Moving Forward on Housing Finance Reform:
A Policy Brief from the Center for NYC Neighborhoods
December 2013

Executive Summary

The purpose of this policy statement is to delineate the Center for NYC Neighborhood's positions regarding reforms to the housing finance market. The perspectives presented here reflect our experience coordinating services with federal, state, city and private partners, working directly with homeowners across the city, and analyzing opinions from leading researchers and policy makers engaged in these issues. Because our work centers on homeownership of 1-4 unit properties, this memo does not address the goals for, or effects of, reform in regards to financing for multifamily rental properties.

The Center works in coordination with a network of neighborhood-based partners to promote and protect affordable and sustainable homeownership in neighborhoods across New York City. The Center is committed to identifying housing reform solutions that ensure stability in, and access to, the housing market for all New Yorkers.

From the Center's experience in New York City's unique housing landscape, the role of homeownership in wealth building for low- and moderate-income families, and in creating stable and vibrant neighborhoods, is clear. The most accessible path to homeownership is the 30-year, fixed rate mortgage, which establishes a monthly payment that fits most easily into household budgets and remains stable and predictable over the life of the loan. The Center is dedicated to ensuring that the opportunity to own a home is affordable and accessible to as many of our neighbors as possible.

Background: How Did We Get Here

Government involvement in housing finance, most specifically through Fannie Mae and Freddie Mac, collectively referred to as government-sponsored enterprises (GSEs), was not a primary cause of the collapse of the housing market in 2008. The structure of Fannie Mae and Freddie Mac, however, pairs two competing interests: on the one hand, a responsibility to shareholders for increasing profits and, on the other hand, a government charter to work for higher homeownership rates. This conflicted mission, combined with the implicit government guarantee, was untenable and propelled the GSEs into a race to the bottom, leading to their insolvency and to the present federal conservatorship.

This is an opportune time to explore the issues of housing finance reform because both the Senate and the House are currently reviewing proposed legislation. Since the financial crisis and collapse of the housing market in 2008, the federal government has played an outsize role in housing finance, most explicitly through the conservatorship of Fannie Mae and Freddie Mac. The proposed legislation will address and define the role of the federal government in the housing finance market.

Reform: Four Key Ingredients

From the Center's perspective, any housing finance reform must address four core issues:

1. Stability

Though the housing finance market will always cycle through ups and downs, the government has a role in ensuring the continued availability of mortgages at a baseline level, regardless of fluctuating market conditions. In times of growth, private capital may provide sufficient liquidity for housing finance, and it should be relied upon to do so. But, in times of stress and instability, private capital is likely to exit the housing finance market, leaving home buyers and home sellers struggling to complete transactions. Instead, the government should step up its role when private capital leaves, in order to maintain a liquid market for homes. There are a variety of mechanisms that can be implemented to achieve this outcome. Leveling out the booms and busts of the housing finance market will always be especially important for homeowners with lower incomes and tighter budgets.

2. Government Guarantee

The federal government should provide an explicit, actuarially priced guarantee for mortgage backed securities containing mortgages meeting specified criteria. This guarantee should stand behind private capital and thus only be called upon in catastrophic circumstances. The private market is prone to consolidation, resulting in larger institutions with an ever-larger footprint. It is unlikely, in the event of a large recession or housing cycle bust, that congress will allow these large institutions, which play a critical role in the country's economy, to fail. Thus, the government guarantee implicit in our previous housing finance system will not disappear. It is far better, though, to make the government guarantee explicit and to price it accordingly. In addition, including an explicit guarantee allows the existing To-Be-Announced (TBA) market for mortgage securities to continue providing added liquidity, allowing for wider availability of a 30-year, fixed rate mortgage, and the ability of home purchasers to lock in an interest rate before closing.

3. Equal Access

All creditworthy borrowers, across the country, should have equal access to the same mortgage products. This speaks to the need for a strong regulatory agency, but also to the importance of the continued availability of a 30-year, fixed rate mortgage. It also indicates the need to ensure that all mortgage originators across the country, both large and small, have access to the liquidity provided by the secondary market. Active regulation is required to prevent predatory lending or discrimination against equally creditworthy borrowers with the ability to repay, such as steering to higher cost mortgage products. In addition to regulation, it is also important to ensure that a broad segment of homebuyers can access a 30-year, fixed rate mortgage. The 30-year, fixed rate mortgage provides a stable, unchanging mortgage payment for the life of the loan and therefore fits more easily into household budgets than shorter term, adjustable loans—making homeownership achievable for more Americans.

4. Funding for Affordable Housing

A successful housing finance policy must provide for a stable source of funding for affordable housing initiatives outside of the congressional appropriations process. Such funding would support approved housing affordability initiatives, both single-family and multifamily. Creating such a system ensures funding for these important programs in all economic conditions, including counter-cyclical, recessionary environments when the government is inclined to pull back support.

Conclusion

The bill under review in the Senate (S. 1217, Corker-Warner) addresses some of these goals, but the proposed legislation in the House of Representatives (H.R. 2767, the PATH Act) pushes housing finance away from these goals. The Corker-Warner bill in the Senate, while leaving room for improvement in the details, commendably proposes solutions towards each of the four goals enumerated here. The PATH Act in the House, however, proposes a fully privatized housing finance system without any government guarantee or dedicated funding for housing initiatives. This bill is likely to increase the volatility of the market and limit access to the 30-year, fixed rate mortgage.

Reforming the housing finance system will be challenging and complicated, but a successful housing finance structure must continue within the framework of these four fundamental goals.

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