BIPARTISAN POLICY CENTER

# Housing America's Future: New Directions for National Policy

## Report of the Bipartisan Policy Center Housing Commission

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# About the Housing Commission

- **Created by the Bipartisan Policy Center, a non-profit organization founded in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell**
- **Launched in October 2011 with four co-chairs:**
  - Christopher S. "Kit Bond – Former U.S. Senator; Former Governor of Missouri
  - Henry Cisneros – Former Secretary, U.S. Department of Housing & Urban Development
  - Mel Martinez – Former U.S. Senator; Former Secretary, U.S. Department of Housing & Urban Development
  - George J. Mitchell – Former U.S. Senate Majority Leader
- **Composed of 21 members drawn from diverse political and professional backgrounds**
- **Report, *Housing America's Future: New Directions for National Policy*, issued February 25, 2013**

# Housing Commission Principles

- A healthy, stable housing market is essential for a strong economy and a competitive America.
- The nation's housing finance system should promote the uninterrupted availability of affordable housing credit and investment capital while protecting American taxpayers.
- The United States should reaffirm a commitment to providing a decent home and a suitable living environment for every American family.
- The primary focus of federal housing policy should be to help those most in need.
- Federal policy should strike an appropriate balance between homeownership and rental subsidies.

# Principal Areas of Recommendations

- **The Continuing Value of Homeownership**
- **Reforming Our Nation's Housing Finance System**
- **Affordable Rental Housing**
- **The Importance of Rural Housing**
- **Aging in Place: A New Frontier in Housing**

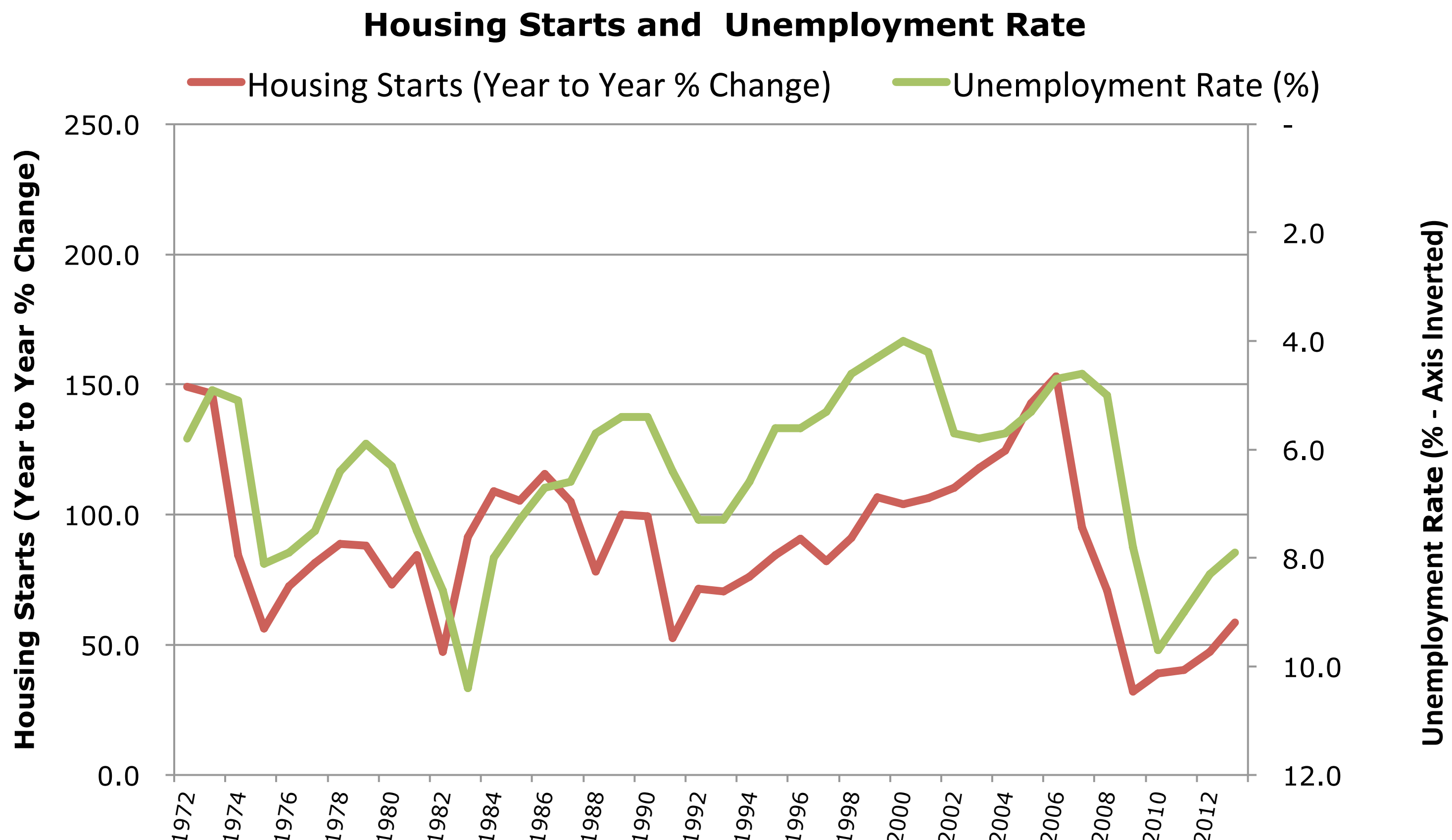
# Aim of BPC Report - A Call to Action

- **Provide guidance on how best to respond to challenges, such as -**
  - **Homeownership remaining out of reach for far too many families;**
  - **Limited access to credit impeding the nation's economic growth;**
  - **Rising rental housing costs as demand continues to increase;**
  - **Desire to age in place in one's own home through senior years.**
- **Serve as a catalyst for bipartisan action**
- **Visit www.bipartisanpolicy.org/housing to download the report**

# Reforming Our Nation's Housing Finance System

# Overall Context: Housing is Key to the Economic Recovery

**A robust housing market is essential to a strong economic recovery. One of the reasons the economy continues to struggle is that the housing market, although improving, is far below historical levels.**




Source: U.S. Census Bureau

# In Looking to the Future of the Nation's System of Housing Finance, the Commission Identified Five Policy Objectives

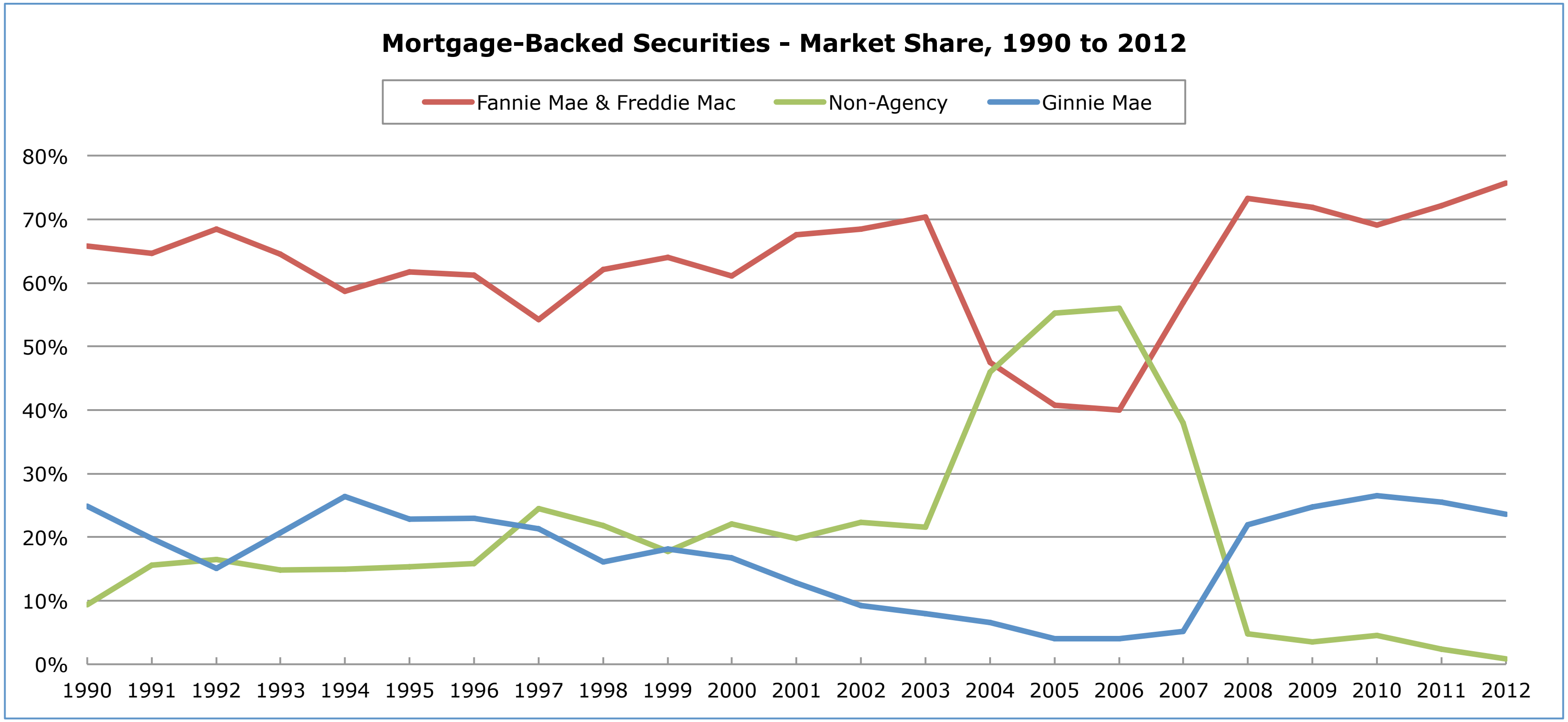
1. A greater role for the private sector
2. The elimination, over an appropriate period of time, of Fannie Mae and Freddie Mac
3. A continued but limited role for government-guaranteed MBS
4. A continued, but more targeted, traditional role for the Federal Housing Administration (FHA)
5. Access to credit for all creditworthy borrowers and lenders of all types and sizes

# Consensus on Policy Objectives

- **Although the BPC Housing Commission outlines a fairly detailed proposal on a structure to achieve these policy objectives, <u>the first step to long-term housing finance reform is achieving agreement on the fundamental policy objectives among the various stakeholders</u> (e.g., lenders, investors, consumer groups, home builders, Realtors, securities dealers, etc.) and policymakers (e.g., the Administration and Congress).**
- **The BPC Housing Commission report could serve as a catalyst to help achieve such agreement.**

# A Greater Role for the Private Sector






| Funds for MBS, share of market by source, selected years | | | | | |
|---|---|---|---|---|---|
| | 1990 | 1996 | 2000 | 2006 | 2012 |
| Fannie Mae & Freddie Mac | 65.76 | 61.22 | 61.11 | 39.95 | 75.67 |
| Ginnie Mae | 24.82 | 22.91 | 16.79 | 4.02 | 23.55 |
| Non-Agency | 9.42 | 15.87 | 22.11 | 56.03 | 0.78 |

Source: Bipartisan Policy Center tabulations of data from Inside Mortgage Finance, "Mortgage and Asset Securities Issuance," *Inside MBS & ABS*.

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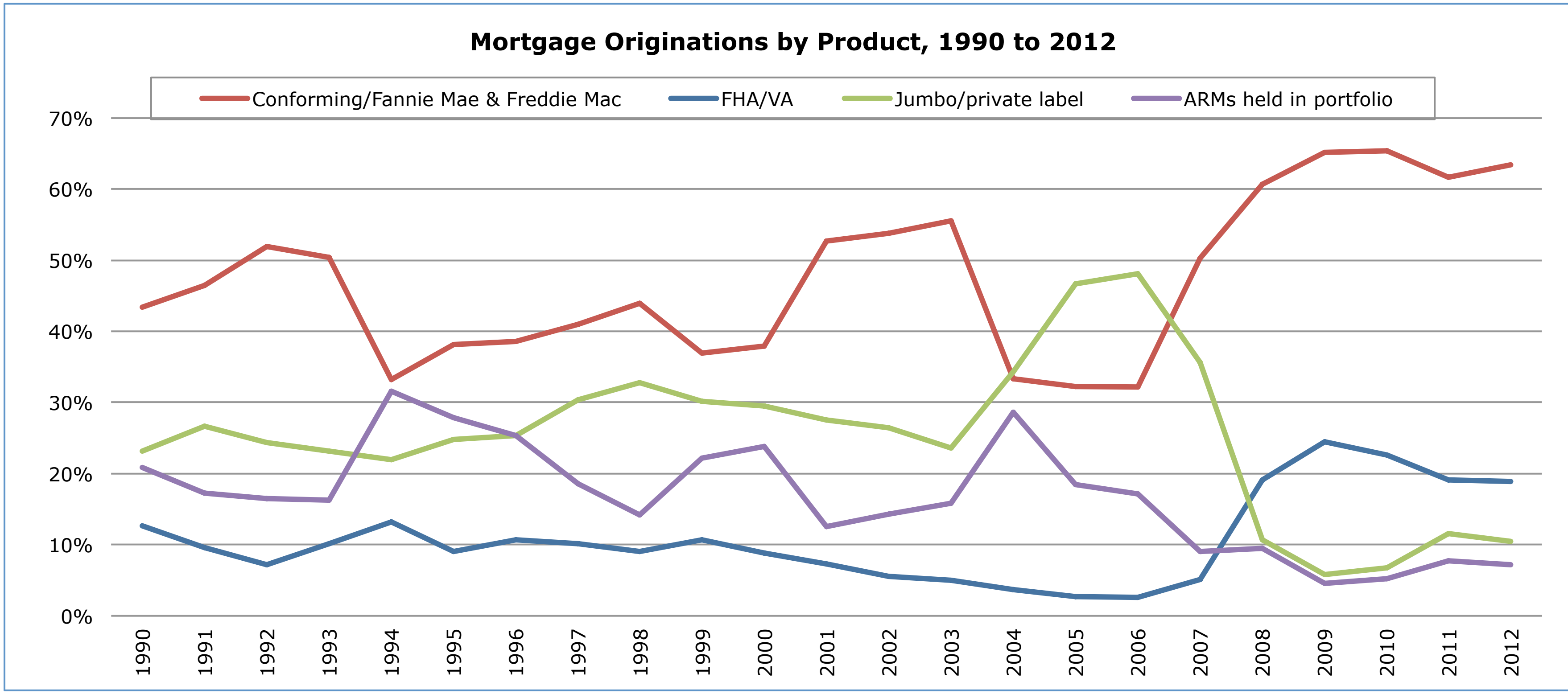
# A Greater Role for the Private Sector




| Mortgage originations by product share of market by source, selected years | | | | | |
|---|---|---|---|---|---|
| | 1990 | 1996 | 2000 | 2006 | 2012 |
| Conforming/Fannie Mae & Freddie Mac | 43.4 | 38.6 | 37.9 | 32.2 | 63.4 |
| FHA/VA | 12.7 | 10.7 | 8.8 | 2.6 | 18.9 |
| Jumbo/private label | 23.1 | 25.4 | 29.5 | 48.1 | 10.5 |
| ARMs held in portfolio | 20.8 | 25.4 | 23.8 | 17.1 | 7.2 |

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Source: Bipartisan Policy Center tabulations of data from Inside Mortgage Finance, “Mortgage Originations by Product” and “ARM Securitization by MBS Type”

# The Structure of the New Housing Finance System

- **Following the model of Ginnie Mae, private sector entities would originate and service mortgages, issue mortgage-backed securities, and provide private credit enhancement to cover "predominant loss" risk**
- **The private sector would take the "predominant loss risk" (first loss) through <u>private credit enhancers</u>**

  Credit enhancement requirements could be met through a combination of options:

  - Well-capitalized private mortgage insurance
  - Capital market mechanisms where the amount of capital required to withstand severe losses is reserved upfront through such mechanisms as senior/ subordinated debt models or approved derivative models using fully funded credit linked notes or margined credit default swaps
  - A combination of capital market and private mortgage insurance options

# The Structure of the New Housing Finance System (cont'd.)

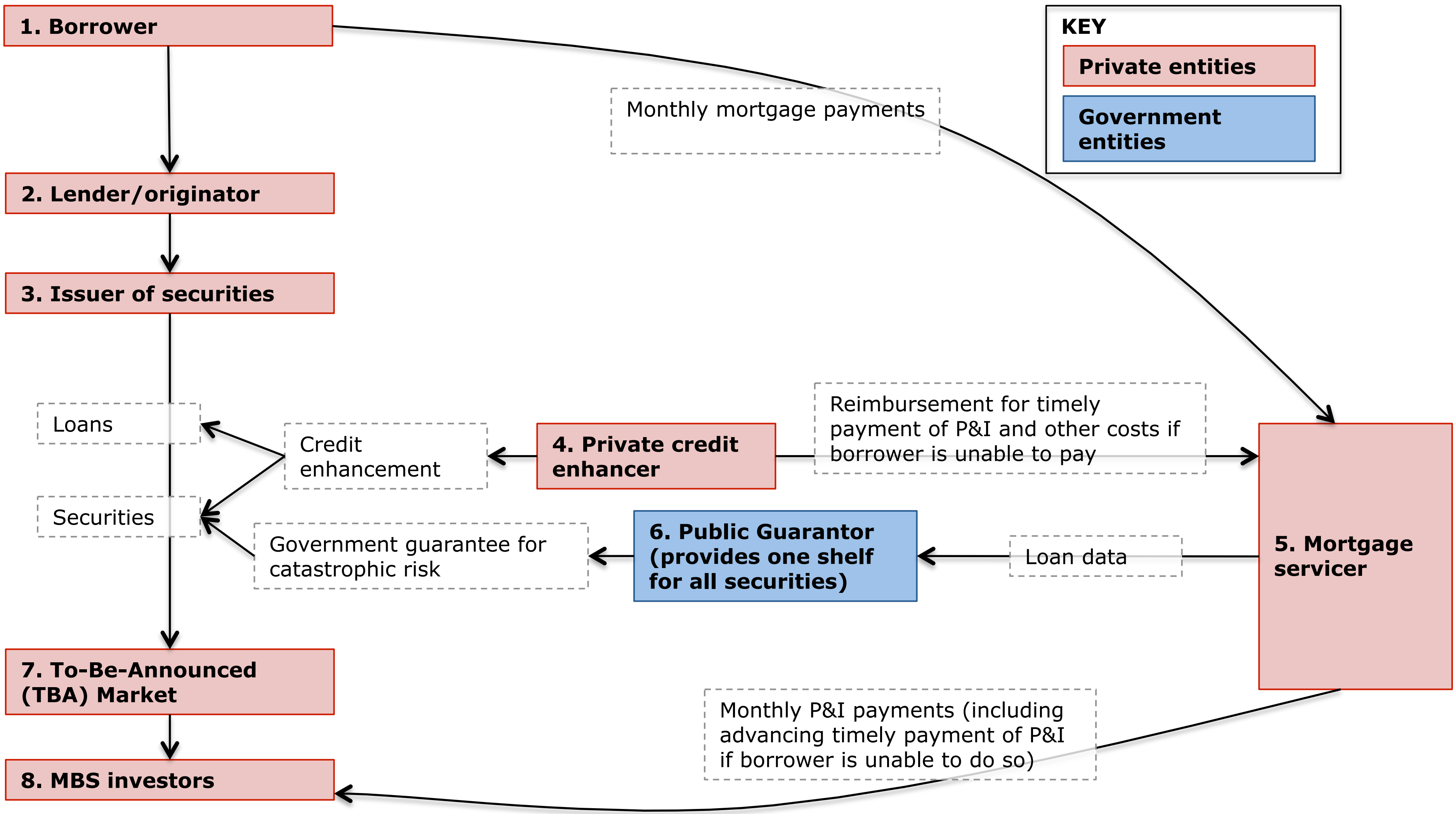
- **The GSEs would be eliminated over time, and replaced by an independent, wholly-owned government corporation, the <u>Public Guarantor</u>, that would provide a limited government guarantee for catastrophic risk for both single-family and multifamily housing finance**
  - A limited government-guaranteed secondary market is essential for adequate liquidity to support the mortgage needs of American households
  - The To-Be-Announced (TBA) market relies on a government backstop for credit risk
  - The Public Guarantor will set the standards for originating mortgages, issuing MBS, providing private credit enhancement, and servicing the mortgages
- **The limited government guarantee would be:**
  - Explicit and actuarially sound (fully funded with premium collections exceeding expected claims with a safe reserve cushion)
  - Apply only to the mortgage backed securities (and not cover the equity or debt of the entities that issue or insure the MBS)
  - Apply only to catastrophic risk (and apply only after the private sector entities in the predominant loss position have fully exhausted their own equity capital)

# Who Bears the Risk? -- The Capital Stack

The government is in the fourth loss position

| Resources | Entity | Risk/Responsibility |
|---|---|---|
| 1. Household resources | Homeowner/ mortgage holder | Down payment and home equity |
| 2. Corporate resources | Originator/ Issuer | Representations and warranties |
| | Servicer | Timely payment of principal and interest (to be reimbursed by the private credit enhancer) |
| 3. Private credit enhancer resources | Private credit enhancer | Credit risk – with sufficient capital set aside to survive a stress test no less severe than the recent downturn (e.g., home price decline of 30 percent to 35 percent, which would correspond to aggregate credit losses of 4 percent to 5 percent of prime loans) |
| 4. Government resources | Government guarantee for catastrophic risk/ Public Guarantor | Catastrophic credit risk (with dollars set aside in a catastrophic risk fund paid for by a portion of the g-fee) |

# Flow of Mortgages



# Transition

- **A dynamic, flexible transition is essential to the development of a redesigned housing finance system**
- **Congress and the Administration should enact changes to allow an extended period (5 to 10 years) to unwind and repurpose the operations of the GSEs in an orderly fashion and to rebalance capital flows as the private sector steps in and the government footprint shrinks**
- **Loan limits will be a key policy "dial" in reducing the size of government involvement in the mortgage market (with metropolitan area loan limits)**
- **Other policy dials include, and have been set in motion by the FHFA:**
  - Increasing guarantee fees (g-fees)
  - Shrinking the portfolios of the GSEs
  - Establishing a single platform for the issuing, trading, and tracking of MBS

# The Single-Family Housing Finance System of the Future

**The Commission expects that the single-family housing finance system of the future will have three distinct segments:**

- Mortgages that are not covered by any government guarantee
- Mortgages in securities that are covered by the new limited government guarantee provided by the Public Guarantor
- Mortgages insured or guaranteed by FHA, VA and USDA

# The Rental Housing Finance System of the Future

**The rental/multifamily housing finance system will be reformed according to similar principles, and access to the government guarantee will be contingent on compliance with an affordability requirement:**

- Should support a <u>broad</u> backstop for multifamily housing to ensure liquidity and avoid the overuse of the government guarantee for high-end rental properties

- Compliance would be assessed by the Public Guarantor using the rents established at loan origination

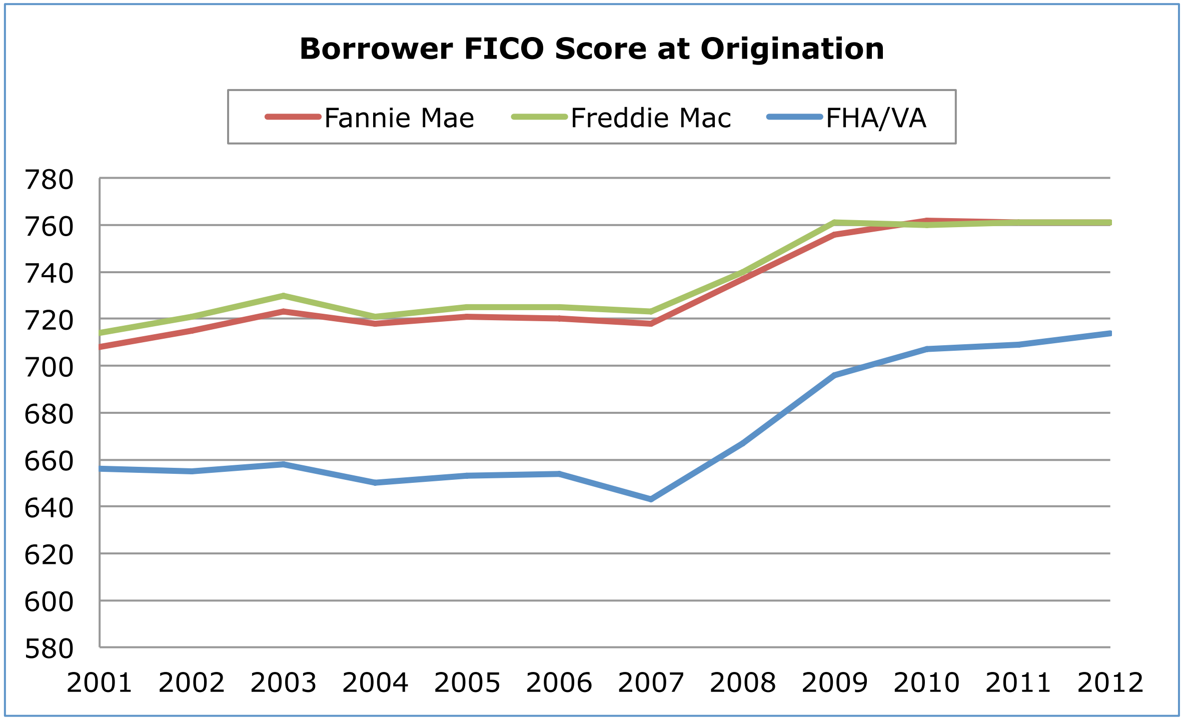
- Compliance with any percentage of qualifying-unit standard would be determined based on the issuer's portfolio of qualifying securities over a rolling two- to three-year period.

- Issuers that fail to comply with any percentage of qualifying-unit standard applied over this rolling period could be subject to a variety of actions, including losing approval status to do business with the Public Guarantor

# Short-Term Issues Preventing a Robust Housing and Economic Recovery

# Although Housing is Beginning to Recover from the Great Recession, the Nation Still Faces Major Housing Finance Challenges

- **Many qualified buyers cannot get a mortgage**




Source: CoreLogic, 1010Data, Amherst Securities Group

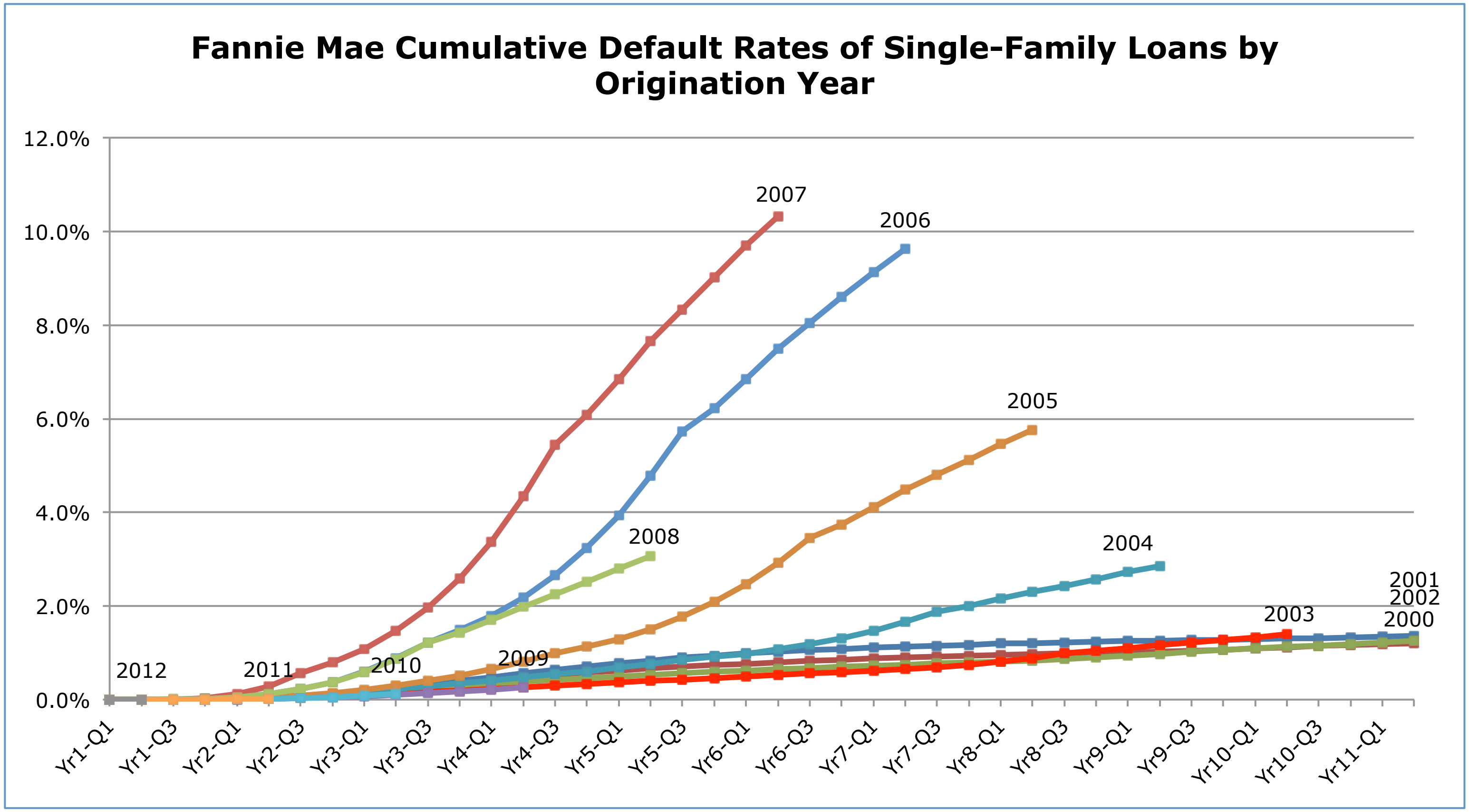
- **There is great uncertainty regarding a wide range of housing finance regulations**

- **There is great uncertainty regarding the future of the GSEs**

# What Needs To Be Done Now

- **Relief from overly strict lending standards**

Restore appropriately conservative underwriting standards that were in place before the housing bubble




Source: Fannie Mae

# What Needs To Be Done Now

- **Improve access to credit for well qualified self-employed individuals**
- **Further clarification for lenders on put-back risks for reps and warrants**
- **Deal with appraisal concerns**

  (i.e., Fannie Mae, Freddie Mac, and FHA could refuse to accept distressed sales as valid comps)
- **Clarify uncertainty related to pending regulation and implementation of new rules**

  The Commission suggests the President should direct the Treasury Department to coordinate with the various regulatory agencies to inventory, assess, and coordinate the various regulatory initiatives related to housing finance and to assess their current and likely impact on the affordability and accessibility of mortgage credit.