BIPARTISAN POLICY CENTER

Housing America's Future: New Directions for National Policy

Report of the Bipartisan Policy Center Housing Commission

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Background: BPC Housing Commission

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**

The Continuing Value of Homeownership

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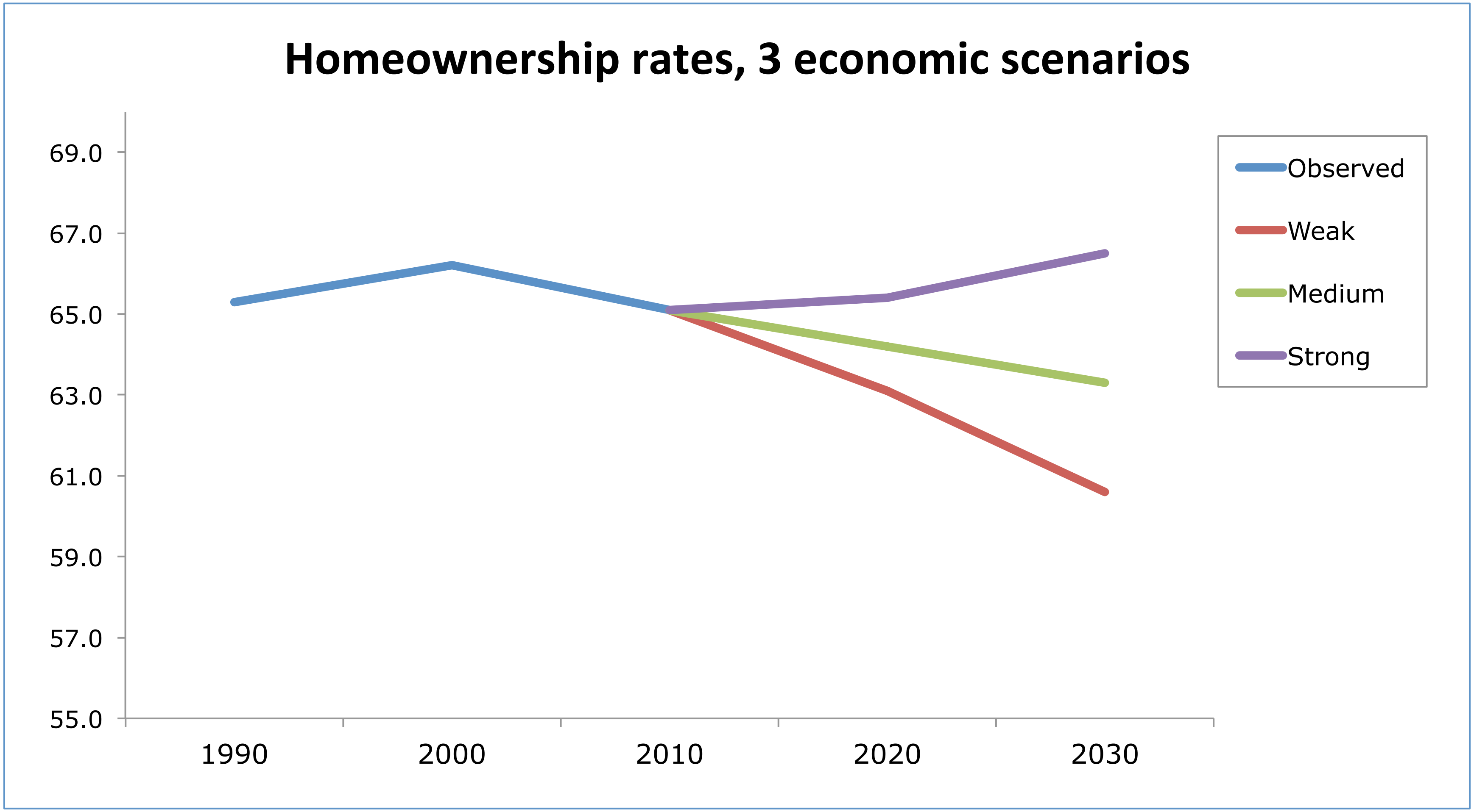


Source: *Demographic Challenges and opportunities for U.S. Housing Markets* (March 2012). Prepared for the Bipartisan Policy Center by Rolf Pendall and Lesley Freiman, The Urban Institute; Dowell Myers, University of Southern California; and Selma Hepp, National Association of Realtors.

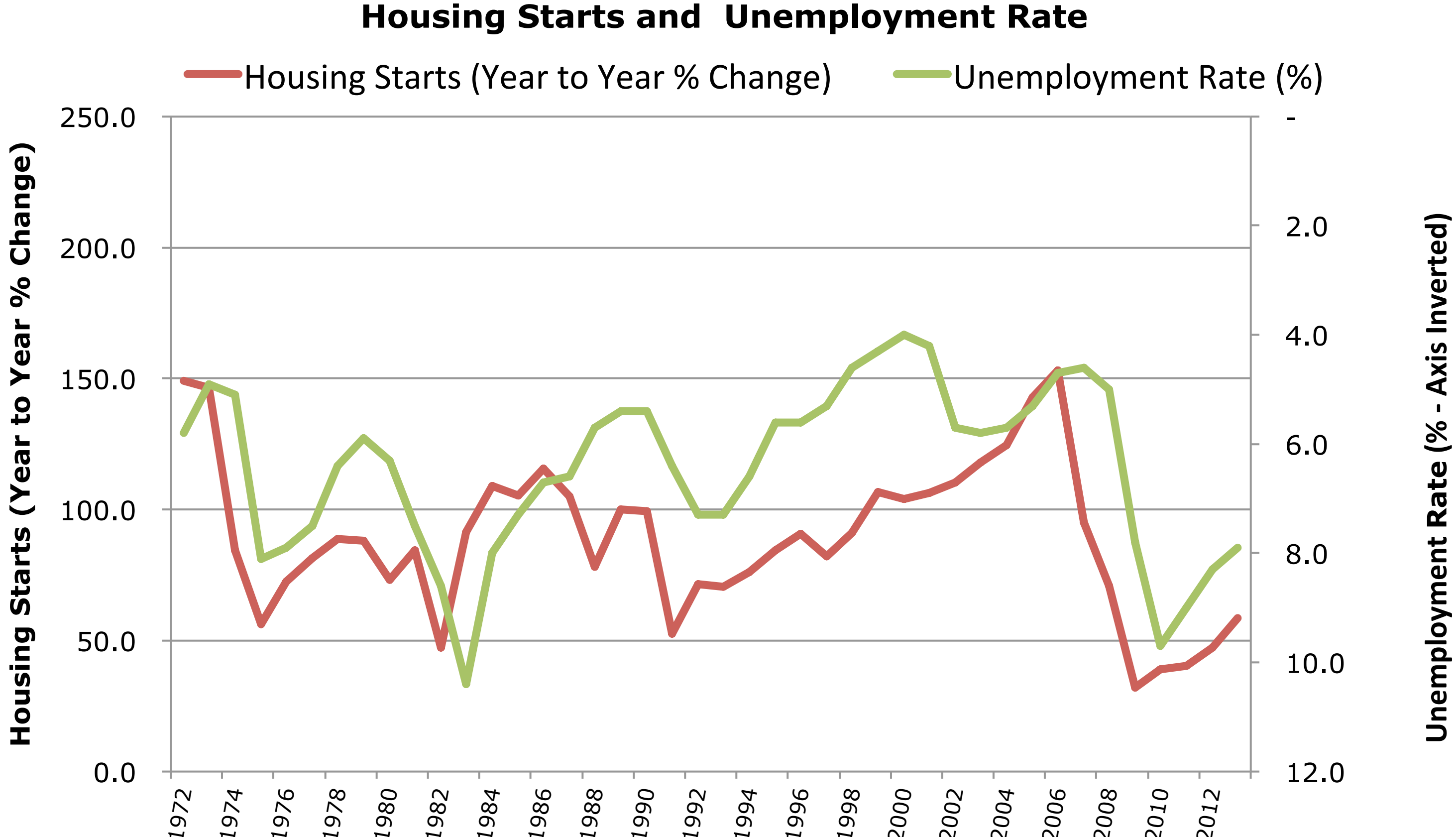
The Continuing Value of Homeownership

- **Homeownership will continue to be the preferred housing choice of a majority of households**
- **When responsibly undertaken, homeownership can produce powerful benefits**
- **Housing counseling can improve prospective borrowers’ access to affordable, prudent mortgage loans. Four key elements are necessary:**
    - A strong counseling infrastructure
    - Clear standards
    - An understanding of the proper role for counselors
    - The adoption of best practices for integrating counseling into the mortgage market
- **Hybrid tenure options and manufactured homes present other opportunities for affordable homeownership**

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

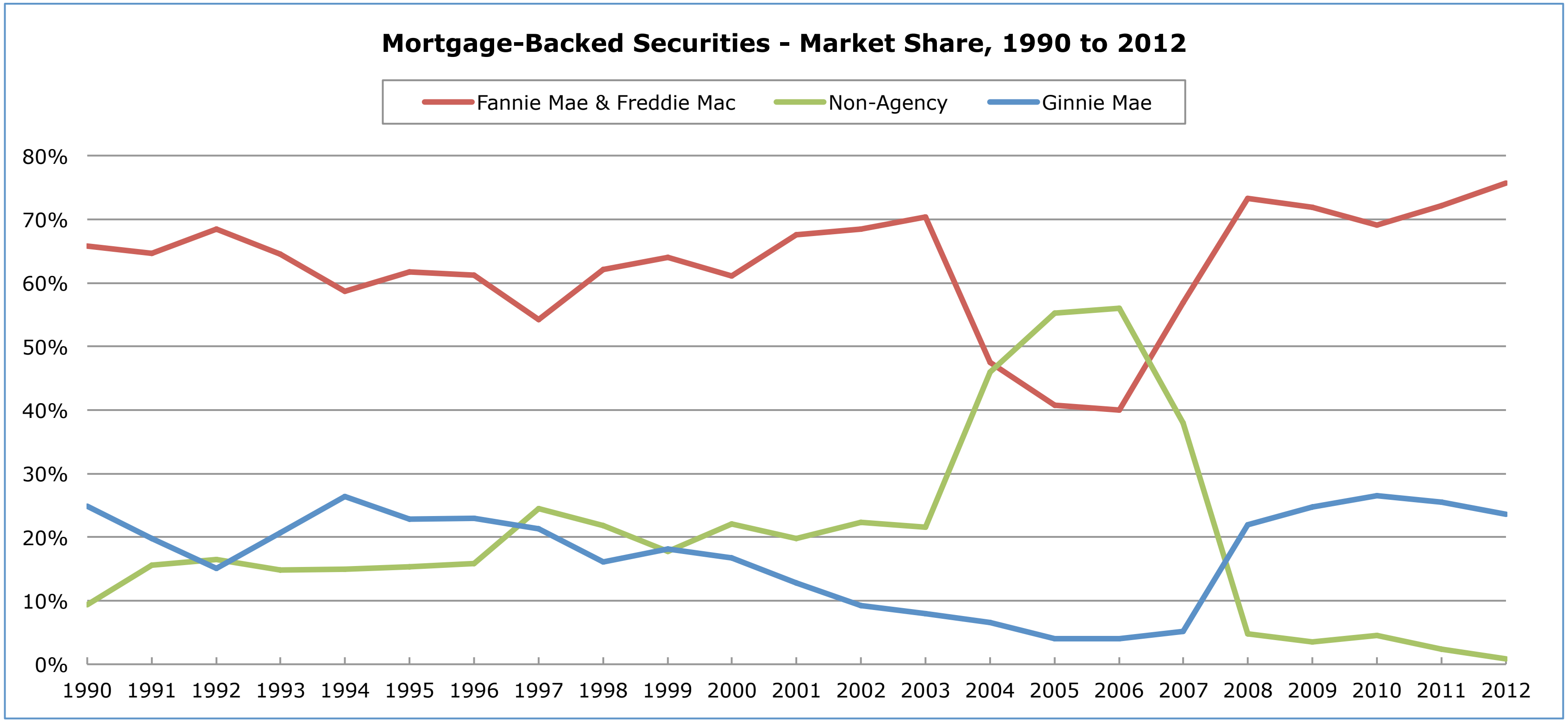
In Looking to the Future of the Nation's System of Housing Finance, the Commission Identified Five Policy Objectives

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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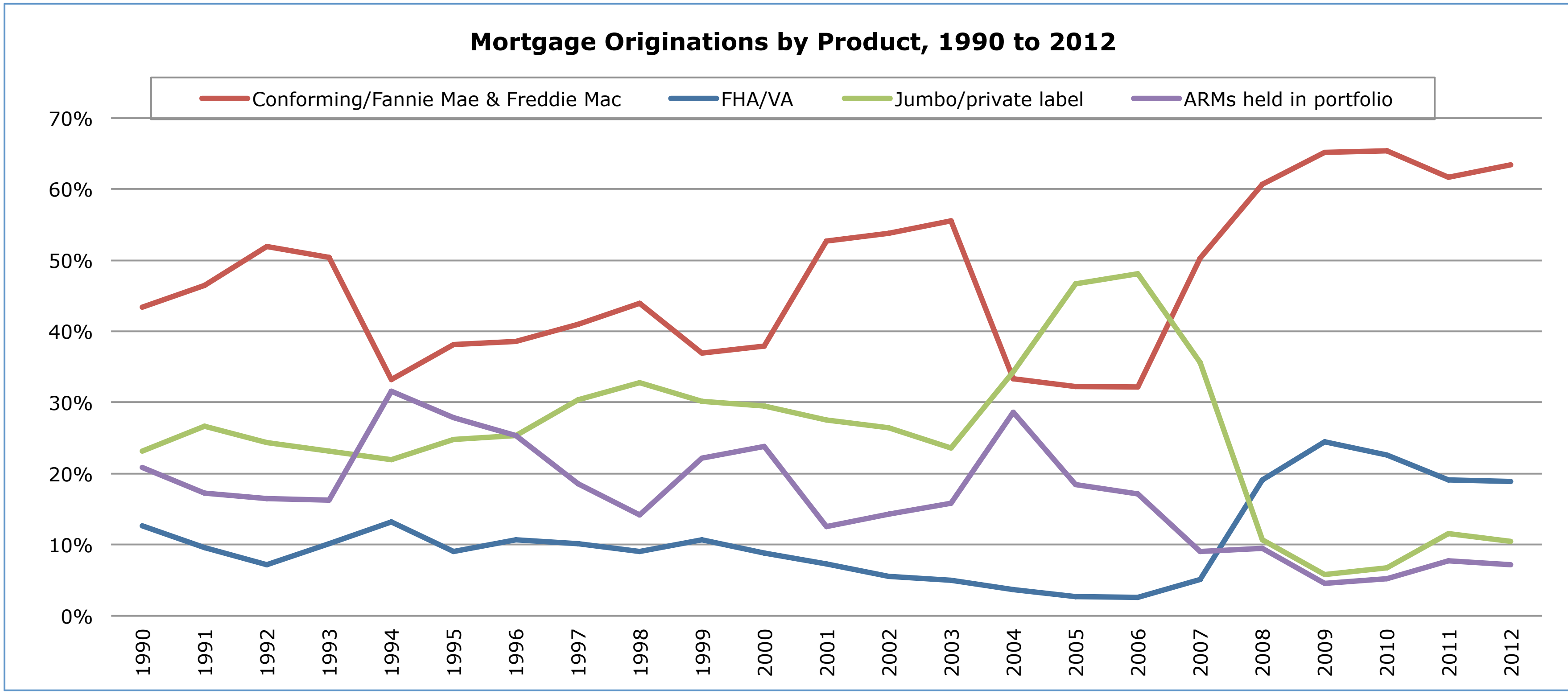
A Greater Role for the Private Sector



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.)

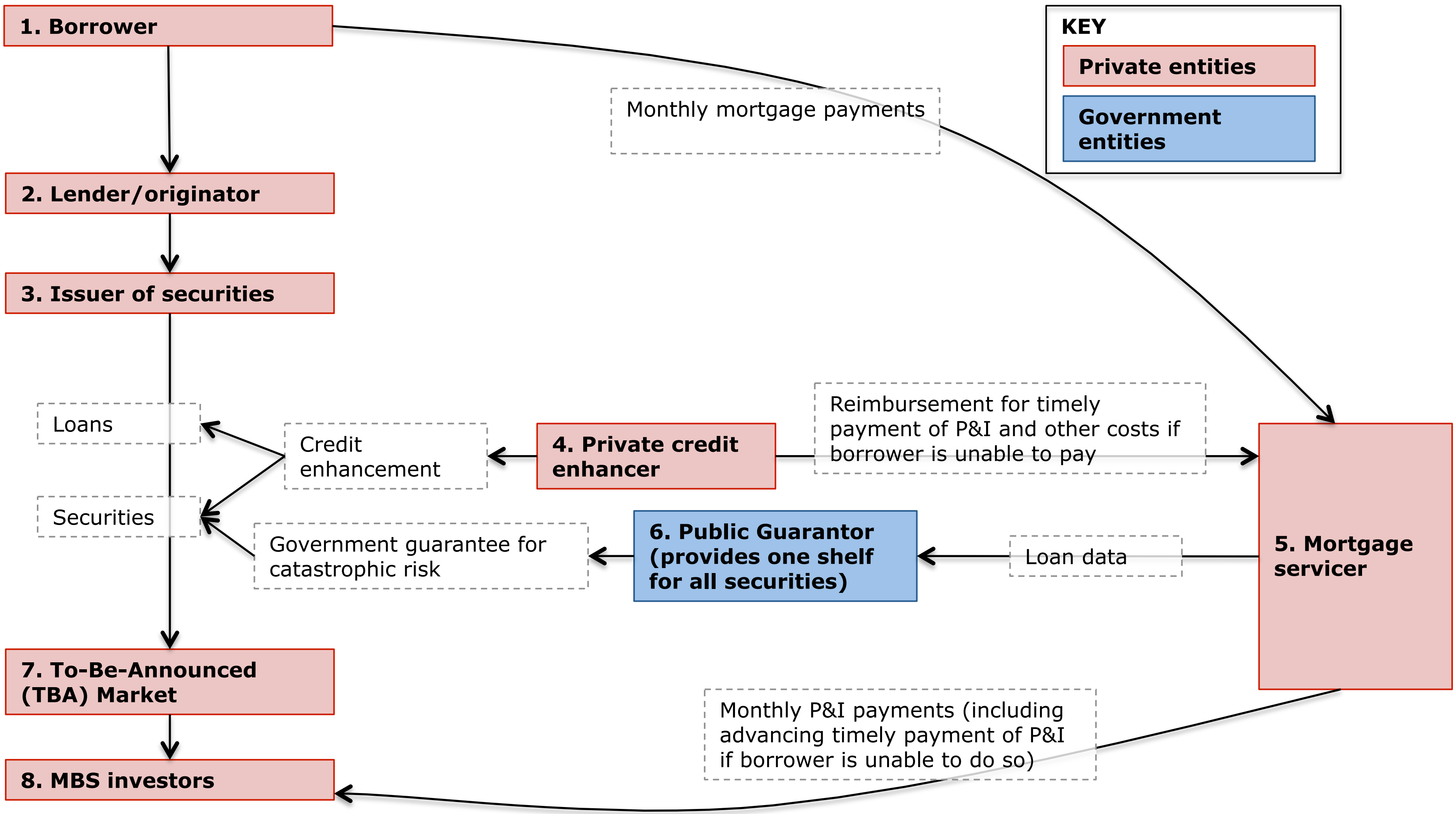
- **The GSEs would be eliminated over time, and replaced by an independent, wholly-owned government corporation, the Public Guarantor, that would provide a limited government guarantee for catastrophic risk for both single-family and multifamily housing finance**
  - A limited government-guaranteed secondary 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

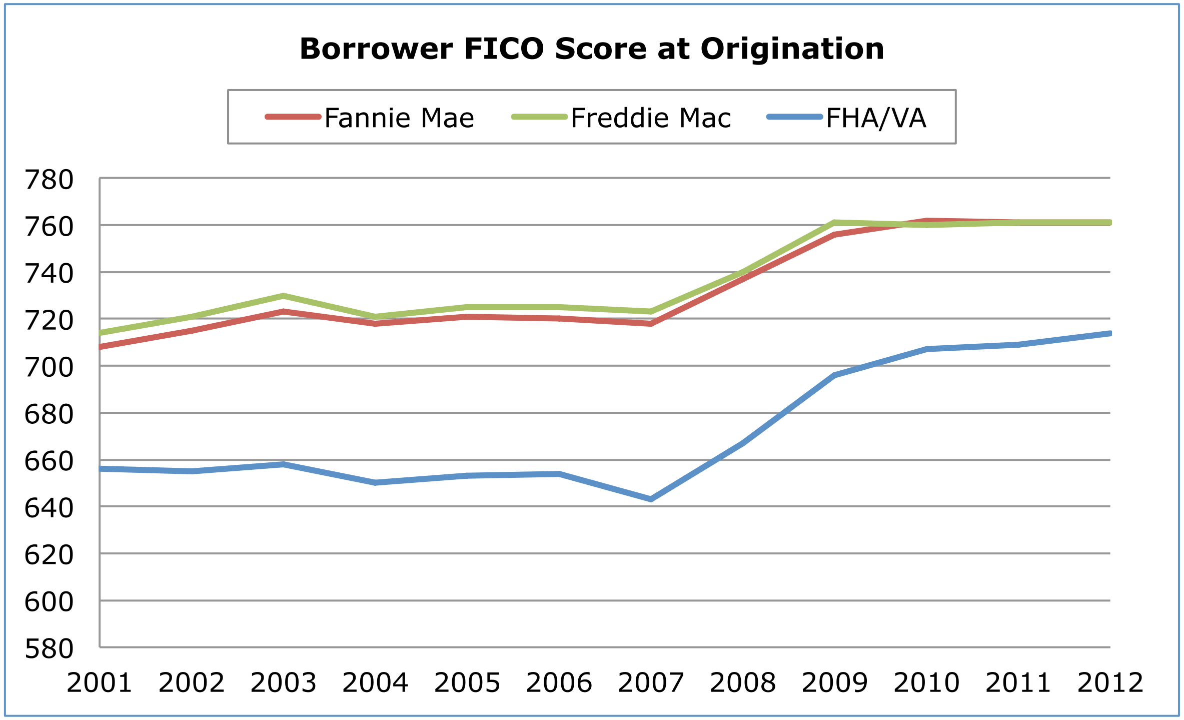
The rental/multifamily housing finance system will be reformed according to similar principles, and access to the government guarantee will be contingent on compliance with an affordability requirement:

- 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

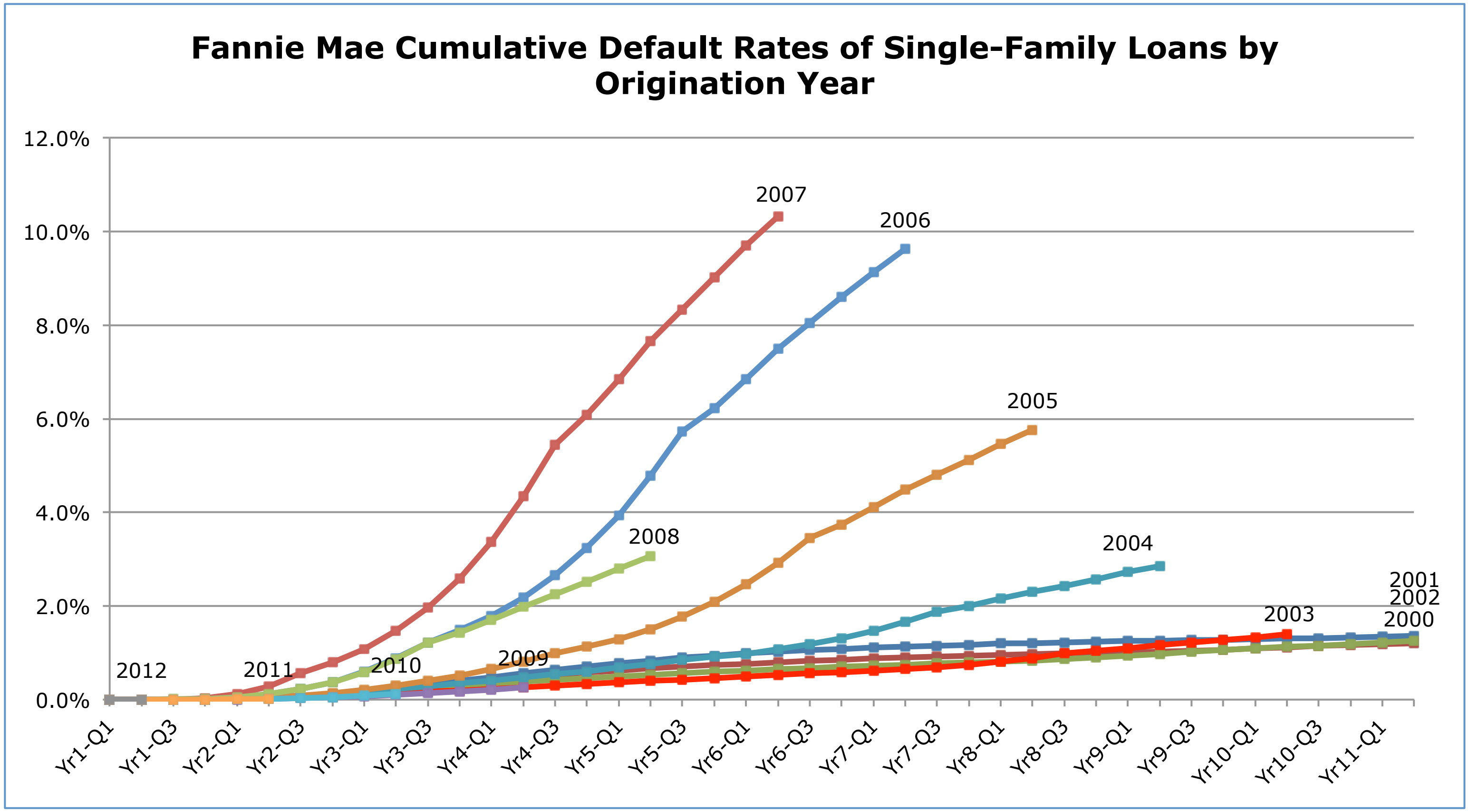
- **There is great uncertainty regarding a wide range of housing finance regulations**

- **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)

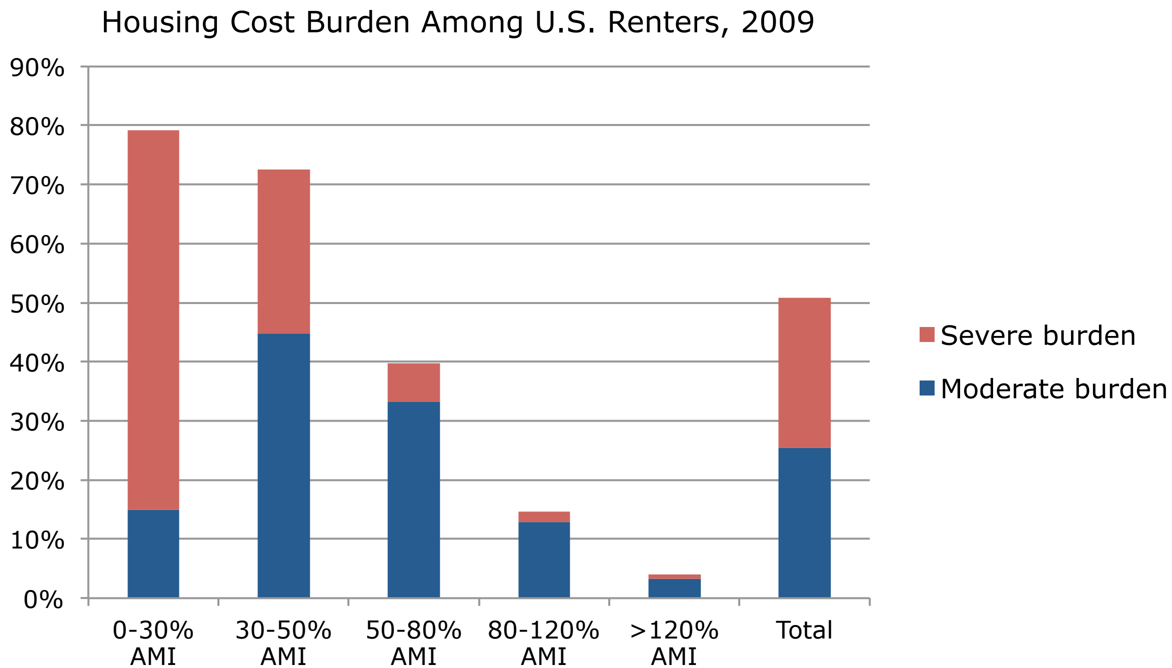
- **Clarify uncertainty related to pending regulation and implementation of new rules**

  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.

Affordable Rental Housing

Challenges for Affordable Rental Housing

- **A majority of our nation's most vulnerable renter households spend unsustainable amounts of their income on housing**



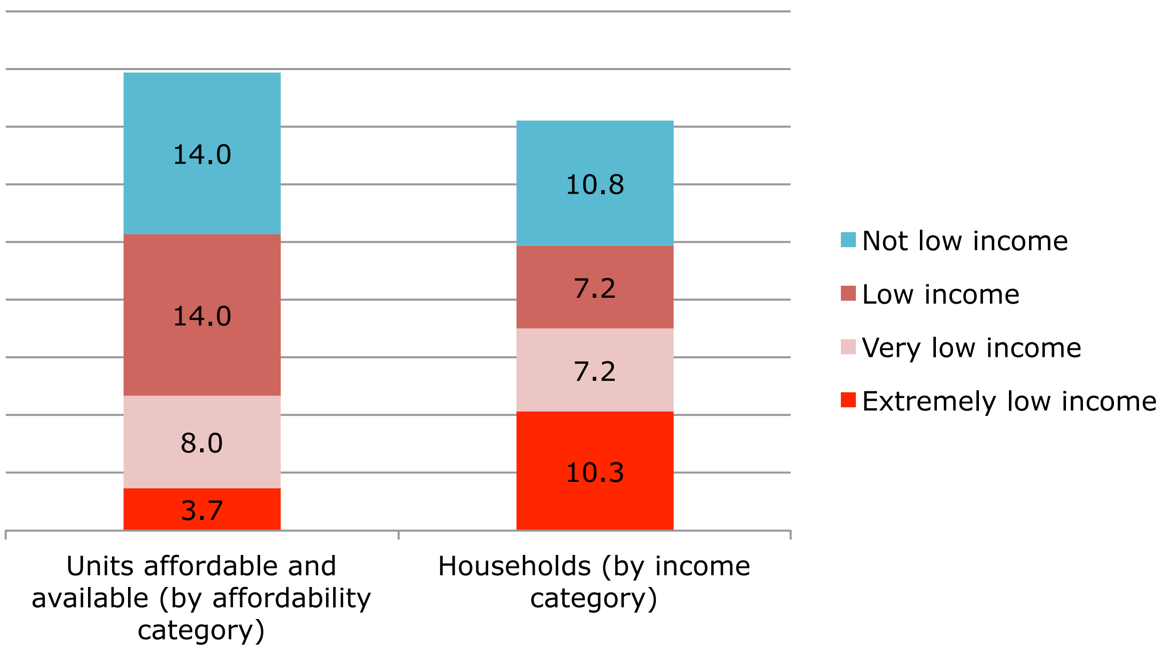
Source: Steffen, Barry et al. *Worst Case Housing Needs 2009: Report to Congress*. (Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011), 28.

- **Nearly 80 percent of extremely low income renters report a rent burden, with 64 percent reporting a severe rent burden**
- **Federal housing assistance only meets a fraction of the need: only about one in four renter households eligible for assistance actually receives it**

Challenges for Affordable Rental Housing

- **Extremely low income renters face disproportionately high housing cost burdens**

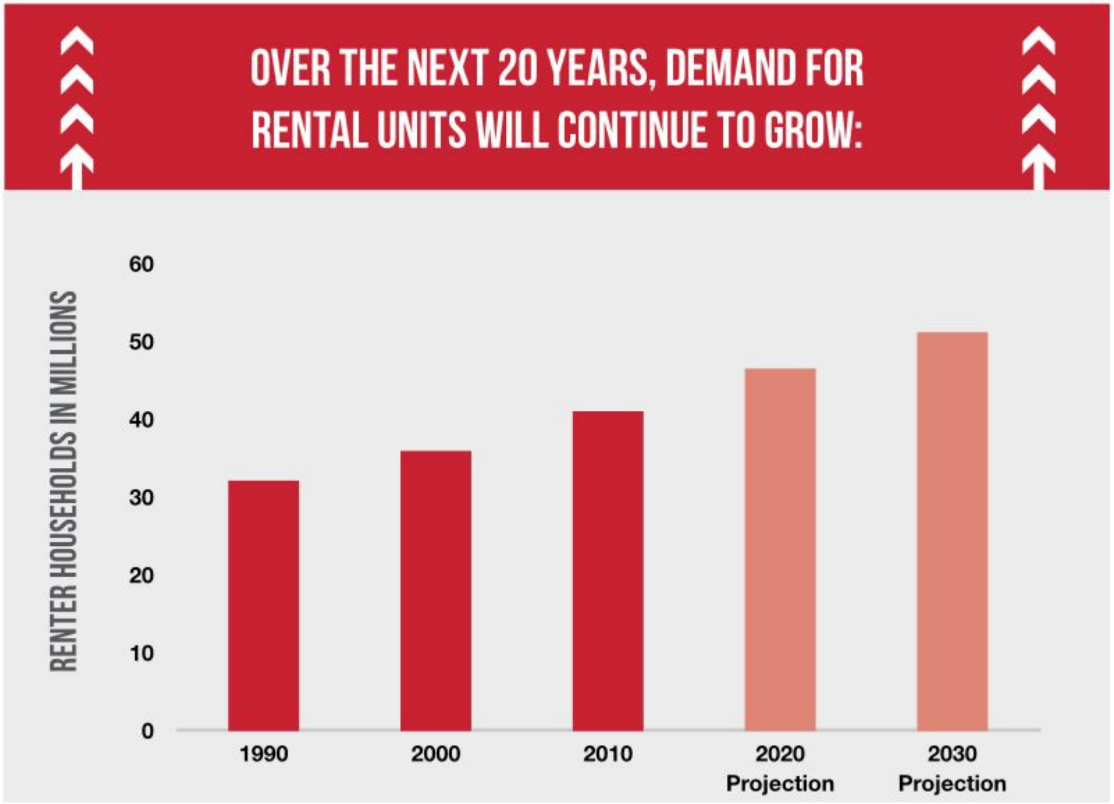
Rental Units and Renters by Affordability and Income Categories (in millions)



- **In 2009, only 3.7M rental units were affordable and available to the nation's 10.3M extremely low income renter households**
- **There is a mismatch between the number of extremely low income renters and the number of affordable units available**

Context: Demand for Rental Housing is Increasing

- **The slowdown in new construction during the downturn, coupled with growing demand means rental market conditions are tight**
- **It is estimated that at least 5 to 6 million new renter households will form over the next ten years**



Source: *America's Rental Housing: Meeting Challenges, Building on Opportunities* (Cambridge, MA: 2011).

Principal Recommendations for Affordable Rental Housing

- **<u>Reform</u> delivery of HUD rental assistance programs to increase impact**
  - Improve accountability and flexibility within the delivery system
  - Devolve housing investment decisions to states and localities
- **<u>Reprioritize</u> housing assistance to target existing resources on the most vulnerable households (those at 30 percent of AMI and below)and <u>increase</u> funding to end the current "lottery" of coverage and serve all eligible households**
- **<u>Stabilize and increase the supply</u> of affordable and decent rental homes to help meet current and projected demand**
  - Preserve and expand the Low Income Housing Tax Credit by 50 percent
  - Address the capital backlog and ongoing accrual needs in public housing
- **<u>Provide short-term emergency assistance</u> to minimize harmful housing instability among low-income renters (those with incomes between 30 and 80 percent of area median income) who suffer temporary setbacks**

Consensus on How to Make it Work

- A more targeted approach to providing rental assistance that directs scarce resources to the lowest-income renters while insisting on a high level of performance by housing providers
- Evaluate federal housing programs on a forward-looking basis, with attention to how effectively responds to housing needs of tomorrow
- Leverage resources of the private and nonprofit sectors with state and local government funds
- Offset any increased spending with reductions in federal outlays in other areas, savings from system reforms, and/or through the adoption of new revenue sources

Structure of a Reformed Rental Assistance Program

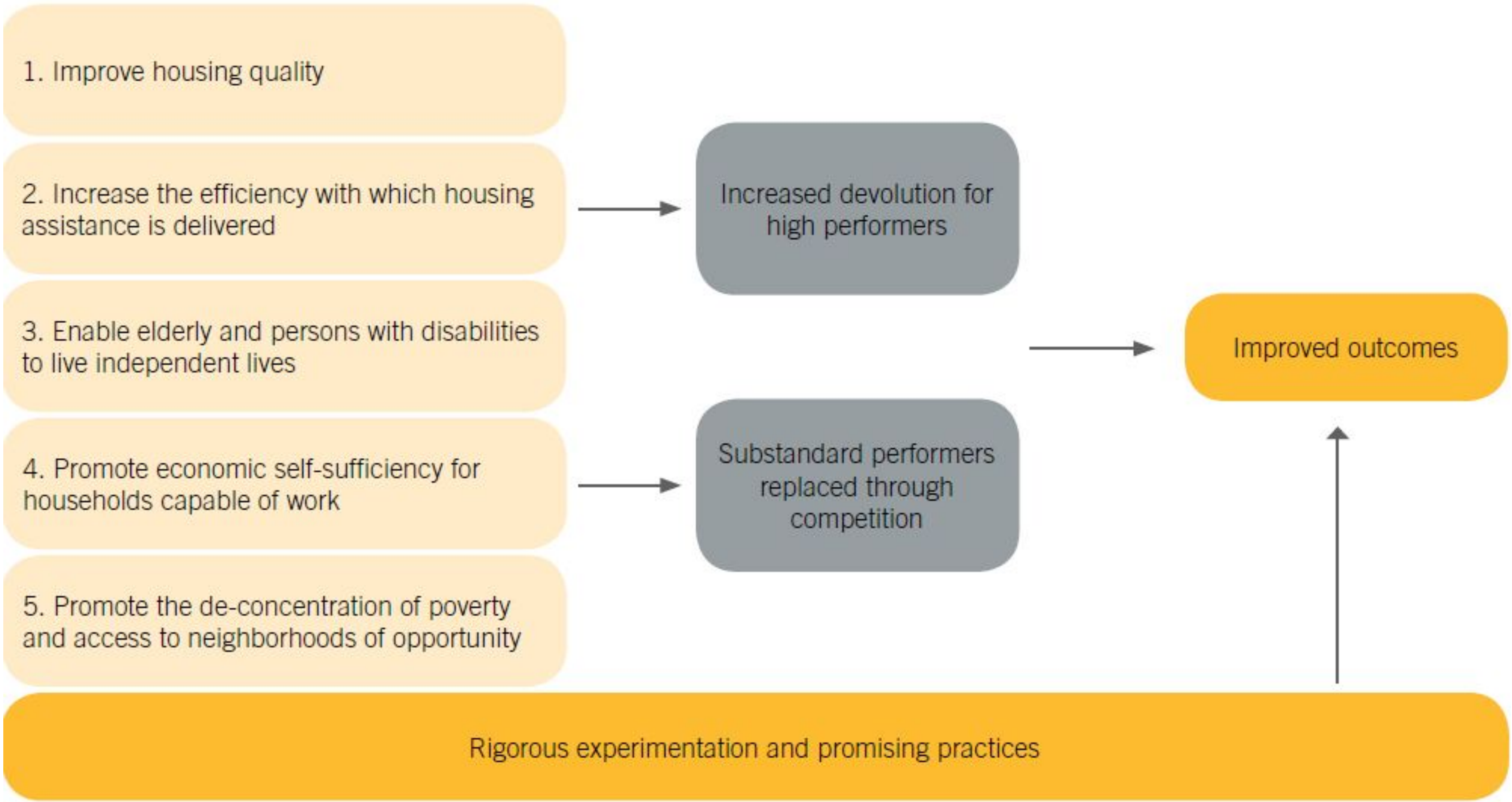
- **Establish a new performance-based system for delivering federal rental assistance that focuses on outcomes for participating households, while offering high-performing providers greater flexibility to depart from program rules**
- **This strengthening of HUD's rental assistance programs will require a fundamental shift in the incentives' structure for HUD-funded housing provider**
- **This new system would be marked by the following characteristics:**

  - a focus on outcomes, rather than process
  - expanded deregulation for high performers
  - increased accountability through competition
  - a real-time learning environment
  - greater focus on interagency partnerships

- **Providers achieving a high level of performance across outcome areas would be rewarded with increased flexibility to depart from programs rules, while substandard providers would be replaced**
- **A dynamic, flexible transition period is essential to appropriately identifying and phasing in the relevant metrics for measuring the desired outcomes**

Performance-Based System for Delivering Assistance

Outcome-Based Performance Standards



Reprioritize housing assistance to the most vulnerable

- **Nearly 80 percent of extremely low-income renters spend more than 30 percent of their income for housing, and almost two-thirds spend more than half of their income for housing**
- **Recommend making federal rental assistance available to all eligible households with incomes at or below 30 percent AMI who apply**
- **Families currently enrolled in the housing voucher program would not lose assistance, but as they turn back their subsidies due to rising household income or other factors the newly available voucher would be issued to an extremely low-income household**

Stabilize and increase the supply of rental housing

- **With adequate funding for maintenance and modernization the existing affordable housing stock of nearly 5 million units can provide decades of additional service**

Preserve and expand the Low Income Housing Tax Credit

- Successfully administered at the state level where investments can be tailored to meet evolving housing needs, competitive program, minimizing risk to federal government, and leverages private sector investment

- Recommend 50 percent increase in program credits to support the preservation and construction of 350,000 to 400,000 units over a ten-year period

Address the capital backlog and ongoing accrual needs in public housing

- Incentivize public private partnerships and facilitate access to private sources of capital by public housing authorities

- As part of maintenance and modernization of the existing stock, improve the energy efficiency of existing public housing structures

Provide short-term assistance to minimize instability

- **Recommend dedicating supplemental funding to the HOME program to for the delivery of short-term, one-time emergency assistance to households between 30 – 80 percent AMI experiencing – job loss, death or departure of a working household member, or major medical crisis**
- **Targeted funding to be used for security deposits, back rent payment, temporary rental assistance, and other limited forms of assistance – utility payments**
- **Estimated assistance level up to $1,200 per household**

Consensus on How to Make it Work

- **The commission supports the continuation of tax incentives for homeownership, but as part of the ongoing debate over comprehensive tax reform and budget priorities, also recommends consideration of modifications to the these incentives to allow for increased support for affordable rental housing**

- **Any changes to current tax incentives should be made with careful attention to their effects on home prices and should be phased in to minimize any potential disruption to the housing market**

The Importance of Rural Housing

Snapshot of Rural Housing

- **Median income for rural households ($40,038) is more than 20 percent lower than the median income for urban households ($51,998)**
- **Rural poverty rates are higher than national poverty rates, at 16.5 percent and 15.1 percent respectfully**
- **Nearly 30 percent of all rural households spend more than 30 percent of the monthly income on housing costs and are considered cost-burdened**
- **Rural housing is generally older, with approximately 35 percent of rural rentals building more than 50 years ago**
- **Nearly 6 percent of rural homes are either moderately or severely substandard – without hot water, or with leaking roofs, rodent problems, or inadequate heating systems**

Rural Housing: Recommendations

- **Support and strengthen USDA's role in rural housing to leverage the existing resources and infrastructure of rural service providers**
- **Extend the current definition of rural areas through the year 2020, pending the availability of decennial census data**
- **Increase budget allocations to serve more households**

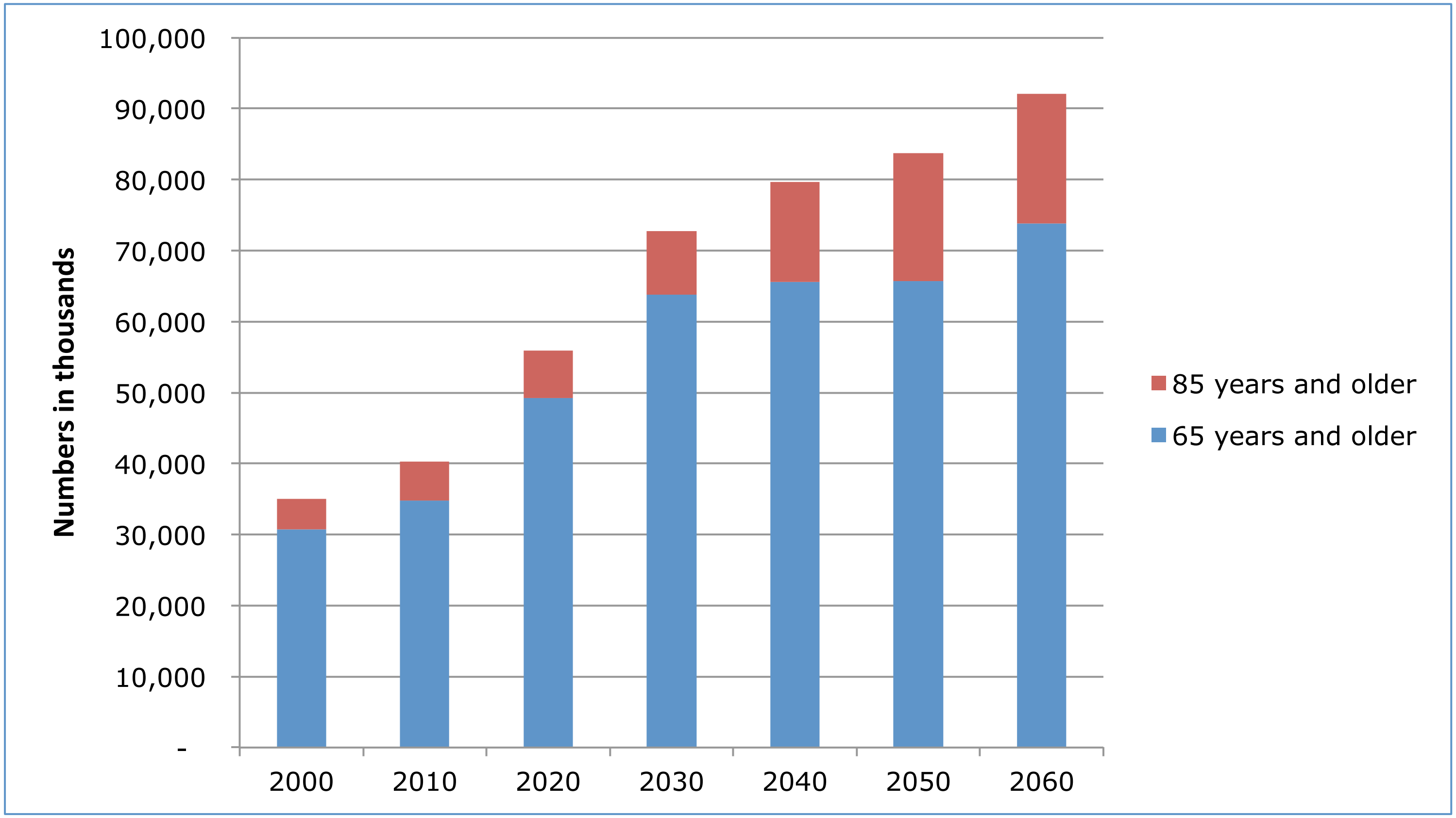
  Additional funding for the Section 502 Direct Loan program should be contingent on an evaluation of underwriting risks associated with the program.

- **Dedicate resources for capacity-building and technology to strengthen USDA providers**

Aging in Place:
A New Frontier in Housing

Aging in Place: A New Frontier in Housing

U.S. Population Aged 65 and Older



Source: U.S. Census Bureau, "Table 2. Projections of the Population by Selected Age Groups and Sex for the United States: 2015 to 2060," *2012 National Population Projections: Summary Tables*. U.S. Census Bureau, "Census 2000 and 2010 Summary File 1, Matrices DP-1: Profile of General Demographic Characteristics: 2000 and 2010."

Aging in Place: Recommendations

- Identify and remove barriers to allow for better coordination of housing and health care
- Support initiatives to retrofit homes and apartments for energy conservation and aging in place
- Place greater emphasis on integration of aging-in-place priorities into existing federal programs
- Provide reverse mortgage counseling that assures consumers fully understand the financial mechanics of these loans and promote development of alternative, low-cost home equity access products
- Convene a White House conference on aging in place

Conclusions

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**