The Mortgage Crisis: Causes, Solutions and Aftermath

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The Foreclosure Crisis: Challenges and Solutions to the Mortgage Meltdown

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

Durham, NC      Washington, DC    Oakland & Sacramento, CA

http://www.responsiblelending.org
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

Mortgage Originations by Product Type (2001-2008)

(Source: Inside Mortgage Finance)
Private-label securitization drove the housing bubble

Figure 4
Share of Total Residential Mortgage Originations

Crisis caused by risky products, not homeownership

Subprime and Alt-A Originations

Homeownership rate < AMI

House Price to Rent index (right axis)

Source: Inside Mortgage Finance; US Census Bureau

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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

- 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: Home Mortgage Disclosure Act

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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

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Credit Remains Extremely Tight

Share of Single-Family Conventional Business Volume

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

**Primary Barrier**

- **Lending standards**: 60%
- **Lack of qualified borrowers**: 26%
- **Lack of suitable properties**: 14%

### Mortgage Insurance Guidelines

- Most Commonly Cited: 7
- Second Most Commonly Cited: 8

### Fannie/Freddie guidelines

- Most Commonly Cited: 11
- Second Most Commonly Cited: 16

### FHA Guidelines

- Most Commonly Cited: 15
- Second Most Commonly Cited: 20

### Non-FHA Lender Overlays

- Most Commonly Cited: 26
- Second Most Commonly Cited: 26

### Lender FHA Overlays

- Most Commonly Cited: 43
- Second Most Commonly Cited: 25

Source: Abundance of Caution: Report Forthcoming from Enterprise Community Partners and UNC CCC

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QRM: The Wrong Answer

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

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