THE PINK ELEPHANTS IMPEDING THE RESTRUCTURING OF FANNIE MAE AND FREDDIE MAC

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At The
Annual Financial Services Conference
Consumer Federation of America
Washington, DC
December 12, 2014

REwired

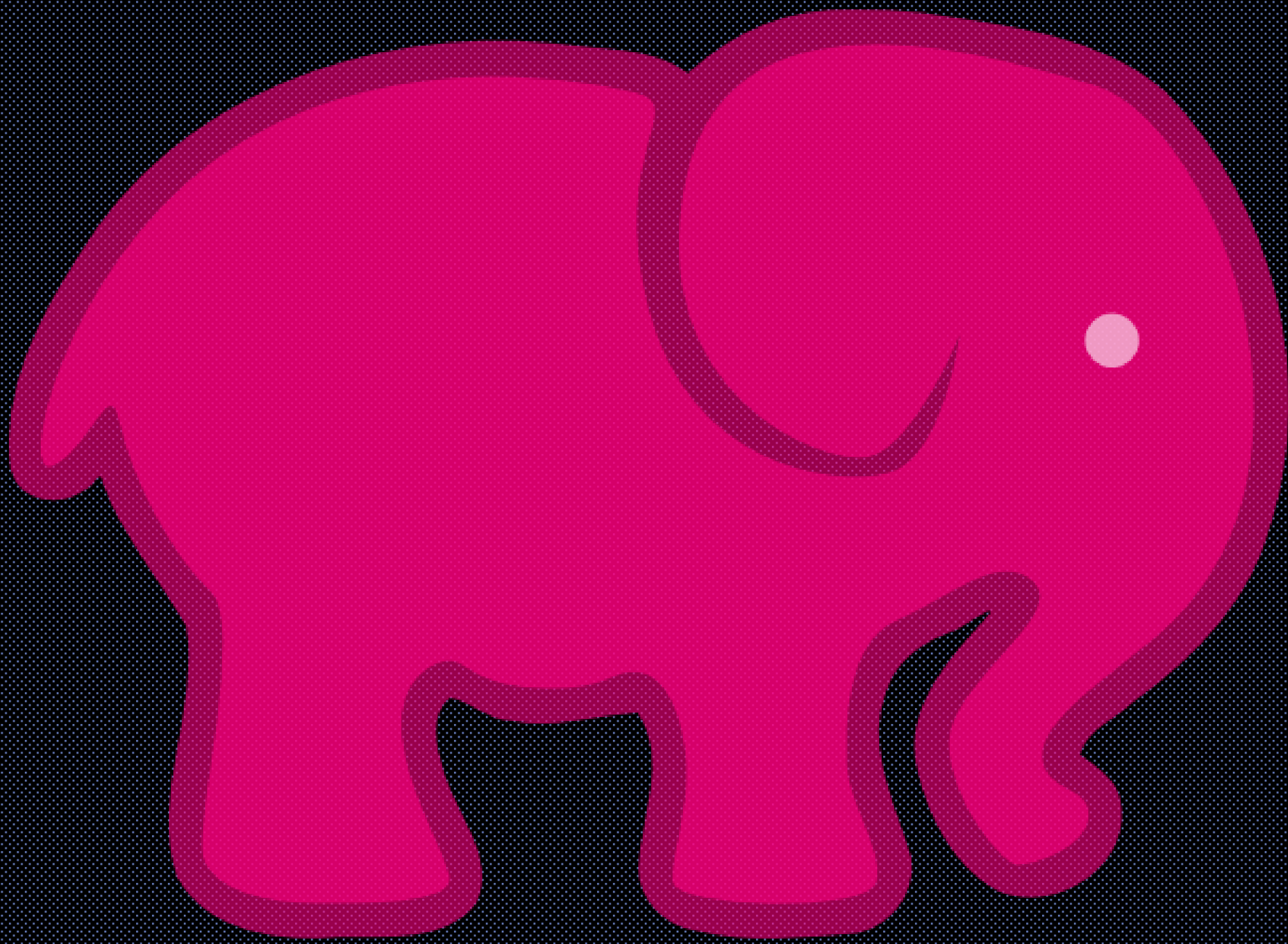
Recap and Release: Not the right path to affordable mortgages

The government's role in all this

November 16, 2015 Barry Zigas

"…The government's role should be to ensure a set of critical outcomes:
The broadest possible access to sustainable mortgage credit by the greatest range of credit worthy borrowers, everywhere in the country
A deep and liquid market for mortgage backed securities to ensure reliable investment at all times from the broadest possible range of investors at the lowest possible cost, enabling rate locks for consumers
The choice to have a long term fixed rate mortgages at a reasonable price for consumers who prefer them…"

Source: Zigas, Barry. Housing Wire.



MANY PROPOSED HOUSING FINANCE REFORM PROPOSALS WOULD

Institutionalize the current dual mortgage credit market that provides lower-cost, higher quality loans to non-Hispanic white borrowers and higher cost, and often predatory loan products to borrowers and communities of color.

MISALIGNED GOALS OF HOUSING FINANCE LEGISLATION RELATIVE TO PRE-CRISIS HOUSING MARKET PROBLEMS

The most often repeated goal for housing finance reform legislation is to "increase private capital in mortgage finance."

THE IRONY OF PRIORITIZING INCREASING PRIVATE CAPITAL

- Lack of private capital did not contribute to the housing market crisis
  - Between 2003-06, private label securities rose from 8% to 38% of the market.
  - 85% of subprime loans were financed with private label securitization.
  - Private label securities failed at a rate of 6 times those for Fannie Mae and Freddie Mac.

Source: David Min. Faulty Conclusions Based on Shoddy Foundations. Center for American Progress. Washington, DC. February 2011.

DUAL CREDIT MARKETS AS NATIONAL POLICY

- Almost all major housing finance reform proposals either strongly imply or explicitly state that if the restructured housing finance system does not meet the credit needs of people of color, those consumers should rely on the FHA.

- Stated otherwise, the restructured system need not be designed to meet the housing credit needs of people of color, who, ironically, are, and will continue to grow as the majority of net new household formations in America for the foreseeable future.

- An institutionalized dual market for home loans would codify higher-priced and riskier mortgages for lower-income families and people of color.

- And an institutionalized dual credit market would lock historically disadvantaged borrowers into lending channels that are disproportionately plagued by discriminatory, predatory, and otherwise unscrupulous originators.

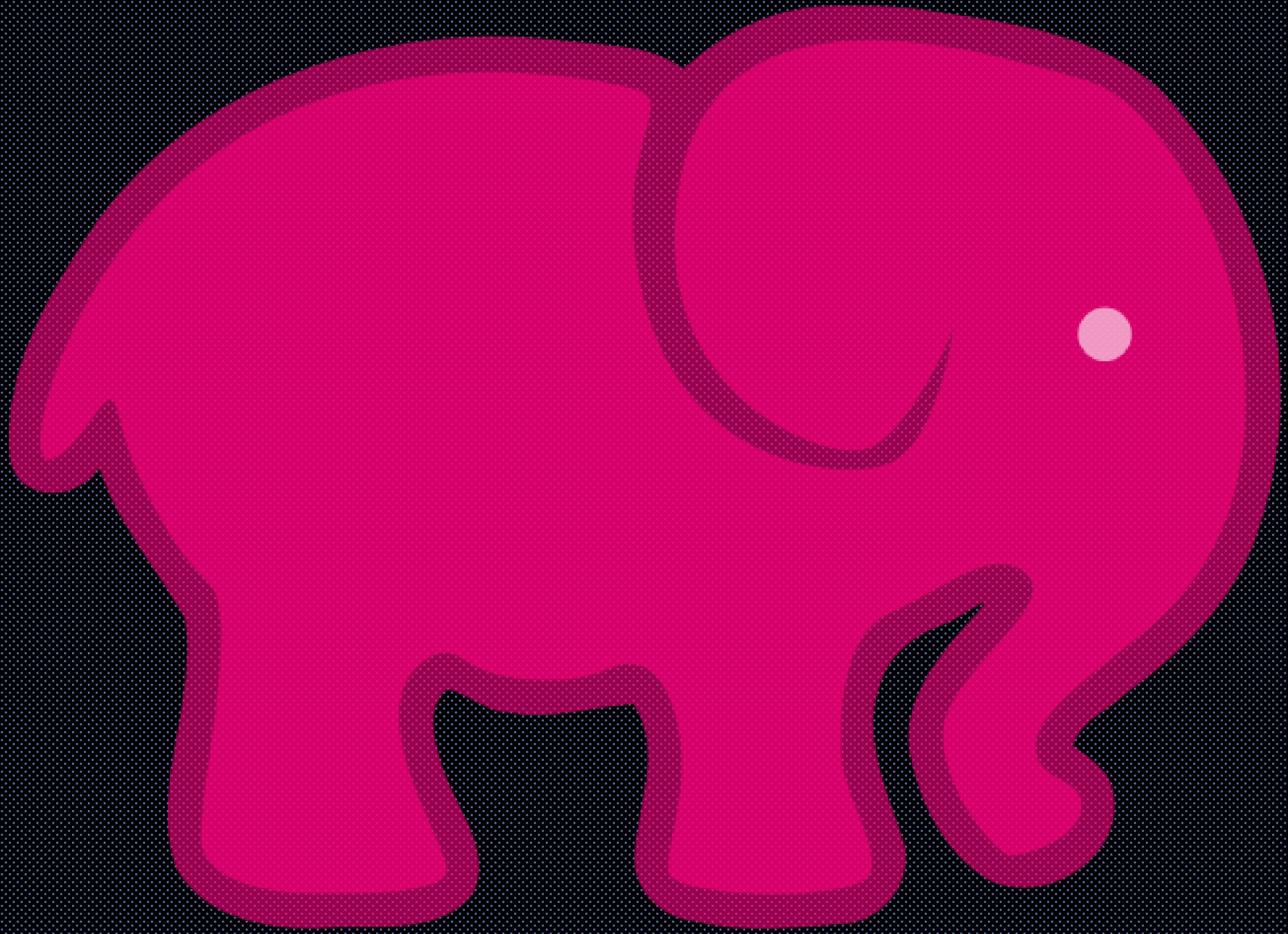
THE POST CRISIS HOUSING FINANCE SYSTEM SHOULD DO MORE THAN THE FAILED PRE-CRISIS SYSTEM

- Three additional needs of the housing finance system:

- Leverage the current climate of historically low mortgage interest rates, vast pools of foreclosed and distressed properties, and greatly lowered home prices in order to promote homeownership particularly for historically underserved borrower groups.

- Ensure an adequate supply of credit for rental housing and pioneer new products for rental as well as rent-to-own and shared appreciation ownership financing products.

- Provide capital to developers at favorable rates to finance comprehensive, mixed use, community investment efforts that include community infrastructure via a community infrastructure bank.



There is also little support within the housing finance industry for changes that could be accomplished now, to the existing system, that could greatly improve access to credit for lower-income and low-wealth households and borrowers of color.

CREDIT RISK VERSUS CREDIT SCORE

- Different *measures* of credit risk do not necessarily translate into differences in *actual* potential credit behavior.
- Measures of credit risk are only as reliable as the credit scoring models that drive them. Outdated credit scoring models, such as those currently in use by Fannie Mae, Freddie Mac and FHA can yield misleading results and produce exclusionary impacts.
- The industry should immediately adopt more sophisticated and predictive scoring technologies such as FICO 9 or VantageScore.
- According to VantageScore, the number of originations to African Americans and Latinos could be increased by as much as 30 percent through the use of more predictive credit scores.
- Use of more predictive credit measures would improve credit access and while also improving credit standards.

Additional Changes That Could Be Implemented Now

- Redefine the GSE underserved markets designation to include race/ethnicity.*
- Adjust FHA fees to reflect the fact that the agency is no longer undercapitalized; fees should be calibrated to cover only those risks posed to the Mutual Mortgage Insurance Fund by future borrowers.
- Clarify buy-back requirements at FHA so as to eliminate that issue as a justification for excessive lender overlays or banks pulling out altogether of FHA lending.
- Establish a loss reserve account within the Department of the Treasury (not recapitalization) to cover potential future losses by Fannie Mae and Freddie Mac.

*Zonta, Michela. Do the GSEs Meet the Credit Needs of Underserved Communities? Center for America Progress. Washington, DC. December 2015.

IT'S A SIMPLE MATTER OF INCOME AND ASSETS

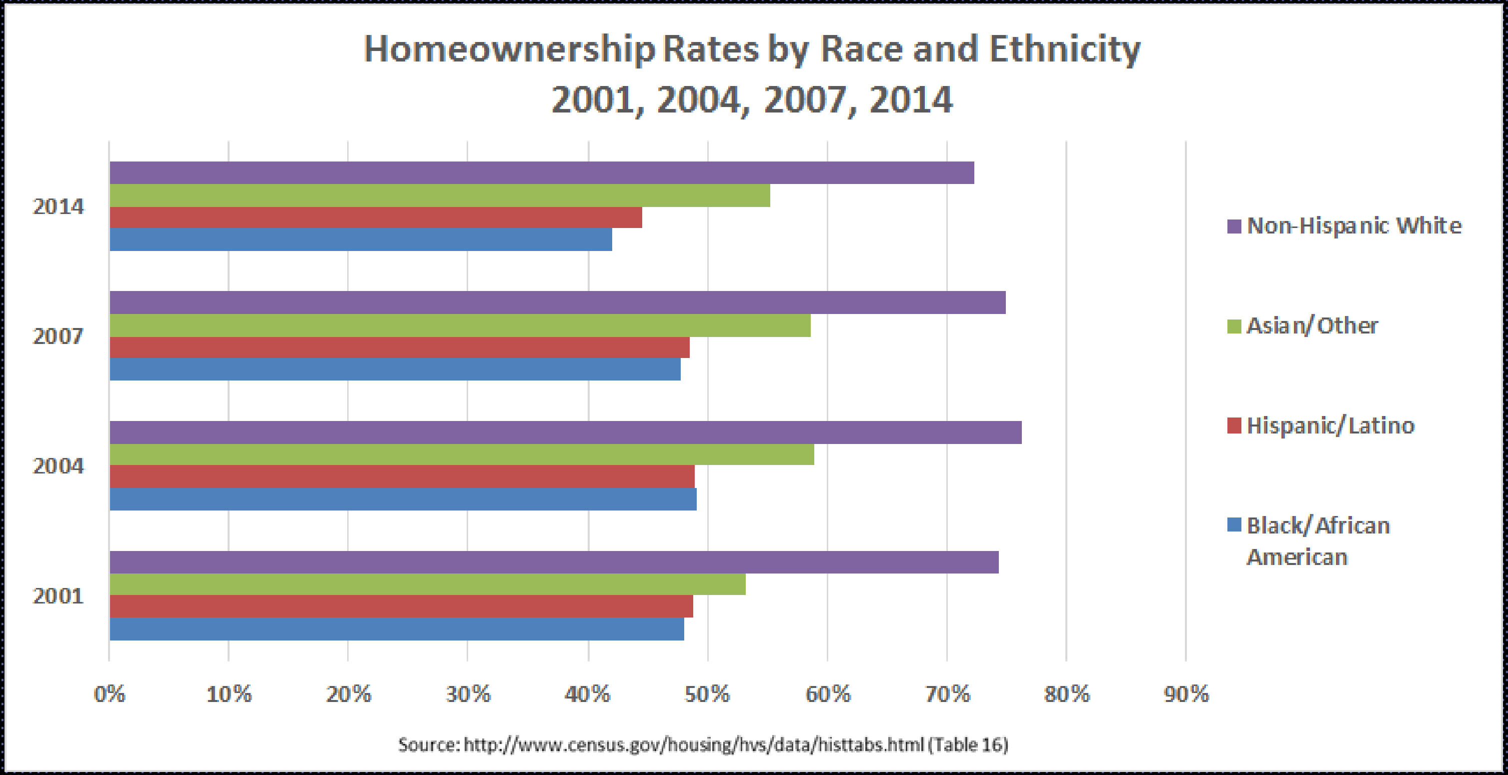
Source: FHA NewsBlog.com

LOAN ORIGINATIONS RETURN BELOW 2001 LEVELS

Year	Conventional Loans	Non-conventional Loans	All Loans
2001	12,045,860	1,589,455	13,635,315
2014	4,561,433	1,418,333	5,979,766
Total Change	(7,484,427)	(171,122)	(7,655,549)
Percent Change	(62%)	(11%)	(56%)

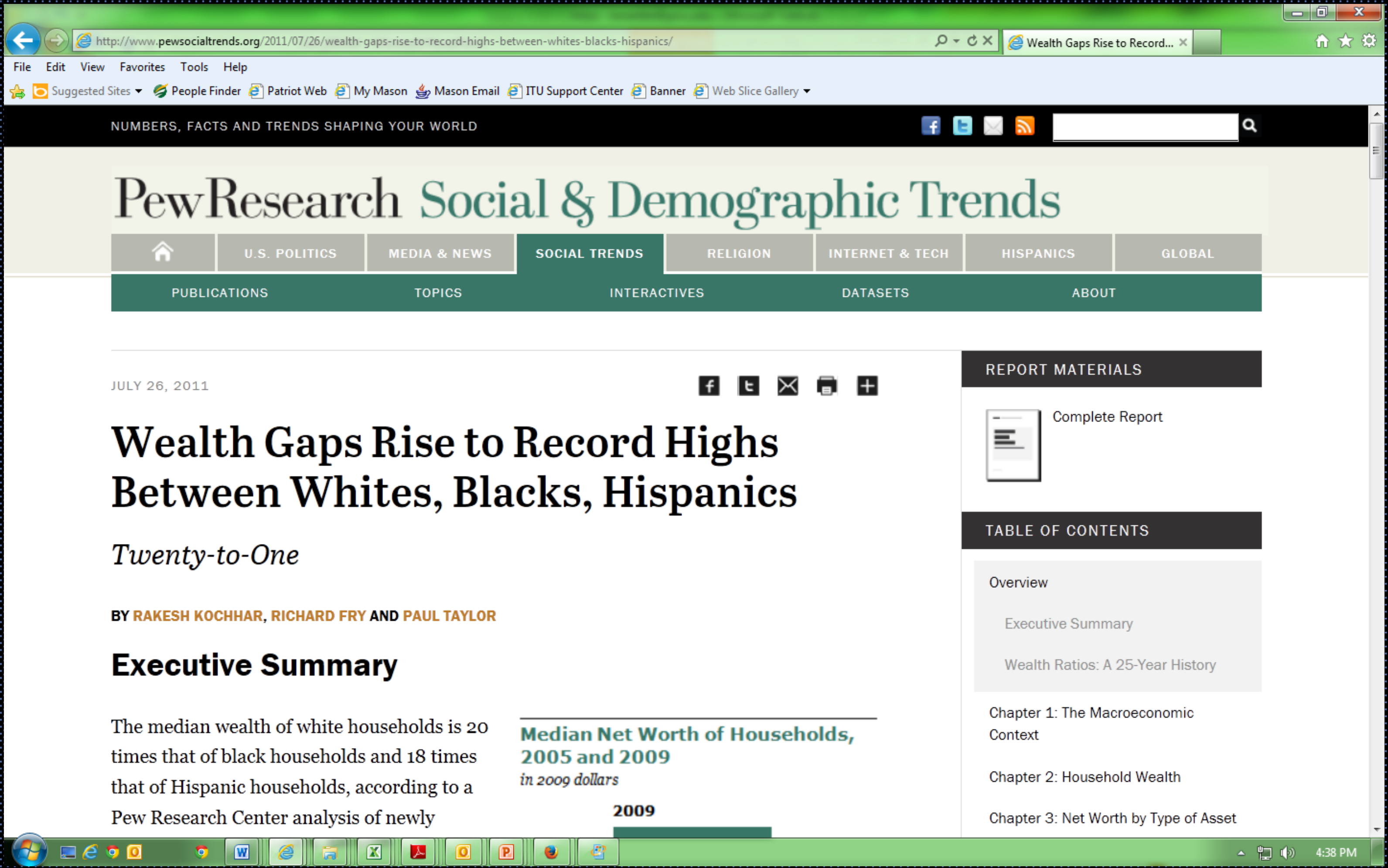
Source: Tabulations based on Urban Institute 2014 HMDA Dataset.

FALLING HOMEOWNERSHIP RATES



Source: http://www.census.gov/housing/hvs/data/histtabs.html (Table 16)

GROWING RACIAL WEALTH DISPARITIES


http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/

NUMBERS, FACTS AND TRENDS SHAPING YOUR WORLD

PewResearch Social & Demographic Trends

U.S. POLITICS | MEDIA & NEWS | SOCIAL TRENDS | RELIGION | INTERNET & TECH | HISPANICS | GLOBAL

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JULY 26, 2011

Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics

Twenty-to-One

BY RAKESH KOCHHAR, RICHARD FRY AND PAUL TAYLOR

Executive Summary

The median wealth of white households is 20 times that of black households and 18 times that of Hispanic households, according to a Pew Research Center analysis of newly

Median Net Worth of Households, 2005 and 2009

in 2009 dollars

2009

REPORT MATERIALS

Complete Report

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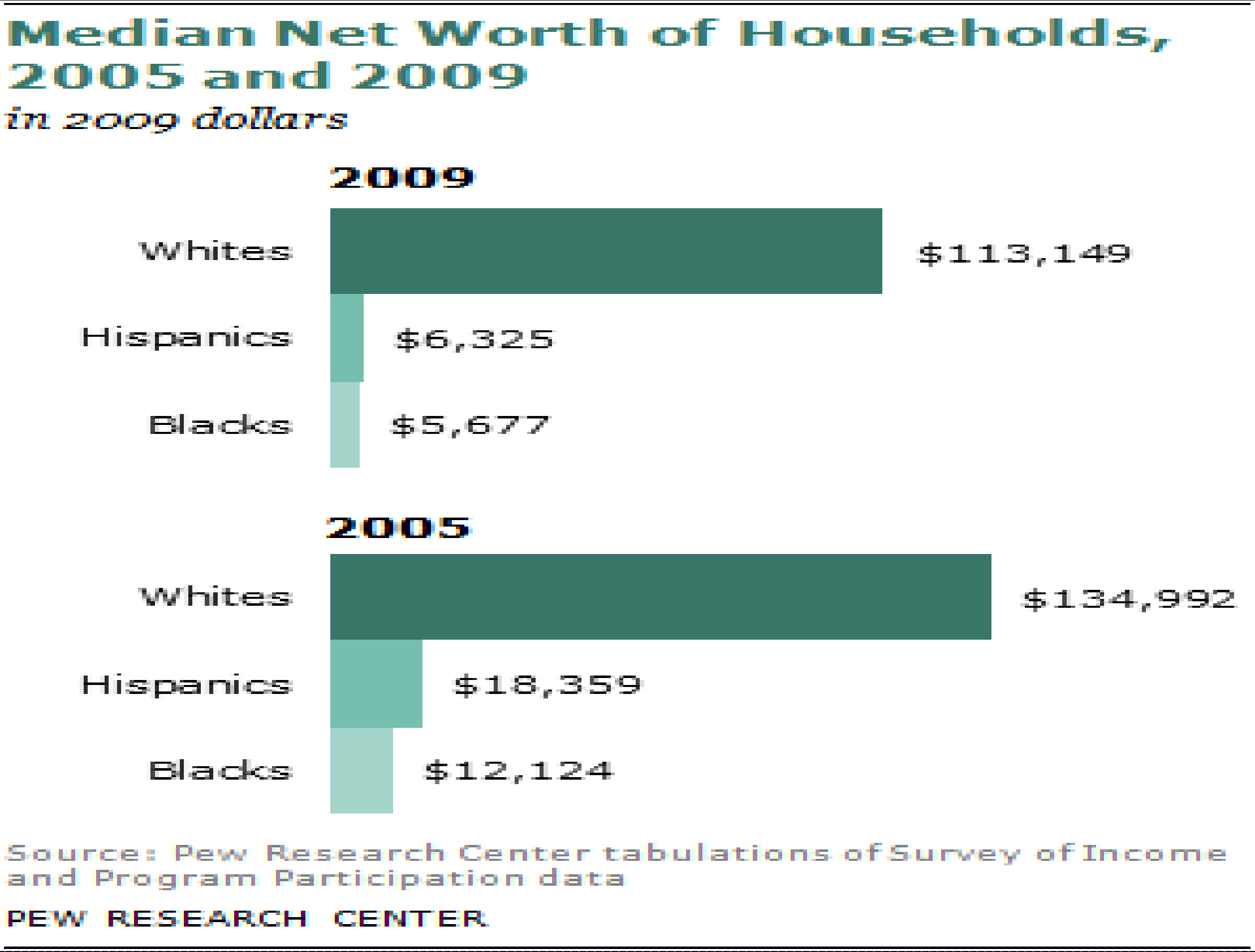
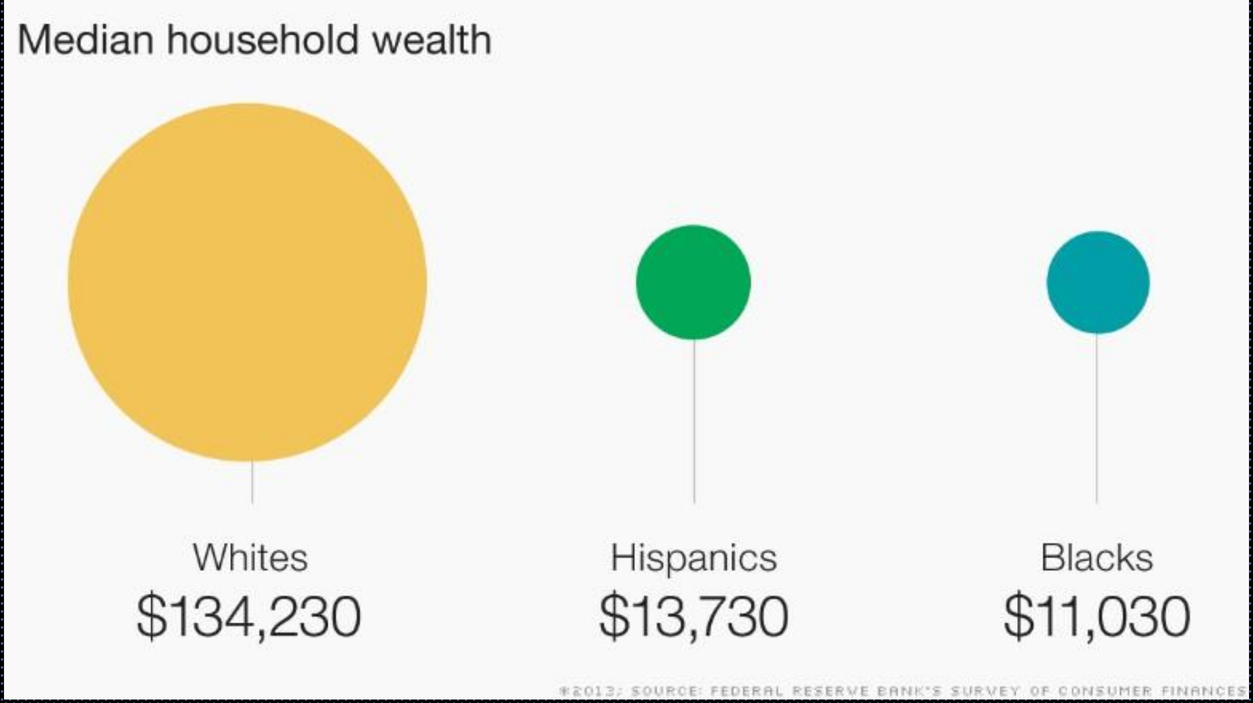
CHANGE IN NET WORTH, 2005-2009



Source: http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/

RACIAL WEALTH DISPARITIES IN 2013



Source: http://money.cnn.com/2015/11/24/news/economy/blacks-whites-inequality/

MEDIAN HOUSEHOLD INCOMES IN 2014

Source: http://money.cnn.com/2015/11/24/news/economy/blacks-whites-inequality/

HOMEOWNERSHIP: THE GREAT WEALTH EQUALIZER

Figure 4. Changes in the Racial Wealth Gap if Rates of Homeownership Were Equalized

	Wealth Gap with White Families Before Equalizing Homeownership Rates	Wealth Gap with White Families After Equalizing Homeownership Rates	Change in the Racial Wealth Gap	Percent Change in the Racial Wealth Gap
Black families	$104,033	$71,920	-$32,113	-31%
Latino families (any race)	$102,798	$73,585	-$29,213	-28%

Source: Survey of Income and Program Participation (SIPP), 2008 Panel Wave 10, 2011

Source: Taub, Amy and Catherine Ruetschlin. The Racial Wealth Gap: Why Policy Matters. Washington, DC. March 10, 2015.

Other Often Discussed Wealth-Creating Policies Not As Impactful

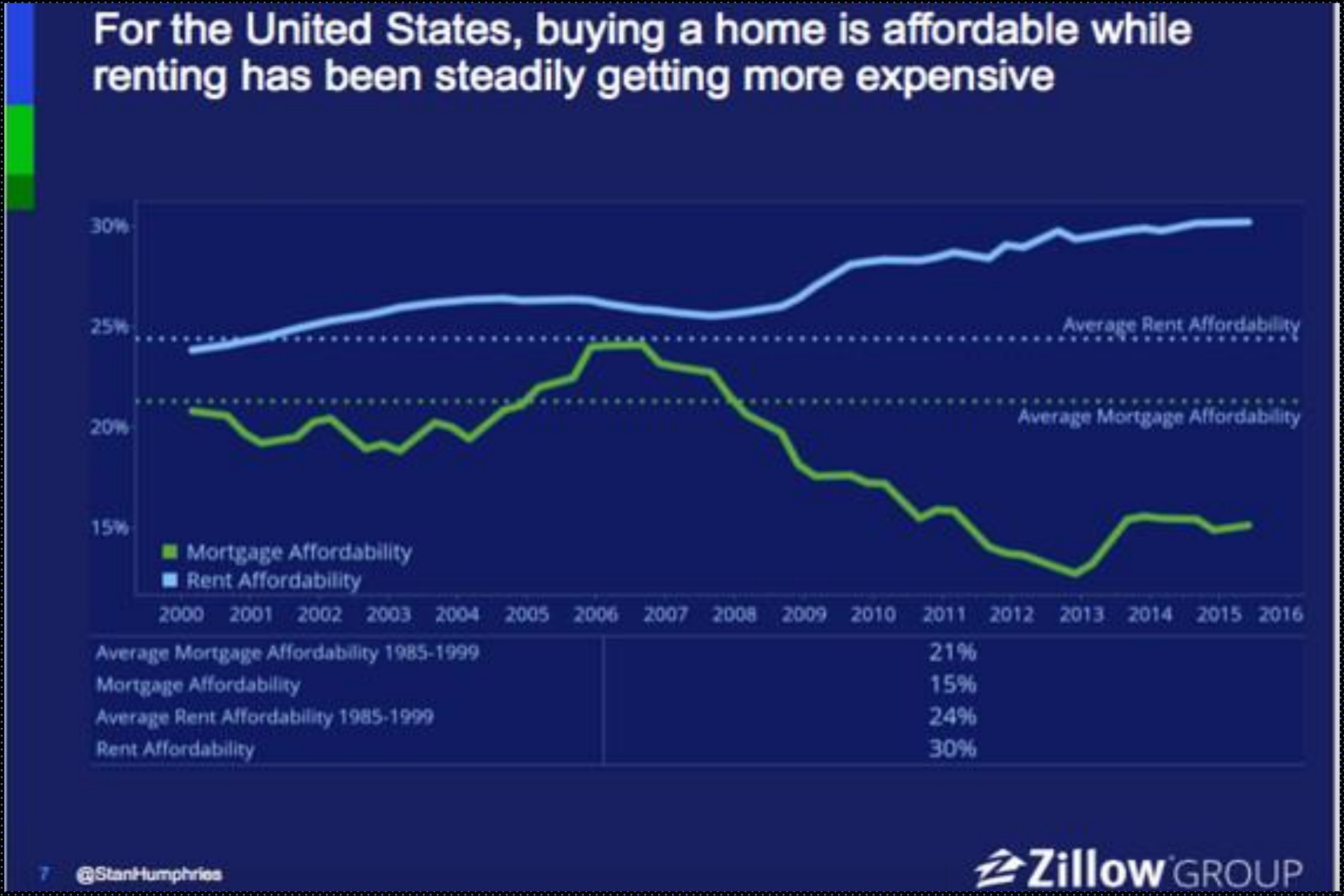
Figure 13. Changes in Racial Wealth Gap if Returns on College Graduation Were Equalized

	Wealth Gap with White Families Before Equalizing Graduation Returns	Wealth Gap with White Families After Equalizing Graduation Returns	Change in the Racial Wealth Gap	Percent Change in the Racial Wealth Gap
Black families	$104,033	$93,247	-$10,786	-10%
Latino families (any race)	$102,798	$96,920	-$5,878	-6%

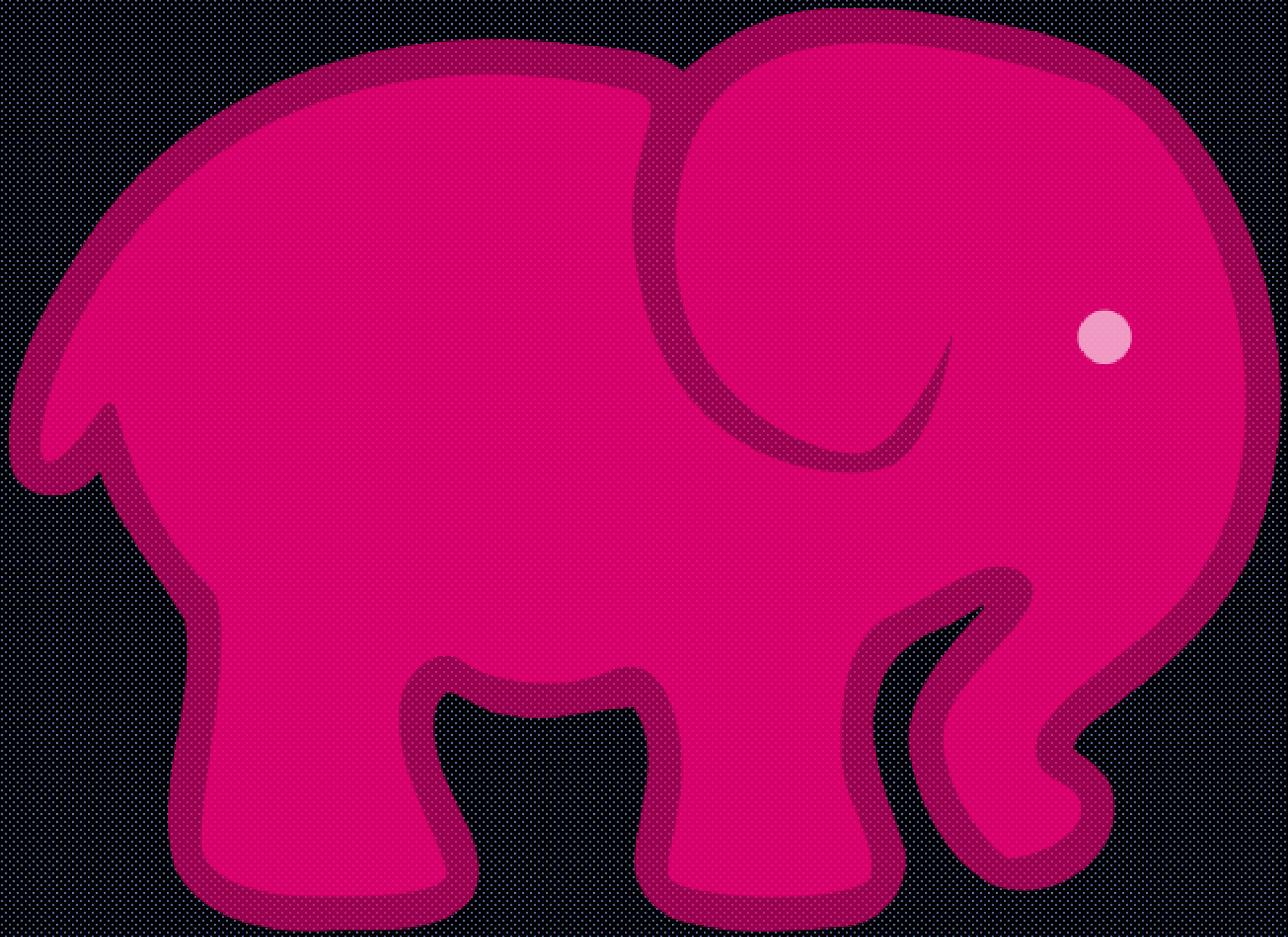
Source: Survey of Income and Program Participation (SIPP), 2008 Panel Wave 10, 2011

Source: Taub, Amy and Catherine Ruetschlin. The Racial Wealth Gap: Why Policy Matters. Washington, DC. March 10, 2015.

FAVORABLE HOMEOWNERSHIP AFFORDABILITY; INCREASINGLY UNAFFORABLE RENTAL MARKET



Source: Humphries, Stan. Zillow Group. 2015



FIXING THE HOUSING MARKET DOES NOT REQUIRE ROCKET SCIENCE

$$\int_p^\infty \exp\left(-\pi^2 \frac{k^2}{L^2}\alpha\delta\right)dk = \int_0^\infty \exp\left(-\pi^2 \frac{k^2}{L^2}\alpha\delta\right)dk - \int_0^p \exp\left(-\pi^2 \frac{k^2}{L^2}\right.$$

$$= \frac{L\sqrt{\pi}}{2\pi\sqrt{\alpha\delta}} - \frac{L\sqrt{\pi}}{2\pi\sqrt{\alpha\delta}}\operatorname{erf}\left(\frac{\pi\sqrt{\alpha\delta}p}{L}\right) \cong$$

$$\cong \frac{L\sqrt{\pi}}{2\pi\sqrt{\alpha\delta}} - \frac{L\sqrt{\pi}}{2\pi\sqrt{\alpha\delta}}\left(1 - \frac{e^{-\pi^2 p^2 \alpha\delta/L^2}}{\sqrt{\pi}\pi\sqrt{\alpha\delta}\frac{p}{L}}\left[1 - \frac{2!}{1!\left(2\pi\sqrt{\alpha\delta}\frac{p}{L}\right)^2} + \frac{4!}{2!\left(2\pi\sqrt{\alpha\delta}\frac{p}{L}\right)^4} - \right.\right.$$

$$\cong \frac{e^{-\pi^2 p^2 \alpha\delta/L^2}}{2\pi^2\frac{p}{L^2}\alpha\delta}\left[1 - \frac{2!}{1!\left(2\pi\sqrt{\alpha\delta}\frac{p}{L}\right)^2} + \frac{4!}{2!\left(2\pi\sqrt{\alpha\delta}\frac{p}{L}\right)^4} - \ldots\right]$$

$$< \frac{e^{-\pi^2 p^2 \alpha\delta/L^2}}{2\pi^2\frac{p}{L^2}\alpha\delta} < \frac{e^{-\pi^2 p^2 \alpha\delta/L^2}}{\pi^2\frac{p}{L^2}\alpha\delta}, \qquad \frac{p^2\alpha\delta}{L^2} > 0.05$$

PERHAPS KEEPING IT SIMPLE IS BEST

$$1 + 1 = 2$$

For many organizations demanding access to safe affordable mortgage credit--

Almost any change is better than the status “no”

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Source: Detroit, MI

Sources:

Slide 3: Pink Elephant- Clipart Panda
Slide 22: Equation- Unknown from web