Goodman
Director, Housing Finance Policy Center
said at 10:01 am on March 16th, 2018:

I believe the Senate bill would be good for access and affordability by better targeting the benefits and making the cross- subsidization transparent. Moreover, these cross-subsidization features would become legislative, rather than dependent on the goodwill of the head of the FHFA. That said, I am very pessimistic about the likelihood of legislative GSE reform in the next 5 years. I don't think the political will is there: there is no consensus as to what the new system should look like, and the present system seems to most of be working well enough.

So where does that leave us? As Mark Zandi put it so well, we continue down the path of administrative reforms. GSE credit risk transfer expands, the Common Securitization Platform and the Single Security become a reality next year, the GSE portfolios reach their target size and stabilize. The wildcards here are the GSE footprint and the access and affordability features. Mel Watt's 5-year term as head of the FHFA expires in January of 2019. His successor could choose to substantially curtail the GSE footprint by decreasing loan limits or raising guarantee fees (which are already higher than the risk of the book of business plus the administrative costs of running the GSEs require). His successor could also choose to substantially weaken the access and affordability features in the present system. That is, the cross-subsidization in the current pricing structure could be reduced, the housing goals could be weakened or eliminated, and the new guard could fail to enforce the duty to serve mandate.

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Shekar Narasimhan
Managing Partner, Beekman Advisors
said at 10:05 am on March 16th, 2018:

September 7, 2018 will mark the 10th anniversary of conservatorship. Easiest prediction is that the current state continues indefinitely- there really are a lot of people who like it and are benefiting from it! Most lenders- for- and non-profit and also non-banks are having banner years. Minor details in my view- it is not stable and is not fully serving the market. But change is inevitable-Jan 2019 Mel Watt, Jeb Hensarling and Bob Corker are no longer in their current seats. Therefore, an administrative solution in 2019 would be my prediction with real congressional reform in 2022. The administrative solution would be to move to receivership and then start selling "assets" to redeem the subordinated debt and possibly preferred stock. That would leave a shrunken and likely much less effective system by the time Congress gets to it in 2022. Or a miracle happens and the leaked Senate bill sees the light of day and reform is a compromise- like everything else in life!

Mike Calhoun
President, Center for Responsible Lending
said at 2:34 pm on March 16th, 2018:

Dramatic housing finance reform has already been implemented over the past ten years, and it is ongoing and should continue through the administrative process. The Housing and Economic Recovery Act of 2008 provided a blueprint on access and affordability issues in our housing finance system. These statutory requirements should make us less concerned about the replacement of the FHFA director next year. Furthermore, our view is the Senate draft would do much more harm than good, and we should not rush to legislate simply because there will be new leadership at FHFA. The Senate draft, if it became law, would have negative ramifications baked into statute, making the policies extremely difficult to change.

A necessary change within the power of FHFA is for the GSEs to stop the excessive risk-based pricing that occurs in LLPAs and PMIERs. This would bring in many of the potential homeowners that Urban Institute reports are locked out.

Homeownership is the way that most Americans build wealth over time. The future of the market is now. Most new household formation is families of color and new homebuyers are increasingly families of color. The market depends on ensuring that millennials and people of color are well served. This also benefits existing homeowners, especially older Americans, who will need buyers when they want to sell, when new families will need access to affordable mortgage credit to buy their homes.

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As Lisa stated, the federal government has facilitated discrimination in the mortgage market and now has an obligation to correct those wrongs. Black homeownership is where it started at passage of the Fair Housing Act in 1968. The exclusion of Blacks, Latinos, and other people of color must be addressed to achieve a well-functioning system.

Testimony we delivered before the House Financial Services Committee last year highlights the federal government's role in fostering the racial wealth gap and the steps the government can take to remediate the system toward access and affordability.

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