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**FHA, Fannie Mae and Freddie Mac Reform:  
What Is Congress Thinking?**

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**UC Irvine School of Law**

**Nov. 9, 2013**



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# Debunking the Myths About Housing Finance



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**Myth #1: Before the rise of Fannie, Freddie, and Ginnie in the 1980s, we had a private mortgage market**

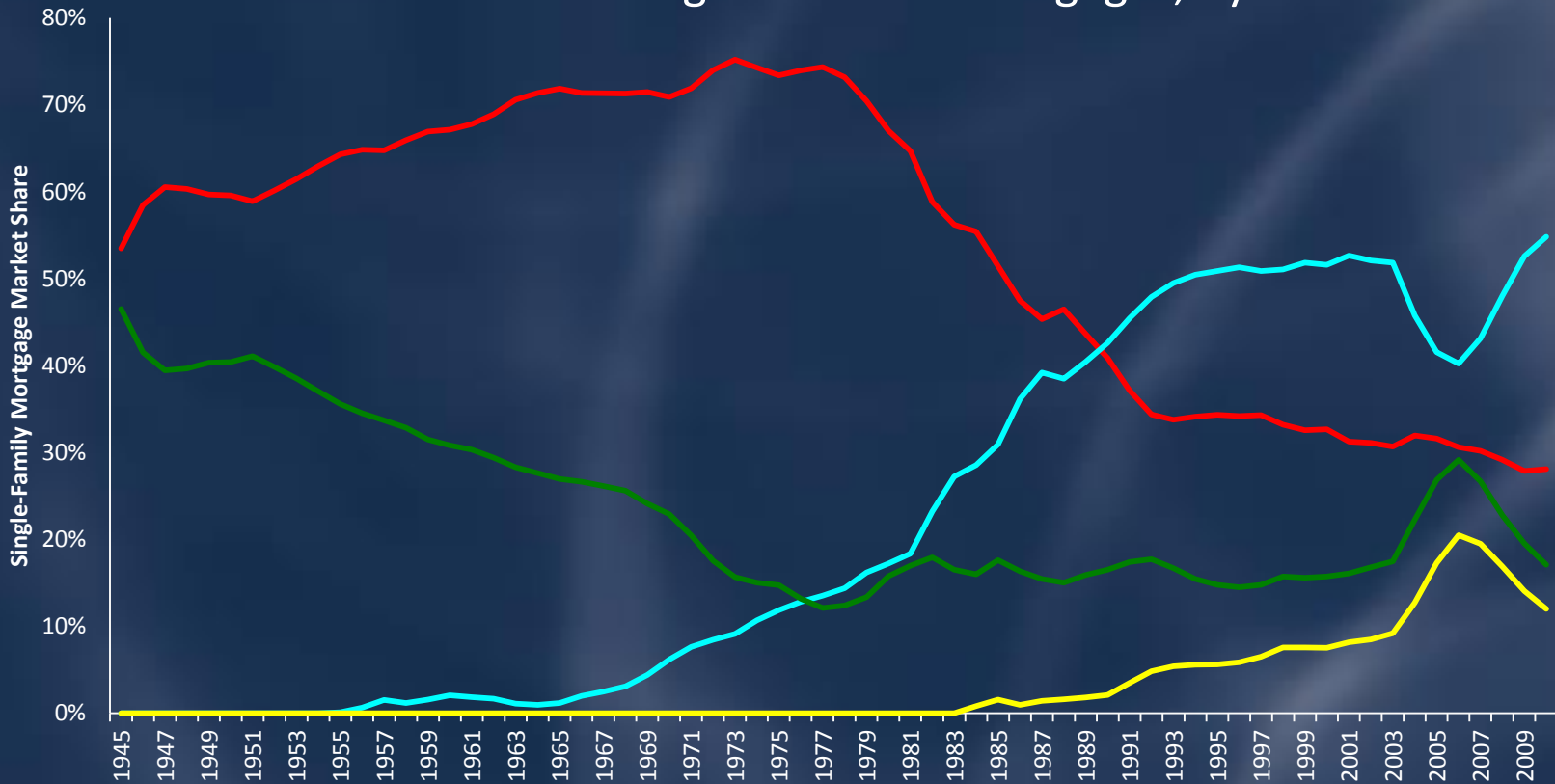


# Govt Guarantees Prevalent Since the Great Depression

## Sources of U.S. mortgage financing, historical

— Deposit-Backed — Agency — PLS — Other (including PLS)

### Share of outstanding residential mortgages, by source



Source: Federal Reserve Flow of Funds Data, Statistical Release Z.1, Table L218 (historical)



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**Myth #2: The era of private housing  
finance was a great success**



## Pre-Depression Mortgage Finance

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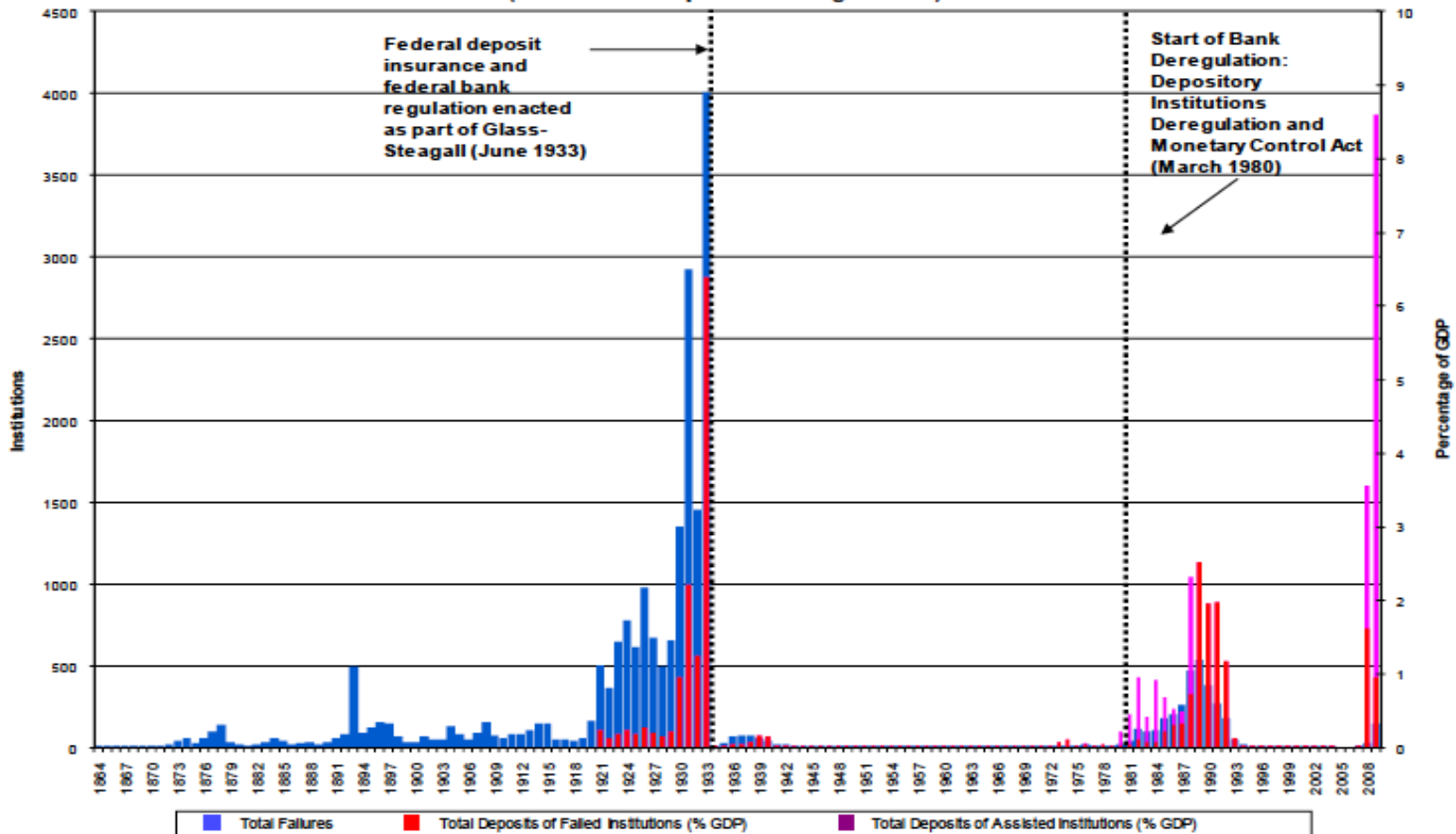
- Very limited and costly availability of mortgage credit
  - The typical mortgage was 50% down, 2-5 years in length and non-amortizing (interest-only).
  - Lender-friendly characteristics: no prepayment risk, limited interest rate risk, and large buffers against credit risk.
  - Homeownership rate around 40%, despite policies encouraging homesteading through cheap or free land grants. In DC and NY State, HO rate around 30%.
- Unstable financial system
  - Financial crises every decade or so
  - Frequently recurring bubble-bust cycles in real estate
  - Large systemic costs in terms of economic and capital markets retardation.



# Government Intervention and Financial Stability

Figure: A Unique Period of Calm Amidst the Storm<sup>6</sup>

Bank Failures and Suspensions, 1864-2009  
(with data on deposits starting in 1921)



Source: David Moss, "Reversing the Null: Regulation, Deregulation, and the Power of Ideas" (2011)



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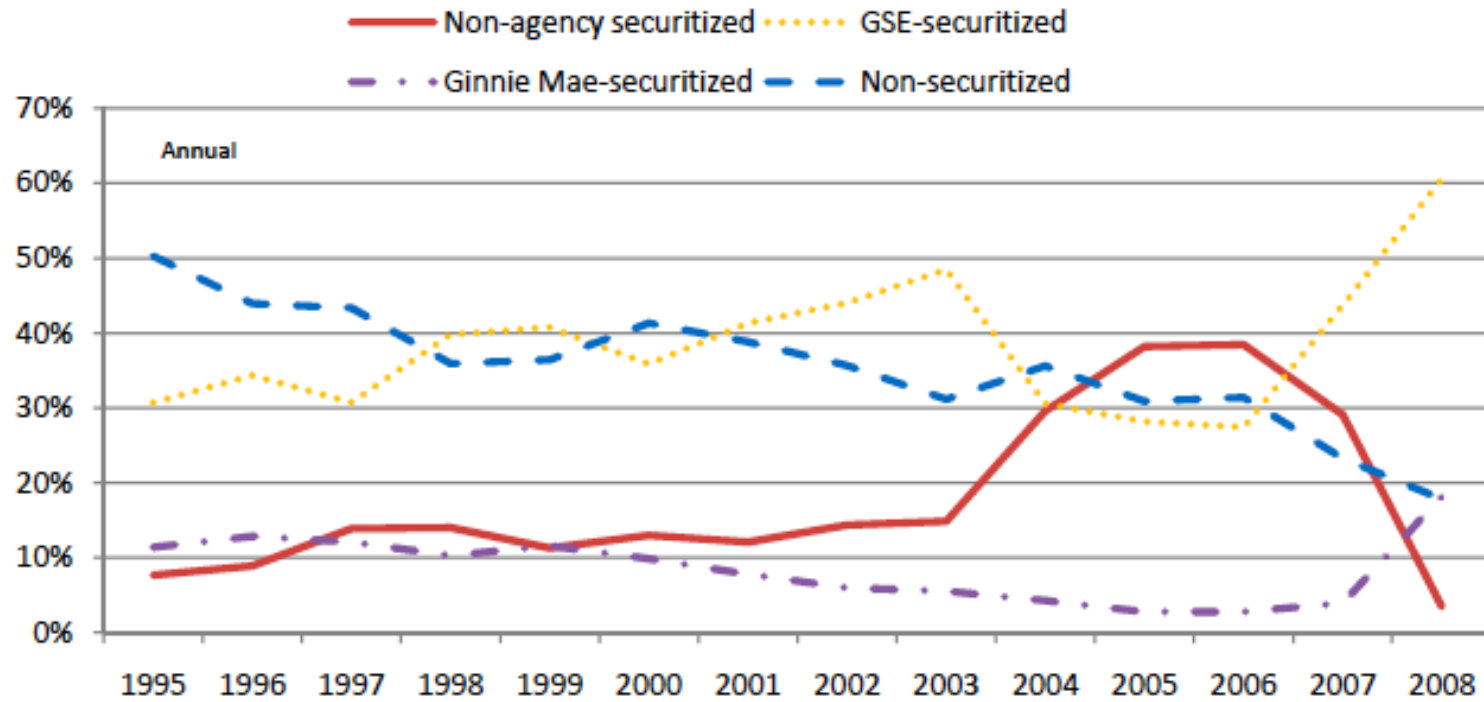
# **Myth #3: Affordable Housing Policies Led to the Financial Crisis**





# What does the market share data tell us?

**Figure 4**  
**Share of Total Residential Mortgage Originations**

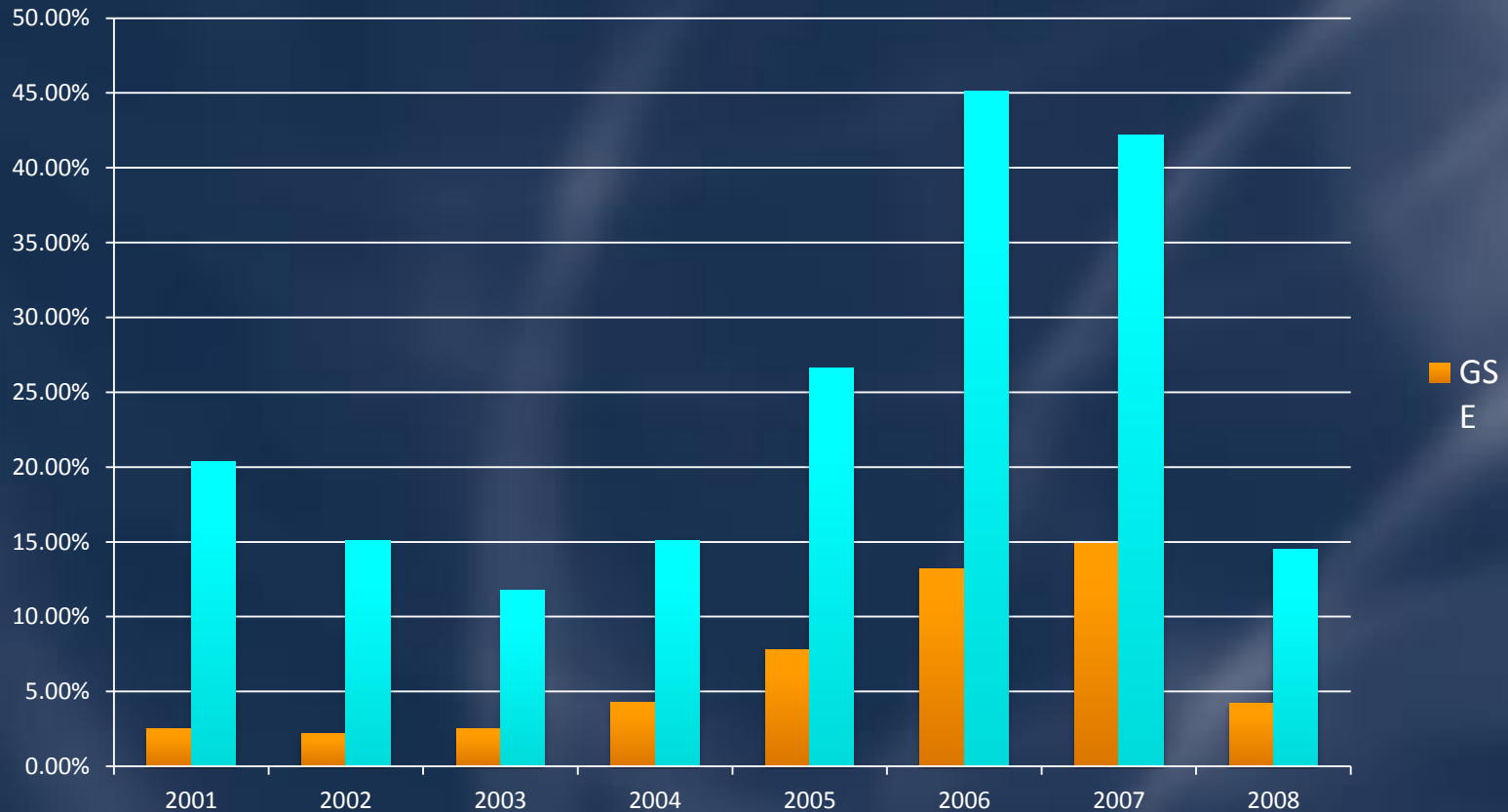


Source: Inside Mortgage Finance (2009).



## What do the delinquency rates tell us?

### 90 day delinquency rates by channel and origination year

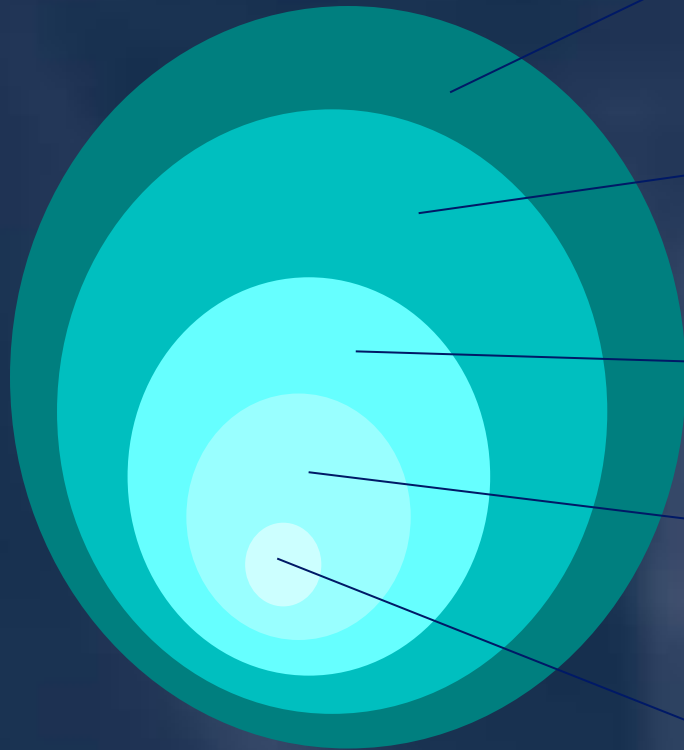


Source: Federal Housing Finance Agency (using data from Inside Mortgage Finance, Fannie Mae, Freddie Mac, and CoreLogic, Inc.)



## CRA Loans Did Not Cause the Crisis

2004-2007



All Loans (first-lien, 1-to-4 unit properties in metropolitan areas, home purchase or refinance)

66.3% Banks and Thrifts - CRA-regulated + their subsidiaries and affiliates

28.8% within CRA Assessment Areas

11% eligible for CRA credit (lower-income borrowers or neighborhoods)

1.3% *Subprime CRA-eligible (only 5.9% of high-cost loans)*

Note: Circles are drawn to scale.

Source: UNC Center for Community Capital (utilizing data from the Home Mortgage Disclosure Act)



## The Wallison Argument

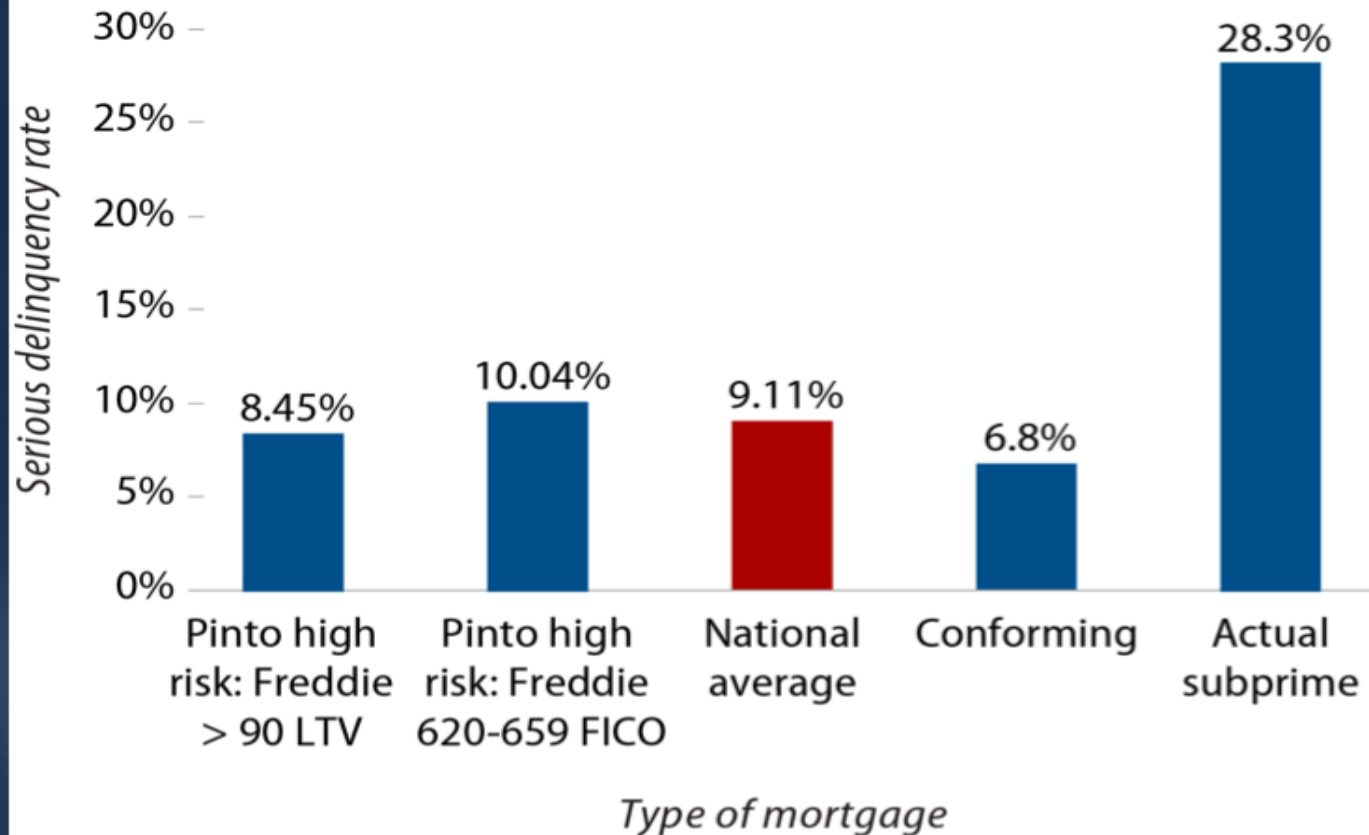
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- Wallison claims that federal affordable housing policies are responsible for 19 million (out of 27 million) subprime mortgages. This compares to GAO, which found only 4.5 million subprime mortgages, with federal government responsible for de minimis amount of these.
- Wallison claims Fannie and Freddie were directly responsible for 12 million subprime loans
- This argument is based on the work of Wallison's AEI colleague Ed Pinto, who categorizes loans with a single risk characteristic (e.g., LTV>90 or FICO<660) as subprime or high risk.



# Loan Performance of Wallison/Pinto “Subprime” Mortgages

Serious delinquency rates on Pinto high-risk loans vs. national average, conforming, and actual subprime loans, Q2 2010

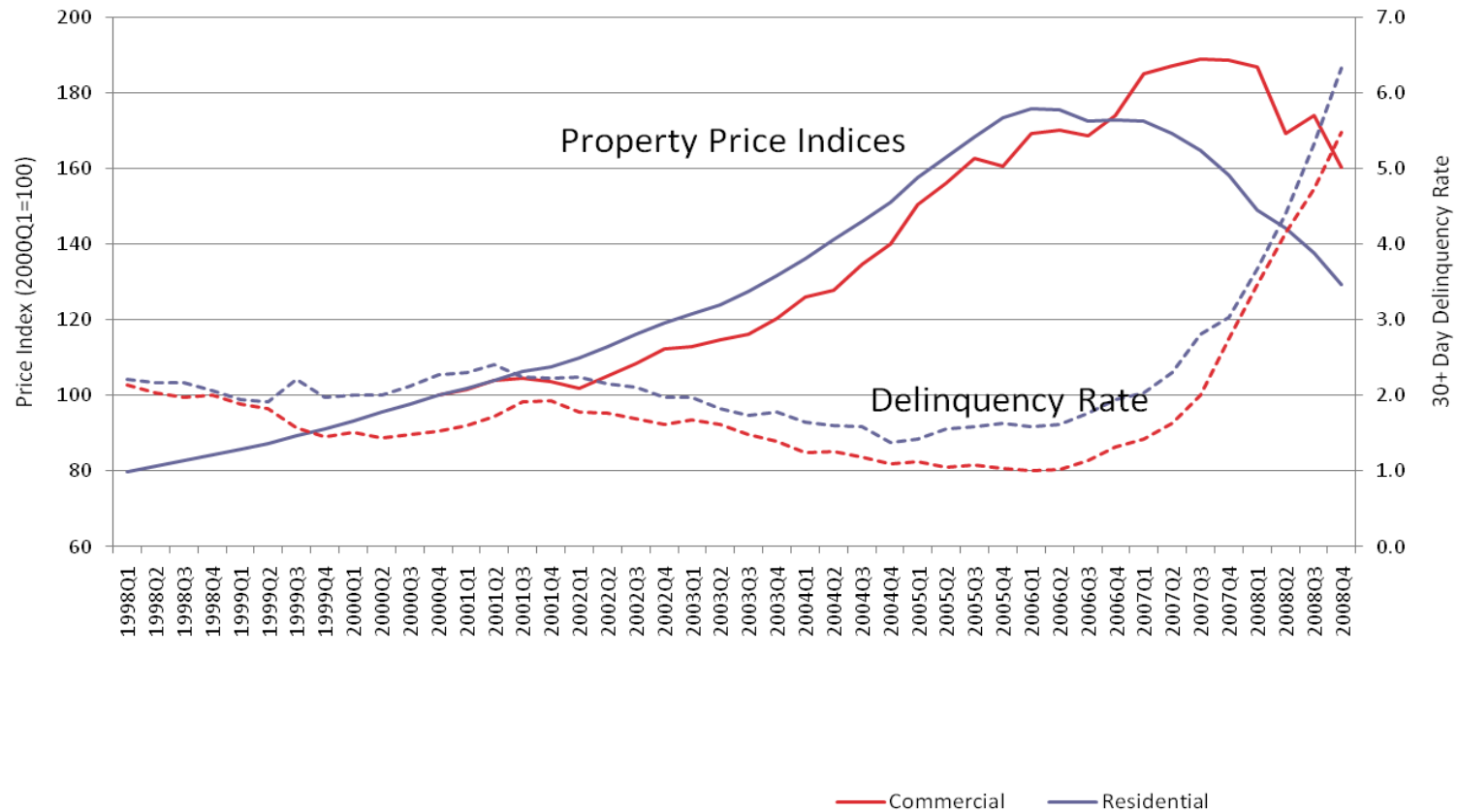


Source: Freddie Mac Q2 2010 Credit Supplement, Mortgage Bankers Association National Delinquency Survey



# Commercial real estate did not have affordable housing policies but had a more severe bubble

- We see the same bubble-bust pattern in Commercial Real Estate...



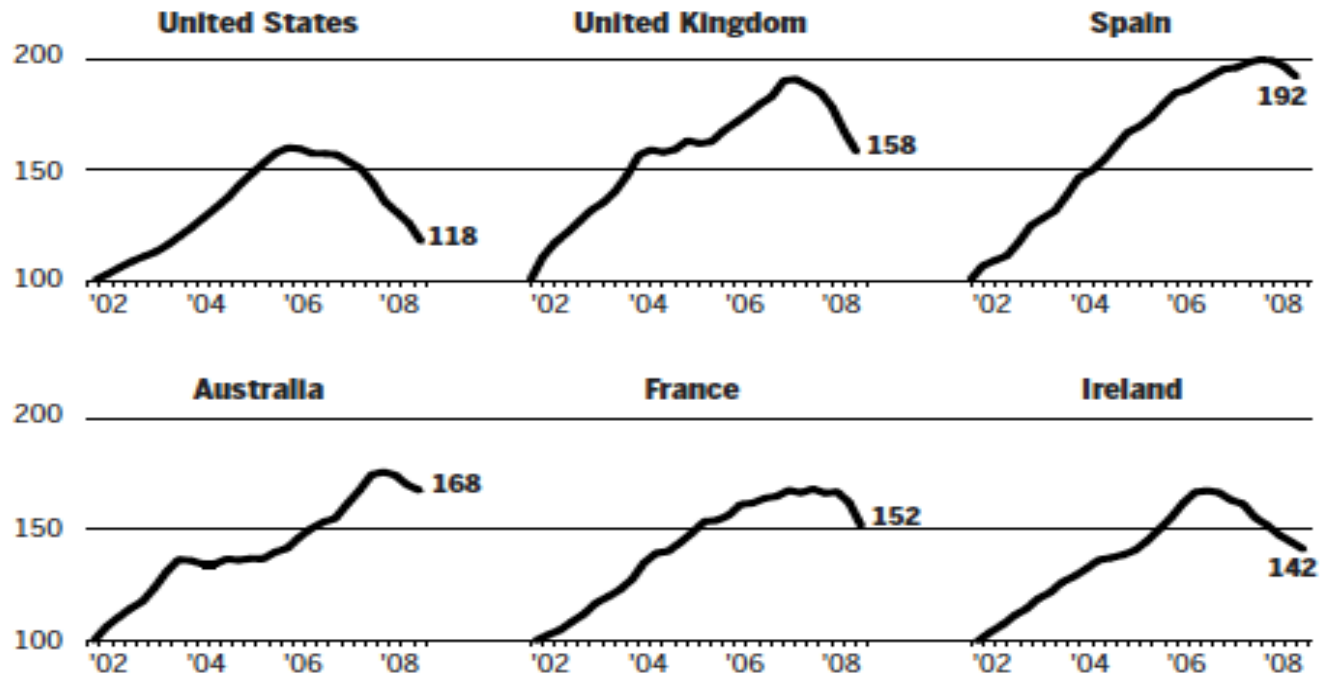


# The Global Nature of the Housing Bubble

## House Price Appreciation in Selected Countries, 2002-2008

*The United States was one of many countries to experience rapid house price growth*

2002 INDEX = 100



Source: Financial Crisis Inquiry Commission Report, Dissenting Statement of Commissioners Keith Hennessey, Douglas Holtz-Eakin, and Bill Thomas (citing Standard and Poors, Nationwide, Banco de Espana, FNAIM, and Permanent TSB).





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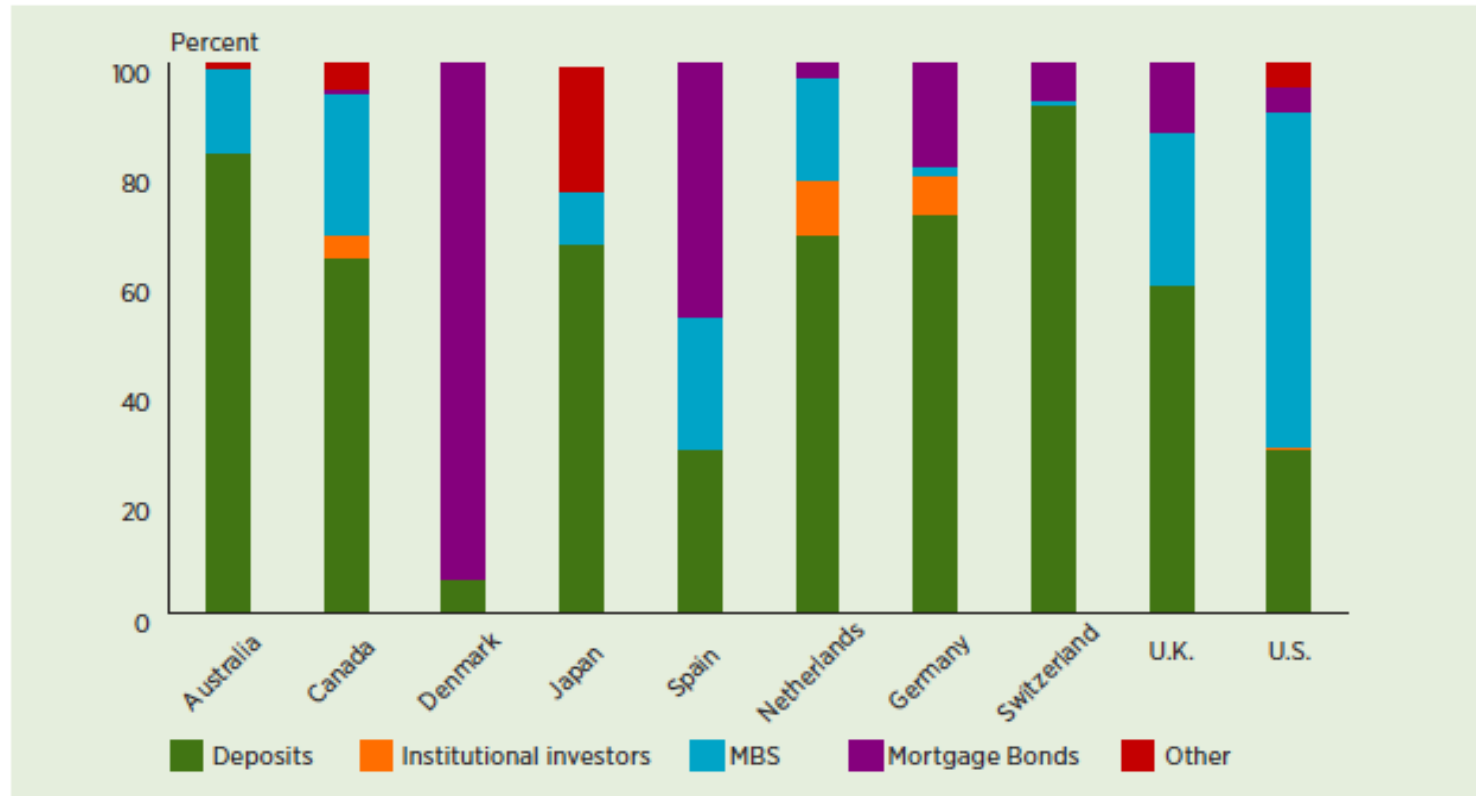
**Myth #4: The United States is  
unique in providing government  
guarantees for housing finance**





# Sources of Mortgage Funding

**Figure 11**  
**Developed Country Mortgage Funding**



Source: ABS, CMHC, EMF, ESF, FRB, Merrill Lynch Europe, AU, CA, U.S. 2008, Japan 2006.

Source: Michael Lea (2010)

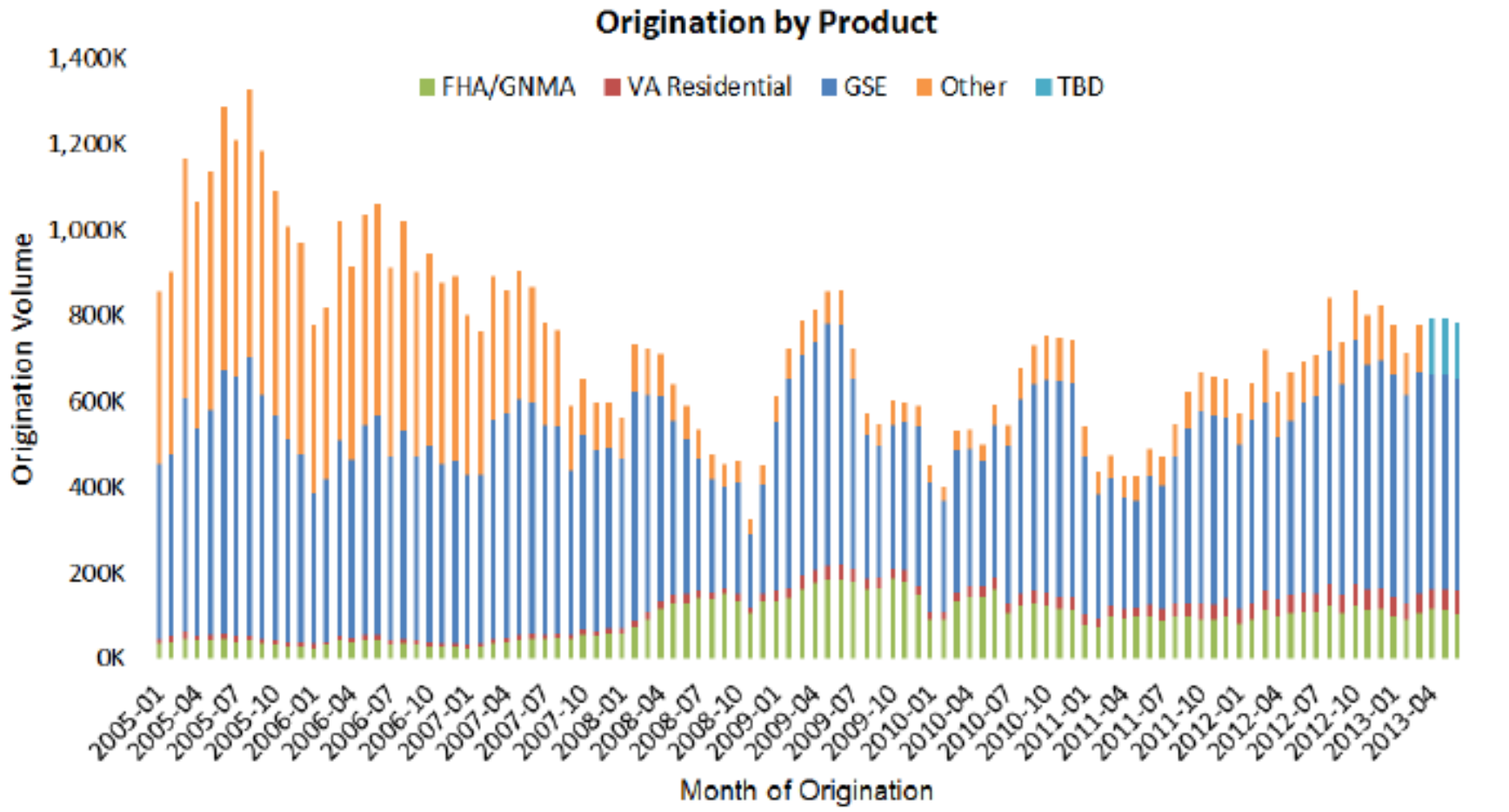


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# Where Will Future Liquidity Come From?

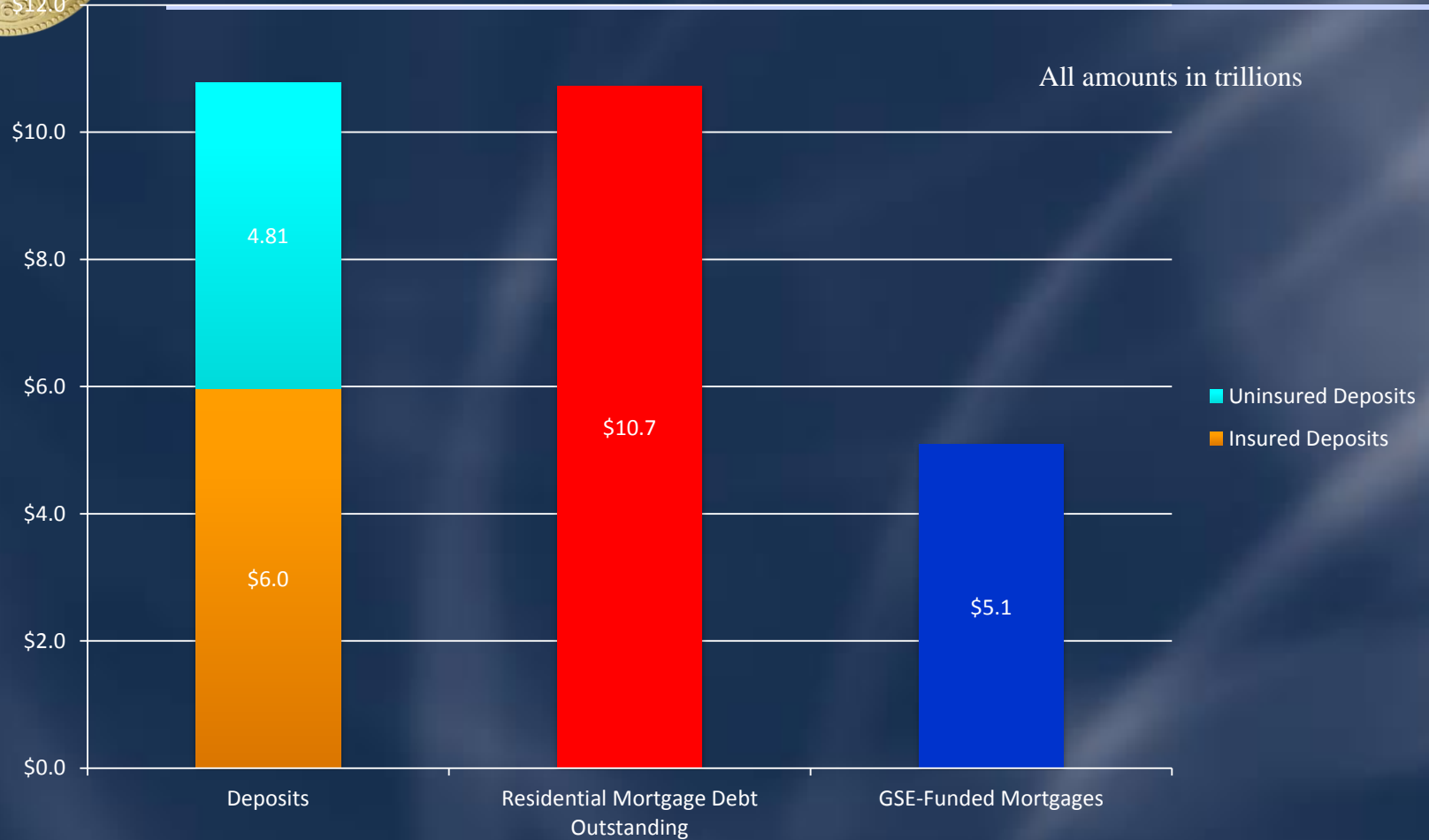


# FHA and Fannie/Freddie Liquidity





# Where Will Future Liquidity Come From?



Sources: FDIC Quarterly Banking Profile (2013Q2), Federal Reserve Statistical Release Z.1 (2013Q2), Fannie and Freddie Monthly Summary Reports (September 2013)



## Characteristics of Post-Crisis PLS

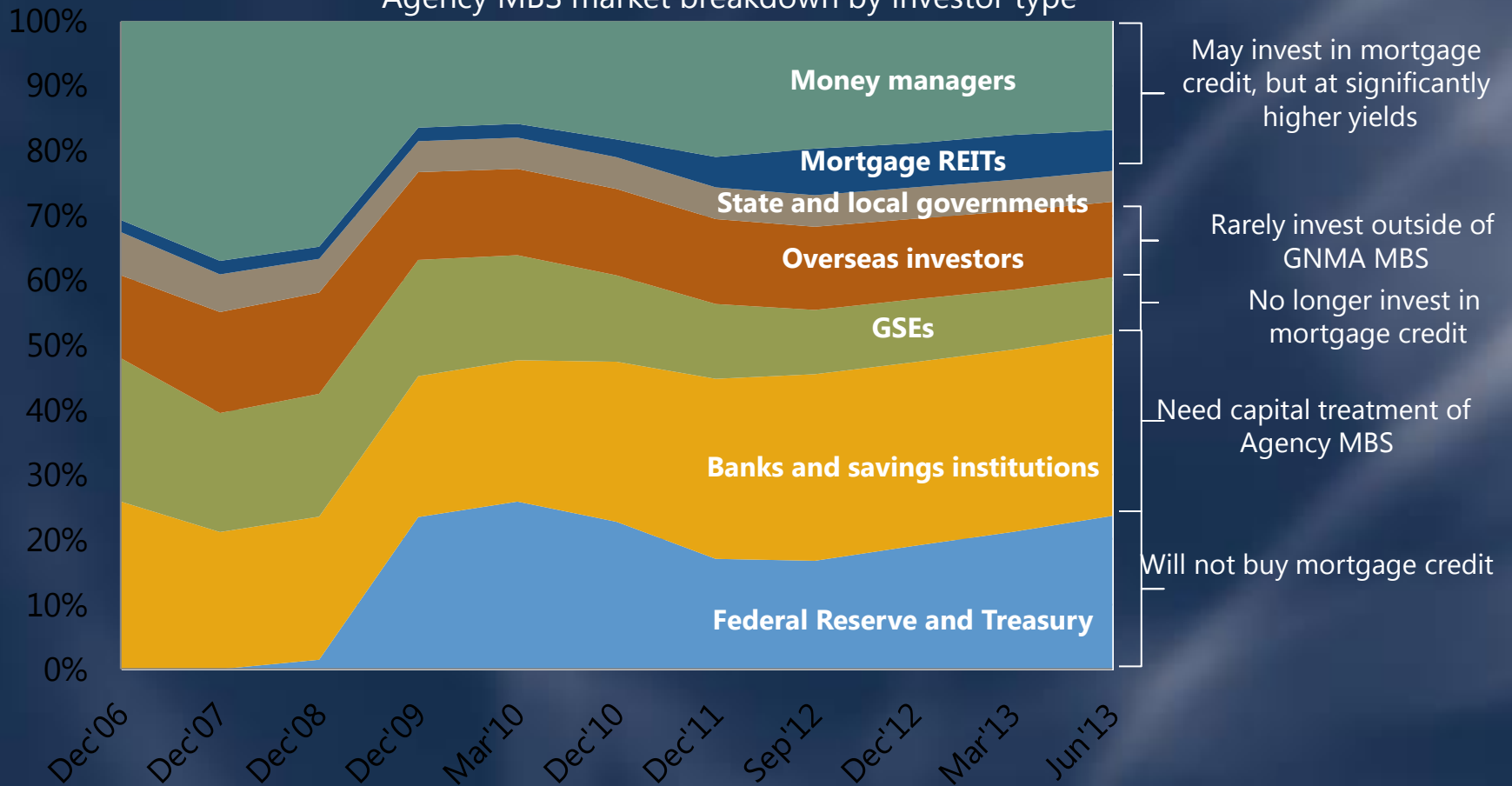
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<b>Total dollar volume</b>	<b>\$15.3 billion</b>
Total number of PLS deals	33
Total number of mortgages	16,778
Average home price	\$1.26m
Average mortgage balance	\$825,000
Average CLTV	65%
Average DTI	30%
Average FICO	723



# Where will demand for mortgage credit come from?

Agency MBS market breakdown by investor type



As of 30 June 2013  
SOURCE: Nomura Securities  
Slide taken from PIMCO

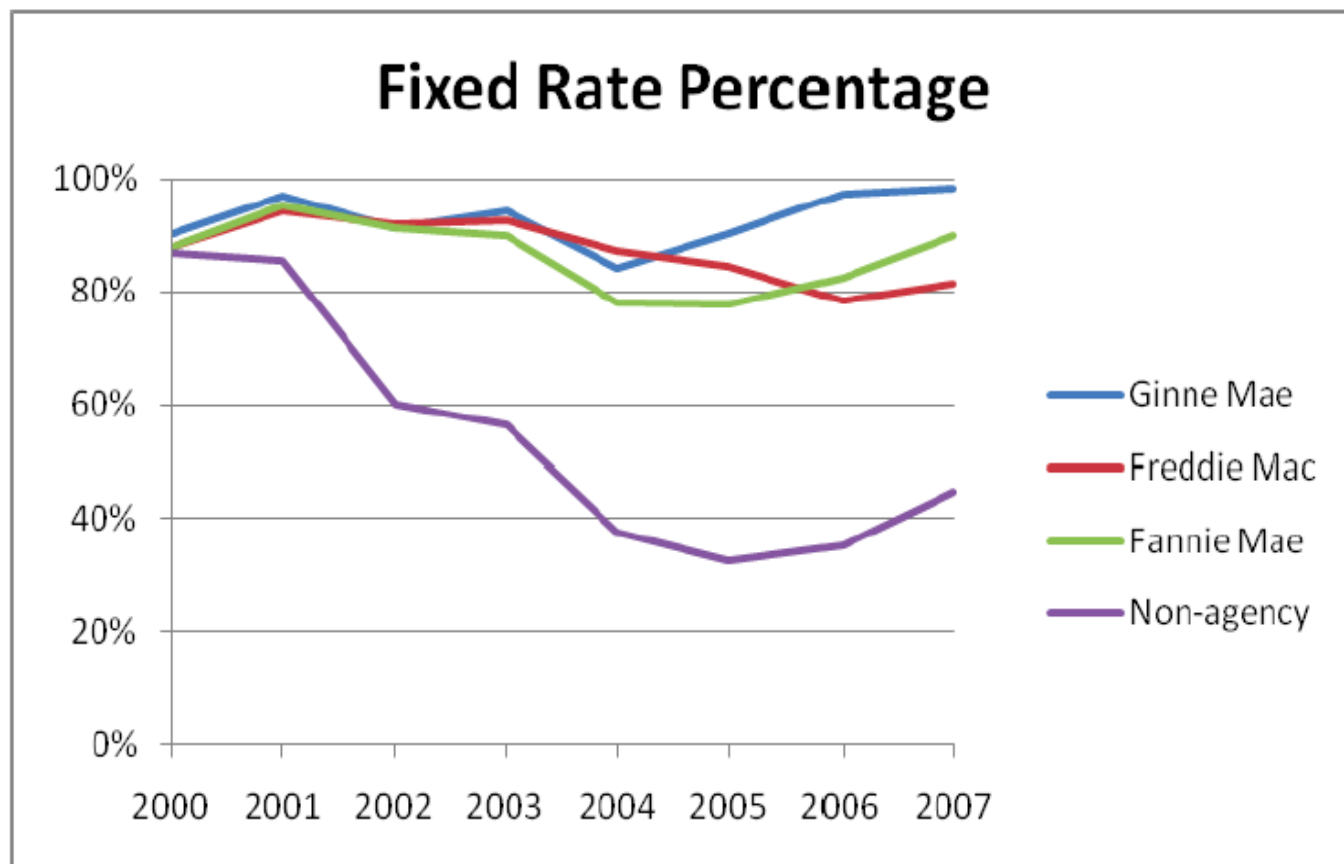


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# Whither the 30-Year Fixed-Rate Mortgage?



## FRM vs. ARM Originations







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**Where Do We Go Next?**



## The Politics of Housing Finance Reform

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- Option 1: No government backstop
  - Rep. Hensarling, Rep. Garrett, AEI
- Option 2: “Guarantee mechanism to scale up during times of crisis”
  - Scharfstein
- Option 3: “Catastrophic reinsurance behind significant private capital”
  - Sens. Corker/Warner, Reps. Campbell/Peters, Bipartisan Policy Center, CAP’s Mortgage Finance Working Group, Mortgage Bankers Association, Nat’l Ass’n of Realtors, Nat’l Ass’n of Homebuilders, Credit Suisse, FS Roundtable, Marron/Swagel, Passmore/Hancock, Mark Zandi.
- Option 4: Muddle through the status quo
  - FHFA Director Edward DeMarco and/or his replacement, Sen. Majority Leader Harry Reid (?)

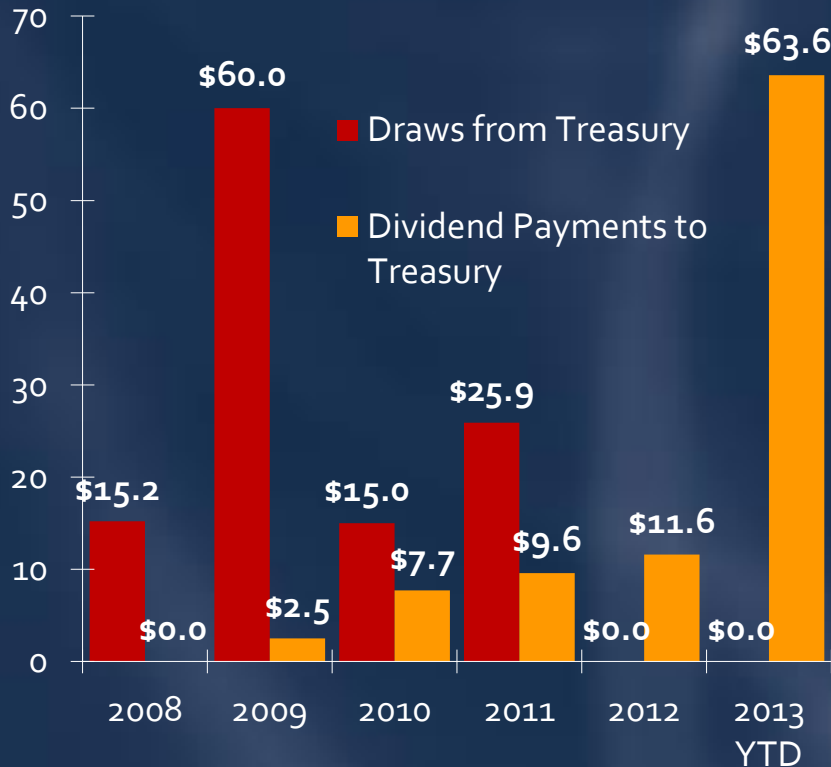


# Treasury Draws Diminished and Dividend Payments on the Rise

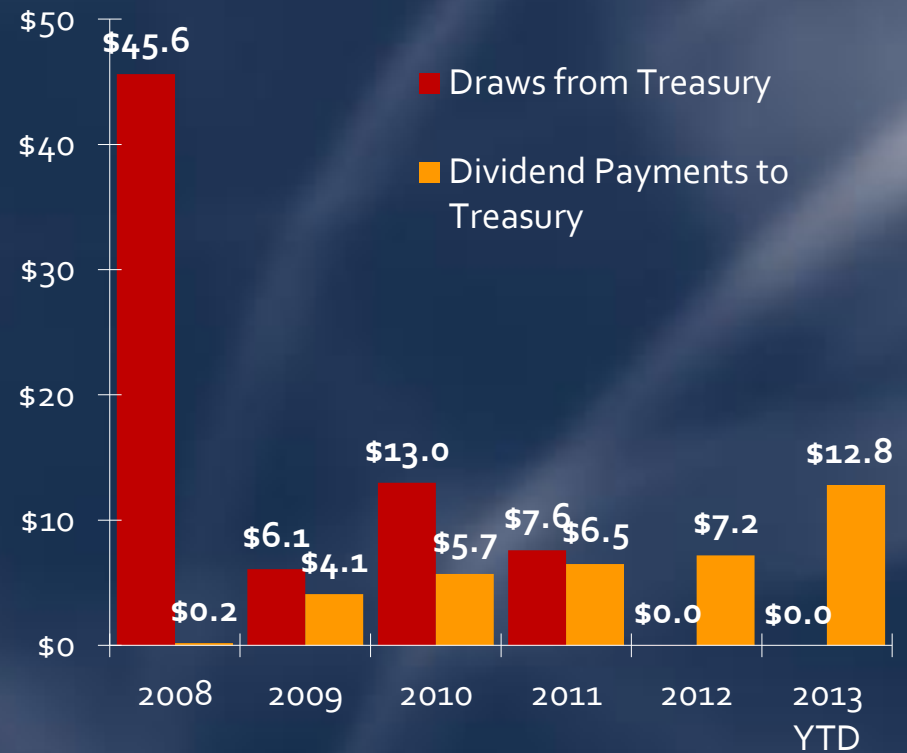
## Fannie Mae

## Freddie Mac

\$ in Billions



\$ in Billions



SOURCE: Fannie Mae and Freddie Mac (reproduced with permission from California Association of Realtors)