



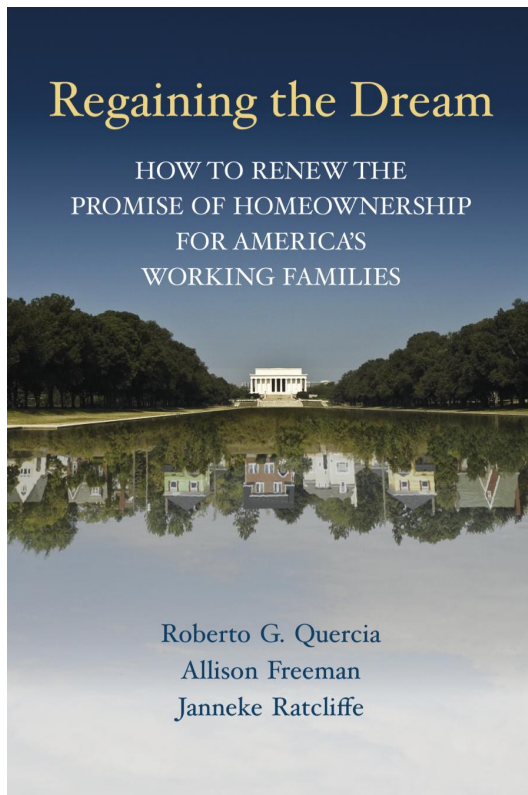
# Rebuilding the Housing Finance System and the Future of Homeownership

Roberto G. Quercia

Kevin A. Park

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



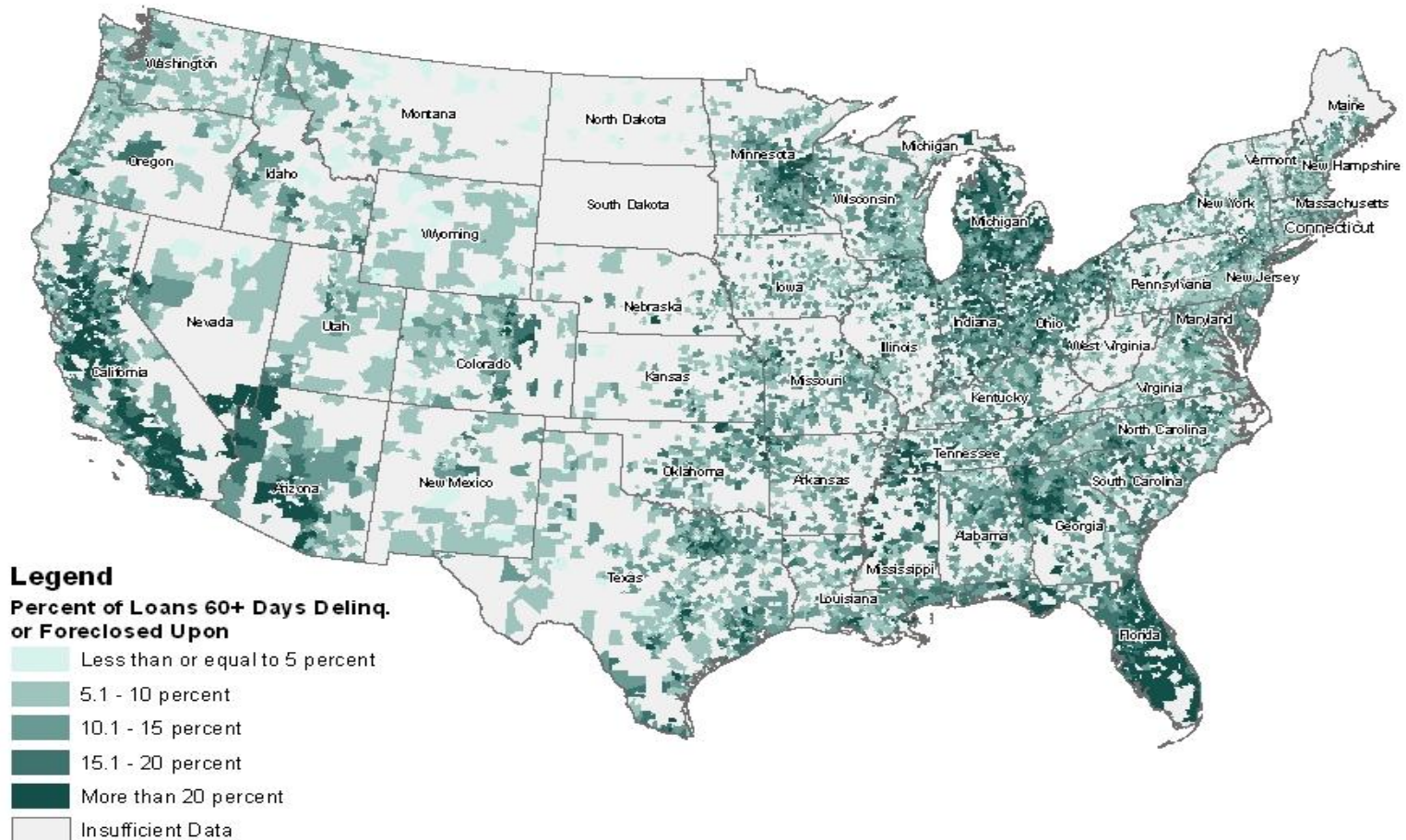


# Outline of Presentation

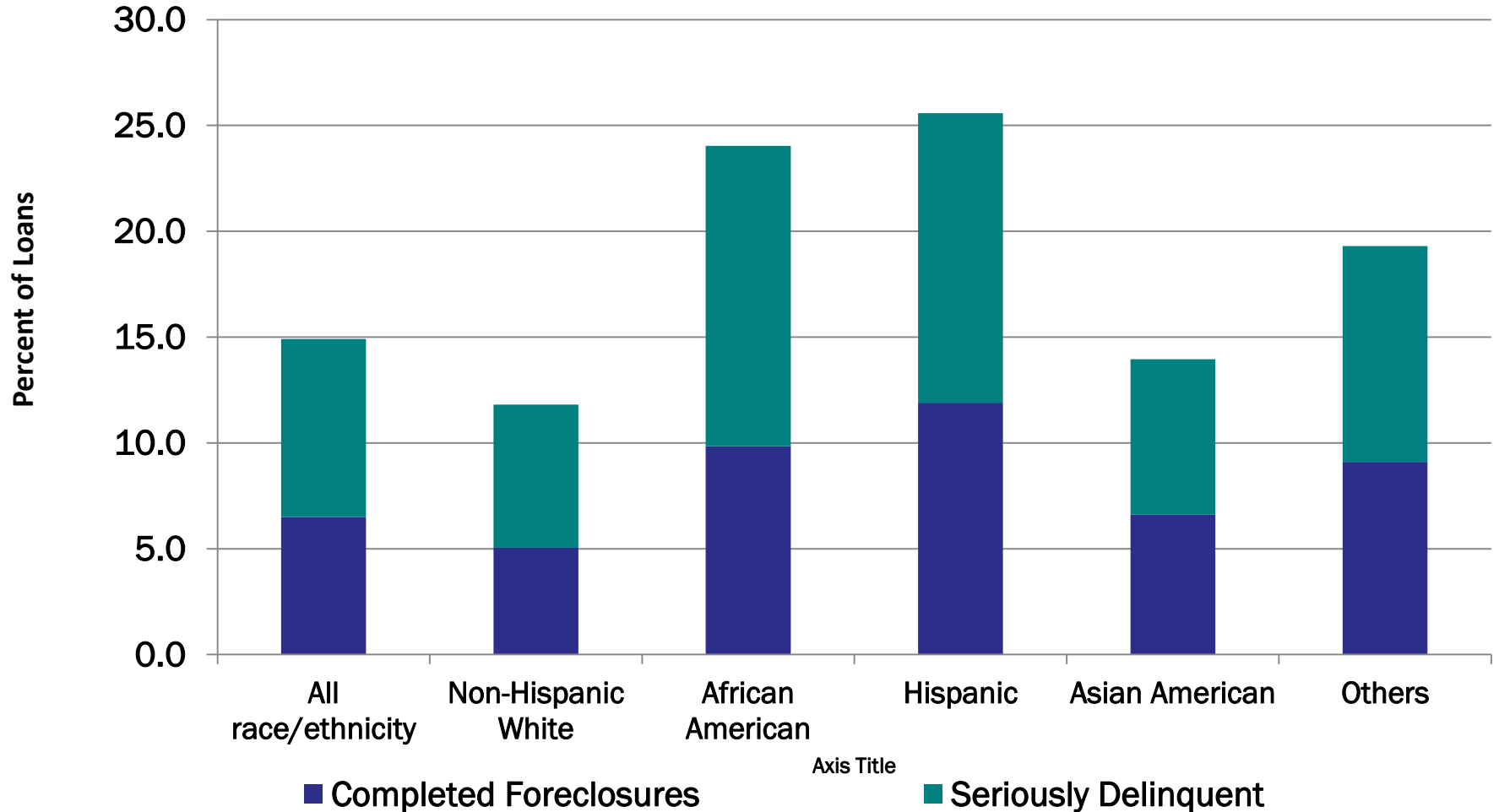
- The scale of the foreclosure crisis today (20112Q)
- Behind the foreclosure numbers
- What did NOT cause the crisis: evidence v. ideology
- Dodd-Frank and unfinished business
- Fixing the foreclosure mess
- Looking forward



# The Scale of the Foreclosure Crisis

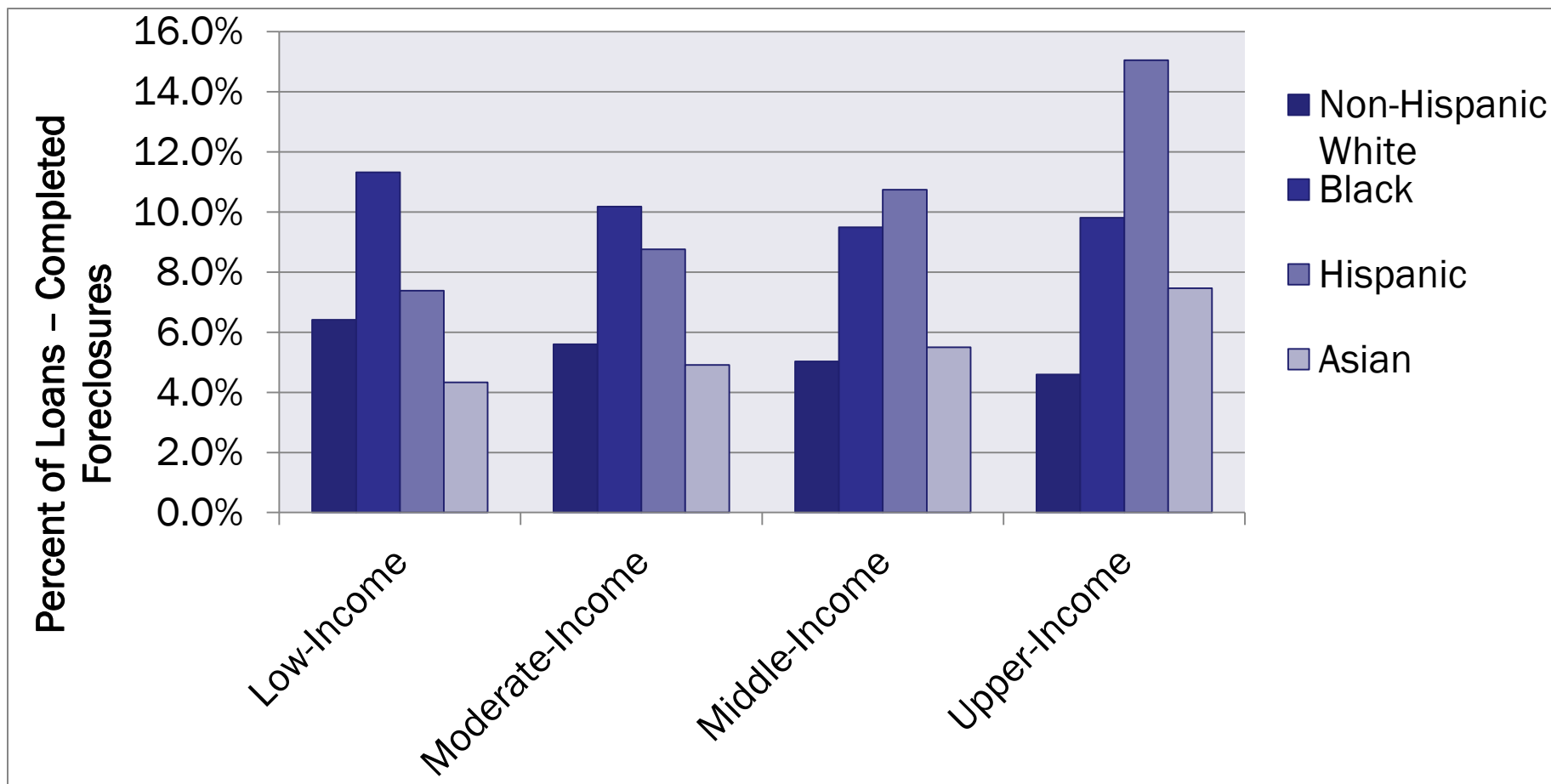


## Disproportionate Impact among Borrowers of Color





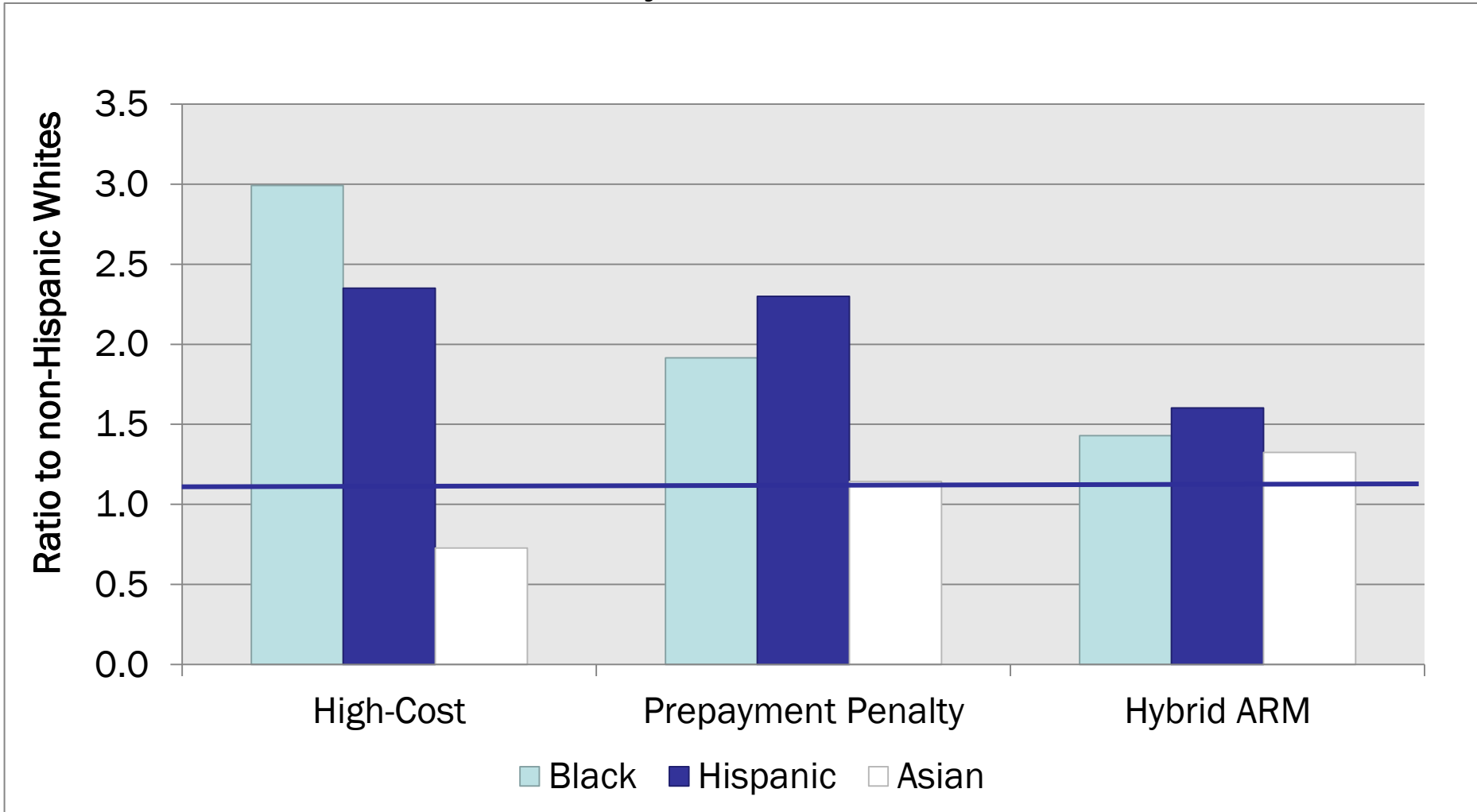
## Differences Persist across Income Groups





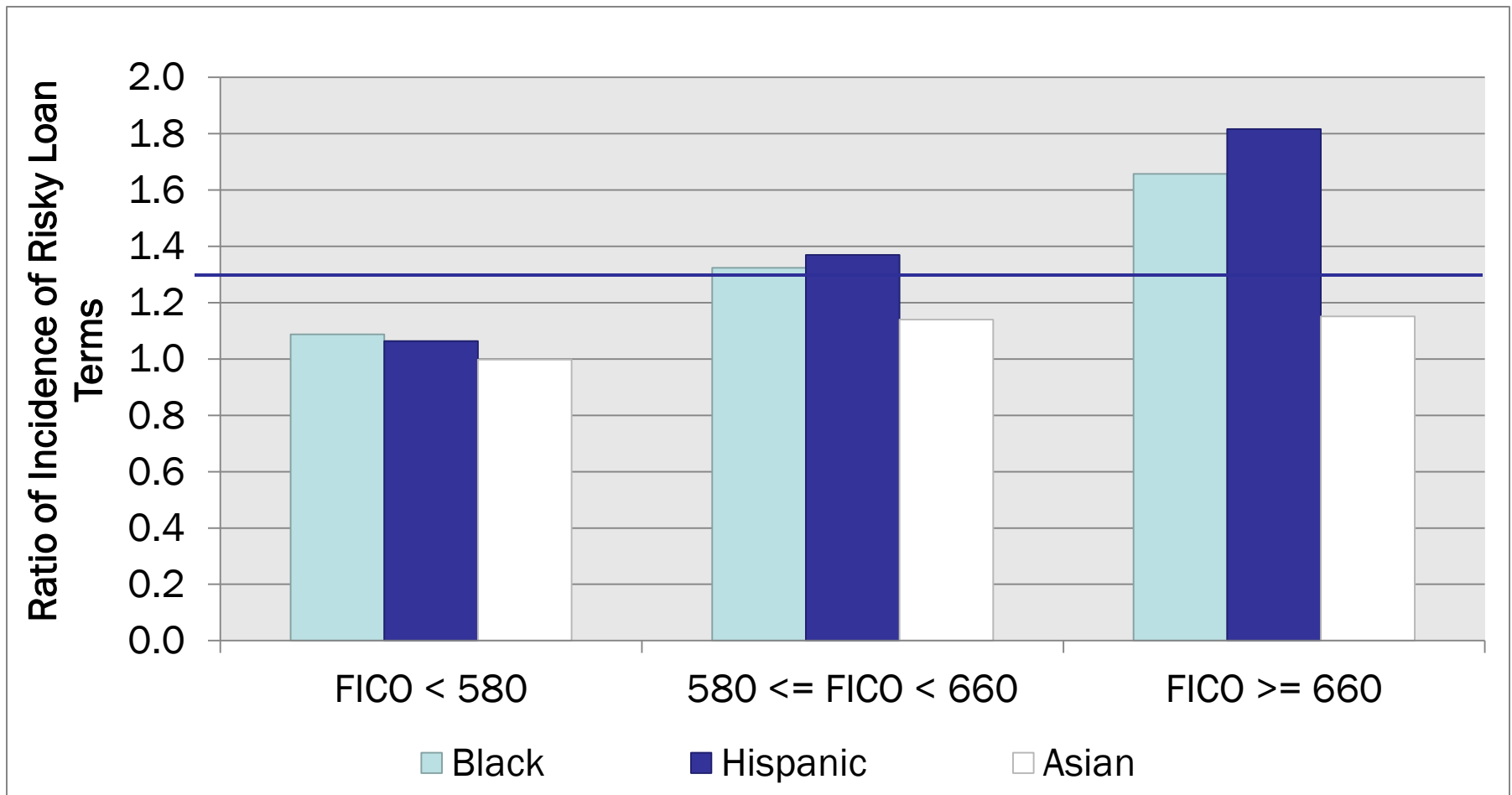


## Borrowers of Color More Likely to Receive Loans

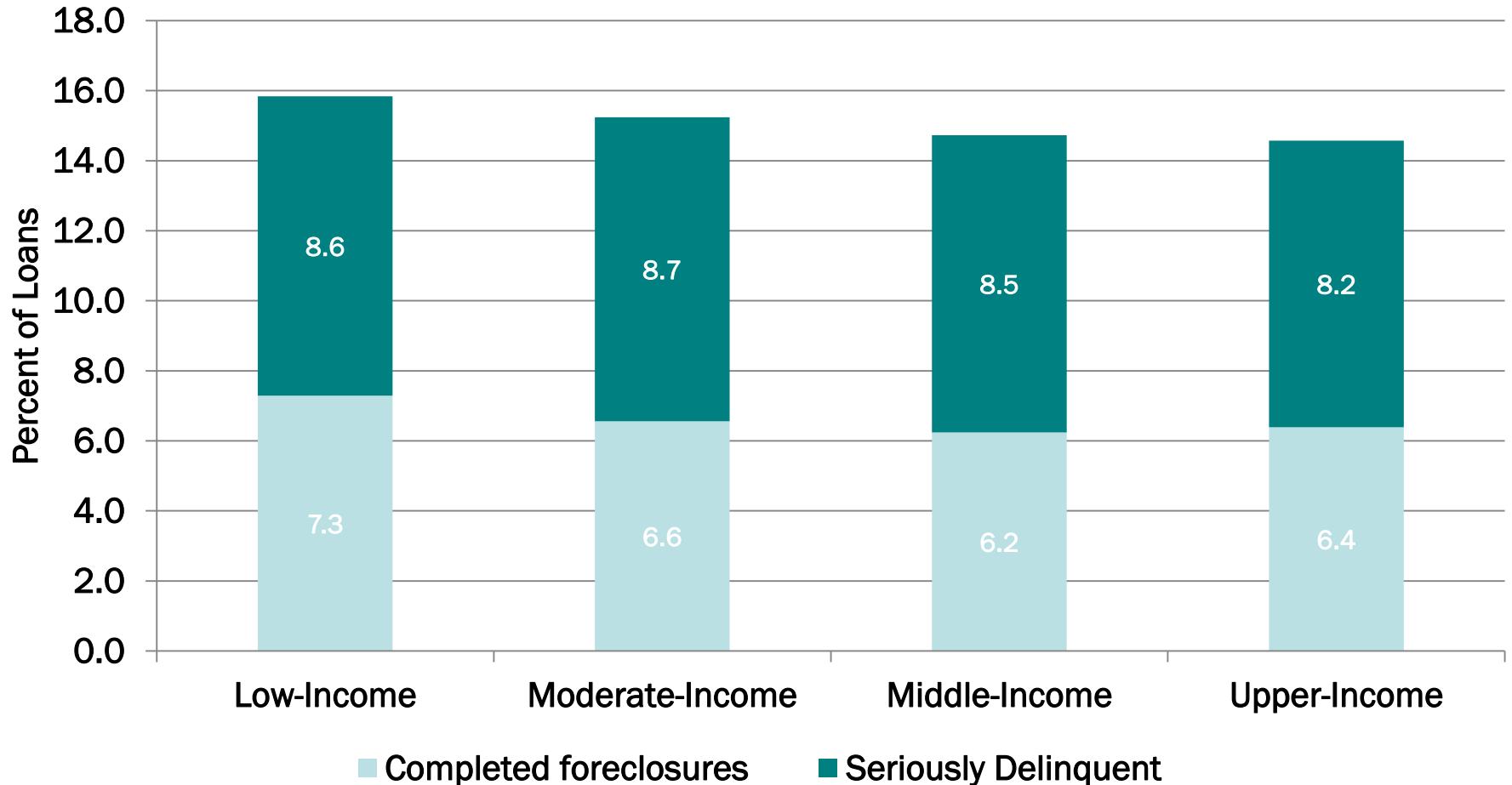




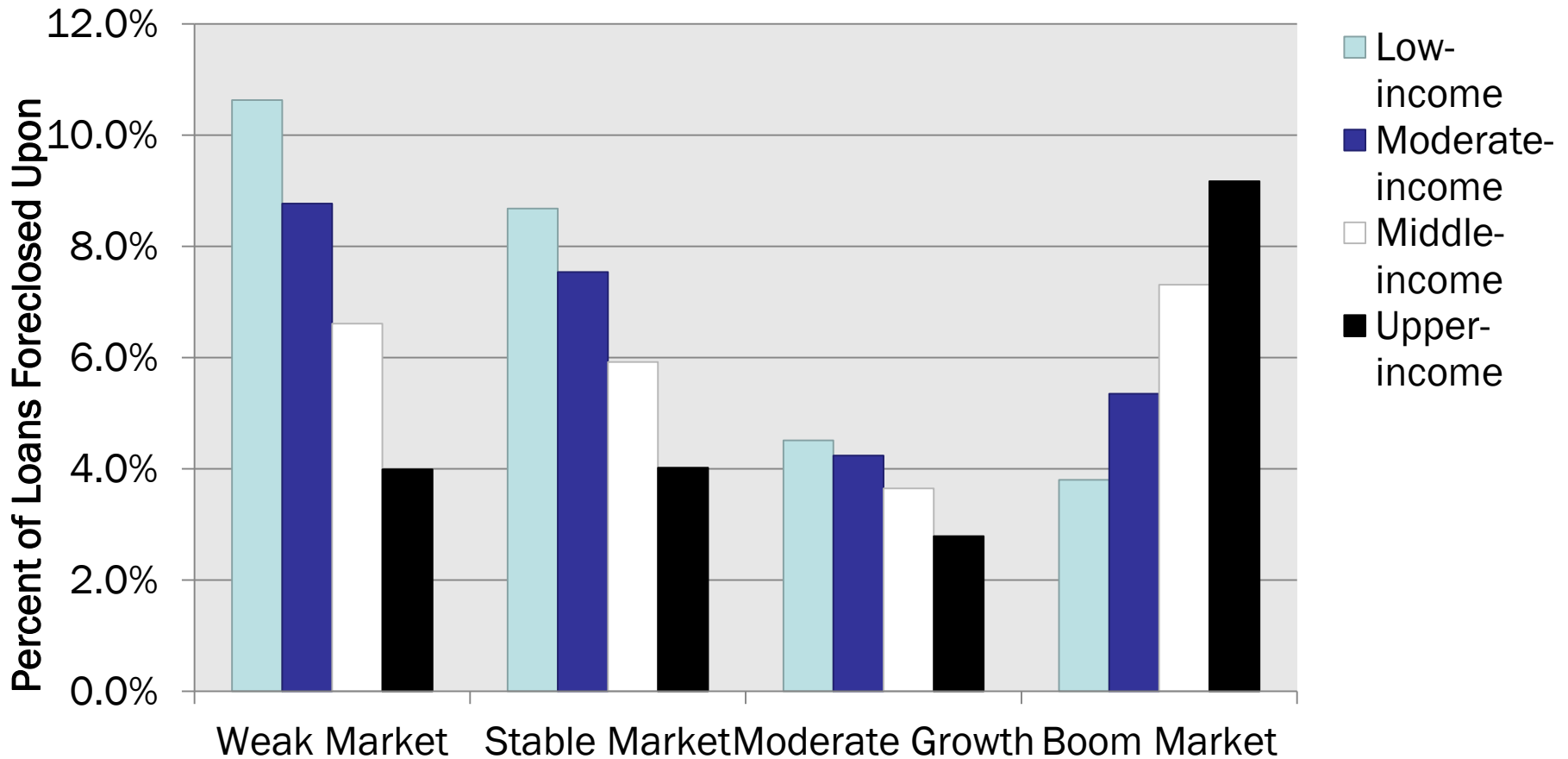
## This Finding Persists, Even After Controlling for FICO Scores



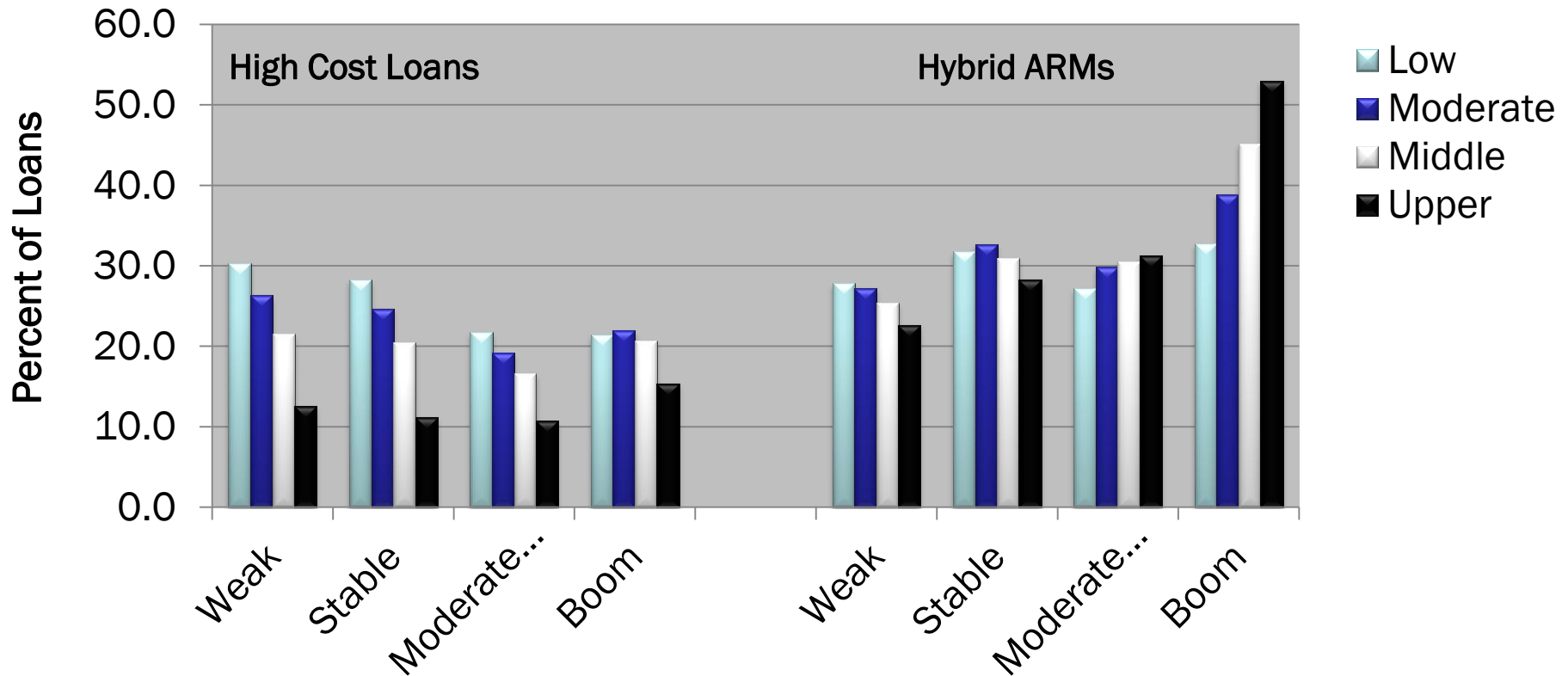
# Disparities by Borrower Income Less Stark



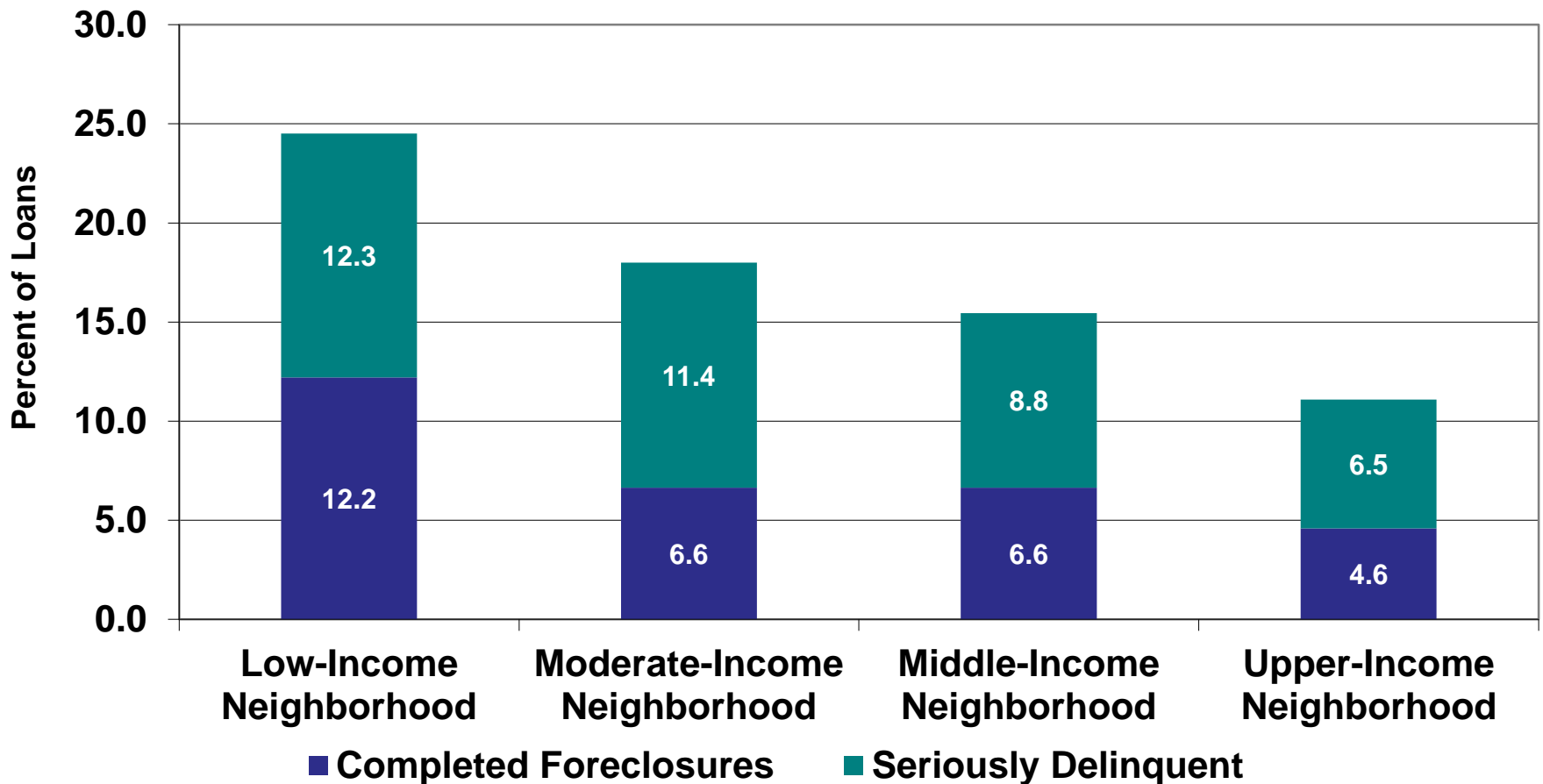
## But, Different Story Emerges When We Disaggregate by Regional Housing Markets



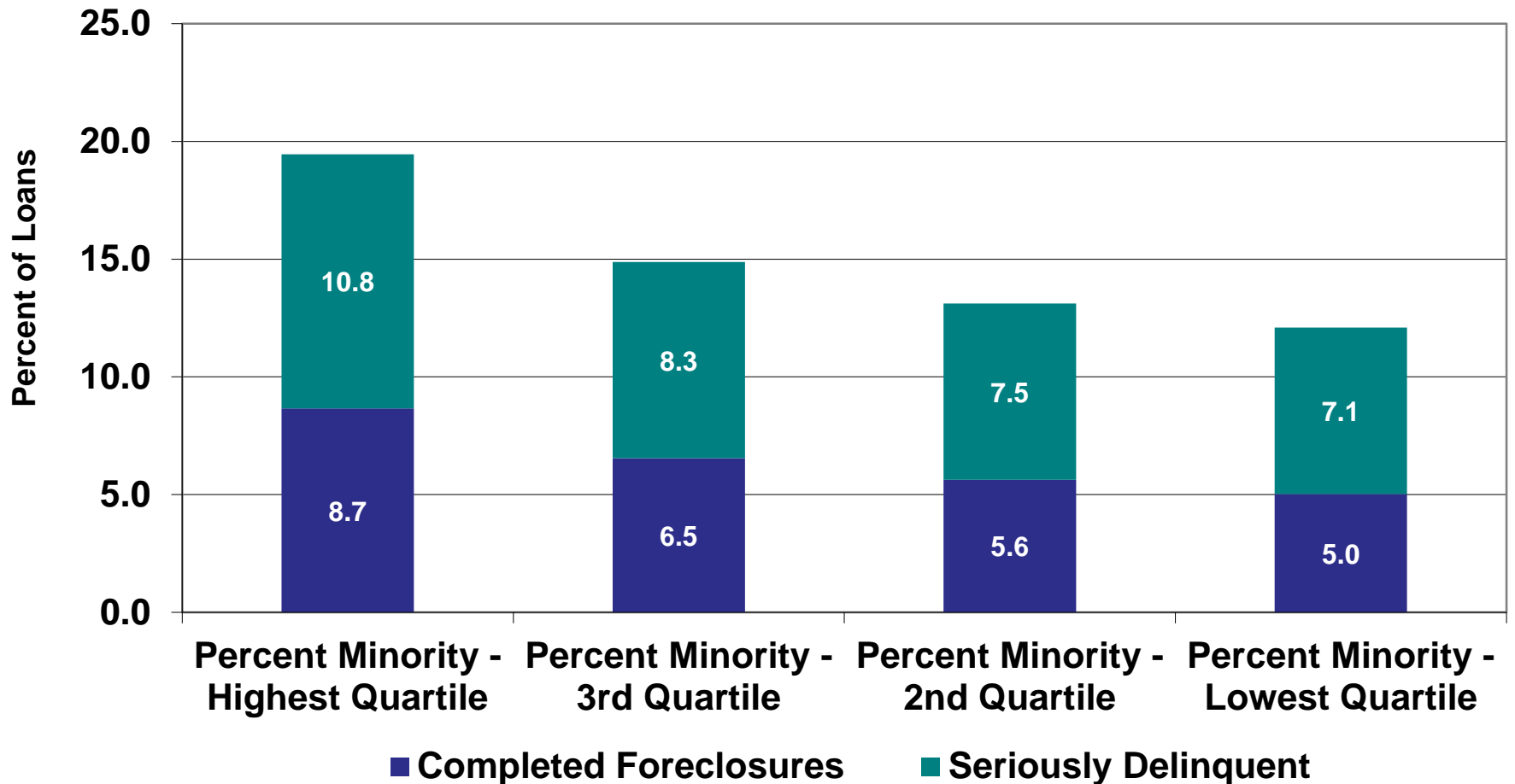
## Analysis of Borrower Income Reveals Importance of Link Between House Prices and the Marketing of Risky Products



## Lower-Income and Minority Areas Disproportionately Affected



## Lower-Income and Minority Areas Disproportionately Affected

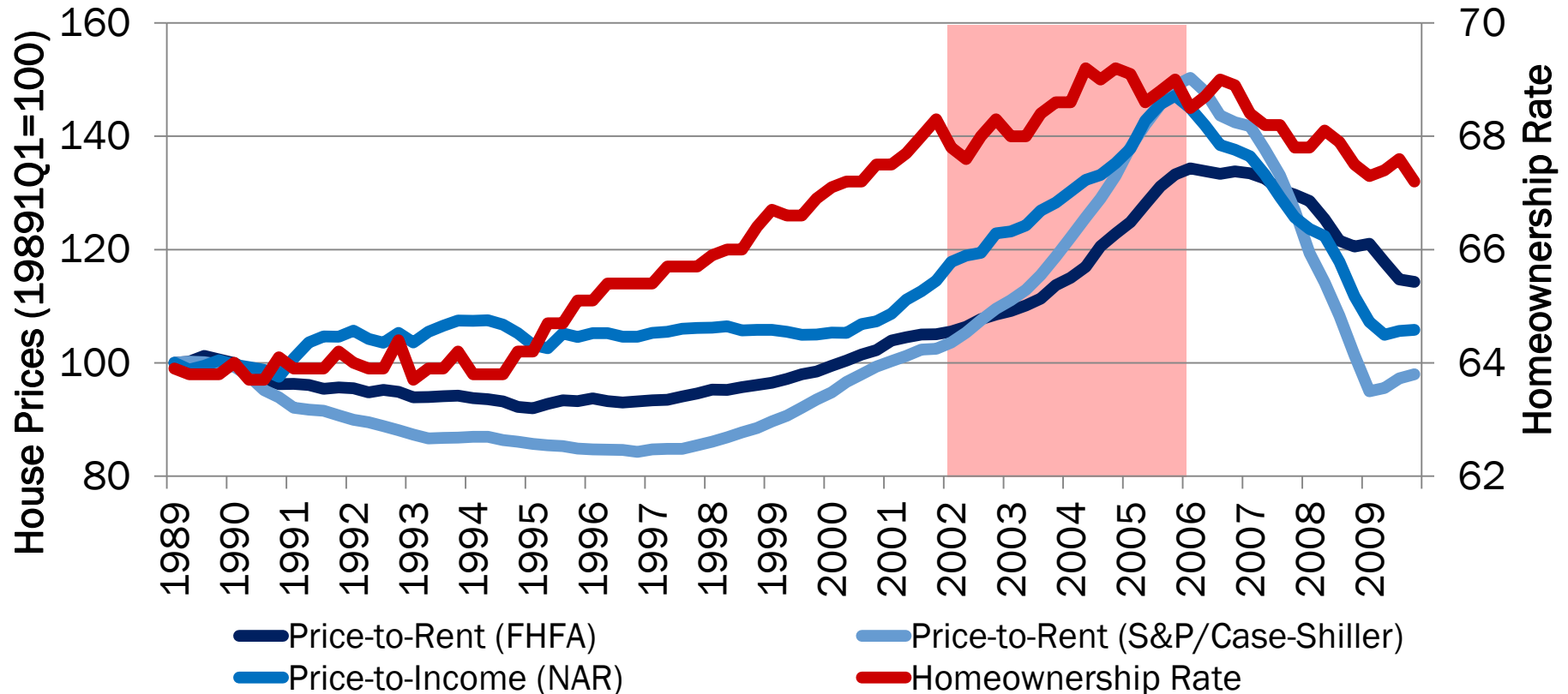


## Behind the Foreclosure Numbers

- Homeownership peaked before house prices
- Subprime lending did not increase lower-income homeownership
- Homeowner equity fell despite rising prices
- Unemployment never recovered from the early 2000s recession and now drives defaults

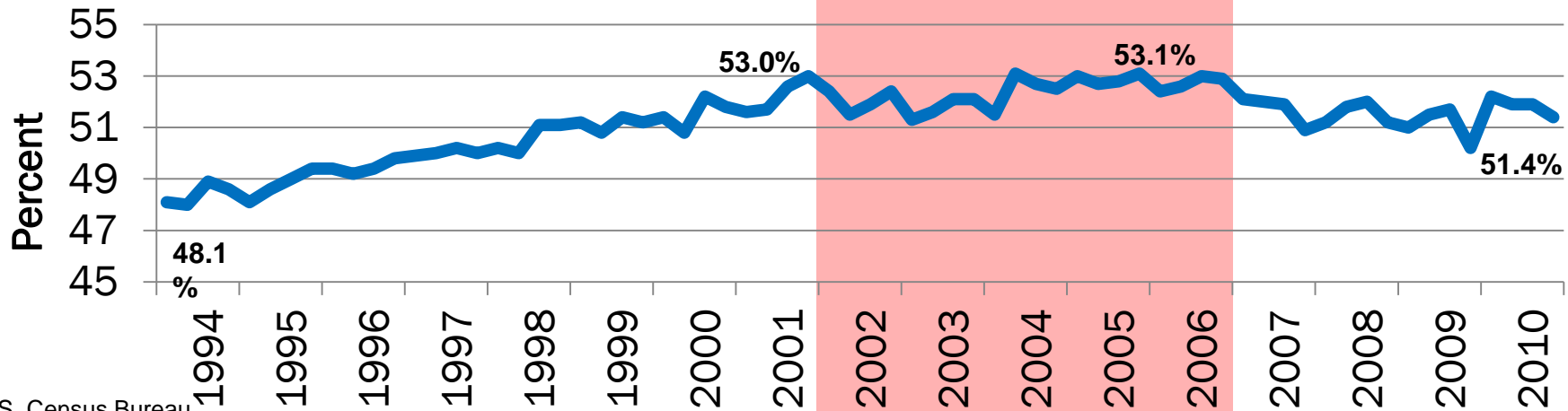


# Homeownership and House Prices



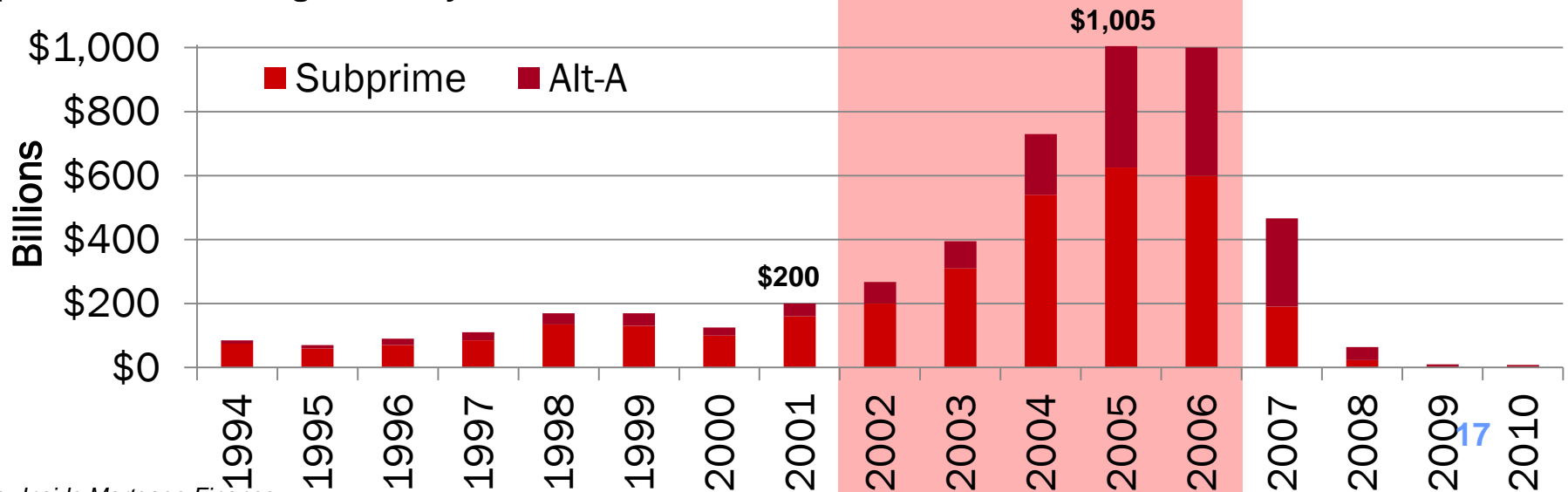
Source: S&P/Case-Shiller National House Price Index; Federal Housing Finance Agency House National House Price Index; National Association of Realtors; U.S. Bureau of Labor Statistics; U.S. Census Bureau

## Homeownership Rate Among Households With Less Than Median Family Income



Source: U.S. Census Bureau

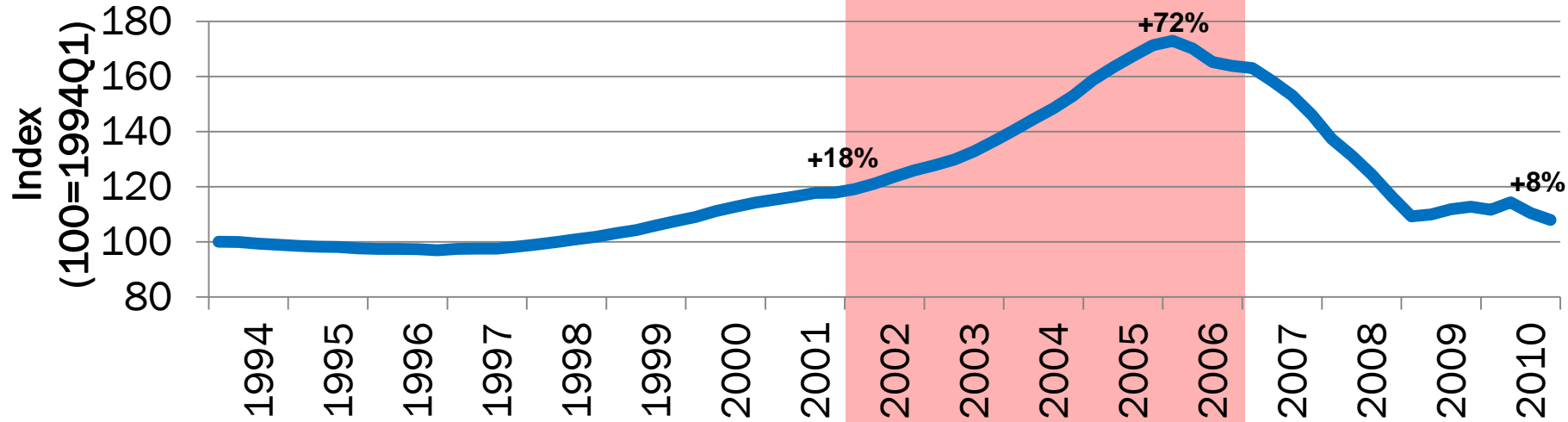
## Subprime and Alt-A Origination by Nominal Dollar Volume



Source: Inside Mortgage Finance

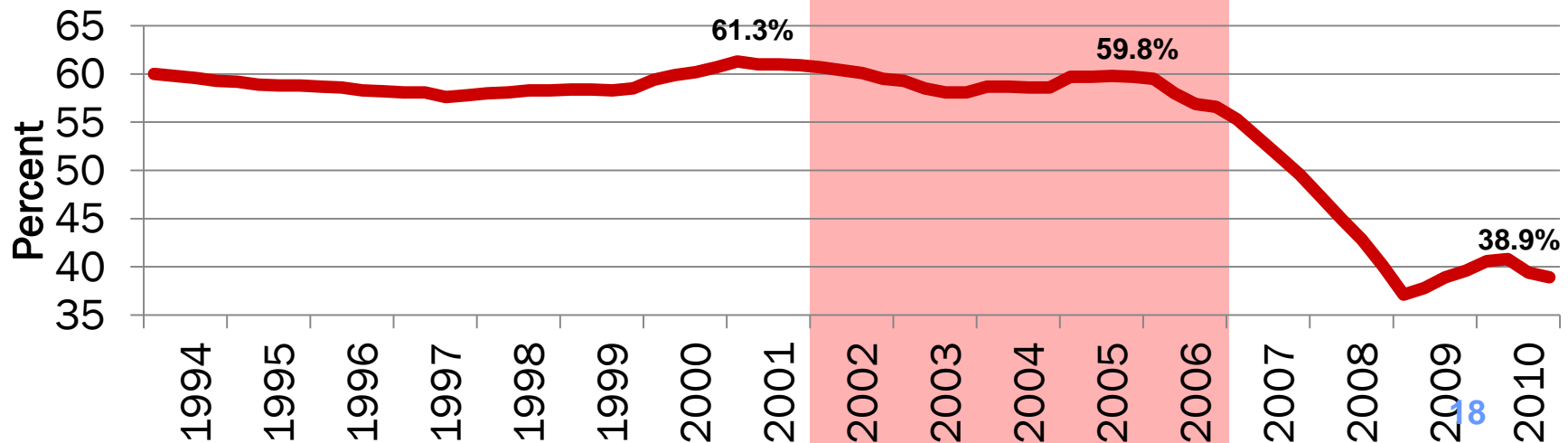


### House Prices Indexed by Owners' Equivalent Rent



Source: S&P/Case-Shiller National House Price Index; U.S. Bureau of Labor Statistics

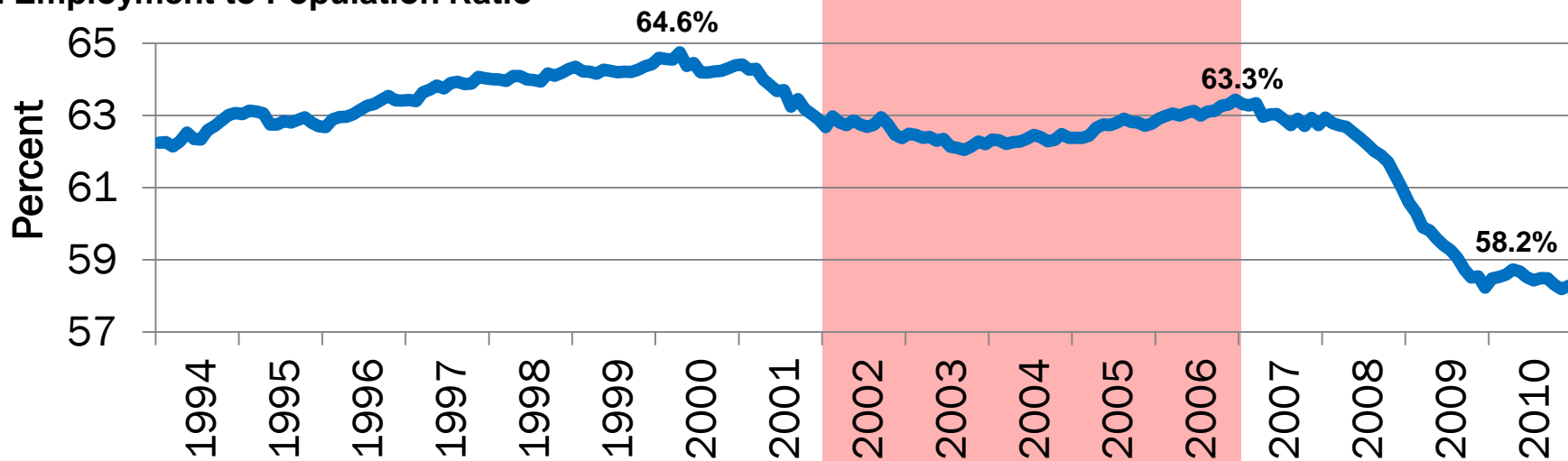
### Household Equity in Real Estate as a Percentage of Value



Source: Federal Reserve Flow of Funds

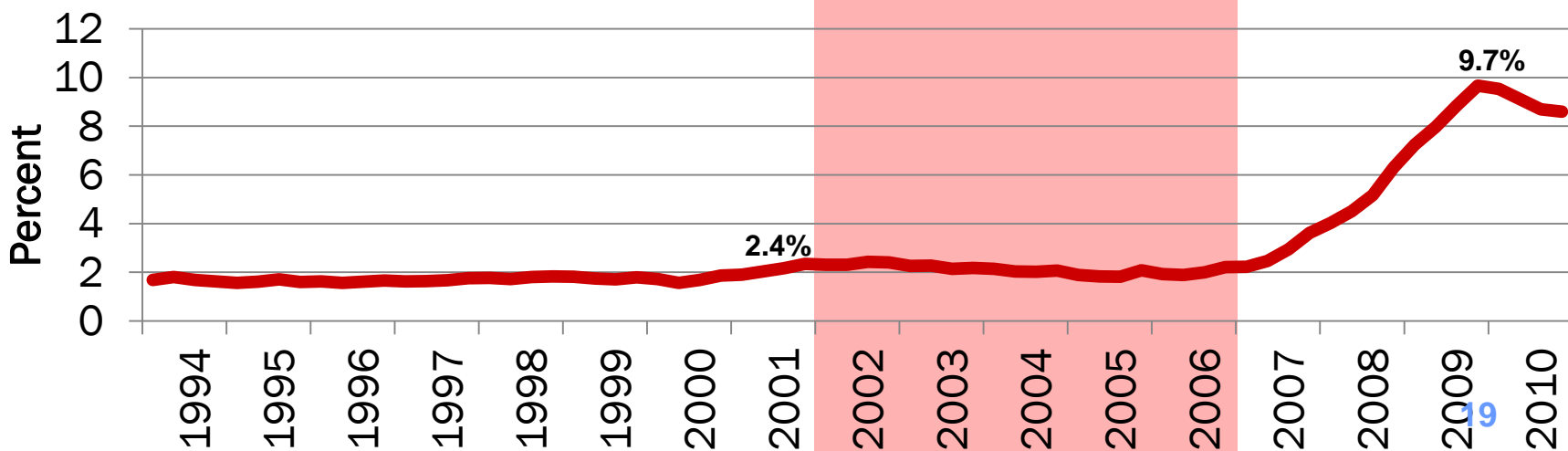


### Civilian Employment to Population Ratio



Source: U.S. Bureau of Labor Statistics

### Serious Delinquency (90+ Days Late or in Foreclosure) Rate



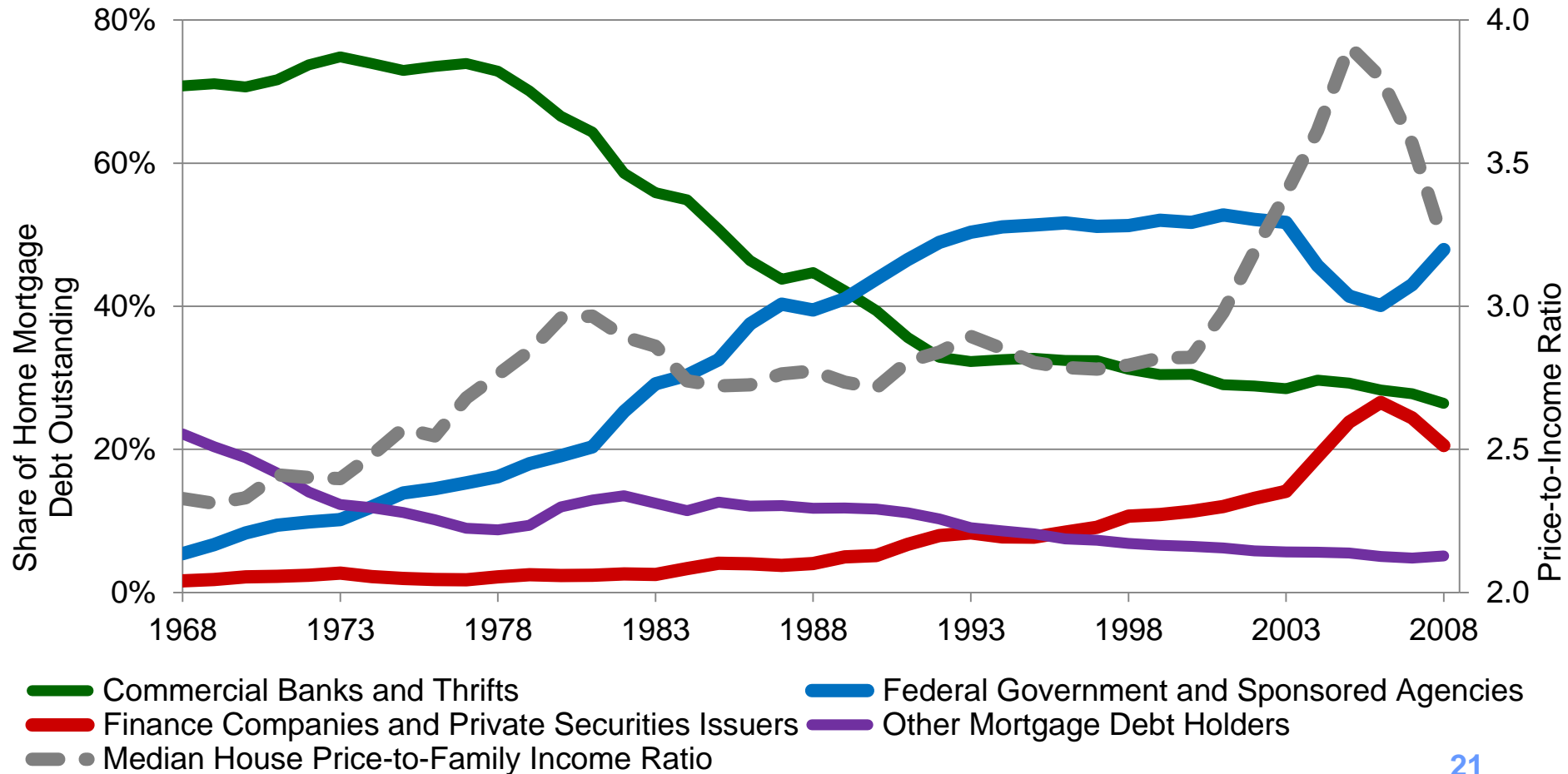
Source: Mortgage Bankers Association

## Little Evidence That These Cause Crisis...

- Fannie & Freddie
  - Affordable Housing Goals
  
- Community Reinvestment Act
  - E.g., Self-Help's Community Advantage Program

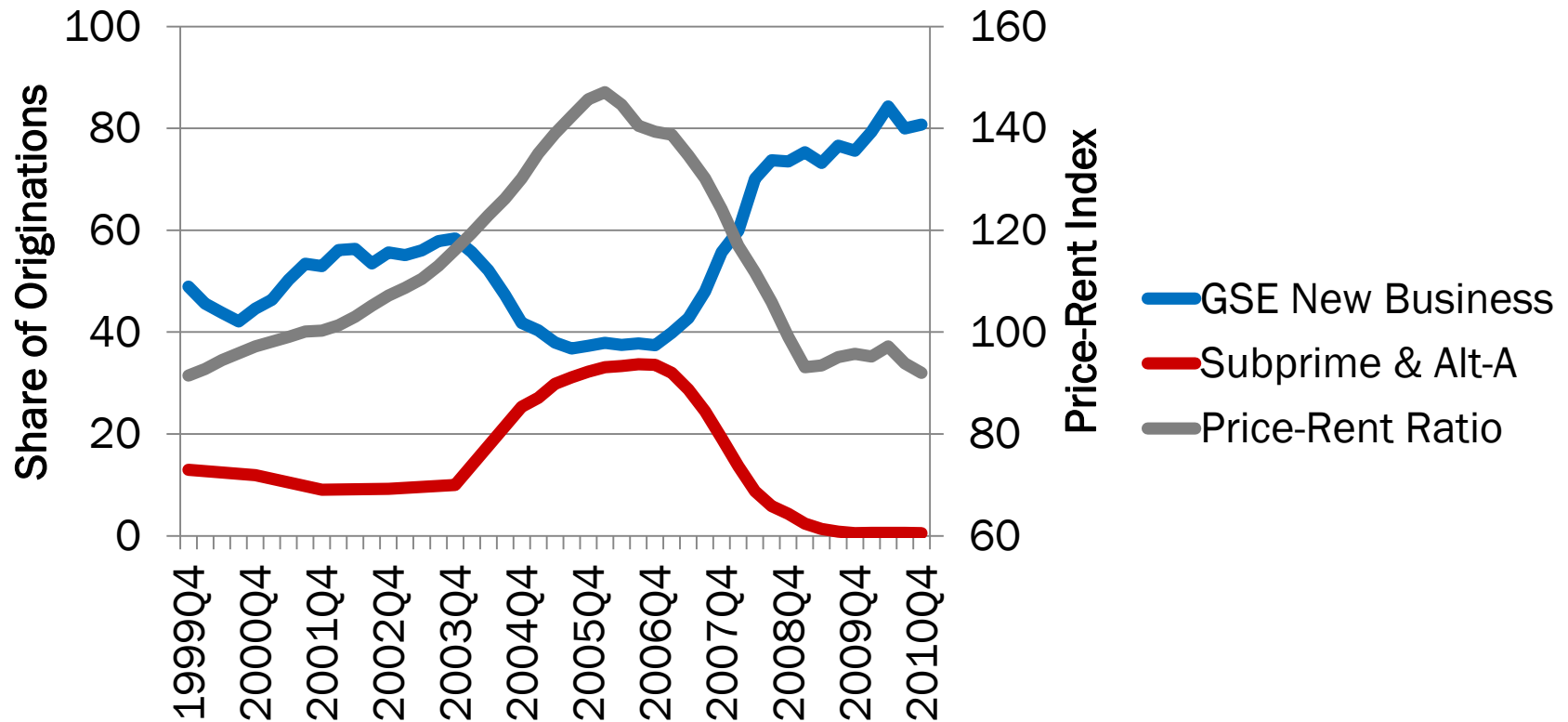


# Evolution of the Mortgage Market





# Fannie & Freddie New Business and Subprime Lending

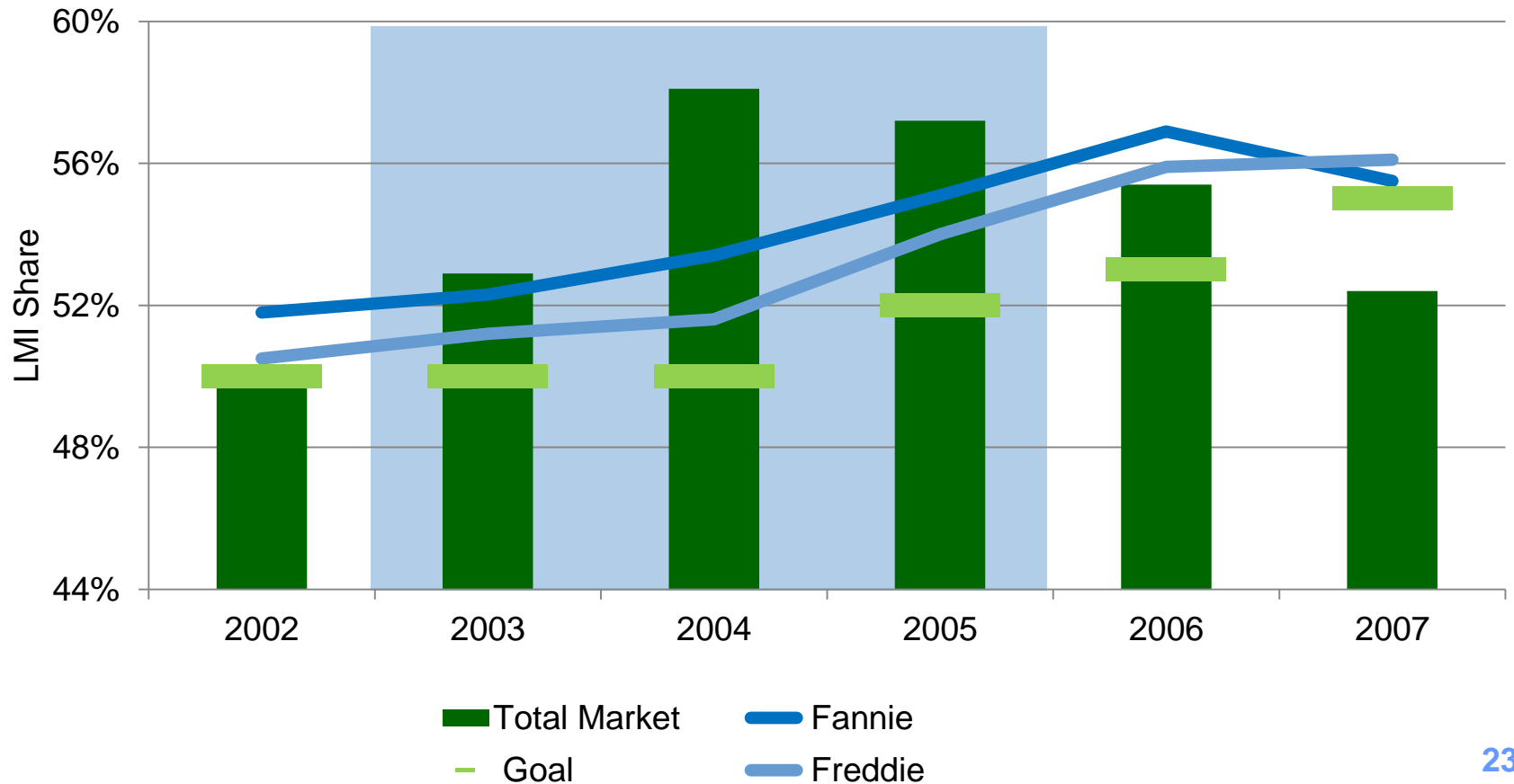


Notes: House price index is scaled by owners' equivalent rent of residences and indexed to the average of 1987 to 2010 equals 100. Market share calculated as 4-quarter moving totals.

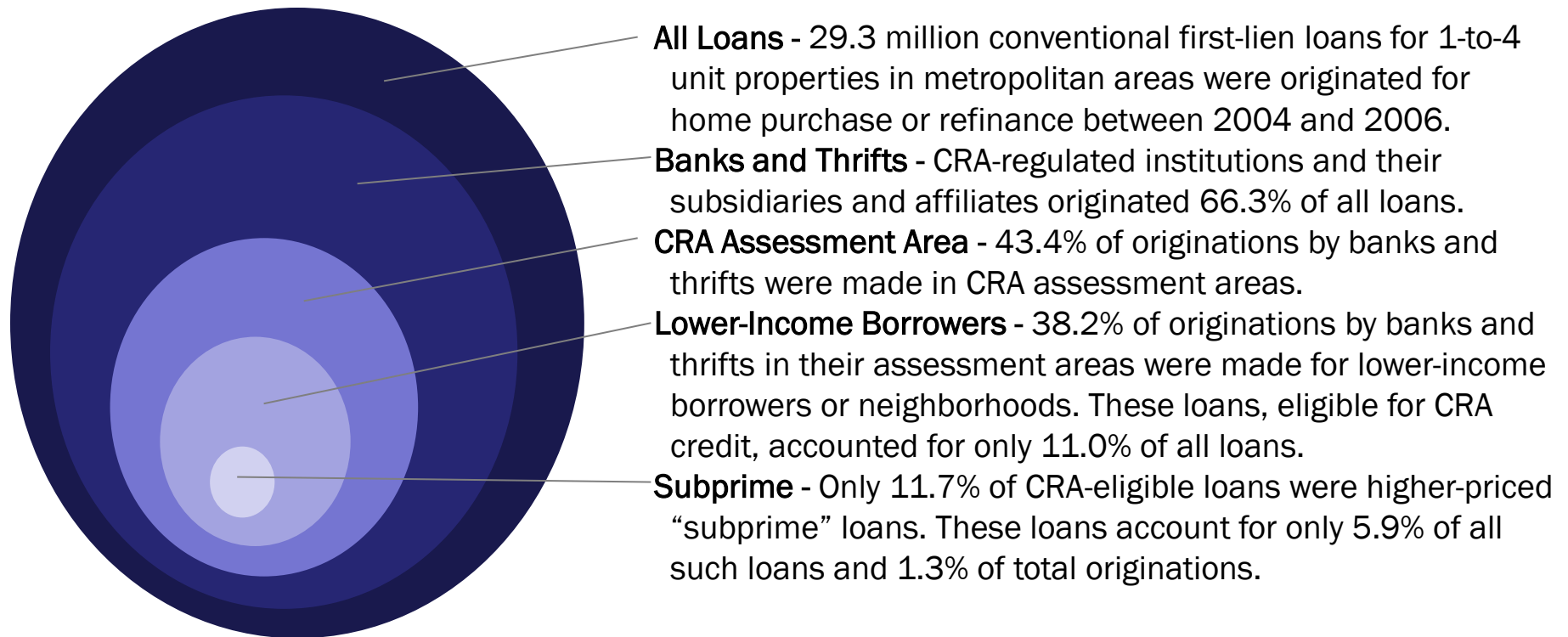
Sources: *Inside Mortgage Finance*; S&P/Case-Shiller National Home Price Index; Bureau of Labor Statistics



# LMI Affordable Housing Goals 2002-2007



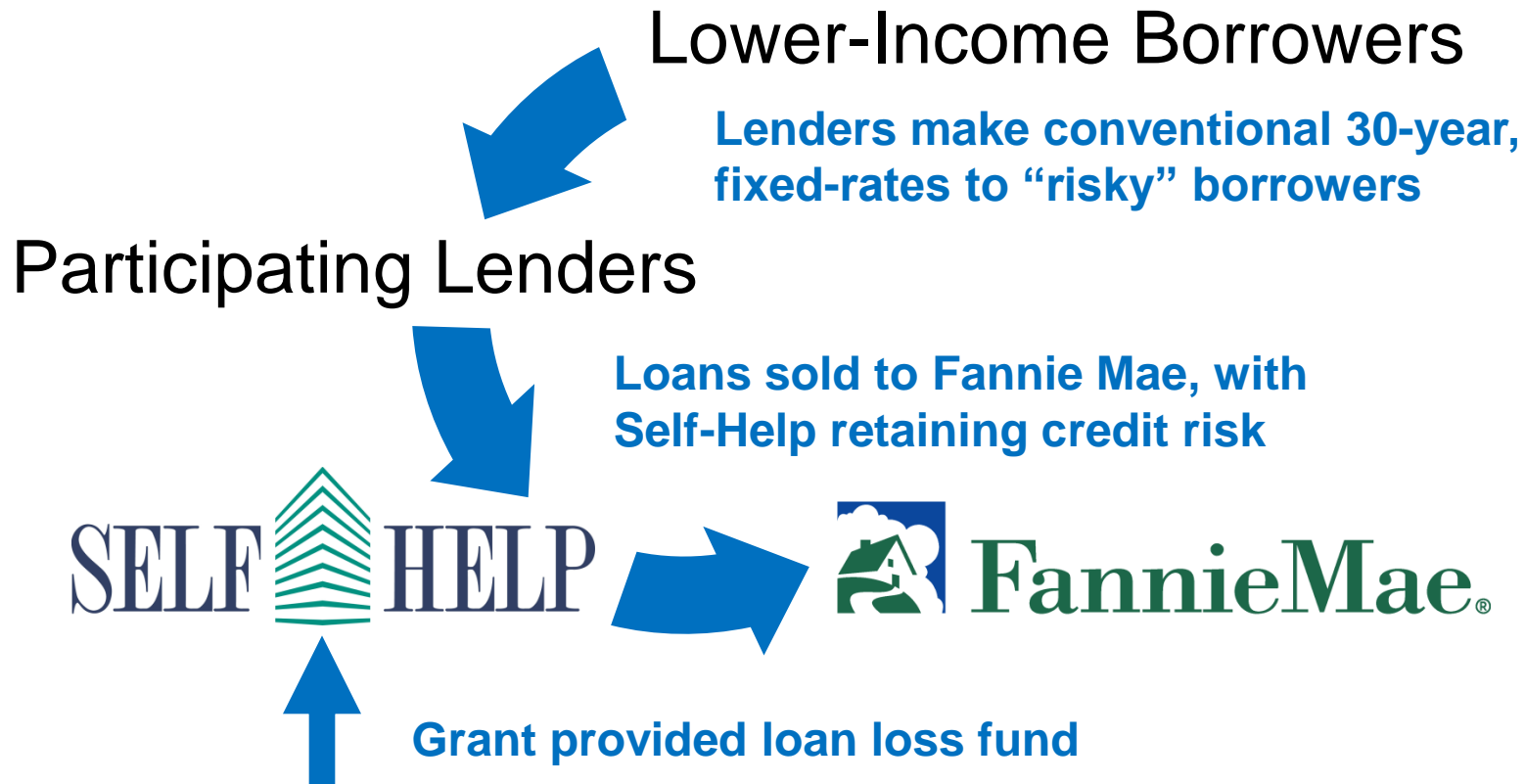
# Loans Covered Under CRA



Note: Circles are drawn to scale.

Source: Home Mortgage Disclosure Act

# CRA Lending Done Right: The Community Advantage Program



# The Community Advantage Program

46,453 loans

Most (68%) put down less than 5%

1/2 < 680 credit score

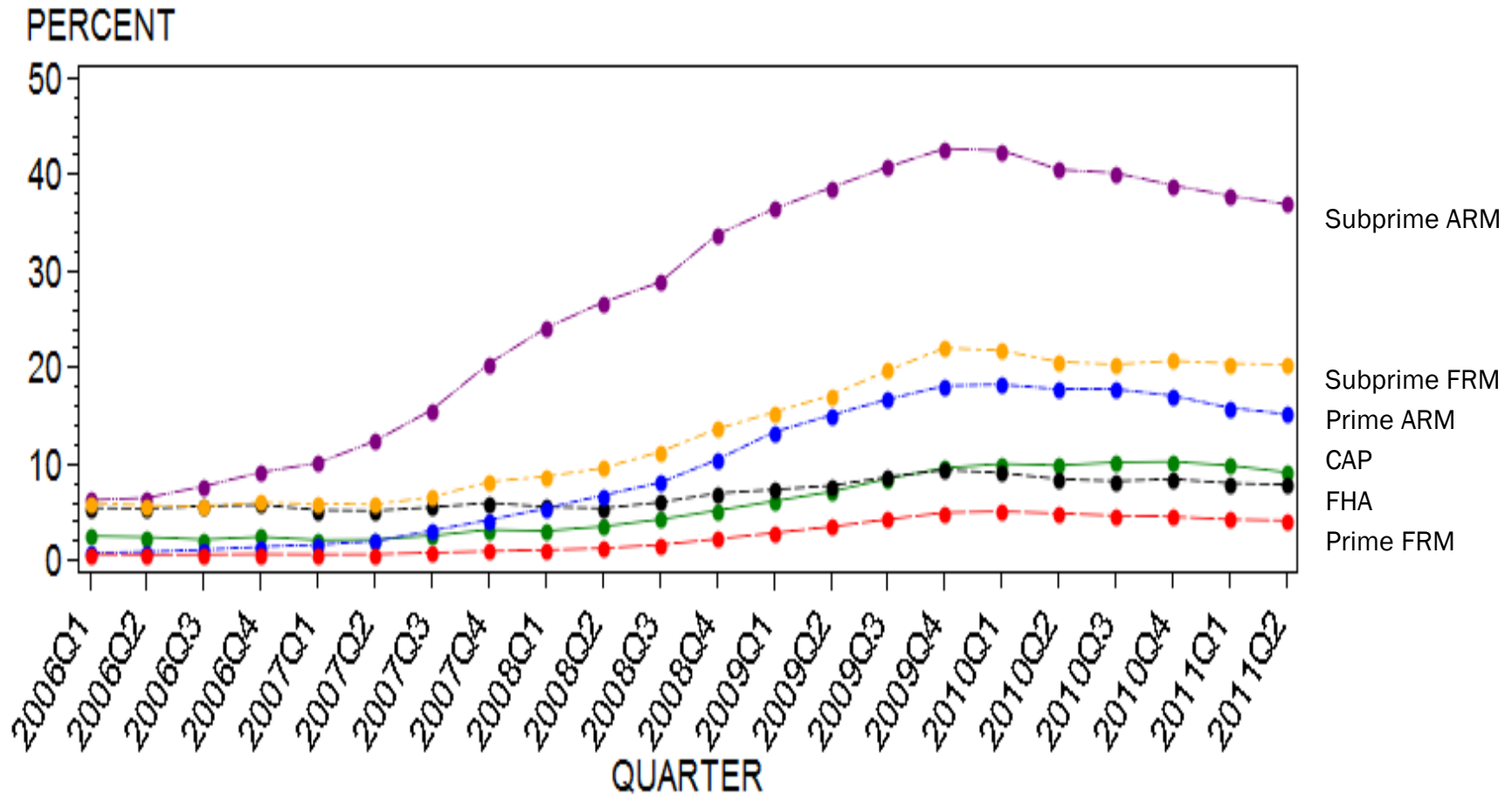
\$30,972 median income

41% female-headed

40% minority

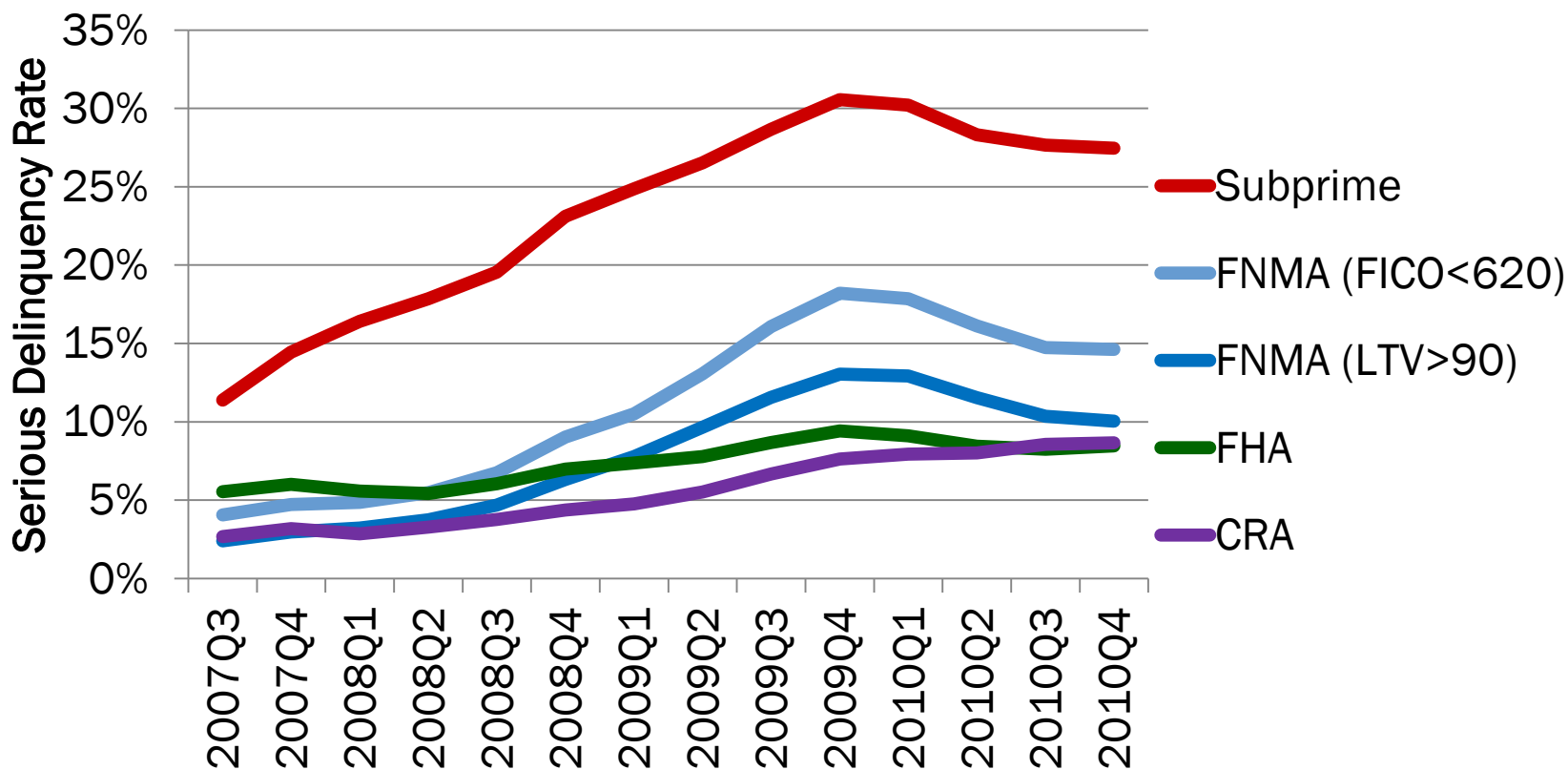


# Serious Delinquency (90 days+ or in foreclosure) by Mortgage Type





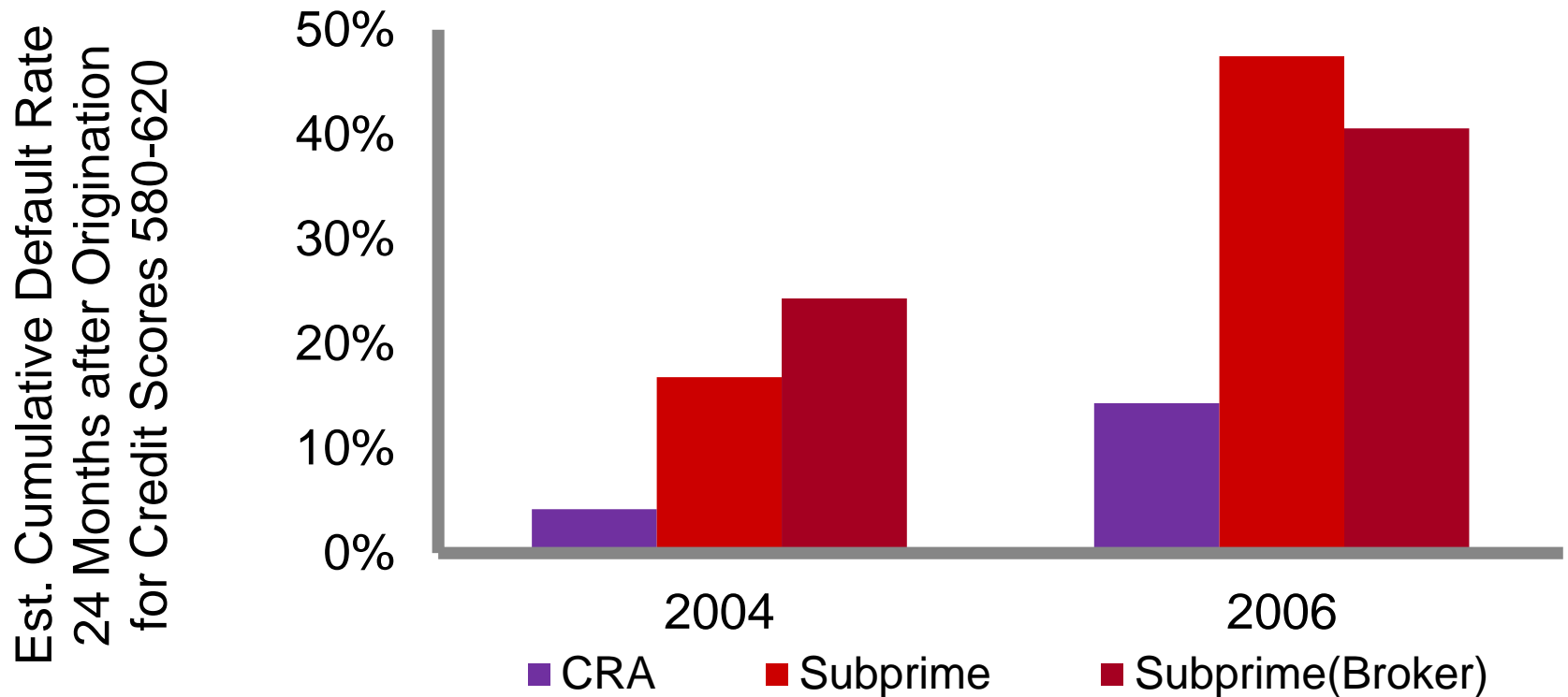
# Similar Pattern for Comparable Borrowers



Note: CRA delinquency rate taken from a portfolio of CRA loans managed by Self-Help Credit Union. Serious Delinquency defined as 90+ day delinquent or in foreclosure.

Sources: Mortgage Bankers Association; Fannie Mae; Center for Community Capital

# Risky Borrowers or Risky Mortgages



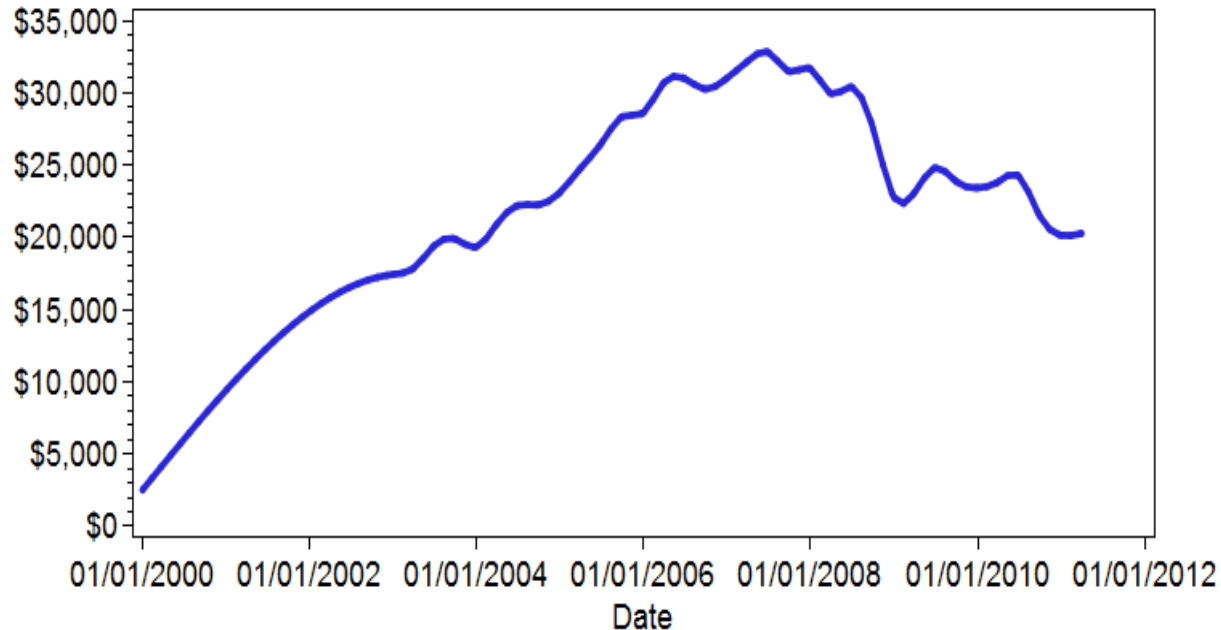
Source: Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe (2009). "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models." Center for Community Capital. Exhibit 11. Estimation is based on a borrower with a FICO score between 580-620 with the mean value of other regressors. "Broker" indicates broker-originated loans, "PPP" indicates loans with prepayment penalties, and "ARM" indicates adjustable-rate mortgages.

# Lending Done Right Leads to Wealth Building

Median annualized CAP house price appreciation since origination stands at 1.4%, with annualized return-on-equity at 25%.

This appreciation translates into median wealth gains of \$17,000, or about 60% of borrower annual income at the median.

Median Total Equity Accumulated Since Origination



Equity gains have been mostly retained, despite the financial crisis



# 2010 DODD-FRANK FINANCIAL REFORM AND THE UNFINISHED BUSINESS

# Dodd-Frank Financial Reform Act

- Requires assurance of borrower's ability to pay
- Bans financial incentives that promote risky lending
- Broadens definition of who is protected by
  - Lowering interest rate, points, and fees for a high cost loans (HCL)
  - Requiring escrow of taxes and insurance in HCL
- Requires ARM loans to be underwritten at full indexed rate
- Establishes penalty for non-compliance
- Requires death plans to deal with “too big to fail”
- Creates Consumer Financial Protection Bureau (CFPB)
  
- Defines qualified mortgages (QM) to ensure ability to pay
- Defines qualified residential mortgages (QRM) to promote skin in the game safe loans that require no risk retention when part of MBS

# Definitions

## ⑩ QM proposal

- ⑩ Full documentation, no negative amortization, no interest only, no balloon, no adjustable interest rates with fixed terms under 5 years, fee restrictions

## ⑩ QRM proposals

- ⑩ Downpayment= 3, 10, and 20%
- ⑩ Debt to Income ratio (front-end)=28 and 30%
- ⑩ FICO=660 and 690

## ⑩ Default

- ⑩ 90+ days delinquent, in foreclosure or foreclosed - 2/11



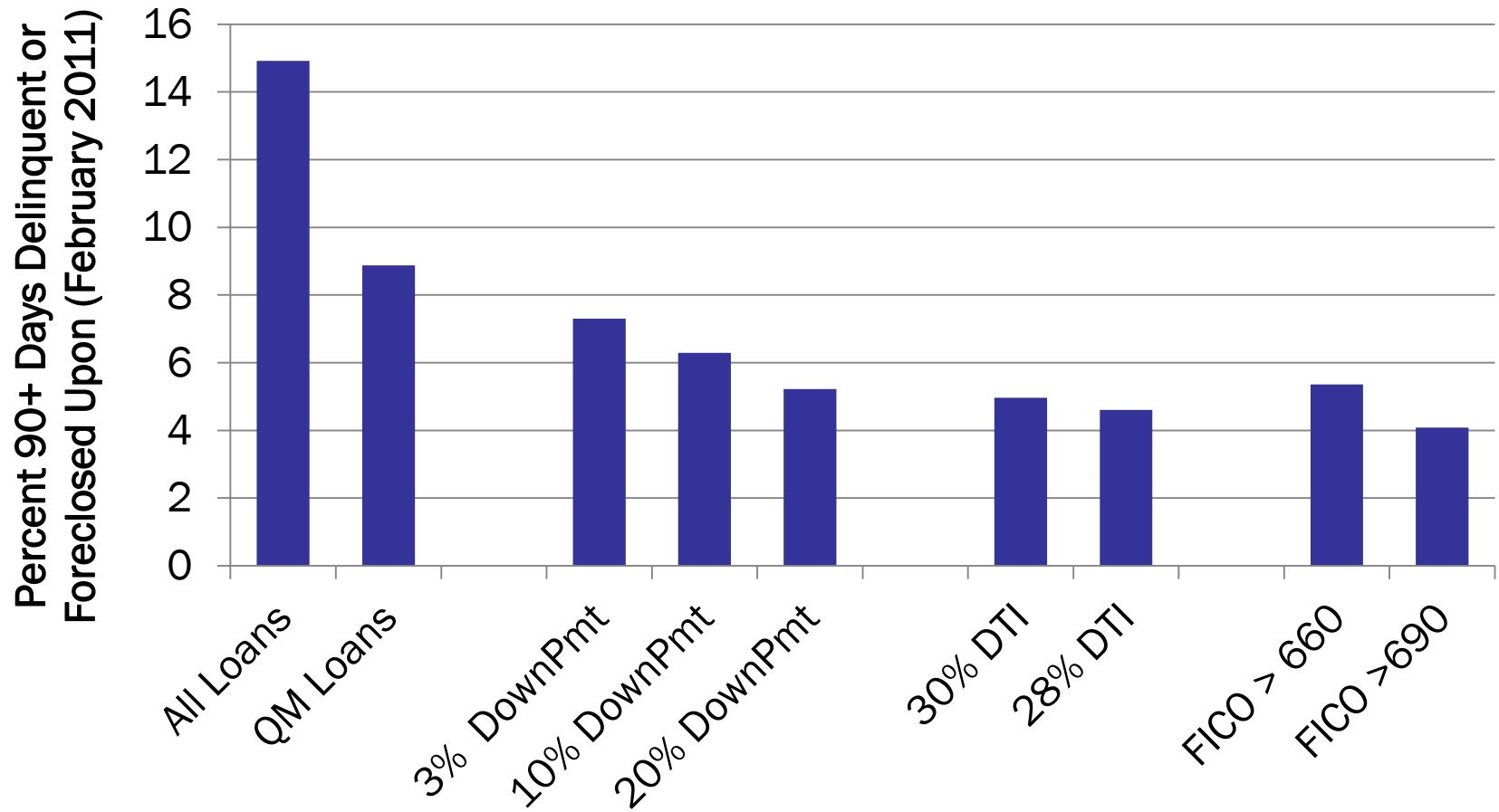
- ⑩ Concerns that proposed restrictive QRM guidelines will disproportionately restrict access to credit for low-income, low-wealth, and minority households
  
- ⑩ We estimate the relative changes in mortgage access and default for different groups that would occur under different QRM guidelines, assuming that the QM guidelines are in place
  
- ⑩ We use a unique nationally representative database on loan performance with borrower and neighborhood demographics information

## Loan Performance for Different Loan Market Segments

Market Segment	Number of Loans	Percent Foreclosed
Subprime conventional	1,988,800	29.7
Alt-A conventional	589,024	25.7
All loans	26,679,477	14.9
FHA/VA	2,126,801	13.0
Prime conventional	15,488,531	9.9
QM loans	5,213,617	8.9

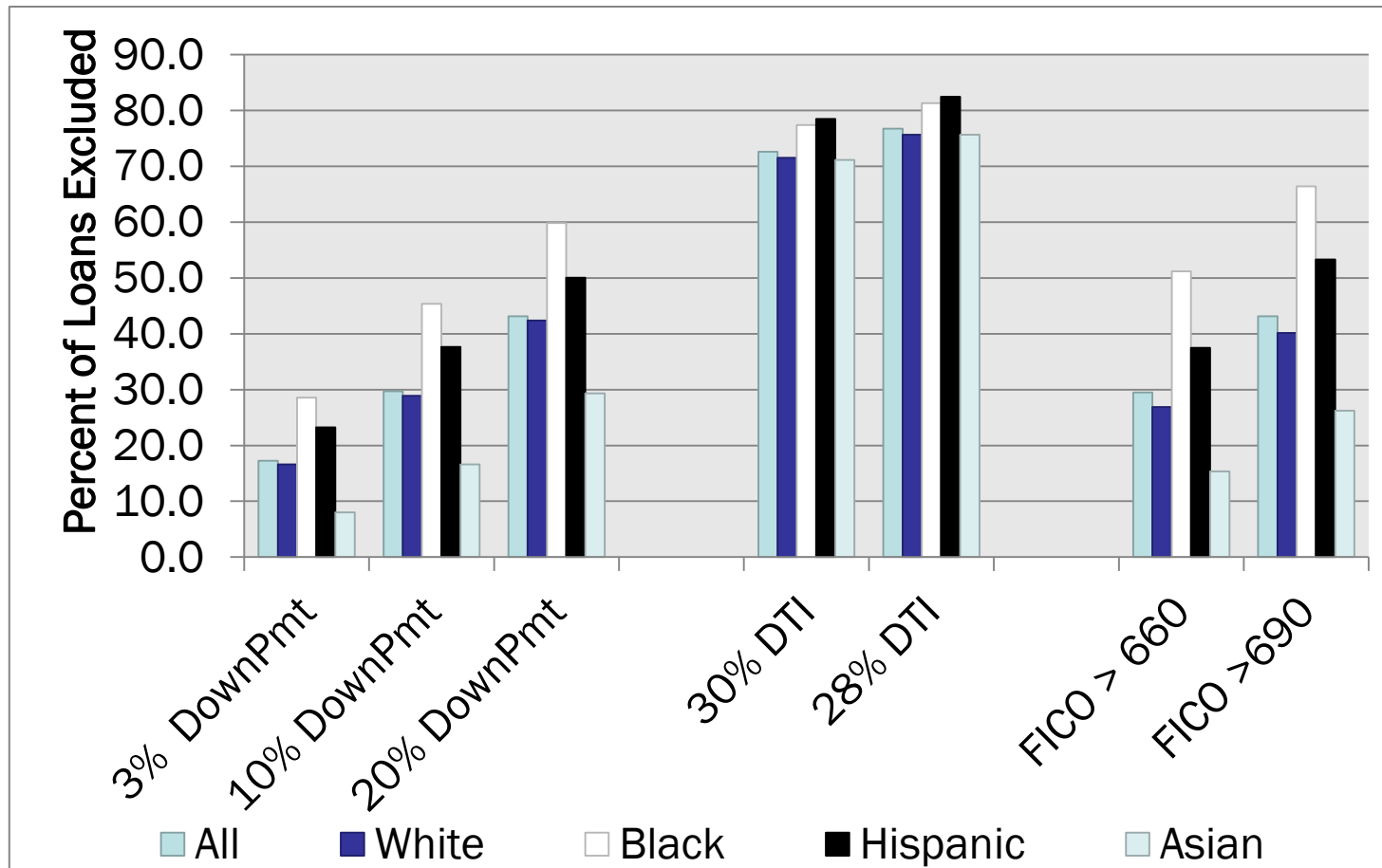


## Loans Foreclosed by Proposed QRM Guidelines



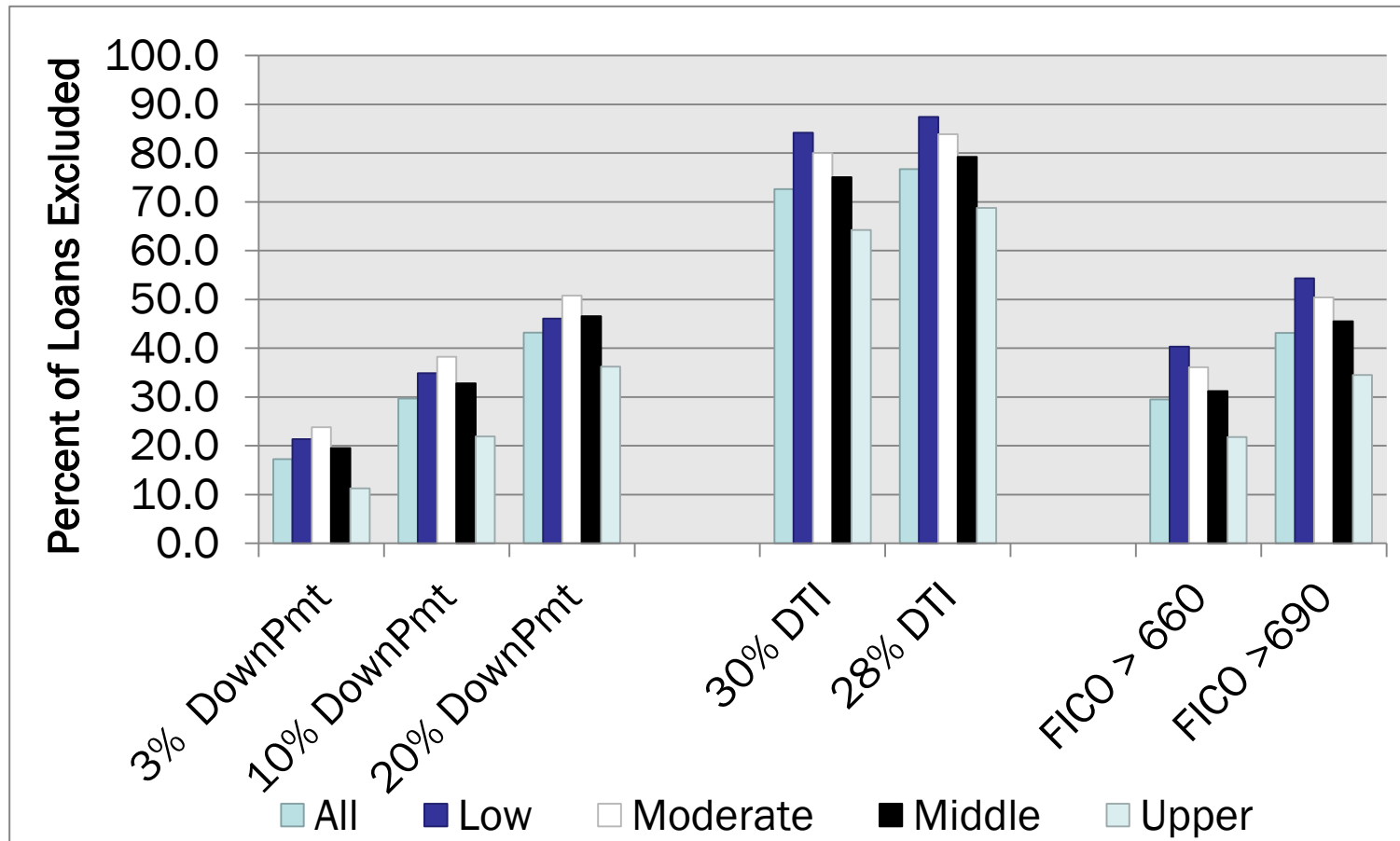


## Exclusion from the QRM Market Disproportionately Impacts Minority Borrowers



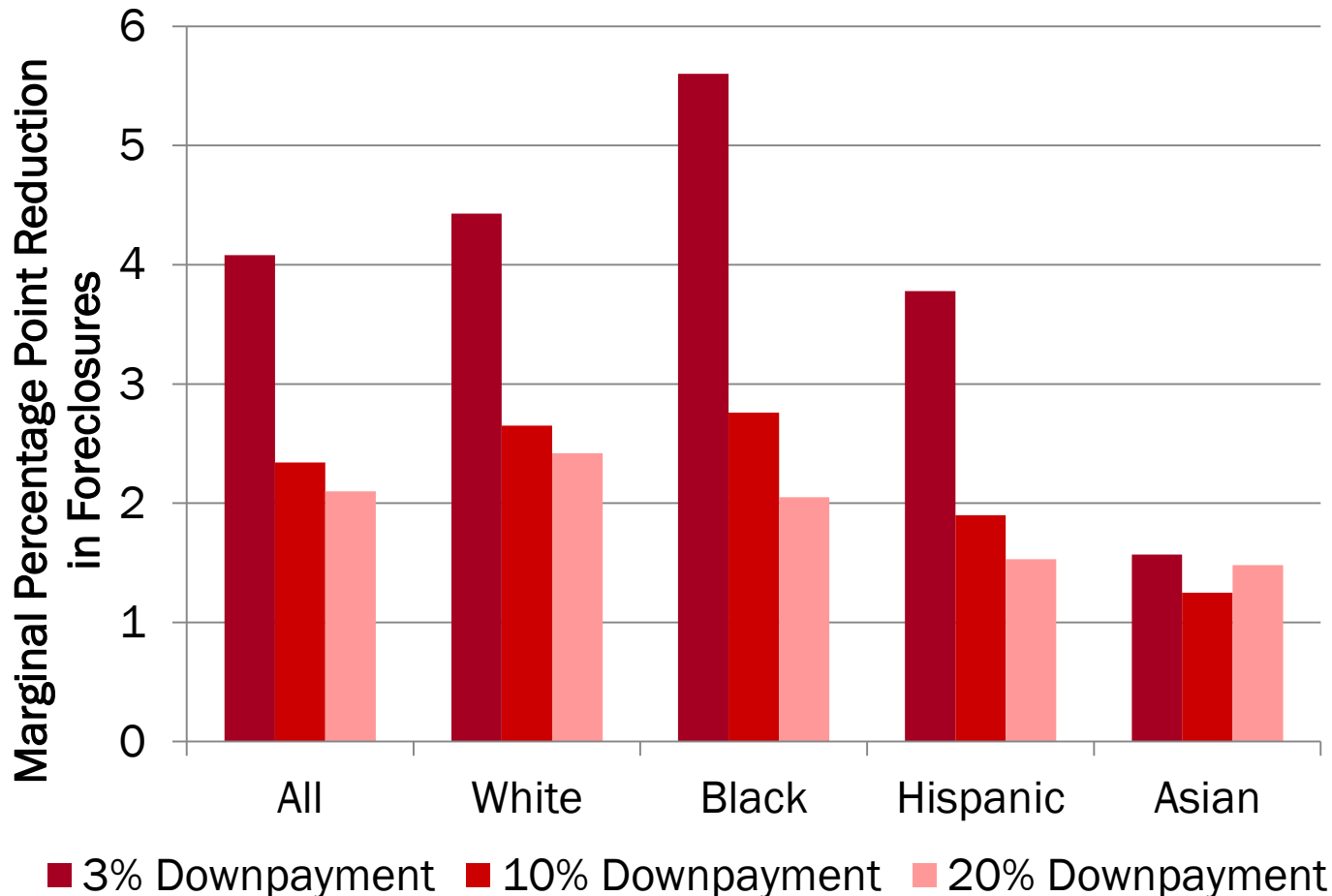


## Impacts on Access to Credit: Exclusion from the QRM Market by Income





## Marginal Reduction in the Number of Foreclosures Diminishing Returns from More Restrictive QRM LTV Requirements

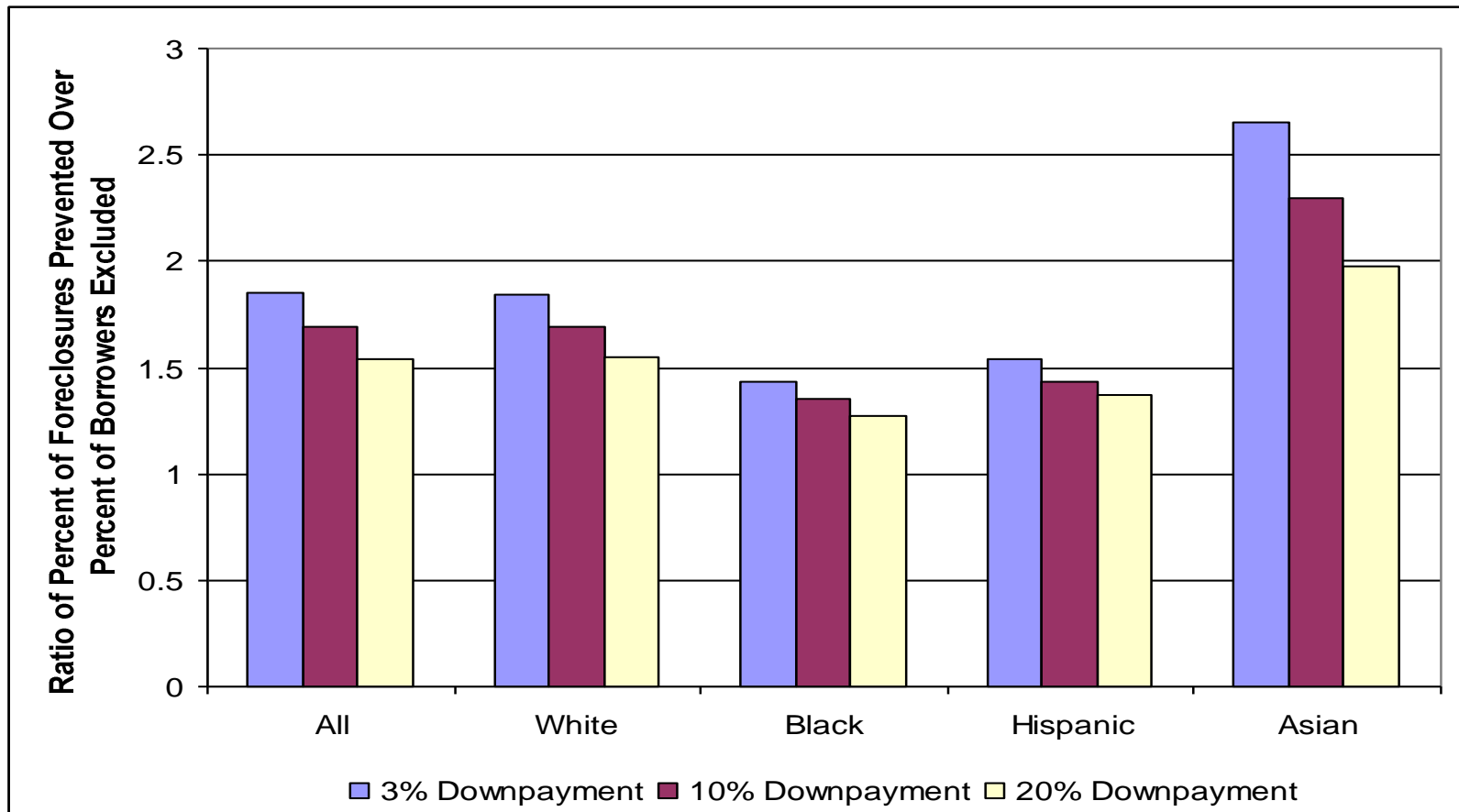


## Definition of Benefit - Cost

- ⑩ Benefit= Percent reduction in the number of foreclosures (“benefit” of more stringent QRM standards)
- ⑩ Cost= Percent reduction in the number of borrowers who would have access to QRM mortgages (“cost” of excluding borrowers)
- ⑩ Benefit/Cost ratio
- ⑩ A larger ratio would suggest that the proposed change provides greater marginal benefit than one with a smaller value.

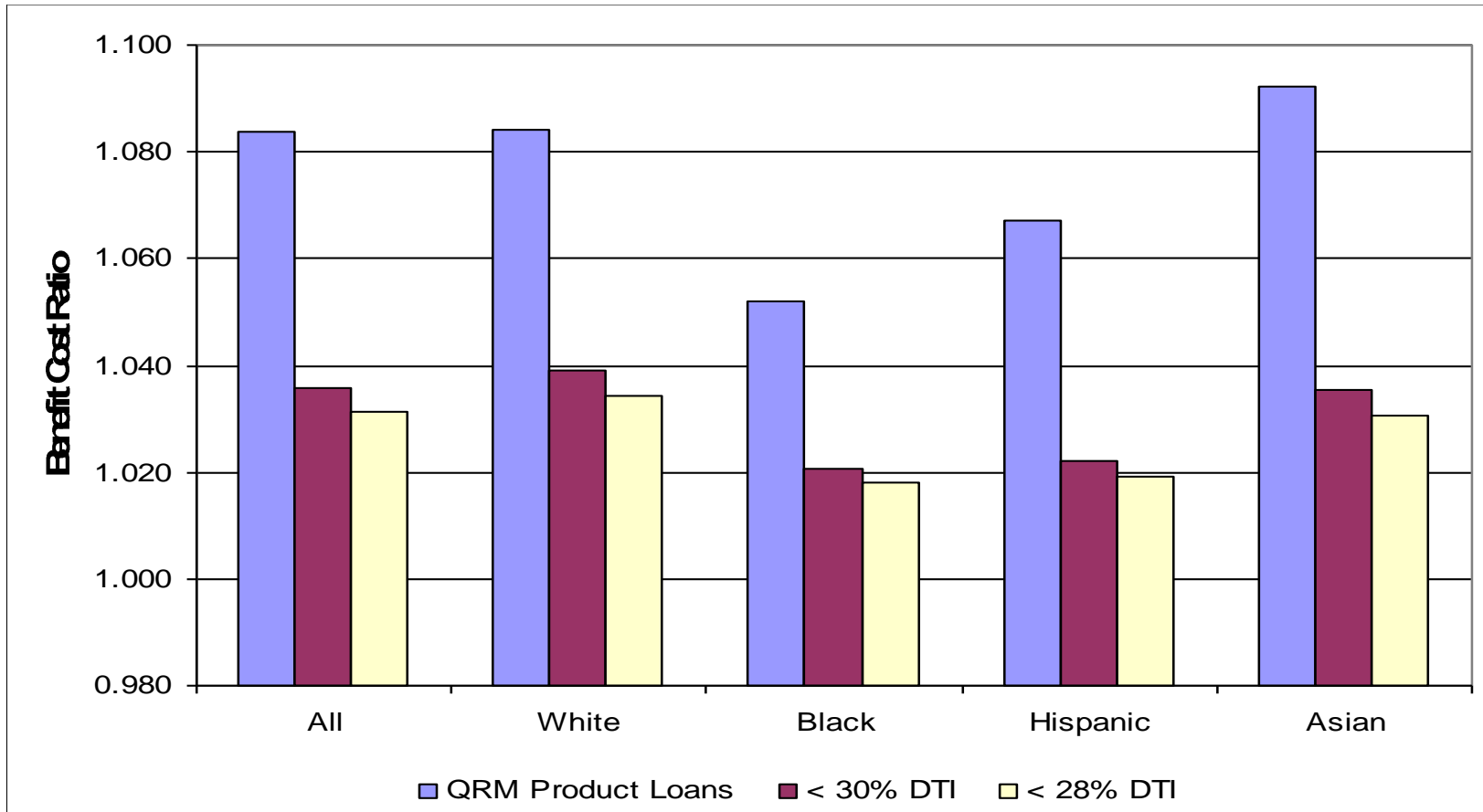


## Benefits and Costs of Different QRM LTV Guidelines by Race/Ethnicity



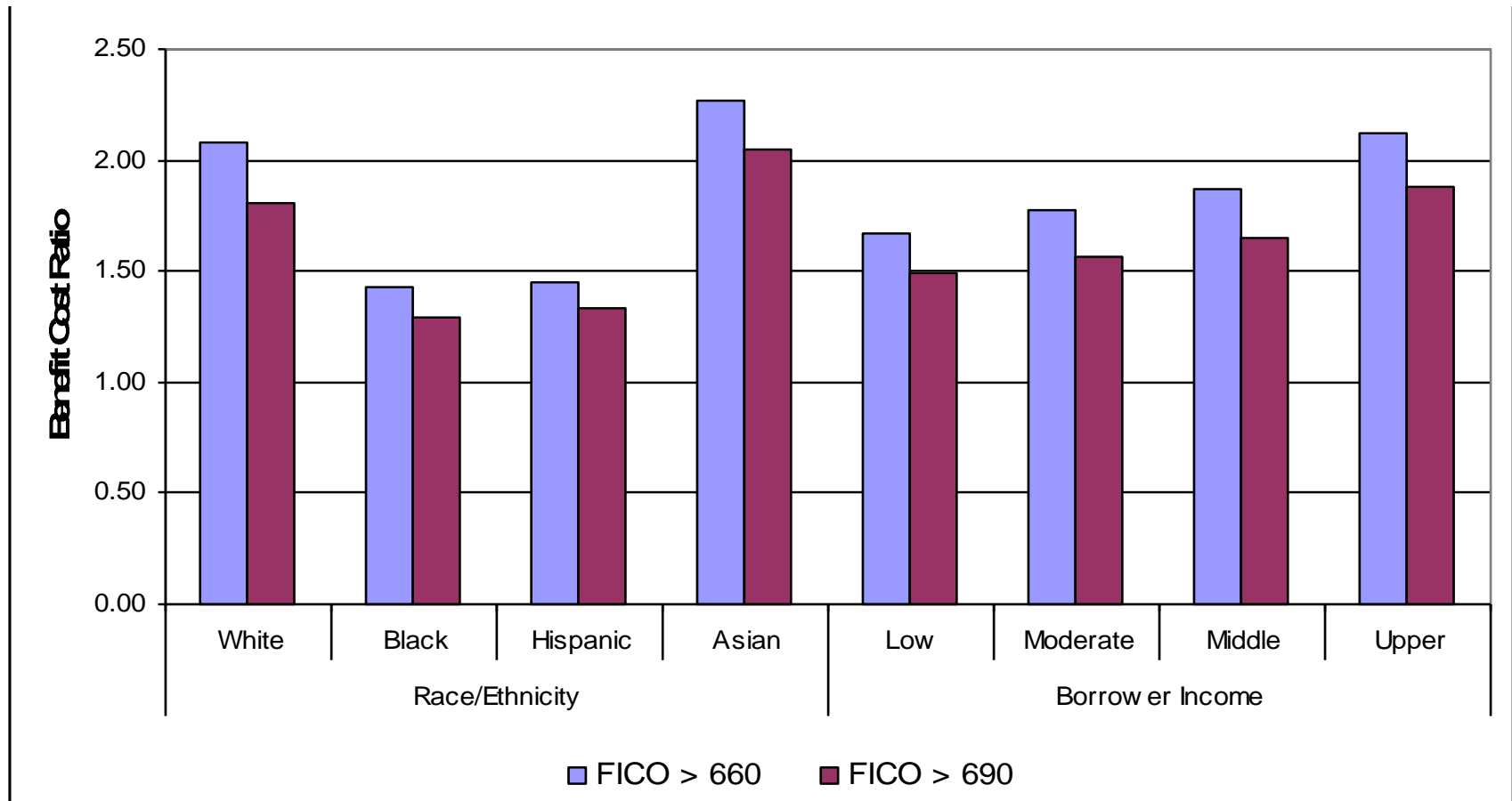


## Benefits and Costs of Different QRM DTI Guidelines by Race/Ethnicity





## Benefits and Costs of Different QRM FICO Guidelines by Race/Ethnicity and Income



# Implications: Fixing the Foreclosure Mess

- Unfortunately, there is no silver bullet.
- More than one foreclosure problem – local differences matter
- Do nothing. Let the market do what it does... Green shoots...
- 15 million homeowners underwater
- House prices boomed because of subprime lending, without it, prices are unlikely to recover for many years
- Short sales and principal reduction modifications are needed. Investors are already getting 50 cents per \$1 when they foreclosed, why not reduce principal instead?
  - People continue to pay anyway
  - Moral hazard problem
  - Shared appreciation option?
- Mortgage solution cannot fix unemployment (short/long term)

## Implications: Looking to the Future

- Homeownership is not for everybody; it is not a remedy or antidote for social ills, including financial insecurity
- When done right, it can be a long term means of wealth creation
- Done right means a fixed rate 30 year mortgage, appropriately underwritten, and serviced, and backed by needed secondary market functions (GSE reform important)
- QM loans on their own would do a lot to curtail the risky lending that occurred during the subprime boom
- Disproportionate impacts of different QRM proposals-- LTV, DTI, and FICO--on low-income borrowers and borrowers of colors
- We urge caution. Dual markets are not desirable. Real solution to “too big to fail” problem still needed



# Regaining the Dream

HOW TO RENEW THE  
PROMISE OF HOMEOWNERSHIP  
FOR AMERICA'S  
WORKING FAMILIES

Roberto G. Quercia  
Allison Freeman  
Janneke Ratcliffe