



# **The Mortgage Crisis: Causes, Solutions and Aftermath**

BCLBE Conference

April 13, 2012

The Foreclosure Crisis: Challenges and Solutions to the  
Mortgage Meltdown

Paul Leonard

California Director

Center for Responsible Lending



## I. Self-Help & The Center for Responsible Lending



**“Promoting policies and practices that encourage  
fair access to credit for low-wealth families”**

**Durham, NC**

**Washington, DC**

**Oakland & Sacramento, CA**

# AG Settlement: California Commitment

- \$18 Billion in CA Benefits, big 3 banks.
- \$12 billion principal reduction modifications or short sales to approximately 250,000 California homeowners
- Incentives for Hardest Hit Counties and First Year
- CA Monitor: Katie Porter

# AG Settlement: Strengths

- Servicing Reforms and Safeguards
- Meaningful Principal Reduction as Template for Moving Market
- Systematic Enforcement by Independent Monitor

# AG Settlement: Weaknesses

- Limited Relief Relative to Scope of Problems
- Lack of Individual Enforcement Mechanism
- Compromise on Servicing Reforms

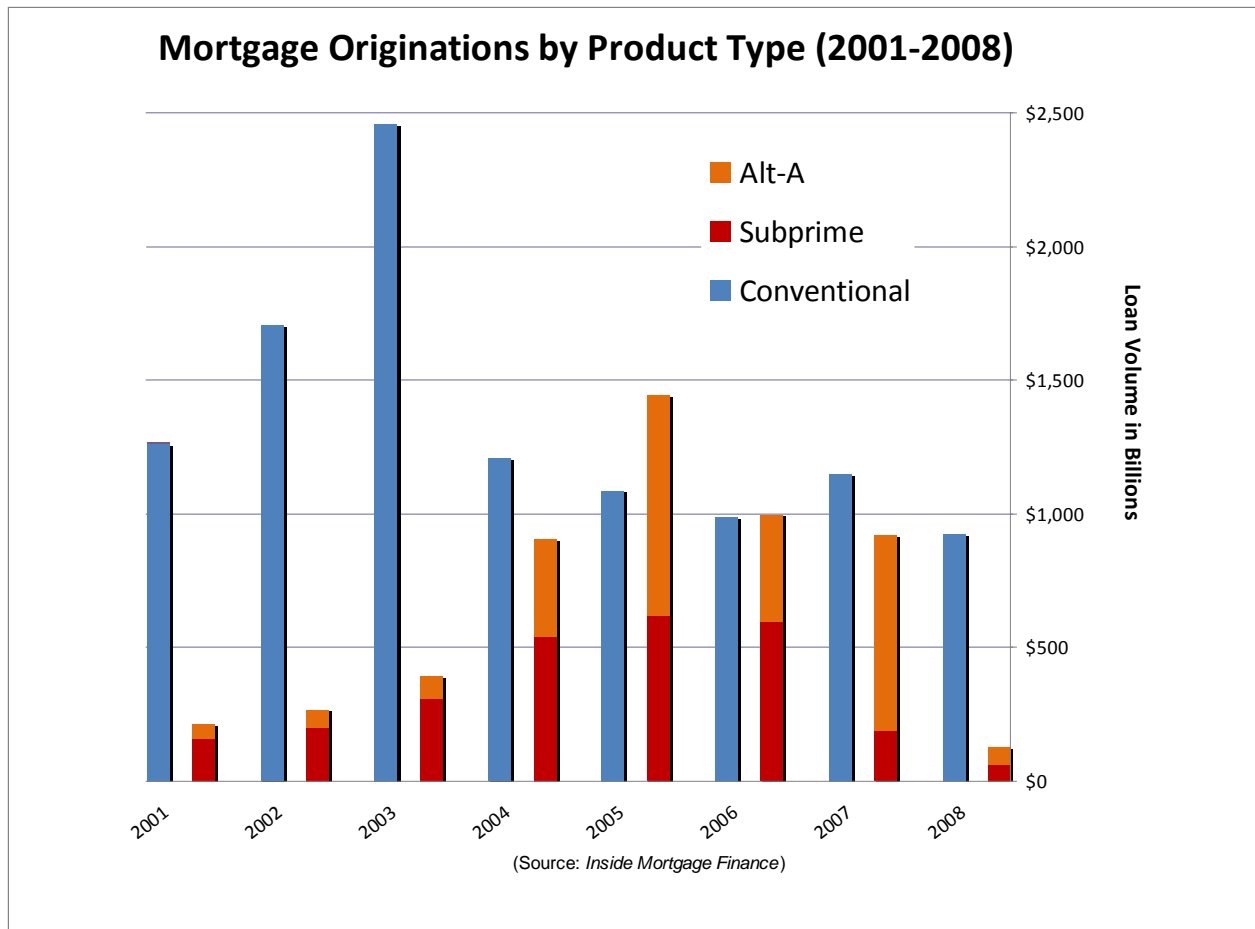
# Next Steps

- Settlement Implementation
- State Legislation
- Potential Additional Litigation
- National Servicing Standards

# Looking Back: Causes of the Crisis

- Dangerous Lending
- Wall Street Demand for Risky Loans
- Failure of Regulators
- Not Fannie/Freddie or the CRA

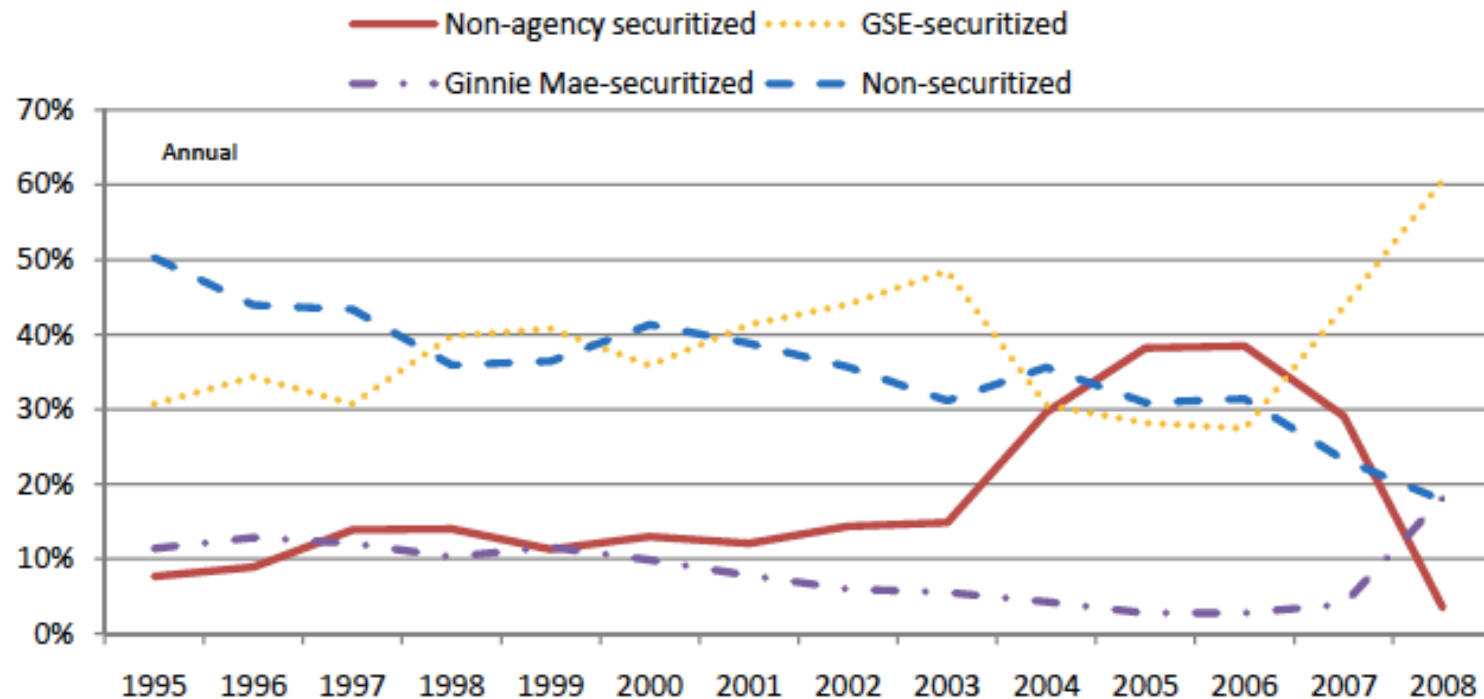
# Rise of Dangerous Lending





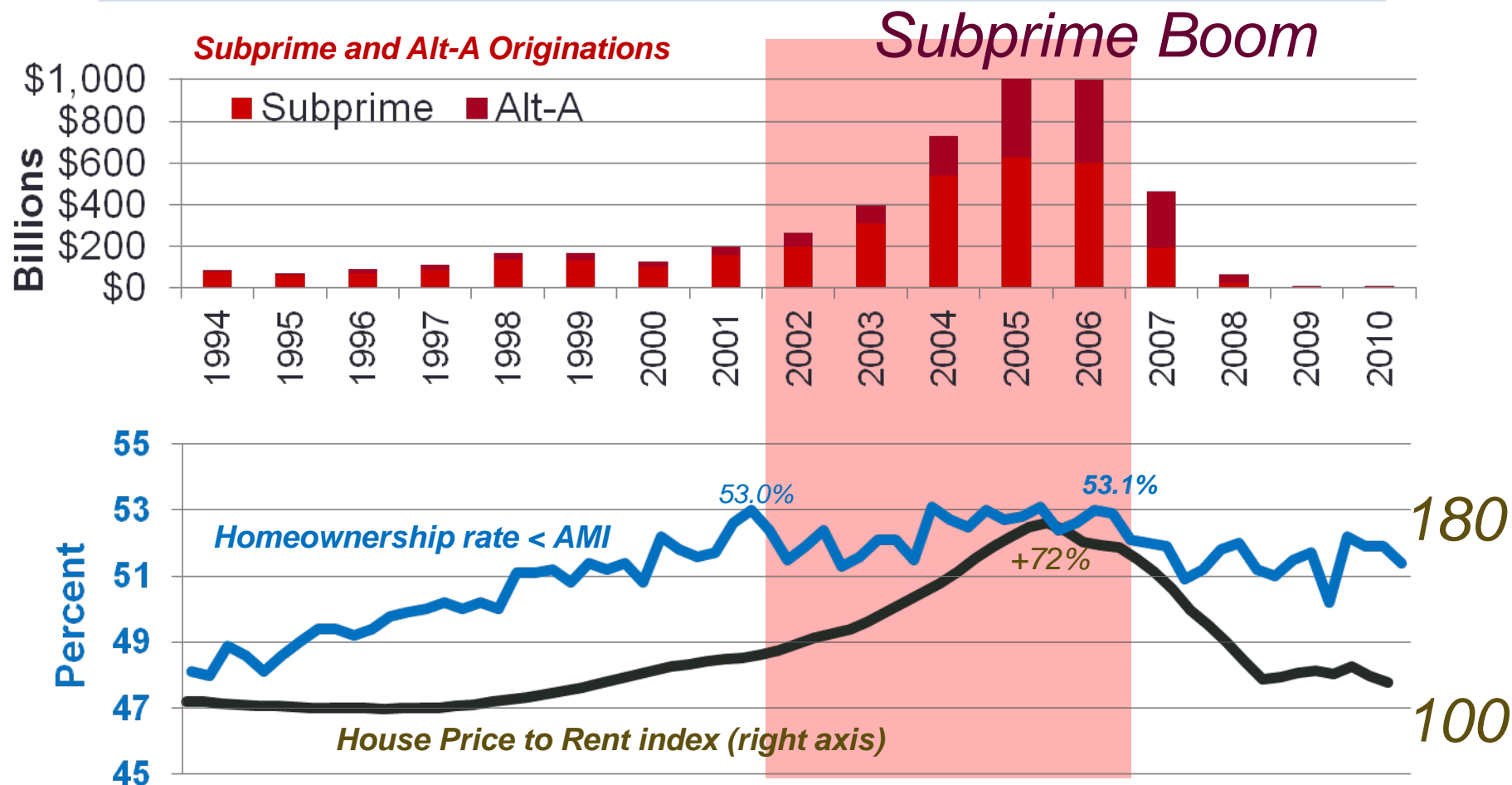
# Private-label securitization drove the housing bubble

Figure 4  
Share of Total Residential Mortgage Originations



Source: Inside Mortgage Finance (2009).

# Crisis caused by risky products, not homeownership



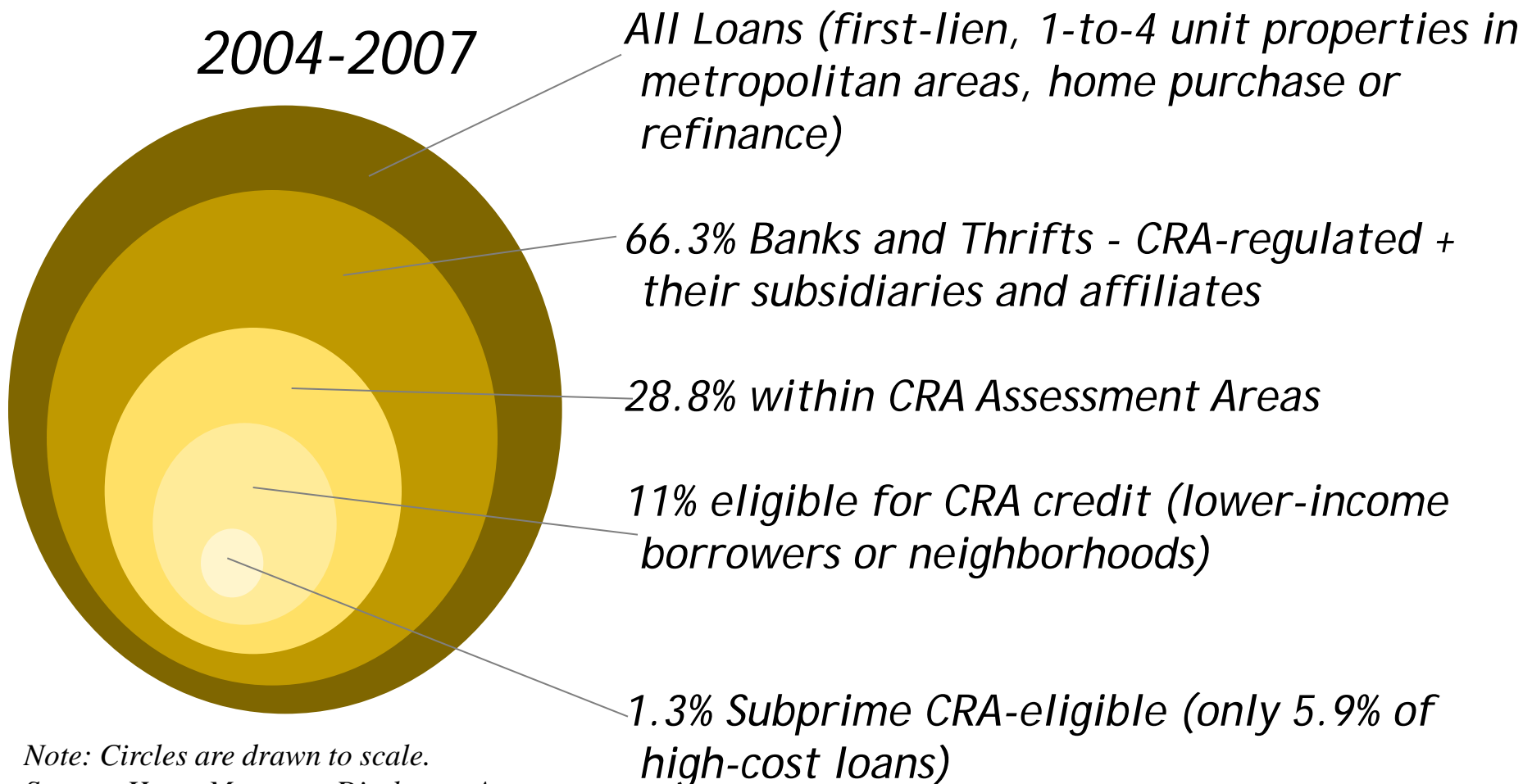
Source: Inside Mortgage Finance; US Census Bureau

# CRA Did Not Cause the Crisis

- Problem loans made by lenders not subject to CRA
- CRA loans have performed better than non-CRA loans
  - CRA loans made in California were half as likely to go into foreclosure as loans to similar borrowers made by lenders not covered by CRA (*Lederman and Reid*)
  - CRA-motivated loans in CAP program, default risk was three times lower than subprime loans made to borrowers with similar risk profiles (*Ding, Quercia, Li, Ratcliffe*)

# ***CRA Loans Did Not Cause the Crisis***

**2004-2007**



*Note: Circles are drawn to scale.*

*Source: Home Mortgage Disclosure Act*

# The Future of Housing Finance



- **Evolution of CFPB**
- Importance of Balancing Access with Responsible Lending
  - **Underwriting/Loan Terms for all mortgages (QM):** Ensure safe terms while ensuring access
  - **Down Payments (QRM):** Don't unnecessarily close off market to creditworthy borrowers
  - **Future of GSEs:** Important to maintain secondary markets that facilitate constant and stable supply of funding, while avoiding dual mortgage market.

# Contact



**Paul Leonard**

**CA Director**

**Center for Responsible Lending**

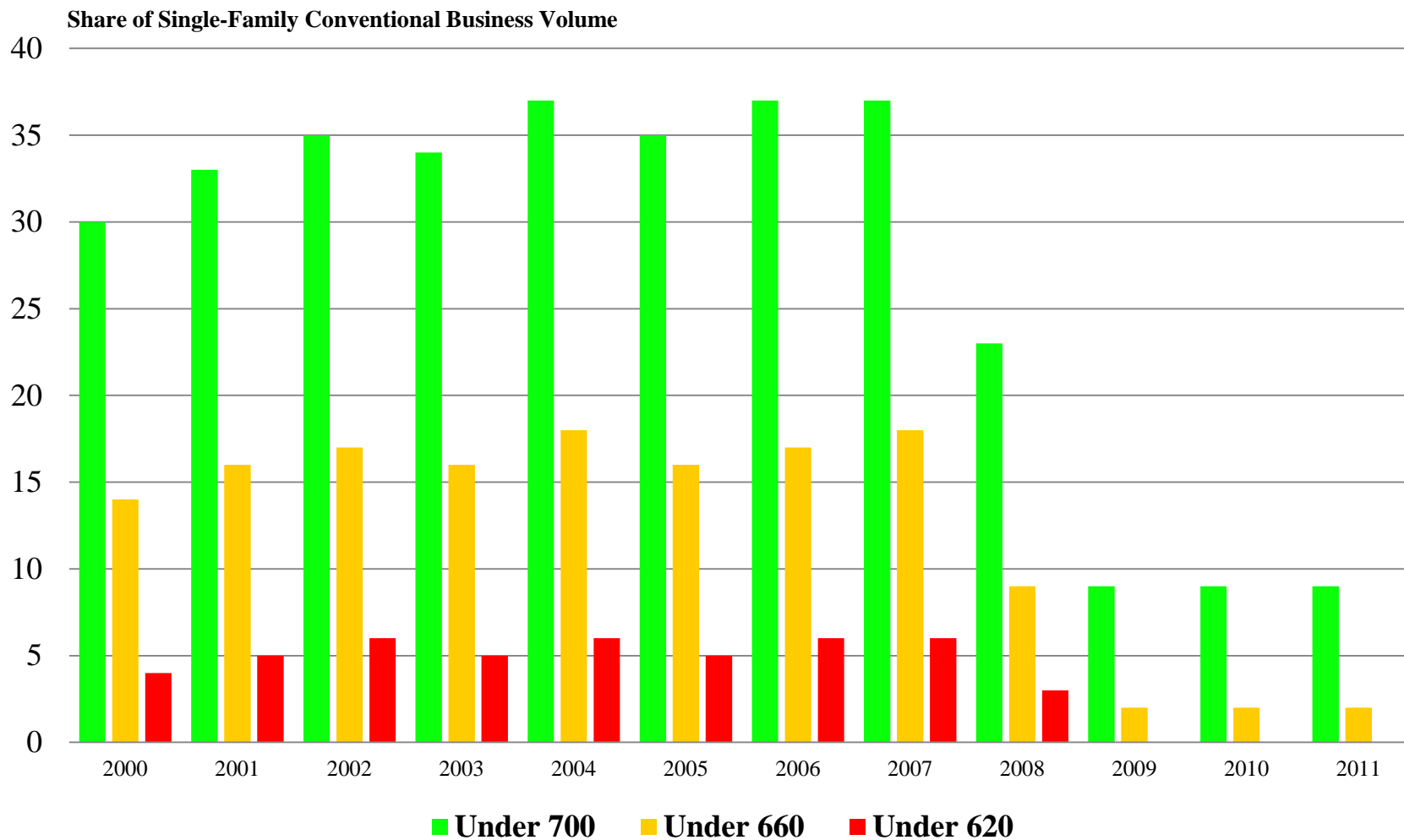
**Paul.leonard@responsiblelending.org**

**510-379-5510**

[www.responsiblelending.org](http://www.responsiblelending.org)

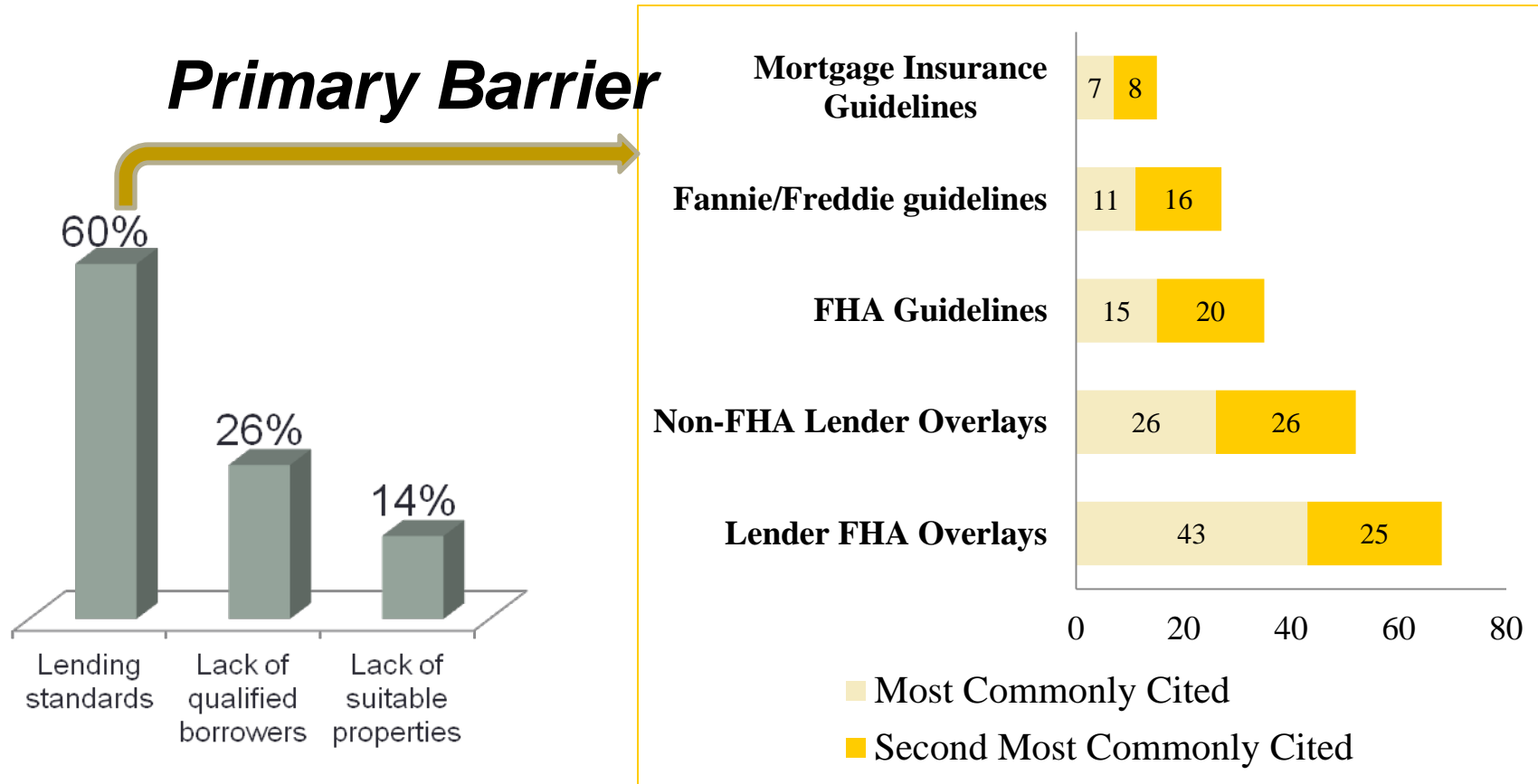


# Credit Remains Extremely Tight



# The Impact of Tight Guidelines

84% of Prepurchase Housing Counselors surveyed report it is **MUCH** harder for reasonably qualified clients to get a mortgage.





## QRM: The Wrong Answer

*7.9 Million loans, 2004-2008, Conventional Prime, FHA, Subprime, Alt-A*

	<b>Good LI Loans Prevented</b>	<b>Good MI Loans Prevented</b>	<b>Bad Loans (Defaults) Avoided vs QM (5.8%)</b>	<b>Good Loans Prevented/Default Avoided</b>
20% Down	62%	85%	-1.8% (4%)	10
FICO 690	39%	30%	-2.3% (3.5%)	7
30% DTI	80%	73%	-1.6% (3.2 %)	11
All 3	85% of all performing loans			12

Source: *Balancing Risk And Access*, Quercia, Ding and Reid. UNC Center for Community Capital, Jan. 2012

---

# Looking Ahead: The Future of Housing Finance

# Importance of Balancing Access With Responsible Lending



- **Underwriting/Loan Terms for all mortgages (QM):** Ensure safe terms while ensuring access
- **Down Payments (QRM):** Don't unnecessarily close off market to creditworthy borrowers
- **Future of GSEs:** Important to maintain secondary markets that facilitate constant and stable supply of funding, while avoiding dual mortgage market.

# Qualified Mortgages

- Will define loan terms & underwriting criteria that will be presumed to have met Dodd Frank's "ability to repay" requirement
- CFPB will issue final rules 2Q 2012
- **Key overarching issues:** Bright-line rules or general guidelines? How to provide some certainty for lenders, while allowing flexibility to ensure access to credit; How to achieve balance between access and safe loans?

# Qualified Mortgages

- **Issues Under Consideration**
  - **DTI ratio**: Where to set? Role of residual income test?
  - **Flexibility in income verification?**
  - **Rebuttable presumption vs. Safe Harbor**

# Qualified Residential Mortgages: What About Down Payments?



## Qualified Residential Mortgages

**(QRM):** Will set underwriting & other guidelines for securitized mortgages that will be exempt from risk retention requirements

- **Disputed Issue: Require Min. down payment?**
  - Locks out creditworthy families w/out much gain
    - 10% down payment excludes nine creditworthy borrowers to prevent just one foreclosure.
  - QM requirements sufficient to minimize risk

# Dangerous Loan Terms & Poor Underwriting, Not Low Down Payments, Caused Massive Defaults that Started Crisis



- Eliminating dangerous loan terms and requiring strong underwriting is the best way to minimize risk
  - CRL analysis: mortgages that meet the QM product guidelines had a foreclosure rate of 5.8% compared to the risky subprime products that had a 32% foreclosure rate.
- Dodd-Frank already eliminates the riskiest loan terms through “**qualified mortgage**” **definition**

# Reforming the GSEs and Housing Finance System



- Fannie Mae and Freddie Mac under Federal Conservatorship September, 2008
- Under current role, 90+ percent of mortgages are federally backed by Fannie, Freddie, FHA.
- BUT GSE model worked reasonably well for 40 years in providing widely available, low cost credit.



# Reforming the GSEs and Housing Finance System



- **Goals of Reform:**

- *Stability*: Ensure stability in the residential mortgage market by facilitating the constant and stable supply of funding for long term fixed-rate single family mortgage loans and for multi-family loans.
- *Coverage*: Serve all parts of the primary mortgage market equally and at all times, without unlawful discrimination, furthering fair housing objectives.

# Features of New System

- Single entity
  
- Public or Co-operative Management
  - Private stock ownership misaligns incentives
  
- Limited Government Guarantees
  - Priced to better reflect risk
  - Limited to low and middle of market
  
- Effective Regulation and Oversight
  - Set realistic capital standards

# Contact



**Paul Leonard**

**CA Director**

**Center for Responsible Lending**

**[caryn.becker@responsiblelending.org](mailto:caryn.becker@responsiblelending.org)**

**510-379-5510**

[www.responsiblelending.org](http://www.responsiblelending.org)