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A Bolder Vision for the Secondary Mortgage Market

The housing finance market is going to be restructured. Here's what we need to consider in order to do it right.

By JAMES H. CARR

Just over two decades ago, the seeds of the affordable homeownership market were planted. Several factors converged at that time to encourage lenders to revisit their underwriting criteria and take assertive and affirmative steps to improve their performance among low and moderate-income and minority populations.

Those factors included the addition of borrower characteristics to the Home Mortgage Disclosure Act (HMDA) database that showed significant disparities in loan denial rates by race and ethnicity even when controlling for income. The U.S. Justice Department's successful lending discrimination challenge against Decatur Federal Savings and Loan Association was another important impetus. And the Boston Federal Reserve Bank's seminal study showing significantly higher denial rates for African American and Latino loan applicants, relative to non-minority loan applicants, throughout the Boston, MA metropolitan area, provided powerful empirical evidence of the existence of widespread unequal treatment of borrowers by race/ethnicity. The Boston Fed study was particularly important since it controlled for all major factors in the lending decision including financial, employment and neighborhood characteristics.

Between 1992 and 1994, mortgage lenders more than doubled their origination of home loans to African Americans and Latinos; importantly, these were low cost, sustainable, 30-year fixed-rate loans. Also, at that time, homebuyer counseling increasingly became an integral aspect of affordable lending programs. Significant investments of time and money were made by a broad coalition of nonprofits, housing organizations, banks, and the government-sponsored enterprises, particularly Fannie Mae and Freddie Mac, to ensure that home purchases by underserved borrowers were accomplished in a financially responsible manner and in a way that would provide the greatest opportunity for success.

Yet, almost from the start, a parallel subprime lending industry grew. Its financially exploitive and irresponsible lending practices were so virulent that by 1999, the North Carolina legislature was compelled to enact the first state-wide anti-predatory lending law.

Failure to regulate the subprime lending industry on the federal level and federal preemption over state anti-predatory lending laws allowed financial exploitation in the mortgage market to flourish. The sad results of that experience are clear today. According RealtyTrac data, more than 11 million foreclosure filings have occurred since 2007, with more than 1 million foreclosure filings in just the first six months of 2012. Vacant and abandoned properties litter the landscapes of communities across the nation. And an unimaginable loss of wealth, particularly for people of color, has occurred. According to the Pew Research Center, net worth has declined by fully two-thirds for Latinos and by more than half for Asians and African Americans.

As with most problems, repairing the damage will require a lot more thoughtful and intelligent action than the recklessness that created the mess. And despite the relative good news on a number of recent housing market statistics, housing is far from out of the woods. As a result, the manner in which the mortgage finance system is rebuilt will have a profound effect on the overall health of the housing market for years to come.

Rebuilding the Housing Finance System

Since the onset of the recent foreclosure crisis and the collapse of much of the nation's housing finance system, questions have been growing as to how best to rebuild the system in a manner that avoids the problems inherent in past mechanisms. *The Nation*al Council of La Raza (NCLR), University of North Carolina-Chapel Hill Center for Community Capital (UNC-CCC), and Center for American Progress (CAP) have been working together to develop a set of recommendations on ways to ensure a robust secondary mortgage market that serves all households in an equitable manner.

That effort is part of a broader initiative by the National Council of La Raza's "Home for Good" campaign, a multi-pronged effort being pursued by a broad coalition of organizations including The Opportunity Agenda, National CAPACD, National Urban League, Kirwan Institute, Center for Responsible Lending, and National Fair Housing Alliance. The goal of the initiative is to encourage policy makers to take assertive and positive actions to successfully address the continuing foreclosure crisis, rebuild communities traumatized by the housing crisis, and create a strong and vibrant housing market—one that offers equitable, affordable homeownership opportunities as well as quality rental housing options to all of America's families.

On September 24, NCLR and UNC-CCC convened a group of housing experts to discuss the requirements of a restructured secondary mortgage market. Those experts highlighted five core requirements as essential secondary market functions going forward:

1. Ensure a liquid and reliable source of credit for housing in all geographies, including urban, suburban, and rural locations, and diverse products to accommodate a wide range of housing types, including co-ops, manufactured housing, senior housing, small rental structures, and energy efficient dwellings.
2. Guarantee the risks involved in housing finance are fully internalized and paid for by the system (and not potentially by the American taxpayer).
3. Limit excessive risk-taking (as opposed to legitimate innovation) by design and not solely by regulation.
4. Affirmatively further fair housing and equal credit access.
5. Employ more sophisticated measures of credit risk appropriate to various underserved borrower groups and invest in and share publicly data and information on the effective reach of loan products by borrower and community demographics characteristics.

Beyond those core functionalities, I suggest three additional requirements that should be fulfilled that take into account the realities of the current housing market and, in particular, the damage that has occurred from rampant foreclosures:

1. Leverage the current climate of historically low mortgage interest rates, vast pools of foreclosed properties, and greatly lowered home prices to promote homeownership particularly for historically underserved borrower groups.
2. Ensure an adequate supply of credit for rental housing and pioneer new products for rental as well as rent-to-own and shared equity homeownership.
3. Support developers on comprehensive community investment efforts that include community infrastructure (i.e., a limited or pilot community infrastructure bank).

Current Proposals Do Not Meet the Challenges Ahead

The Center for American Progress has prepared a comprehensive side-by-side report of the major proposals that have been advanced to date to revamp the secondary market, titled "The $5 Trillion Question: What Should We Do with Fannie Mae and Freddie Mac?" Most proposals do not address all five of the above-suggested core requirements for a revamped secondary market. In particular, most proposals fail to include a duty to serve lower-income or minority consumers. In fact, several proposals by their design would create eligibility hurdles to access mortgage credit that few minority consumers can meet. The result would be a dual credit market in which people of color are channeled almost exclusively into loans through the FHA. Recreating a dual credit market is as bad of an idea today as it was in the 1960s when civil rights legislation began the process of dismantling separate and unequal credit markets due to their inherent weaknesses, flaws, and inferiority. Dual credit markets have historically resulted in minority borrowers receiving higher cost and inferior quality products and have served as a breeding ground for fraud and other customer abuses.

One growing justification for failing to ensure that a newly revamped secondary market serves lower-income and minority families is that the limits of homeownership have been reached and that homeownership should no longer be a national priority. But that perspective is based on the discredited argument that the housing market's collapse was the result of financial institutions pushing the boundaries of legitimate attempts to expand homeownership. The homeownership rate for African Americans and Latinos is currently in the mid-to-low 40 percent range. There is much more room for homeownership growth among these populations with safe, reliable, affordable, and sustainable loan products.

Moreover, rents are now outpacing the cost of ownership in major metropolitan areas across the United States. And homeownership remains the single most significant source of asset accumulation for the typical American family. With home prices down more than 30 percent nationally and more than 50 percent in many communities, leveraging this unique environment to promote sustainable homeownership and rebuild lost wealth, particularly within communities of color, should be a public policy priority.

Beyond serving low- and moderate-income and minority consumers with basic mortgage products, there is little discussion in the proposals for the new secondary market about how to provide enhanced credit access for alternative housing types. In an environment where the need for financing of alternative structure (and ownership) types is arguably greater than ever, it would be an oversight to remake the secondary market and leave in place deficiencies in the manner in which small rental, manufactured housing, co-operative units, seniors' accommodations, and energy efficient dwellings are served. It would also be unfortunate to create a structure that is incapable of pursuing, or is not directed to pursue, innovative loan types such as rent-to-own products that could further expand access to homeownership for nontraditional borrowers.

Likewise, most of the major secondary market recommendations are silent on, or provide no detail about, the manner in which access to credit for rental housing construction should be provided. In an environment where rents are climbing rapidly and affordable rents are already nearly impossible to find in any market in America, improving access to low-cost financing for affordable rental units is essential. And it should be explicitly addressed in the remaking of secondary mortgage market.

Finally, no proposal addresses ways for the secondary market to support nonprofit and for-profit developers engaged in comprehensive community redevelopment including infrastructure development or modernization. President Obama has addressed the need for infrastructure investment in America on numerous occasions. He has also proposed additional federal spending through Project Rebuild to address vacant and abandoned foreclosed properties in communities where foreclosures have been concentrated. And the National Community Reinvestment Coalition has repeatedly encouraged federal officials to better link REO strategies to workforce development efforts.

Enabling a new secondary market institution to pursue broader community investment, initially on a limited basis, in the form of a pilot community infrastructure bank, would empower the new secondary market to address comprehensively the multiple difficulties created by the continuing housing crisis. It could also act to help create jobs in communities that need them the most.

The Role of Structure

The structure of the government's support of the secondary mortgage market will have a profound impact on its functions that market. One feature common to most of the proposed secondary market plans is the replacement of Fannie Mae and Freddie Mac with multiple private institutions to issue qualifying mortgaged backed securities.

Multiple institutions, however, multiply the challenges presented in requiring the secondary market to serve housing policy goals beyond meeting the credit needs of middle-income borrowers with traditional loan products. Enforcing duty-to-serve requirements, piloting innovative products and services, and pushing the envelope on comprehensive community investment are better achieved through a single institution with a broad mandate to address these and related concerns.

Lifting the housing market from the rubble of the subprime debacle will require more than the secondary market operations in place leading up to the bursting of the housing bubble. In response to the housing crisis of the 1930s, federal policy makers aggressively launched numerous new institutions including the Federal Home Loan Banks, FHA, , and Fannie Mae. The government's role in home lending was further enhanced after World War II through the Veterans Administration and in the 1960s with the establishment of Freddie Mac. The damage to the housing markets as a result of the current crisis is, on some indicators, worse than the housing market collapse of Great Depression. As a result, now is the time for policy makers to think with a bolder vision. Now is the time for housing proponents, particularly advocates for moderate-income families, people of color, and rural communities to demand a solution that is up to the challenges presented.

The new secondary market must have the mandate, tools and resources to firmly reinstate sustainable, affordable homeownership as a principal and achievable cornerstone of the American Dream for the vast majority of families who seek it, while also ensuring an adequate supply of decent, safe and affordable rental housing to working families who choose that housing option.

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