



# The Aftermath of the US Financial Crisis: Implications for Affordable Housing Finance

Roberto G. Quercia

Director, Center for Community Capital

Professor, Department of City and Regional Planning

5/30/11

Center *for* Community Capital  
*Research and analysis on the  
transformative power of capital*



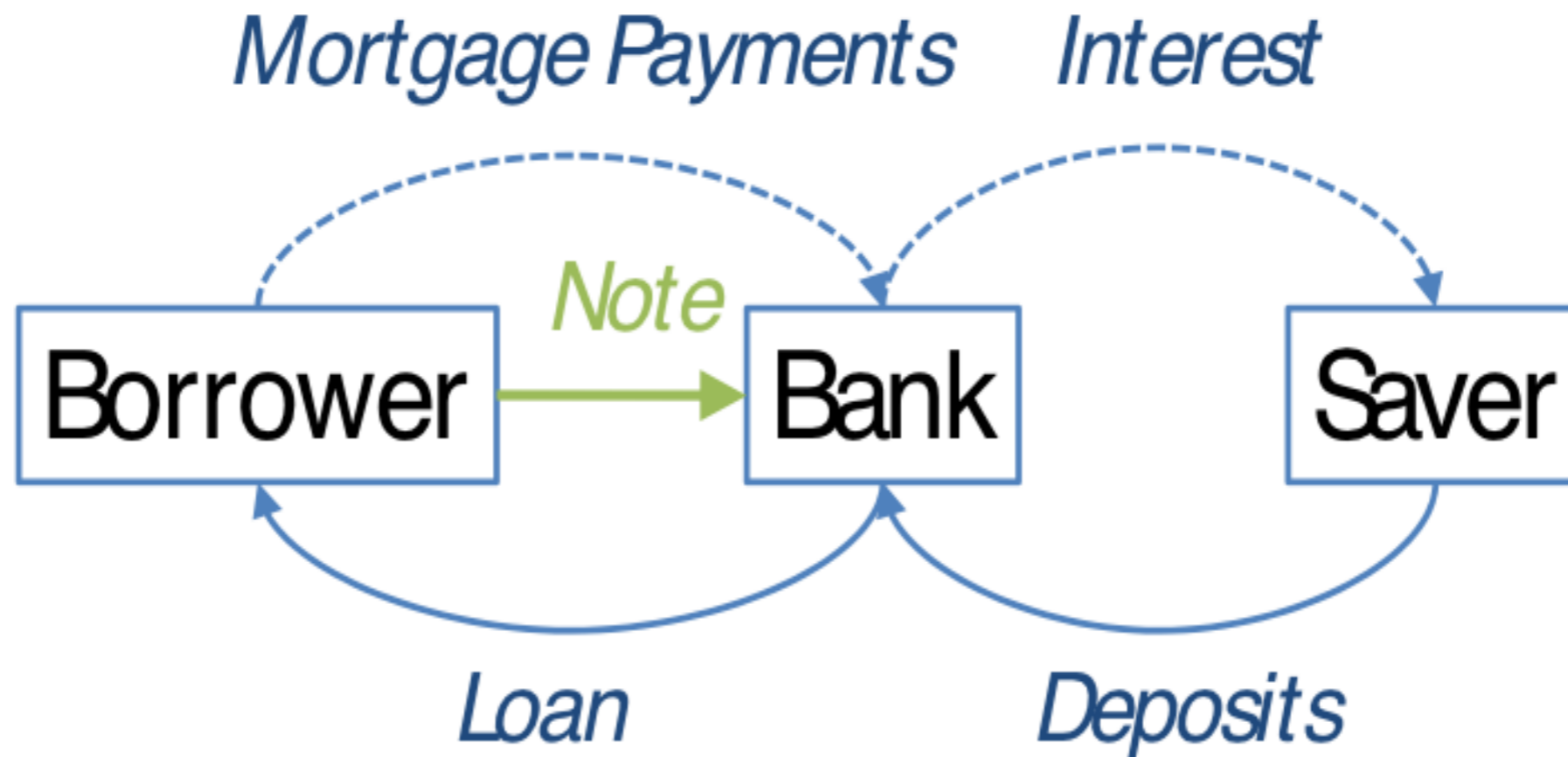
# Outline of Presentation

- ⑩ Old mortgage lending model
- ⑩ New model
- ⑩ Causes of US financial crisis
- ⑩ Need for financial reform
  - Dodd-Frank Wall Street Reform and Consumer Protection Act
- ⑩ Affordable housing finance in the aftermath of the crisis
- ⑩ Non-Federal Considerations



# Mortgage Lending: The Old Model

Dominant form of mortgage lending into the 1980s





# Government Created Housing Finance System

- Federal Deposit Insurance Corporation
- Federal Housing Administration – FHA insurance
- Federal National Mortgage Association (Fannie Mae)
- 30 year fixed rate mortgage
- Federal Home Mortgage Loan Corporation (Freddie Mac)
- Mortgage backed securities

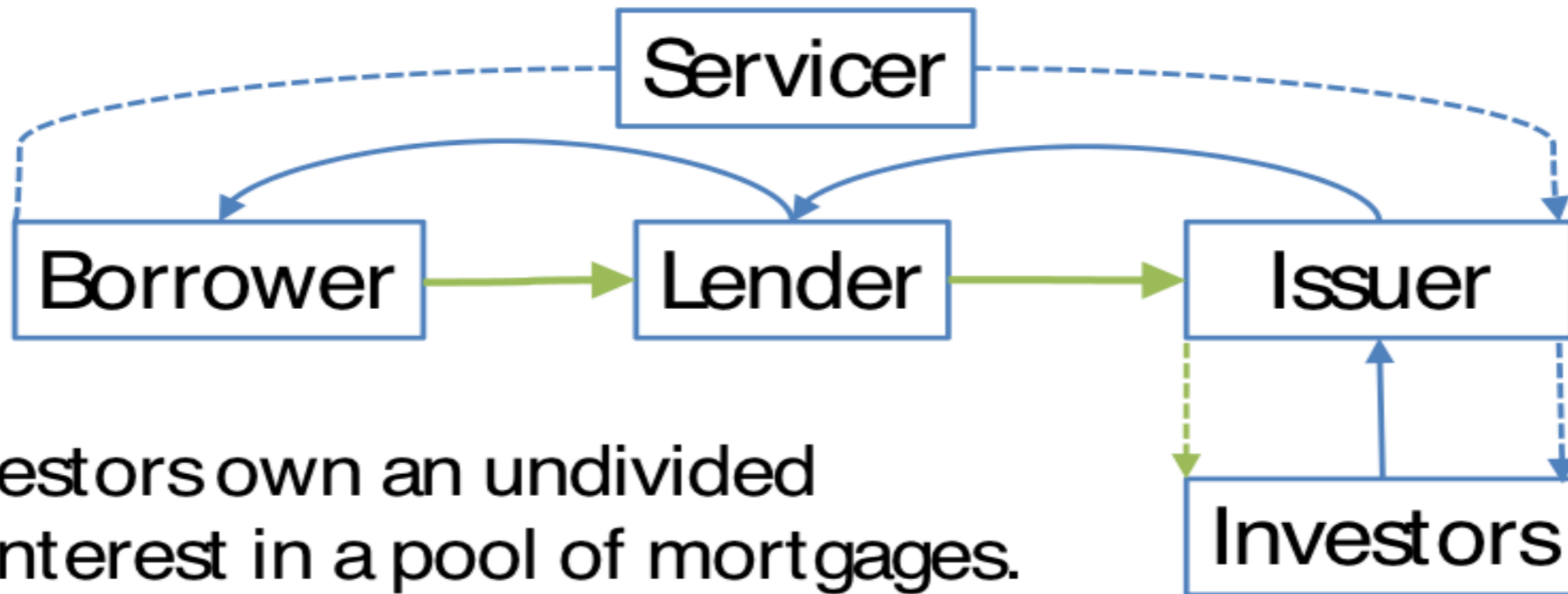


# Fannie Mae and Freddie Mac

- Fannie Mae “privatized” in 1968. Becomes a “government sponsored enterprise” (GSE). Retains federal charter but is a private corporation
- Freddie Mac created in 1970 to provide secondary market to savings and loan industry
- GSEs issue bonds (later mortgage-backed securities) to purchase mortgages in the 1980s
- 1992 GSEs’ affordable housing goals, at 50%. Half of the mortgages they buy to low income households



# Mortgage Lending: The New Model



Investors own an undivided interest in a pool of mortgages.

Secondary market provides liquidity to originators – new capital to originate another loan.

Passes interest and prepayment risk onto investors

# What Caused the Crisis

## ⑩ “Global Savings Glut”

- Low Interest Rates, Desire for higher yield investments

## ⑩ Underpriced Risk

- New Subprime Loan Products

## ⑩ Misaligned Interests

- No “Skin in the Game”

## ⑩ Others

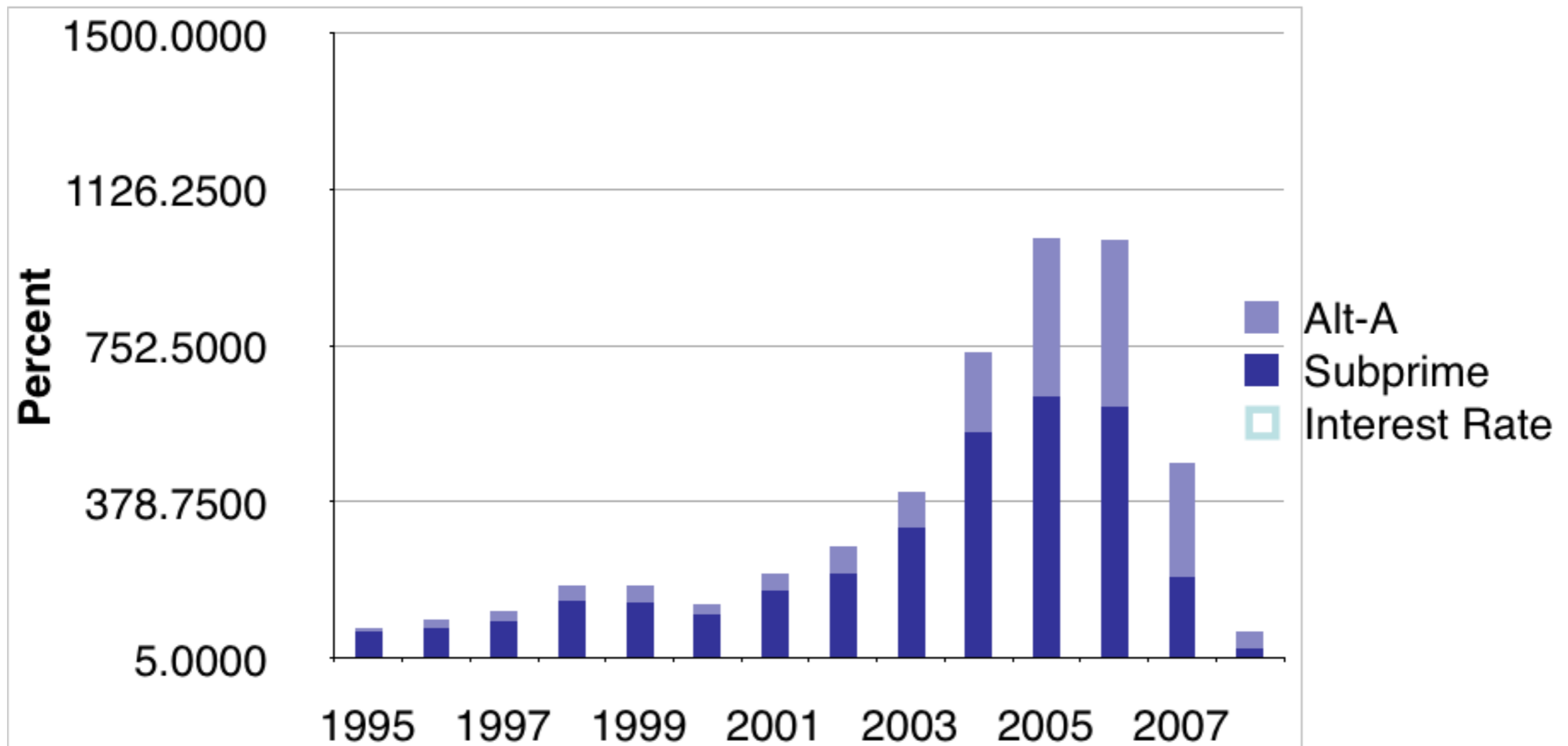
- Lack of regulation, greed, lack of due diligence, too much affordable lending

# Characteristics of Subprime Mortgages

- ⑩ Originated without regard to ability to repay
- ⑩ Mortgages underwritten at a low initial teaser rate, much higher rate soon afterward
- ⑩ Loan greater than the value of the house, 125%
  
- ⑩ With each innovation, more could be borrowed with less
- ⑩ Ever greater ability to borrow more, allowed borrowers to bid more and more for housing, fueling the housing bubble

## As Interest Rates declined, Origination of Higher Yielding Toxic Mortgages Boomed

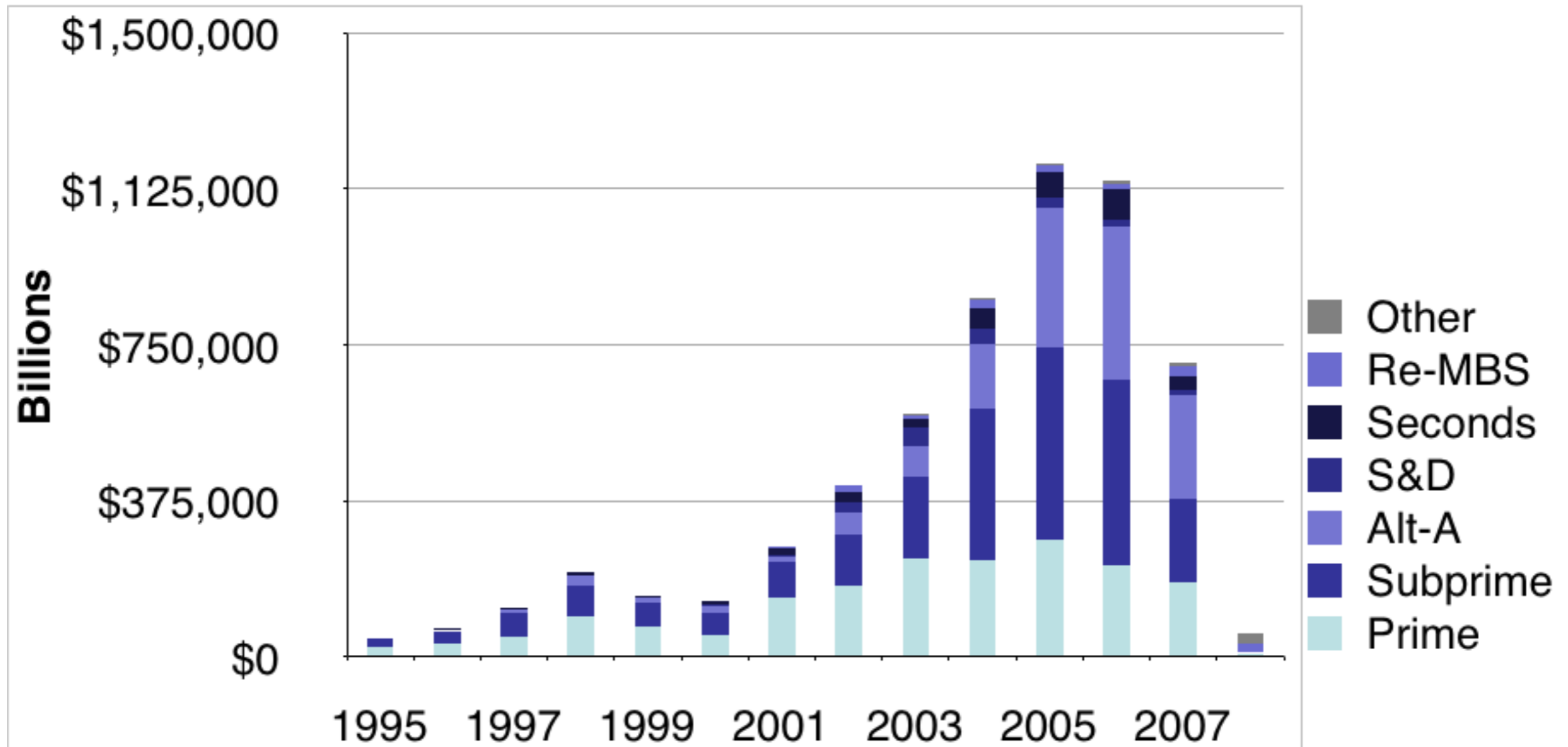
Subprime and Alt-A Mortgage Originations





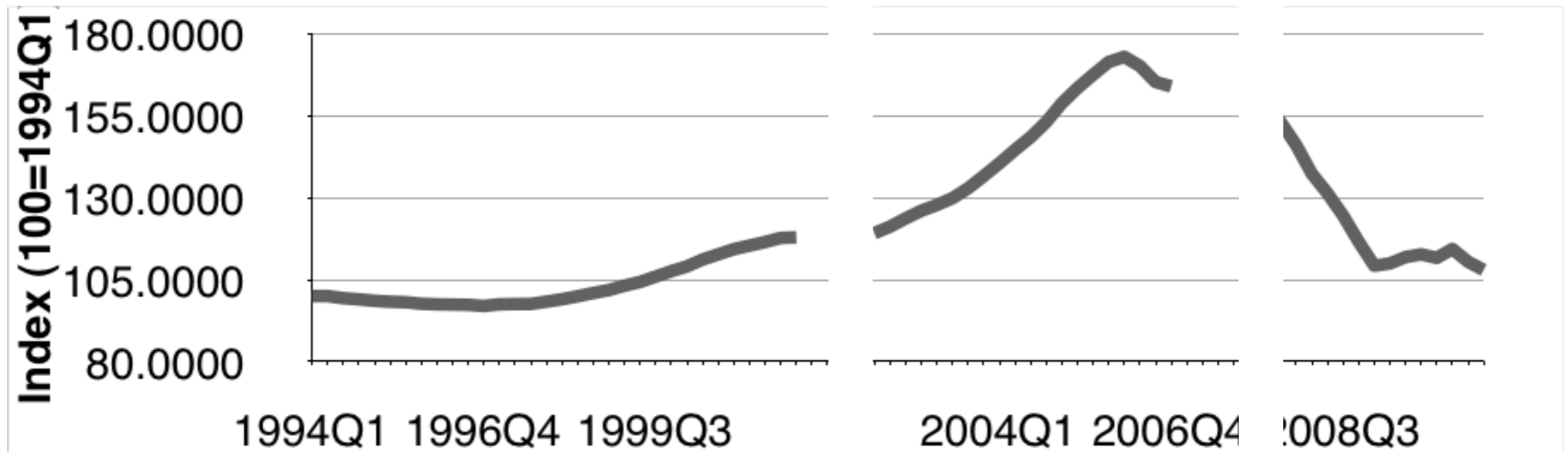
# Securitization of Toxic Products also Boomed

## Non-Agency Mortgage Securities Issuance





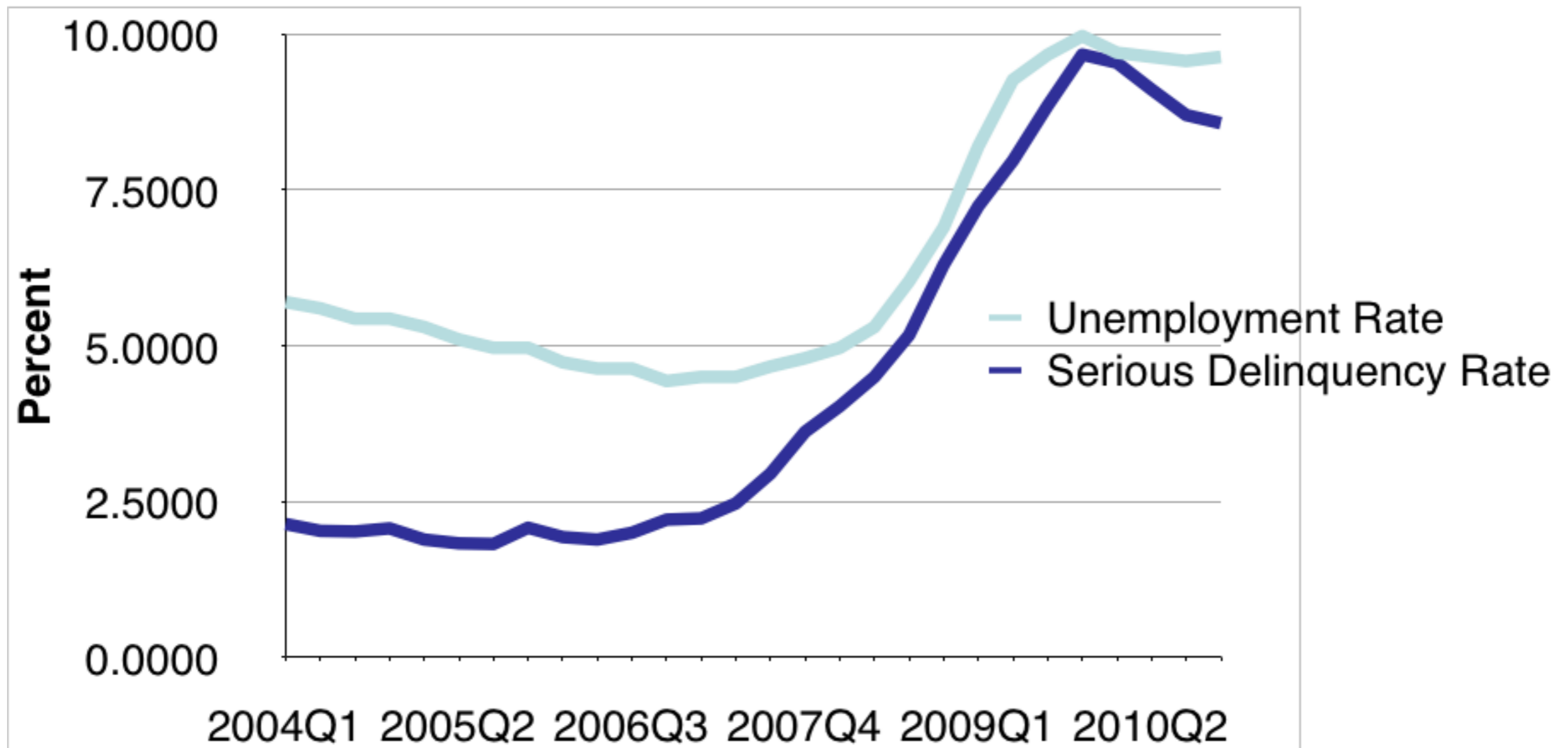
# House Prices



Note: Repeat-sales house price index scaled by owners' equivalent rent of primary residence..  
Source: S&P/Case-Shiller National House Price Index; U.S. Bureau of Labor Statistics

# Bubble Burst, Spillover

Unemployment and Serious Delinquency



## **Lesson: Markets do not regulate themselves**

“Those of us who have looked to the self-interest of lending institutions to protect shareholder's equity, myself especially, are in a state of shock and disbelief.”



“I found a flaw... in the model that I perceived is the critical function structure that defines how the world works, so to speak.”

## Need for Financial Re-Regulation: Dodd- Frank Act

- Consumer Financial Protection Bureau created
- Deals with “skin in the game” problem in securitization
  - ⑩ 5% of non-qualified loans must be held
- Underwriting must meet “ability to pay” requirement
- Independent property appraisals
- No extra profits from originating riskier loans

# Affordable Housing After the Crisis

## ⑩ Community Reinvestment Act

- 1977 legislation creates “affirmative obligation” to lend to lower income borrowers/neighborhoods

- Based on old mortgage lending model

## ⑩ Increasingly less relevant as lending moves away from bricks and mortar institutions

## ⑩ Positive impacts will likely weaken overtime

# Current proposals to replace the GSEs

⑩ A fully private secondary market

✦ Will probably be dominated by 4 biggest financial/banks

⑩ As above with emergency government backstop

✦ Same as above likely to dominate

⑩ Same as above but with one or more chartered mortgage institutions (CMI) that will issue MBS to be backed by the government if they include qualified mortgages

## Shortcomings of Current GSE Proposals

### ⑩ Lack portfolio functions

○ In the past, affordable loans were often held in portfolio (not made part of mortgage backed securities)

### ⑩ Lack counter-cyclical liquidity

○ In 2009, Fannie Mae and Freddie Mac guaranteed 75% of new residential mortgages (FHA/VA guaranteed most of the rest)

○ OCMI's lack counter-cyclical liquidity/credit capacity which would exacerbate future economic cycles

# Uncertainty at the Federal Level likely to Make State and Local Efforts More Relevant

## ⑩ States

- Implement federal programs: Federal money will decline in future
- States have their own programs
  - ✦ Housing trusts, housing bonds, others
- Unfortunately, though improving, many states are running deficits

## ⑩ Localities

- Localities are also experiencing budgetary difficulties, problem of relying on property taxes as house values continue to decline
- Inclusionary zoning, only effective if economy recovers

# For copies of the research in this presentation

⑩ Please visit [ccc.unc.edu](http://ccc.unc.edu)

⑩ 非常感谢！