Pursuing the American Dream:
Homeownership and the Role of Federal Housing Policy

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This paper was prepared at the request of the Millennial Housing Commission to survey federal housing policy issues related to homeownership. The findings of this paper are based on extensive interviews with leading experts in government and industry, focus groups with practitioners and a review of the research into salient issue areas as identified by the MHC staff and membership. The objective of this document is to provide an overview of homeownership issues and policy options, as well as specific recommendations for issues on which existing information could be agreeably synthesized. This is not a comprehensive report regarding every homeownership-related policy or proposal, but rather key issues and information useful for evaluating options facing the MHC. A series of policy option papers specific to various key recommendations is also reflected in this paper.

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Comments, questions and feedback are encouraged. Send an e-mail to: michael_collins@prodigy.net

Executive Summary 3

Section 1: The Role of Homeownership in the U.S. 5

Section 2: Barriers to Homeownership 6

I.) Income Barrier to Homeownership 7
II.) Wealth Barriers to Homeownership 8
III.) Credit History Barrier to Homeownership 9
VI.) Information Barrier to Homeownership 11
V.) Affordable Supply Barriers to Homeownership 11

Section 3: Extending the reach of mortgage markets 13

The Growth of Subprime Mortgage Lending 14
Role of Federal Policy in Extending the Reach of Mortgage Markets 15
I.) Credit Enhancement: FHA, VA and RHS Mortgage Insurance 15
II.) Below Market Interest Rates: Mortgage Revenue Bonds 19
III.) Regulation: Community Reinvestment Act (CRA) and GSE Goals 21
VI.) Government Sponsored Enterprises: Support of the GSEs 22
V.) Expanding the Reach of Mortgage Finance Through Tax Policies 24

Section 4: Educating And Protecting Consumers Engaged In Mortgage And Home Equity Markets 27

Balancing Risks of Homeownership Policies with Consumer Welfare 27
Fair Lending 27
Consumer Disclosure 28
Consumer Education and Counseling 30
Predatory versus Aggressive Lending 33
Individual Development Accounts and Promotion of Financial Literacy 34
Employer Assisted Homeownership 35
Balancing Below Market Rate Mortgages with Need for Tap Future Home Equity: 36

Section 5: Developing and preserving the supply of affordable units suitable for homeownership 38

Developing New Affordable Units for Homeowners 38
Manufactured Housing's Critical Role 40
Acquisition and Redevelopment of Units Suitable for Owner-Occupants 43
Preservation of Homeownership and Units Suitable for Owner-Occupants 44
Preserving Homeownership for the Disadvantaged Homeowner 45
Re-focusing on Placed-Based Revitalization 46

Section 6: Opportunities in the New Millennium for Homeownership Policies 48

Section 7: Conclusions 51

Appendix Tables: 52

TABLE A: Homeownership by Education 52
TABLE B: FHA Portfolio Profile 52
TABLE C: Legislative Proposals Regarding Predatory Lending 2000-2001 53
TABLE D: Secondary Market Sales by Institution Type 54
TABLE E: Mortgage Insurance 54
TABLE F: Homebuyer Location 55
TABLE G: HMDA Purchase Loan Volume by Lender Type 55
TABLE H: Age of Homes Purchased by First-Time Buyers 55
TABLE I: Units Purchased by First-Time Buyers 56
TABLE J: Homeownership Rates by Income and Region, Manufactured Housing Share 56
TABLE K: Placements of Manufactured Units 1994 and 1999 by Region 57
FIGURE A: Subprime FICO Scores 58

EXECUTIVE SUMMARY

Homeownership has always been a strong component of housing and housing policy in the United States. Owning one's home is a social and economic indicator of having a stake in society and brings stability to the community. The system for financing of home mortgages, as well as for developing housing units suitable for homeownership, has evolved dramatically in recent decades. Technology and innovations have increased speed, efficiency and volume, resulting in more families finding mortgage financing than ever before and new homes being produced in record numbers. While homeownership rates are near all-time highs, particular demographic and economic populations, as well as distressed areas, lag behind. Other populations and neighborhoods face greater access to credit, but at increased risk and cost.

This paper attempts to provide an overview of U.S. housing policies related to homeownership, an analysis of the barriers to homeownership, as well as background on pressing federal policies, programs, and regulations that could be refined to better support homeownership. As the Millennial Housing Commission considers recommendations regarding federal homeownership policy, several issues are paramount:

1. What more can the Federal government do to encourage and support homeownership?
2. What can the Federal government do to encourage innovations in the mortgage market, while adequately protecting consumers?
3. What can the Federal government do to help ensure that mortgage borrowers understand the rights and responsibilities of homeownership and are prepared to assume them?
4. What can the Federal government do to encourage the production and preservation of homes affordable to those with lower-incomes?

Buying a home is typically the largest and most complicated financial commitment most households ever make. Would-be first-time buyers face many barriers, including being able to afford monthly payments, having enough savings for a downpayment and closing costs, as well as the low debtloads and income stability needed to qualify for a conventionally-priced mortgage. Even if they qualify, potential buyers may be hampered by a lack of affordable homes in a desirable area, or even information on how to buy a home or negotiate the best deal. Veiled or overt discriminatory practices still employed by some actors in the real estate and financial industry also conspire against some potential homebuyers. In combination these hurdles, especially among low-income and minority populations, keep homeownership, and its ancillary social and economic benefits, out of reach.

Policy makers and practitioners should understand the risks and implications of expanding homeownership to lower-income families. Unlike in the rental housing market, individual families must be able to successfully maintain their home and their mortgage. Individual households need to have the capacity to stay current on their loan and to undertake needed repairs and upkeep. When families fail at homeownership, entire neighborhoods can be affected beyond the substantial losses individual households must endure. To the extent extending homeownership to low- and very-low income people is a priority, correlated issues of banking, personal financial management and education policy should not be ignored.

Based on interviews with leading practitioners, focus groups and other research, a series of policy changes are explored. Generally, policy prescriptions can be grouped into three categories:

(I.) Expanding the reach of mortgage markets for sustainable homeownership;
(II.) Educating and protecting consumers engaged in mortgage and home equity markets; and
(III.) Production and preservation of units suitable for affordable homeownership.

ACRONYMS USED IN THIS DOCUMENT:

ACA	Asset Control Areas
AHECI	American Homebuyer Education and Counseling Institute
AHP	Affordable Housing Program
APR	Annual Percentage Rate
BEA	Bank Enterprise Awards
CDBG	Community Development Block Grant
CDFI	Community Development Financial Institutions
CMOs	Collateralized Mortgage Obligations
EAH	Employer Assisted Housing
FASIT	Financial Asset Securitization Investment Trust
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHA	Federal Housing Administration
FHFB	Federal Housing Finance Board
FHLB	Federal Home Loan Bank
FICO	Fair Issac's Company
FIRREA	Financial Institutions Reform, Recovery and Enforcement Act of 1989
GSEs	Government Sponsored Enterprises
HHS	Department of Health and Human Services
HMDA	Home Mortgage Disclosure Act
HOEPA	Home Ownership and Equity Protection Act
HOME	HOME Investment Partnerships Act Block Grants
HOPE VI	Public Housing Recovery Program
HUD	Department of Housing and Urban Development
IDAs	Individual Development Accounts
IRA	Individual Retirement Account
IRS	Internal Revenue Service
LIHTC	Low Income Housing Tax Credit
LTV	Loan-to-Value (ratio)
MBS	Mortgage-backed securities
MCC	Mortgage Credit Certificate
MI	Mortgage Insurance
MPF	Mortgage Partnership Finance
MPP	Mortgage Partnership Program
MRB	Mortgage Revenue Bond
NCSHA	National Conference of State Housing Agencies
OFHEO	Office of Federal Housing Enterprise Oversight
REMIC	Real Estate Mortgage Investment Conduit
RESPA	Real Estate Settlement Procedures Act
RHS	Rural Housing Service (also called Farmer's Home or Rural Development)
TANF	Temporary Assistance to Needy Families
TILA	Truth In Lending Act
TOTAL	Technology Open To All Lenders
USDA	United States Department of Agriculture
VA	Veteran's Administration

SECTION 1: THE ROLE OF HOMEOWNERSHIP IN THE U.S.

Over 70 million families own homes in the U.S. For most families, buying a home is their largest investment and greatest source of wealth. Owner-occupied houses furnish a stable place to raise children and a secure base from which to establish social networks. Homeowners take care of their property, are likely to work to improve their neighborhood and to participate in the democratic system. And, as families buy and build homes, economic benefits —such as business revenue and jobs — are generated for the broader community.

- Homes are crucial to low-income families for financial asset building. The median wealth of a low-income homeowner under age 65 is **12 times** that of a similar renter. [1] Over 66 percent of the total **net worth** of low-income homeowners is stored as home equity.[2]
- Homeowners are **less likely to move**, staying in a community up to four times longer than renters. When neighbors stay in one place longer, they have more time to get to know one another and to establish social networks. Businesses also benefit, as employees with owner-occupied housing are more likely to form a stable workforce. [3]
- Homeowners are **more willing to contribute** to political campaigns and to lobby public officials than similar renters.[4]
- Homeowners are also 16 percent **more likely to belong** to parent-teacher organizations, block clubs and other community organizations.[5]
- Children of homeowners are 116 percent **more likely to go to college** than the children of similar renter families, even after controlling for age, income and length of stay in the community, and 59 percent more likely to become homeowners themselves.[6]
- The **construction** of 1,000 single-family homes supports nearly 2,500 full-time jobs in construction and construction-related industries, $80 million in wages, and $43 million in combined federal, state and local revenues and fees[7].
- Homeownership also provides individuals an **investment** in real estate while benefiting from having a place to live. Nationally, home equity build-up from home price appreciation was more than $700 billion in 2000 alone.[8] Home price appreciation is not risk-free, but exhibits **lower volatility** than stock or bond prices.[9]

Five million families purchase homes annually. An extensive cast of institutions and actors provide for the delivery of homeownership opportunities. Potential buyers typically rely on a real estate agent to help them search for a unit and on private appraisers, attorneys, and inspectors to provide objective judgements at various stages of the home purchase transaction. Mortgage brokers and financial institutions evaluate applicants for mortgage loans and provide access to mortgage capital, often through secondary markets to investors on Wall Street.

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1 Federal Reserve Board 1995 Survey of Consumer Finances, tabulated by Joint Center for Housing Studies.

2 Ibid.

3 Richard K. Green and Michelle J. White, "Measuring the Benefits of Homeowning: Effects on Children," Working Paper, Center for the Study of the Economy and the State, Chicago, 1994.

4 Peter Rossi and Eleanor Weber, "The social benefits of home ownership," *Housing Policy Debate,* Vol. 7, No. 1, 1996.

5 Denise DiPasquale and Edward L. Glaeser, "Incentives and Social Capital: Are Home Owners Better Citizens?" Joint Center For Housing Studies Working Paper Series W97-3, 1997.

6 Thomas P. Boehm, and Alan Schlottmann, "Does Homeownership By Parents Have an Economic Impact on Their Children," Working Paper, Dept. of Finance, University of Tennessee at Knoxville, 1999.

7 Paul Emrath, "Local Economic Impact of Home Building." *Housing Economics*, Vol. 45(3) March 1997

8 The National Association of REALTORS estimate.

9 The standard deviation, on measure of variation, for stocks is 20 percent, for bonds 9 percent, but for owner-occupied housing, the standard deviation is only 4 percent.

The public sector provides a regulatory framework to protect consumers and increase efficiency. In addition, public subsidies are offered to special populations in the form of below-market interest rate loans, grants for downpayments, and funds for the development or renovation of units suitable for homeownership. The public sector also provides tax advantages to mortgage borrowers and investors, as well as credit enhancements, implicit and explicit, for segments of the mortgage market.

The nonprofit sector also plays a role by serving as a third-party ombudsman and educator to potential buyers navigating the process, as well as a provider of financial assistance. Nonprofits also develop units suitable for ownership, using subsidies to build in markets where private sector developers cannot profitably. In many cases, nonprofits are the only source of post-purchase services some families need to sustain homeownership. Through board governance and accountability to residents, nonprofits also can make sure the long-run needs of neighborhoods are addressed, as well as be a force for pluralism by representing minority interests in community development.

Together this system of public-private relationships supports an expansion of homeownership to an increasing number of families each year. Nevertheless, barriers to homeownership remain for some families and neighborhoods.

SECTION 2: BARRIERS TO HOMEOWNERSHIP

While homeownership rates are at all-time highs nationally, higher-income families are much more likely to own homes than lower-income families (Table 1). Only 48 percent of very low-income households live in owner-occupied homes, as opposed to 67 percent of all households, and 88 percent of high-income households. Moreover, homeownership rates are lower in central cities across all income groups. Overall, there is a 24-percentage point difference between central city and suburban homeownership rates, and even a 20-point difference among families in the same low-income range.[10] There are substantial gaps in homeownership attainment between races, even controlling for marriage, central city location age and education. For example, a white, married household under 50 years of age living in a central city without a high school education is just as likely to be a homeowner as a black family with a college degree in the same circumstance (Appendix Table A).

Table 1

Homeownership Rates By Income and Location

Percent of Households Owning a Home

	Income as a Percent of Area Median Income				
	Very Low Income (Less than 50%)	Low Income (51% to 80%)	Moderate Income (81% to 120%)	High Income (Over 120%)	**All Households**
Central City	30.7%	44.5%	58.5%	79.5%	**49.8%**
Suburb	56.1%	64.3%	76.1%	90.3%	**73.8%**
Non-Metro	61.0%	69.7%	78.2%	90.8%	**75.4%**
All Areas	**47.6%**	**58.9%**	**71.9%**	**87.9%**	**66.9%**

Source: 1999 American Housing Survey, author's tabulations

[10] Several factors that contribute to the homeownership gap between cities and suburbs, including a lack of urban single-family detached housing units, a lack of creditworthiness and racial segregation and discrimination.

There are several reasons a renter household may be prevented from buying a home:

I. Lack of income to afford the monthly payment of principal, interest, taxes and insurance;

II. Lack of net savings to put into a downpayment and closing costs and/or high debt;

III. Poor credit history, which results in an increased interest rate, exacerbating income constraints;

IV. Lack of information on how to shop for a home and apply for a loan, and;

V. Lack of quality affordable units in a desirable location.

Each of these barriers is introduced below, with a brief note as to which federal policies respond to this issue. Each of these barriers and policies is explored in further detail in Sections 3 through 5.

Figure 1: Homeownership Barriers and Policy Reponses

Barrier to Homeownership	Federal Policy Response
Lack of Income	Mortgage Revenue Bonds, Mortgage Credit Certificates Government Sponsored Enterprises, Deductibility of Mortgage Interest, Section 8 Homeownership Option
Lack of Wealth and/or High Debt	FHA/VA/RHS Mortgage Insurance, HOME, CDBG, CDFI Downpayment Grants and Loans
Poor Credit History	FHA/VA/RHS Mortgage Insurance, Mortgage Revenue-backed Loans
Lack of Information	Truth in Lending Act and Real Estate Settlement Procedures Act Disclosures, HUD Section 108 Counseling Grants
Lack up Housing Supply	National Manufactured Home Construction and Safety Standards, HOME, CDBG, CDFI Grants and Loans

I.) Income Barrier to Homeownership

According to Census data, in 1995, approximately 90 percent of rental households could not afford to purchase a modestly priced home using a 30 year fixed rate mortgage (Table 2).[11] Prudent mortgage underwriters will only allow a borrower to put about one-third of pre-tax income towards the payment of housing costs, including hazard insurance and property taxes. As a result, potential buyers are limited in the amount they can afford to pay by their income. Given a target house price and interest rate, however, Census analysis shows only two percent were prevented from purchasing a home priced at half of the median price (the lowest quartile) by income constraints alone. Income alone is not a primary barrier to homeownership.

Current Federal Policy Response: Federal policies seek to reduce income barriers to homeownership with below market rate loan programs, such as the Mortgage Revenue Bond (MRB) and Mortgage Credit Certificate (MCC) programs. Because many buyers require credit enhancements that add costs to monthly payments, such as mortgage insurance, many first-time buyers need deeper interest rate subsidies than typically can be offered by mortgage revenue bonds. A small volume of substantially below-market interest rate lending is available through special CRA-motivated bank programs, community-based nonprofit lenders and local governments, but combined this is a relatively small, and unevenly distributed portion of the market. The RHS direct 502 loan program provides loans at rates as low as one percent, for example, but only funded 15,000 loans in 1999, two-thirds of its level in the early 1990s.

[11] Howard Savage, "Who Can Afford to Buy A House?" US Census, 1999. Based on a conventional mortgage at a 30-year fixed rate. Savage intends to revise this study with 1997 data in January 2002.

The tax code also allows borrowers to deduct mortgage interest and real estate taxes, which, if a taxpayer's income is high enough to justify itemized deductions, can help reduce tax liabilities, and, therefore the income families have to devote to monthly payments. Most lower-income taxpayers do not have enough income or tax liability to use these deductions, however.

Federal support, implied or explicit, for government sponsored enterprises (GSEs), such as Ginnie Mae, Freddie Mac, Fannie Mae and the Home Loan Banking System, also help facilitate the efficient flow of mortgage credit to borrowers, theoretically reducing interest costs and increasing affordability. Some analysts argue few of the advantages granted to the GSEs, or in the tax code, are actually transferred to buyers, but rather priced into the market or captured by other entities. While the incidence of these benefits is being debated, these aspects of federal homeownership policy theoretically contribute to overcoming income barriers to homeownership.

Recently HUD has allowed renters using Section 8 rental assistance vouchers to apply the subsidy towards a mortgage. Fewer than 200 families took advantage of this innovative program in 2001, in part because of reluctance by Section 8 administrators. However, this program could allow a portion of the 78,000 low-income households in Section 8 with sufficient earned incomes to continue on a path to self-sufficiency by becoming homeowners.[12]

Table 2

Reason Home Priced at Half of Median Cannot be Afforded in 1995		
	Households (millions)	*Percent*
Current Renters	**21,424**	100.0%
Current Renters Who Can Afford	**2,120**	9.9%
Current Renters Who Cannot Afford	**19,304**	90.1%
…..Reason Cannot Afford:		
Income Barrier Only- Lack income	413	2.1%
Wealth Barrier - Debt level too high	2,402	12.4%
Wealth Barrier – Lack downpayment	2,991	15.5%
Income & Wealth - Lack income & Debt too high	9,323	48.3%
Income & Wealth - Lack income & Lack downpayment	4,175	21.6%
Total	19,304	100.0%
Source: U.S. Bureau of the Census, <http://www.census.gov/hhes/www/hsgaffrd.html> Table 3-5		

II.) Wealth Barriers to Homeownership

Mortgage loans typically require borrowers to make some cash investment in the deal, and also limit borrower total debt load, including non-housing consumer debts. Census data in Table 2 show 28 percent of renters cannot afford a modestly-priced home because they lack savings (15.5 percent) or have high debt loads (12.4 percent). In order to accumulate savings, households must consume less and save more (or receive inheritances or gifts from relatives or other benefactors). The average first-time homebuyer under 35 years of age takes 2.8 years to acquire enough assets to afford to buy a home.[13] Because renters are typically lower-income, and have to spend much of their earnings for rent, health care and food, they often use consumer debt, credit cards and installment loans. The result is many renter families are strapped with high debt loads and small savings.

Given the close relationship between wealth and income, it may not be surprising approximately 70 percent of renters are prevented from purchasing a home by <u>both</u> income and wealth barriers—especially

[12] Based on non-elderly, non-disabled households with earned income over $10,600 from HUD Picture of Subsidized Households, 1998.
[13] Gary V. Englehardt and Christopher J Mayer, "Intergenerational Transfers, Borrowing Constraints and Savings Behavior: Evidence from the Housing Market" *Journal of Urban Economics*. 44, pp 135-157, 1998.

lacking income and having high debt loads. Typically, a household needs sufficient income in order to be able to defer some portion of its consumption into savings or to pay down debts. Thus, having accumulated savings and low debts is correlated with having a higher income. The biggest barrier for these renter households, having a low income and high debt, has likely been exacerbated in recent years as use of consumer credit has expanded, especially among lower-income families.

Wealth barriers can be overcome by lowering downpayments for borrowers who lack savings. Likewise, loan underwriters can allow borrowers to have higher levels of consumer debt and still qualify for a mortgage. However, when loans are approved with low downpayments, lenders have less of a cushion in the event of a decline in house prices if the borrower defaults. To protect themselves in the case of a default, lenders often require mortgage insurance on low-downpayment loans, which raises monthly payments and closing costs, increasing income barriers.

Current Federal Policy Response: The Federal Housing Administration (FHA) has played a significant role in homeownership policy by provide mortgage insurance on loans with low downpayments and high debt-to-income ratios. Farmer's Home, now called Rural Housing Service (RHS), and the Veteran's Administration (VA) created similar loan guarantee programs. Because such mortgages typically involve higher interest rates and larger mortgage balances, however, these programs tend to raise monthly payments, unless combined with below-market rate loans. Federal block grant programs, such as HOME funds, and in some cases CDBG, may be used to provide grants or loans to qualified borrowers for downpayments and closing costs. These direct subsidy programs can help reduce both income and wealth barriers, but are limited in scale. Even smaller in scale, revolving loan funds administered by local governments, as well as by nonprofit agencies funded by the federal Community Development Financial Institutions (CDFI) Fund and other sources, also provide low-cost loans to borrowers ineligible for loans in the private market. Federal tax policy also allows penalty-free IRA withdrawals for first-time buyers, useful for meeting the barrier of downpayment and closing costs.

III.) Credit History Barrier to Homeownership

Decades ago the consumer finance market developed models to predict loan default behavior given borrower characteristics and past credit usage. Over time, credit bureau depositories have developed, offering extensive detail on how individuals access and use credit cards, lines of credit, installment loans and other extensions of credit.[14] Credit scores, often called FICO or Beacon scores based on the names of the issuing company, condense credit bureau information into a single number. While an individual's credit score depends on a number of factors, high-risk scores tend to be associated with a history of late payments, maximizing credit lines and repeatedly applying for additional credit.[15]

Credit scores are now commonly used to assess mortgage applicants. FICO scores generally range from 300 to 850, with higher scores indicating better credit history. Mortgage applicants with FICO scores above 660 are likely to have acceptable credit and can be quickly underwritten. For applicants with FICO scores between 620 and 660, lenders typically perform careful underwriting, scrutinizing traditional factors. FICO scores below 620 indicate high risk, and even after a particularly thorough review are unlikely to be approved by conventional lenders.[16] Even prior to these metrics, however, loan underwriters assessed if applicants "ever had a bankruptcy" or "any overdue accounts" to review loan applications. Quantitative credit scores, however, are easily applied to computerized, automated underwriting systems and have proven more predictive and efficient.

[14] The three repositories are Equifax Credit Information Services, Trans Union Credit Information Company and TRW Information Systems and Services.
[15] Recently, credit bureaus and scoring agencies have changed policies restricting access to credit data and scores. Consumers may obtain this information on their own accounts by request and via the Internet.
[16] These FICO score ranges are approximate. Individual lenders and loan products use a variety of cutoff scores.

According to Home Mortgage Disclosure Act (HMDA) data, the reason most frequently cited for the denial of a single-family mortgage purchase loan is having a poor credit history. Moreover, half of African American applicants denied loans were rejected for this reason. Low-income and minority households tend to have reduced job security, lower levels of savings and higher debt. Due to the intergenerational nature of poverty and historic patterns of economic discrimination, many of these families also may not be able to turn to parents or relatives for financial support. The problem is made worse because many lower-income and minority neighborhoods do not have mainstream lending institutions. Check cashing stores, pawnshops, and rent-to-own stores proliferate. Since 1993 the number of check cashing facilities nationally has doubled, many offering short term, payday loans at high rates.[17] Nationally, 12 million households do not have any conventional banking relationships, including an estimated 44 percent of African-American renters earning under $40,000 in income.[18] This lack of a banking relationship often prevents these households from establishing adequate credit histories, as they turn to expensive fringe financial services with onerous terms. Table 3 shows lower-income areas, and minority individuals, tend to have lower median credit scores.

Table 3

Median Equifax Credit Score For Zip Code		
Poverty Level of "Neighborhood"	All Individuals	Minority Individuals
0-5%	815	780
5-10%	783	783
10-25%	759	763
25% +	691	706

Source: Robert B. Avery, Raphael W. Bostic, Paul S. Calem, Glenn B. Canner, "The Distribution of Credit Scores: Findings and Implications for the Provision of Financial Services." Proceedings of the 33rd annual Conference on Bank Structure and Competition, May 1997.

As a result low and moderate-income households are more likely to have credit records that would disqualify them from obtaining a prime-priced home mortgage loan. Freddie Mac's analysis of the distribution of credit-bureau scores shows African-American borrowers are three times as likely to have FICO scores below 620 as white borrowers, and Latinos about twice as likely. Borrowers earning less than 80 percent of area median income are more likely to have scores below 620 than higher-income borrowers. Freddie Mac's analysis also showed, however, the ability of FICO scores to predict loan performance is equally accurate across income and racial groups.[19]

One source often cited for contributing to high debt is student loans. One in five households currently hold a student loan. A 1998 General Accounting Office report found 52 percent of undergraduate college students took out a loan in 1995, compared to 41 percent in 1992. The average debt per student rose from $7,800 to $9,700 in real terms during the same period. About one-third (31 percent) of borrowers pay more than 10 percent of their monthly income for a student loan, but the median monthly debt-to-income ratio has remained 8 percent for the last decade. Nevertheless, 40 percent of student loan borrowers with higher debt burdens reported their debt delayed their decision to purchase a home.[20]

Current Federal Policy Response: While credit scores are a newer phenomenon in the mortgage application process, poor credit histories have always been a barrier to homeownership for some families. Federal policy has addressed this barrier primarily through offering mortgage insurance and supporting mortgage revenue bond-backed loans. FHA, for example provides insurance for mortgages sooner after a serious loan delinquency or bankruptcy than private sector mortgage insurers. While federal mortgage

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[17] John Caskey, *Lower Income Americans, Higher Cost Financial Service*s. Working Paper, Filene Research Institute & Center for Credit Union Research, University of Wisconsin-Madison, 1997; See also, Financial Service Centers of America Inc., <www.nacca.org/q&a.htm>

[18] Federal Reserve Board tabulations of 1999 Survey of Consumer Finances.

[19] 1997 Freddie Mac, < http://www.freddiemac.com/corporate/reports/moseley/moseidx.htm>

[20] Susan Choy and Sonya Geis, National Center for Education Statistics, 1997; Nellie Mae, 1997

insurance programs have been slower to use credit scores to assess borrowers and price insurance, FHA has developed its TOTAL (Technology Open To All Lenders) system. In contrast, technological tools and precise pricing models have been rapidly adopted in the private sector. The result is private lenders are able to quickly screen borrowers, choosing those with the most favorable credit history, and leaving the higher-risk borrowers to government programs.

VI.) Information Barrier to Homeownership

There is evidence to suggest that a significant segment of potential buyers self-select out homeownership out of fear of rejection, confusion about the complexities of the process or misunderstandings about their financial status.[21] Even if they can afford a home, minority and low-income renters often lack confidence to buy a home. Freddie Mac's survey of "Consumer Knowledge and Confidence" revealed that only half (49 percent) of African-Americans with credit scores that would qualify for loans perceive themselves as qualified. The historical legacy of institutional discrimination may also affect many minority applicants. Minority mortgage applicants continue to be rejected at much higher rates than white applicants. According to 2000 Home Mortgage Disclosure Act (HMDA) data, conventional home purchase loan denial rates were 22 percent for white applicants, 31 percent for Latino applicants and 45 percent for African-American applicants. Studies show some of this differential can be explained by the income and employment history of applicants, the type of property involved, as well as credit quality. But the experience of peers, even if based in accurate economic differences, cannot help but influence applicants' attitudes. Some renters are unwilling to apply for a loan because they expect to be rejected and no not wish to be subjected to such an experience.

Current Federal Policy Response: Federal policies seek to overcome information barriers by providing support for agencies engaged in pre-purchase homebuyer education and counseling, through HUD and state housing finance agencies, as well as outreach to underserved communities through public housing authorities, and national nonprofit intermediaries, such as the Neighborhood Reinvestment Corporation. Other laws regulating information provided to home purchasers, such as the Truth in Lending Act and Real Estate Settlement Procedures Act provide some disclosure documents to borrowers during the buying process regarding their rights and options. To an extent, the Community Reinvestment Act supports financial institutions to perform outreach and education to undeserved markets regarding the availability of mortgage loans, and bank regulatory agencies provide resources and information about homeownership to the public. HUD's National Homeownership Strategy, and annual "Homeownership Week" are examples of national outreach and marketing projects. Likewise, research, publications and marketing by the GSEs also help inform the public on homeownership opportunities. Overall, policy efforts to break down informational barriers are less focused than other federal policies regarding homeownership, but involve a high degree of partnership between sectors and institutions.

V.) Affordable Supply Barriers to Homeownership

There is a delicate balance between growth in home-owning households and housing units suitable for homeownership in each metropolitan housing market. Some markets have a constrained ability to produce new units as population grows, due to geographic or regulatory boundaries. For homeownership rates to increase within a static housing stock, rental units (or more rarely, vacant or commercial units) must be converted to owner-occupied units. Because of homebuyers' preference for single-family detached units (81 percent live in such units, Table 4), the type of housing renters occupy in large part impacts how units can be converted. In some markets, single-family rental units can be converted to owner-occupied homes. In other markets, multifamily units can be converted to owner-occupied cooperative housing, or condominiums. The overall pattern in the U.S., however, is for a growing

[21] Michael S. Ratner, "Many Routes to Homeownership: and Ethnographic study of Minority and Immigrant Experiences," *Housing Policy Debate*, Vol. 7, Issue 1, pp 103-145, 1996.

housing stock, rather than a static stock. New units are being built for existing "move-up" homeowners, allowing existing units to be occupied by first-time buyers. Because of the fixed costs involved in building new houses, and the relatively higher profit margins involved in building higher-cost homes, very few affordable homes are being produced today, with the exception of manufactured homes.[22] The barrier confronting first-time buyers, however, is if they can afford the prices being offered for new units, converted units or existing units suitable for homeownership. Local housing standards, codes and environmental regulations all tend to increase the cost of housing.[23] Likewise, local zoning tends to limit the development of affordable units to specific, often least desirable, areas.

Current Federal Policy Response: Although federal policy has little influence over local zoning or housing codes, the National Manufactured Home Construction and Safety Standards, or so called "HUD-code," facilitates production of affordable owner-occupied units by establishing a national code that preempts local codes. The HUD-code allows assembly-line technology to reduce production costs. Through the use of HOME and CDBG, additional units suitable for homeownership may be newly built, renovated or converted from vacant, rental or commercial space. Likewise, support for community development nonprofits to develop affordable units produces a small number of owner-occupied homes annually. Generally, however, there is little federal policy support for creating affordable single-family homes.

Table 4

Profile of U.S. Housing Stock

Units in Structure	All Occupied	% All Occupied	% of Owner Occupied Units	% of Units built/placed in last 4 years	% of Central City Owner Occupied Units	% of Suburb Owner-Occupied Units
1, detached	64,536	59.0%	80.5%	67.7%	77.4%	81.6%
1, attached	8,572	7.8%	2.1%	0.7%	4.6%	1.6%
2 to 4	8,572	7.8%	2.1%	0.7%	4.6%	1.6%
5 or more	15,947	14.6%	2.4%	1.4%	4.5%	2.5%
Manufactured Home	6,785	6.2%	8.1%	24.9%	1.7%	7.0%
Cooperatives	588	0.5%	0.5%	0.1%	1.5%	0.3%
Condominiums	4,438	4.1%	4.3%	4.4%	5.7%	5.4%
	109,438	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: 1999 American Housing Survey, author's tabulations

[22] Malpezzi, Stephen and Richard K. Green, "What Has Happened To The Bottom Of The Housing Market?", Urban Studies, Vol. 33, Issue 10, p. 1807-1820, 1996.

[23] The Advisory Committee on Regulatory Barriers to Affordable Housing (1991), found code regulations enforce a minimum level of housing quality, truncating the process of units reaching more affordable levels.

SECTION 3: EXTENDING THE REACH OF MORTGAGE MARKETS

Homeownership rates today are over 68 percent, due in part to economic expansion, but also because of an innovative mortgage industry and tightened oversight and regulation. Until the 1930's, homeowners who financed their purchases typically made a downpayment of at least 40 percent, paying only interest for three to five years, until a final "balloon" payment of principal was due. In the Depression, defaults spiraled, as borrowers could not make final balloon payments, and lenders were unwilling to roll loans into another balloon loan. The National Housing Act of 1934 created the FHA insurance program to protect lenders from the risk of default on long-term, fixed-rate mortgages, essentially placing the full faith and credit of the U.S. government behind the borrower. In 1938, Congress created Fannie Mae to purchase FHA-insured mortgages from lenders to increase liquidity in the market. The Federal Home Loan Bank system was also created to exchange capital among regional lending markets. After World War II, Veterans Affairs began to guarantee low-downpayment mortgages made to veterans; similarly the USDA created the Farmer's Home (now Rural Housing Service) loan guarantee. In 1968, the Housing and Urban Development Act established Ginnie Mae as part of HUD to guarantee, or "wrap," FHA, VA, and Rural Housing Service loans sold by private lenders. This act also re-chartered Fannie Mae as a stockholder-owned, non-government corporation to purchase conventional loans. In 1970, Congress similarly chartered Freddie Mac to buy conventional mortgage loans from federally insured financial institutions.

The first mortgage-backed security, wrapped by Ginnie Mae, was issued in 1970. Investors initially shunned mortgage bonds due to their quirky interest rate-driven prepayment behavior.[24] In the 1980's, collateralized mortgage obligations (CMOs) were developed, spawning a flood of innovations in mortgage-backed securities. The Tax Reform Act of 1986 created REMICs, a vehicle that minimizes tax liabilities of CMOs, further accelerating the sources of funds for mortgage loans.

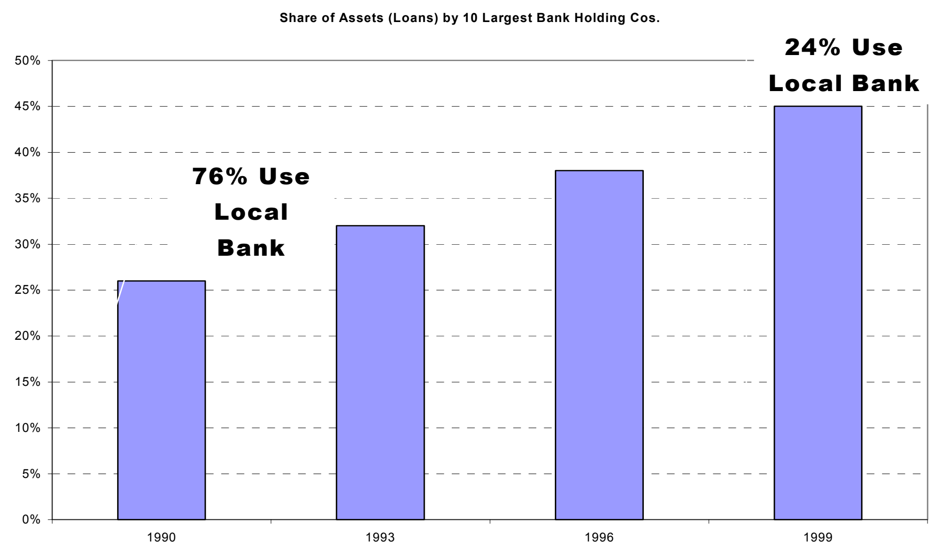
Savings and loans (often called thrifts), dominated the growing mortgage market in the 1970s, originating long-term mortgages financed with shorter-term deposits. Today, traditional depository-based thrifts and credit unions share the market with commercial banks and mortgage bankers, which depend not on deposits but on raising funds in capital markets. Financial institutions have undergone extensive consolidation since the 1980's—from over 13,000 institutions to less than 8,000.[25] The top 10 largest banks have moved from controlling one-quarter to almost one-half of all loans in the last decade (Figure 2). Meanwhile, the shift away from depositories has contributed to the share of mortgage originations made by local (within 30 miles of the borrower) institutions to decline from 76 percent to 53 percent.[26] Credit scoring and automatic underwriting have spurred a system of over 30,000 independent mortgage brokers. The share of originations involving a mortgage broker has increased from near zero in the 1980's to more than half (55 percent) of all residential mortgage originations in 2000.[27]

Advances in technology have improved the capacity of lenders to create highly-customized loan products, deliverable at a high speed, and easily made liquid in the secondary market. Automated underwriting systems were developed in the early 1990s by the GSEs and larger financial institutions and private mortgage insurance companies. The efficiencies created by these systems save $300 to $650 in costs, as well as speed processing and increase flexibility.[28] By screening the majority of applications with automated systems, underwriters have more time to review special cases. While removing human

[24] As interest rates decline, borrowers pre-pay their mortgage, returning principal to investors. Investors no longer receive cash flows from interest and are forced to reinvest their funds in the market at a time when rates are lower.
[25] http://www.federalreserve.gov/pubs/staffstudies/174/default.htm
[26] Federal Reserve Board Survey of Consumer Finances, 1995.
[27] "Mortgage Brokers 2000," Wholesale Access: Mortgage Research and Consulting, July 5, 2001. 60% projected for 2001.
[28] *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families*, Freddie Mac, 1996.

subjectivity from the process makes lending decisions less susceptible to bias, some critics worry these systems may not be well suited for some groups of borrowers by omitting important criteria.[29]

Figure 2



Source: Federal Reserve Bank of New York

The Growth of Subprime Mortgage Lending

Subprime mortgage lending has accelerated in the last decade, particularly to minority and low-income households. These loans, also called "B and C" lending based on the A to D credit quality continuum, serve borrowers who do not meet the underwriting standards of the conforming market, which is also called prime, "A", or conventional lending. Starting as specialized loans allowing existing homeowners to tap into home equity for cash or debt consolidation, the subprime market today provides loans for purchase, refinance and home improvement. The hallmark of these loans is higher interest rates and fees, which compensate increased risks, such as high loan-to-value ratios or debt ratios and low credit scores. Depending on the relative risk involved, subprime loans might charge 1 to 10 percent more than conventional rates. Subprime lenders initially operated as consumer finance firms, offering loans nationally through mortgage brokers. More and more, major financial institutions of all types have purchased or created subprime lending units, enticed both by high returns and the ability to tap new markets. Since the conventional market may be reaching saturation points, lower-quality borrowers, especially those who are close to conventional risk, are an important growth market. Perhaps surprisingly, most subprime borrowers, 57 percent, are A-minus risk quality, and 25 percent are B risk quality.[30]

From 1993 to 2000, home purchase loan originations by subprime mortgage specialists grew by 83 percent, compared to 29 percent growth in total mortgage market originations. In that same period, subprime originations went from 1.3 percent to 5.3 percent of the total purchase market (Appendix Table F). In 1993, subprime lenders made less than 2 percent of all loans in low-income minority neighborhoods. By 1998, that number had grown to over 15 percent of all loans, and 40 percent of

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[29] See M. Cary Collins, Keith D. Harvey, Peter J. Nigro, "The Influence of Bureau Scores, Customized Scores and Judgmental Review on the Bank Underwriting Decision Making Process" working paper from *Changing Financial Markets and Community Development*, Federal Reserve System's Second Community Affairs Research Conference, Washington, D.C. April 5-6, 2001.

[30] *Mortgage Banking* May 2001, page 28.

refinanced loans.[31] Subprime specialists made 51 percent of refinance loans in predominantly African-American neighborhoods, compared to only nine percent in predominantly white neighborhoods.[32] Subprime specialists made almost 16 percent of home purchase loans to African Americans in 1999.[33]

Central to the issue of subprime lending is given the increasing sophistication of lenders using risk-based pricing techniques, ensuring borrowers are offered the lowest-cost credit for which they qualify, regardless of their race, income or where they live. One study shows up to 30 percent of borrowers taking out high-cost subprime loans could have qualified for lower cost mortgages.[34] For a $70,000 mortgage, the difference in cost between an 8 percent interest rate and an 11.5 percent interest rate is $2,097 in the first year alone.[35]

To the extent subprime lenders are gaining market share because of a lack of competition from prime lenders, creditworthy borrowers may be facing higher costs for mortgages than necessary. Other consumer advocates are concerned that as subprime lenders become subsidiaries of larger institutions, lenders might be more inclined to push borrowers into higher-interest rate subprime loans than lower revenue prime loans.

There is also some evidence that subprime loans are priced higher than the credit risks involved. Freddie Mac conducted an analysis finding one pool of loans made by a subprime lender was priced higher than these loans would be priced in the conventional market. Even after allowing for possible differences in borrower quality, collateral risks and costs, the subprime loans in this pool had an unexplained interest rate premium of 100 basis points on average.[36]

Role of Federal Policy in Extending the Reach of Mortgage Markets

Since 1993, the number of home purchase loans made to low-income borrowers has grown 87 percent, compared to 37 percent growth for all borrowers. Lending to African Americans grew 89 percent, relative to 25 percent growth in loans to whites.[37] Overall, it seems some mix of public policy and the marketplace has promoted better access to mortgages. While more low-income and minority families than ever before are able to get mortgage loans, many are also paying higher rates for their credit than conventional borrowers. A nagging issue is how to promote innovation and encourage credit flows to nontraditional borrowers and communities, without subjecting families to undue risks. Federal policies aimed at extending the reach or mortgage markets have five avenues— (1) credit enhancements, (2) below-market interest rates, (3) regulation, (4) government sponsored enterprises and (5) tax policy.

I.) Credit Enhancement: FHA, VA and RHS Mortgage Insurance

The Federal Housing Administration (FHA) mutual mortgage insurance fund has existed for almost 70 years in an effort to provide federal support to the mortgage market in serving targeted populations. FHA has helped millions of Americans, especially low-income and minority families, purchase homes by providing mortgage insurance for loans that allow more flexible underwriting than is available from the conventional market. It also has helped stabilize recessionary markets when private mortgage insurers stop endorsing policies. FHA currently insures a total of about 7 million loans valued at nearly $400

[31] Home Mortgage Disclosure Act Data, 1993-1998, tabulated by HUD.
[32] Harold L. Bunce, Debbie Gruenstein, Christopher E. Herbert, Randall M. Scheessele, *Subprime Foreclosures: The Smoking Gun of Predatory Lending?*
[33] Joint Center for Housing Studies, Harvard University *State of the Nation's Housing 2000*
[34] Hugh Mahoney and Peter Zorn, "Promise of Automated Underwriting" *SMM* November 1996 Vol. 13, #3 <http://www.freddiemac.com/finance/smm/nov96/html/nov96.htm>
[35] Bunce, et al
[36] Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency," February 25, 2000.
[37] Federal Financial Institutions Examination Council tabulations of Home Mortgage Disclosure Act Data.

billion. These obligations are protected by FHA's Mutual Mortgage Insurance Fund, which is sustained entirely by borrower premiums (See Appendix Table B for profile of FHA portfolio).

Related to FHA are the smaller, Rural Housing Service (RHS) and Veteran's Affairs single-family programs. The USDA offers directly-financed 502 loans and 502 loan guarantees, similar to FHA. In 1999, 54,000 total 502 loans were made, 73 percent of which were guaranteed loans. The Department of Veterans Affairs offers veterans, service personnel, and spouses mortgage insurance. Lenders are guaranteed for up to 50 percent of losses for loans less than $45,000 or the lesser of $50,000 or 25 percent for larger loans. In fiscal year 2000, VA guaranteed 176,000 loans.

Approximately 800,000 to 1 million loans are backed by FHA insurance annually, and VA guarantees 180,000 to 200,000. FHA and VA combined served half a million white borrowers in 2000, 125,000 African American borrowers and 150,000 Latino borrowers. Interviews with minority borrowers indicate the FHA name implies the trust and confidence of the federal government, which is valued by consumers who have had difficult histories with the financial sector. Table 5 shows Government insurance programs are less likely to serve white borrowers for home purchase loans, and more likely to serve African Americans and Latinos. These programs are also much more prevalent among lower-income borrowers.

Table 5

2000 HMDA Market Share for Purchase Loans

Share of Total by Race	Conventional	FHA/VA/RHS
White	71.4%	57.7%
Native American	0.5%	0.5%
Asian Pacific	4.1%	1.6%
African American	4.8%	13.0%
Latino	6.0%	15.4%
Other/Joint/Race N/A	13.2%	11.8%
Total	100.0%	100.0%

Share of Total by Income	Conventional	FHA/VA/RHS
Less than 50% of MSA median	7.0%	11.0%
50-79% of MSA median	17.6%	33.6%
80-99% of MSA median	12.5%	20.6%
100-119% of MSA median	11.7%	14.1%
120% or more of MSA median	48.2%	19.5%
Income not available	2.9%	1.3%
Total	100.0%	100.0%

Source: 2000 FFIEC National Aggregate Tables 4-1 & 4-2 <http://www.ffiec.gov/hmda_rpt/natagg_result.htm>

However, FHA and other government-backed loans are growing at a slower rate than other lending, 11 percent from 1993 to 2000, compared to 37 percent rate for all loans. Table 6 shows conventional lending is penetrating into lower-income and minority markets faster than government lending; marking movement into traditionally labeled "underserved" markets by private markets (see Appendix Table E and G). While FHA/VA is increasingly serving more non-white borrowers, the volume of white borrowers is actually declining. FHA/VA lags the growth rates of conventional lending for every racial and income group.

Table 6

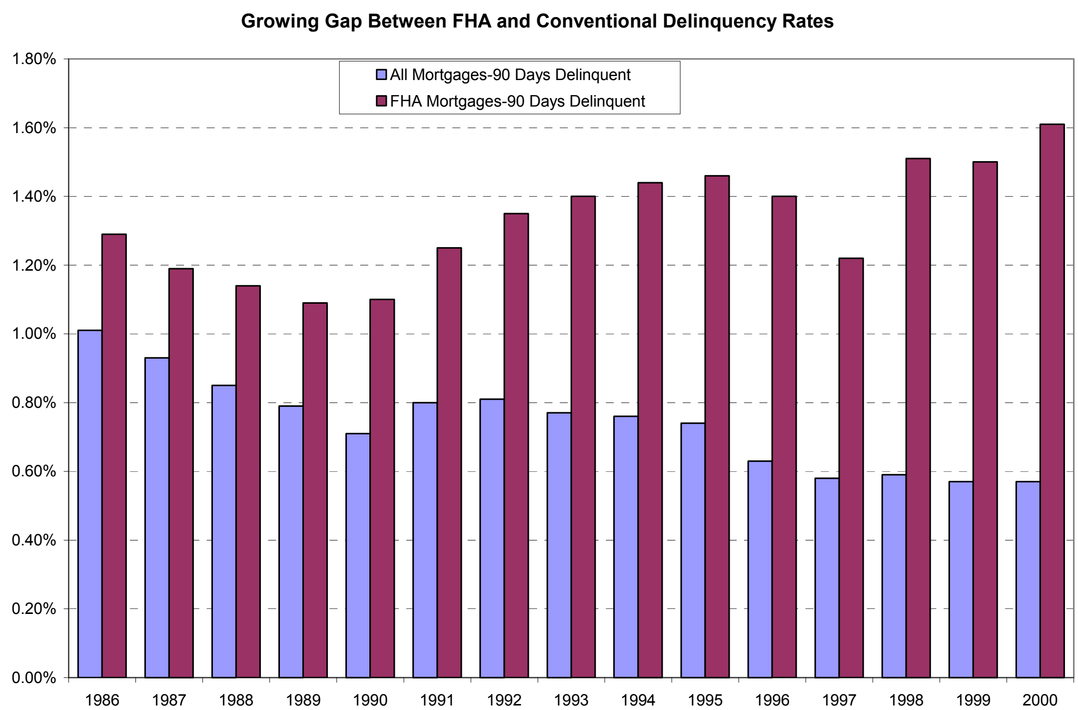
Percent Change in Volume for Home Purchase Loans

% Change 1993 – 2000	FHA/VA/RHS	Conventional	All Lenders
All Loans	11 %	45 %	37 %
Low Income Borrower*	43	113	87
White Borrower	-8	35	25
African-American Borrower	56	122	89
Latino Borrower	125	147	138

*Source: 2000 FFIEC National Aggregate Tables 4-1 & 4-2 <http://www.ffiec.gov/hmda_rpt/natagg_result.htm> * Defined as less than 80 of area median income, as per HUD guidelines.*

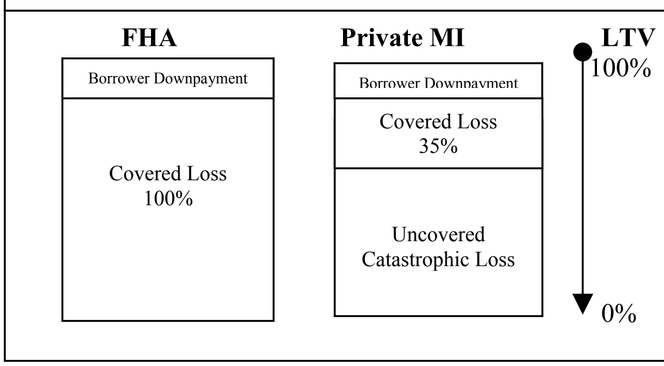
FHA's single-family mutual mortgage insurance fund programs, sometimes called 203(b) after authorizing legislation, have returned to sounder actuarial footing after troubles in previous decades. FHA regularly returns funds to the Treasury from the collection of premiums. In the 1990's, FHA reduced premiums and instituted administrative efficiencies to streamline processing and attempt to achieve higher levels of quality control. FHA cumulative claims for a given origination year range from 5 to more than 10 percent. Each claim averages 30 to 35 percent of the initial loan value. Recently FHA delinquency rates have climbed. Moreover, Figure 3 shows a growing gulf between delinquency rates on conventional and FHA loans.

Figure 3



Private mortgage insurance (MI) covered 1.2 million borrowers in 2000, 40 percent more than FHA. Private MI covers a smaller portion of the loan balance, typically 25 to 35 percent of the home value. FHA insurance provides a payment of a claim of up to 100 percent of the loan balance to lenders in the case of a foreclosure (Figure 4). This difference is largely nominal since most claims to FHA are 35 percent or less of the initial loan value. In a deep recession, where housing prices drop and many borrowers default, FHA's deeper catastrophic coverage is more likely to be utilized, however.

Figure 4



Increasingly FHA and private mortgage insurance markets overlap as more borrowers with marginal credit purchase or refinance homes with high loan-to-value ratios. In the 1990's, private mortgage insurance became more aggressive in targeting lower-income borrowers. Private mortgage insurance today will insure loans above 97 percent loan-to-value ratios, and uses underwriting ratios similar to FHA.[38] At a 90 percent loan-to-value, private MI typically charges approximately the same as FHA in monthly premium, but not FHA's 1.50 percent up-front premium, nor do borrower's face the 1/8th of a point interest rate premium FHA lenders usually charge. Since FHA's premiums are fixed, FHA is a better deal for borrowers than private MI only at high loan-to-value ratios. (Table 7) However, the result is loans with lower loan-to-value ratios, and likely better credit, are siphoned from FHA's portfolio. The resulting adverse selection may be making FHA's book of business riskier, explaining recent increases in relative delinquencies and foreclosures.[39]

Table 7

Mortgage Insurance Premiums: FHA vs. Private MI				
$100,000 House				
	FHA, 2001		RMIC With Annual Refund, 2001	
LTV	Upfront Premium	Monthly Premium	Upfront Premium	Monthly Premium
97%	$1,455	$485	$2,086	$485
95%	$1,425	$475	$1,853	$466
90%	$1,350	$450	$1,080	$306
85%	$1,275	$425	$425	$289
** RMIC used as an example only. Loss coverage on FHA is 100%. Loss coverage on RMIC is 35%. Assumes refund option. RMIC only available for FICO scores >620, or >660 for above 97% LTV and > 640 above 95% LTV mortgages. FHA has no cutoff score.*				

The effectiveness of FHA's mortgage insurance operations compared to its private sector counterparts is questionable. In the 1990's, FHA reduced its staff by one-quarter, consolidated single-family operations into four "homeownership centers," and moved many functions to private contractors. However, problems in overseeing contractors have arisen, shifts in workforce deployment have been uneven, and FHA's long-tenured workforce is faulted with lacking the skills needed in the mortgage industry today. The process of selling FHA foreclosed homes also criticized for being cumbersome and time-consuming, resulting in vacant homes depressing neighborhoods. Some FHA loan claims involve outstanding loans balances in excess of property values, due to inflated appraisals, neighborhood and property decline, or poor loan underwriting.

The desire to stabilize FHA's operations has lead to several reform proposals. Ideas range from more outsourcing, to partnering with private mortgage insurers, to chartering FHA as an independent, government-owned corporation. Some argue these reforms are needed to keep FHA from becoming a dinosaur that no longer effectively expands the reach of mortgage markets. Changes in the mortgage market, and FHA's inability to overcome bureaucratic shackles, require a significantly different for the agency. Others argue FHA continues to serve an important niche market and that FHA's declining market share relative to conventional lending simply shows the private market is effectively being leveraged.

FHA, with the full faith and credit of the U.S. government, enjoys advantages the private market cannot match, however. FHA has AAA credit, a low cost of capital and no need to return profits to investors. The market continues to have segments of borrowers who need a credit enhancement. Given the inequality of wealth, credit and income by race and neighborhood type, it could be argued FHA

[38] Private MI will insure loans at higher than 97% LTV, but face higher capital requirements and therefore charge much higher premiums. As a result, most lending backed by private MI is below 97% LTV.
[39] See Susan W. Gates, "FHA at a Crossroads" Freddie Mac *Secondary Mortgage Markets (SMM),* vol. 11, no 3, 1995.

should provide its specialized low-cost credit enhancement regardless of an extension of the private market.

Policy Proposal: FHA Risk Sharing The blending of private and FHA insured markets has led to proposals to involve FHA in partnerships with private mortgage insurers, mortgage-bond issuers and financial institutions operating in the secondary markets. Under such proposals, FHA typically retains the catastrophic loss position, but share the top 20 to 30 of percent of losses with a private sector partner. Risk-sharing potentially will allow FHA to use existing private market channels to access customers not served by current FHA lenders. FHA may also gain efficiencies by using risk-sharing partners to operate better underwriting and property disposition functions. By entering into risk-sharing agreements, FHA might force private-sector partners to create more transparent systems for loan application and pricing, bringing standardization to emerging markets. The details of a risk-sharing program will have to be carefully and incrementally developed, but in principal these arrangements might present a more vigorous future for FHA.[40] Other models of risk-sharing might also be explored, such as pool-level reinsurance, or captive reinsurance structures, which share risk, and reward risk-management for specific lenders or products. FHA might also experiment with providing loan loss reserves for pools of loans, serving a greater wholesale, rather than retail level in mortgage markets.

Policy Proposal: FHA Disposition of Foreclosed Properties While FHA has increased its monitoring of lenders and streamlined disposition of foreclosed properties, including creating Asset Control Areas (ACA) that allow expedited sales of units at low costs to local governments and nonprofits, the impact of FHA-loan defaults remains contentious. The use of management and marketing contractors has reduced the time properties remain vacant, but fears of disposition practices destabilizing neighborhoods remain. One proposal is for FHA to take assignment of loans and sell them in bulk, direct from the mortgagee. The purchaser of the loans would have an incentive to maximize repayment, shorten time properties are in default, and reduce claim costs. FHA would need statutory authority to pay claims prior to foreclosure and have lenders assign the mortgages to purchasers. Concerns have been raised about private specialists' sensitivity to the neighborhood impact of properties during disposition, as well as FHA's capacity to manage such an arrangement, however.

II.) Below Market Interest Rates: Mortgage Revenue Bonds

Single-family housing bonds, known as Mortgage Revenue Bonds, or MRBs, are sold to investors in order to finance below-market interest rate mortgages for lower-income first-time homebuyers. Investors are willing to purchase these bonds at below-market interest rates because the income from MRBs is tax-free. MRBs have aided 2 million families since 1986 to access below-market rate mortgage loans. In 1999, $10.3 billion in loans were funded for more than 125,000 lower-income families.[41]

A typical MRB mortgage saves as much as 200 basis points compared to a conventional mortgage offering low downpayments and flexible underwriting. MRB loans are limited to first-time homebuyers who earn no more than the median income in their area. If a borrower's income rises above eligible levels, up to half of any profit from the sale of financed home may be recaptured for up to nine years. By lowering the monthly carrying cost of mortgages with subsidized interest rates, MRBs help first-time buyers overcome income barriers to owning a home. MRBs also can help buyers overcome a lack of downpayment and closing costs. The average MRB-backed loan in 1999 had a loan-to-value ratio of 95.5

[40] In 1995, the Administration proposed restructuring FHA and Ginnie Mae as a government-owned corporation within HUD.

[41] MRBs are limited by a "private-activity," tax-exempt bond volume maximum of $75 per capita. Congress increased the private activity bond ceiling (which includes multifamily, commercial, education and other bonds) from $50 in 2000 (with a minimum of $225 million per state), and will be adjusted annually for inflation beginning in 2003.

percent. However, when MRB-funded mortgages ease downpayment requirements, these loans require the payment of mortgage insurance, which raises the effective interest rate on the loan, reducing the impact of below-market rate funds. However, as described in Section 2, most renters cannot afford a home because they lack income and savings combined. As a result, nearly 60 percent of MRB loans are insured by FHA, providing a credit enhancement for low-downpayment loans without limiting affordability.

State housing agencies issuing MRBs can also convert MRB issuing authority into mortgage credit certificates (MCCs). Rather than creating a subsidy that reaches buyers through reduced interest rates, MCCs provide tax credits directly to buyers of owner-occupied housing, reducing their annual tax liability. MCCs provide first-time homebuyers with a nonrefundable income tax credit of 10 percent to 50 percent of the borrower's annual mortgage interest payments (up to $2,000 annually). An MCC worth 25 percent of a house price creates an interest subsidy equal to an average MRB-funded mortgage loan. While allocated by state housing agencies, MCCs do not require access to debt or equity markets. Typically, buyers receive credits directly from state housing agencies after qualifying for a mortgage from a conventional lender. As a result, the administrative costs of MCCs are low. Only 12 states participated in the MCC program in 1999, issuing 5,200 certificates, however. This low utility rate is in part due to the fact that state agencies using MCCs forego an opportunity to earn revenue from issuing bonds. Also, lenders often do not understand how to use the program. The primary factor limiting MCC usage, however, is its non-refundability. Since any amount of the credit exceeding the taxpayer's total tax bill is foregone, many lower-income borrowers have little use for the MCC.

By most accounts, MRBs and the administration of this program by state housing finance agencies is effective at expanding the reach of mortgage markets. Use of the program varies by state—some states deeply target MRB issuance to lower-income families and minorities, others use the program to serve families with more moderate incomes and smaller shares of minorities. State by state variation in the quality and competency of housing agencies creates some inconsistencies in the program, but by devolving decisions to a state-level flexibility to serve housing markets is retained. The major obstacles facing MRB policy are the low level of the maximum purchase price and the limitations imposed by the 10-year rule.

Policy Proposal: Loan Limits Homes purchased with MRB-financed mortgages must cost less than 90 percent of the average area home price, as determined by IRS-published safe harbor limits—which were last updated in 1994.[42] The utility of the MRB program is limited in higher costs areas, because qualified buyers cannot find homes priced below these obsolete limits. The limits are based on data from a survey conducted by the Federal Housing Finance Board and modified by HUD—but HUD no longer analyzes survey data for the IRS. One solution is to re-calculate maximum home values as a multiple of eligible buyer income, similar to HUD median income guidelines, times a fixed multiple, based on standard underwriting ratios. Setting the MRB purchase price limit at 3.5 times the eligible income limit would dramatically simplify this regulation. According to the Joint Committee on Taxation, this will cost $439 million over ten years. Some argue loan limits are simply an extension of income limits, and therefore duplicative. However, some buyers may be income qualified, but have access to substantial sources of equity. Without a loan limit, these buyers could make very large downpayments on high-end homes financed by an MRB-backed loan. Retaining a simplified rule will direct subsidy to more needy buyers and prevent a public relations fiasco.

Policy Proposal: Repeal of 10-year Rule Initially, allocating agencies could use all payments they received from MRB-financed mortgages to make new mortgages. In 1988, however, the law was

[42] States have the option to determine their own limits, but typically rely on the IRS limits due to the difficulty of collecting and analyzing sales price data at a state level.

changed requiring principal payments received after ten years post-origination to be used to pay off bonds, instead of being rolled over into a new mortgage. The maximum term of an MRB loan is already limited to the maximum term of the mortgages financed—30 years. Even when funds are replaced by issuing refunding bonds, typically when market interest rates have declined and older bonds can be reissued at lower rates, all bonds must be redeemed within 32 years of origination regardless. Repealing the Ten-Year Rule will allow more mortgages to be issued under the private activity bond cap. The Congressional Joint Committee on Taxation has estimated that repeal will cost $2.4 billion over 10 years, if MRB-funded debt was treated equally with other tax-exempt private activity bonds. The NCSHA estimates approximately $2.1 billion in mortgage volume will be lost in 2001 due to the ten-year rule, constraining 27,000 first-time homebuyers from MRB-financed homeownership.[43]

III.) Regulation: Community Reinvestment Act (CRA) and GSE Goals

Community Reinvestment Act: CRA has endured a high level of scrutiny recently. The Federal Reserve, at the direction of Congress, recently issued an evaluation of the impact of the law, as did the Treasury department, in addition to private research conducted in academia and by foundations. The intention of CRA more than 25 years ago was to obligate financial institutions benefiting from federal deposit insurance, or under regulation as part of the bank regulatory system, to make credit available in neighborhoods and to populations considered to be underserved.

Banks get credit for loans made in neighborhoods with incomes of less than 80 percent of area median, as well as to borrowers with similar income levels. Lenders are required to disclose information on the race and income of all loan applications, as well as property location, in order to test for disparate treatment among neighborhoods or racial and income groups. Financial institutions regularly undergo CRA exams, receiving ratings of how well it met the goals of CRA. Community groups report that CRA has been a very powerful tool to encourage lenders to become more active in underserved areas. Lenders receive credit for making loans, investments, grants and other activities that stimulate community reinvestment. Recent studies find CRA has been uneven in its enforcement and effectiveness, but overall is a very important incentive for lenders to engage borrowers that otherwise might not be served. Analysis suggests that CRA has helped to expand access to home mortgage credit for low-income and minority borrowers and neighborhoods.[44]

CRA requires bank regulators to assess institutions for meeting a lending test, investment test, and service test. Large banks face the highest level of scrutiny; smaller institutions and limited purpose banks require lower levels of analysis. In recent years, the market assessment areas under which a lender must be accountable under CRA have become muddied as institutions merged and nationalized, simultaneous to the advent of telephonic and internet lending. Some lenders are not covered under CRA, others are, but only in specific markets. Rural areas, generally, are not well patrolled by CRA regulations.

GSE Goals: HUD is responsible for oversight of Fannie Mae and Freddie Mac through OFHEO (Office of Federal Housing Enterprise Oversight). It has set as aggressive goals for secondary market purchases of affordable housing loans and loans to traditionally underserved areas—soon to be 50 percent of all loan volume. The Special Affordable Housing Goal, loans made to low-income families in low-income areas, was recently raised from 14 to 20 percent of all lending. The Geographical Targeted Goal requires 31 percent of all loans to be originated on properties located in central cities, rural areas or underserved areas. Purchases of loans several years post-origination, also called "seasoned mortgages," which have passed the period when defaults are most likely, also are counted if the originating lender is

[43] National Conference of State Housing Agencies (NCSHA)

[44] See: Eric S. Belsky, Gary R. Fauth, Michael Schill, Anthony Yezer, "The Impact of the Community Reinvestment Act on Bank and Thrift Home Purchase Mortgage Lending", working paper from *Changing Financial Markets and Community Development*, Federal Reserve System's Second Community Affairs Research Conference, Washington, D.C. April 5-6, 2001.

issuing new affordable mortgages with the funds. These goals, including oversight and monitoring by HUD, have helped encourage Fannie Mae and Freddie Mac to expand the reach of the mortgage market to thousands of families.

Policy Proposal: Affirm CRA and GSE Goals These two federal regulatory policies play a very important role in expanding the reach of the mortgage markets. In recent years, these regulations, especially CRA, have been frequently attacked. While regulation has its costs, it also ultimately ensures financial institutions benefiting from implicit or explicit federal guarantees do serve the public interest.

VI.) Government Sponsored Enterprises: Support of the GSEs

The U.S. relies heavily on Ginnie Mae, Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System to finance housing. These secondary market entities guarantee half or more of all mortgage debt issued. The market power of these enterprises, and the return that taxpayers receive, are often questioned, however.

Ginnie Mae: FHA-backed loans are sold in the secondary market through Ginnie Mae, a government owned and operated enterprise (in contrast to Fannie Mae and Freddie Mac, which are shareholder owned). Ginnie Mae guarantees FHA-backed loans issued by lenders as mortgage-backed securities purchased by investors. By selling loans, lenders receive liquidity that allows them to issue more loans. Ginnie Mae charges a 6 basis point annual guarantee fee to the originating lender, but also allows loan servicers to charge a 44 basis point servicing fee.[45] By contrast, conventional loans sold through Fannie Mae or Freddie Mac often incur a 20 to 30 basis point guarantee fee and rarely offer more than 30 basis points in servicing fees. However, unlike Ginnie Mae, originating lenders working with Fannie Mae or Freddie Mac do not have to hold any reserve against loans sold or swapped to the secondary market. Lenders may be forced to replace loans that do not conform to contractual agreements, but generally are able to free up capital for further lending. This accounts for some of the differential in guarantee fees. Ginnie Mae allows larger servicing fees due to the higher costs of servicing government-backed loans.

Federal Home Loan Banks: The Federal Home Loan Bank (FHLB) system of 12 regional banks is regulated by the Federal Housing Finance Board, in its effort to insure member institutions have sufficient liquidity. Advances by the Home Loan Banks are crucial to home lending by its members, avoiding regional credit crunches and freeing up capital flows. Each regional bank is required to provide Affordable Housing Program (AHP) grants and loans for targeted buyers and communities. The AHP is dedicated as 10 percent of bank proceeds, in lieu of payment of certain taxes.

In addition to the benefits of increasing liquidity and the AHP, the FHLB of Chicago recently began the Mortgage Partnership Finance (MPF) initiative in 1997. Similar to the Mortgage Partnership Program developed by other banks, these programs allow depository members of the FHLB system to pass loans to the secondary market, instead of holding them in portfolio. While Fannie Mae and Freddie Mac offer a similar outlet, the FHLB program does not levy an annual guarantee fee. Instead, the program pays the originating lender a credit enhancement fee in exchange for the lender taking on the first loss position (after borrower's equity and mortgage insurance). The FHLB takes on macroeconomic interest rate risks with its access to capital markets, diversifies away prepayment risks, and provides liquidity back to lenders. The local lender retains credit and servicing risks, the risks lenders are in the best position to manage. This risk-sharing arrangement ideally keeps lenders accountable, but increases the over efficiency of lending. Lenders have reduced capital requirements using MPP, compared to other secondary market outlets, since capital requirements are based on the mortgage's credit enhancement rather than the full loan balance.[46] There are now several variations on these models (called MPF Classic, MPF 100, MPF 125, MPF 125+, etc. depending on the risk-sharing arrangement involved) and the

[45] In an effort to raise revenues, Congress directed Ginnie Mae to raise the guarantee fee to 9 basis points in 2002. Even at 6 basis points, Ginnie Mae provides a source of positive subsidy to the federal treasury.
[46] The low-recourse rule under FIRREA applies. See also: < www.fhlbc.com/mpf.htm.>

volume of loans using these programs is predicted to increase. Smaller lenders, too small to meet the requirements of Fannie Mae and Freddie Mac, are attracted by the potential to recycle their conventional loans at a lower-cost than in the private-placement mortgage-backed security market. While still a growing effort, it demonstrates the level of innovative strategies possible.

Fannie Mae and Freddie Mac: With special products and aggressive marketing, Fannie Mae and Freddie Mac helped more traditionally underserved borrowers to access homeownership. Congressionally-chartered and privately owned, the mission of Fannie Mae and Freddie Mac is to provide liquidity and stability to the housing finance system while promoting access to mortgage credit throughout the nation.

Homebuyers pay lower interest rates if their mortgages do not exceed the $275,000 "jumbo" limit for loans eligible for purchase by Fannie Mae and Freddie Mac.[47] The cost of mortgage credit is lower for all borrowers purchasing homes with mortgages below this threshold amount. In 1998, when the financial markets faced a liquidity crisis in the wake of a global economic slowdown, U.S. mortgage borrowers did not experience an interruption in credit, in part due to the role of these GSEs. These enterprises also have invested in costly automated underwriting systems, now adopted as industry standards, and have helped reduce overall transaction costs in the market. These GSEs develop innovative loan products, as well as support national marketing and outreach efforts. One example is the "step-down mortgage", targeted to subprime borrowers. These loans have higher interest rates for the first 24 months, but rates decline to conventional, prime rates if the borrower makes regular, timely payments. Freddie Mac's innovative "Don't Borrow Trouble" initiative, and Fannie Mae's partnership with the Self-Help Credit Union to purchase affordable loans are further examples of new approaches supported by these entities.

Fannie Mae and Freddie Mac are considered to have an implicit guarantee from the federal government, allowing them to borrow at rates just above treasury bills and below what their corporate credit ratings would otherwise dictate. These enterprises are also exempt from certain fees, regulations and taxes other corporations would be required to pay. The Congressional Budget Office has conducted controversial research showing consumers do not benefit from Fannie Mae and Freddie Mac's special treatment as much as previously believed. Some primary market lenders and private mortgage insurance companies claim Fannie Mae and Freddie Mac use duopolistic market power to their own advantage against the rest of the industry. Advocates for Fannie Mae and Freddie Mac argue these entities' market power is appropriate since economies of scale are required to efficiently manage and channel risks in the mortgage market. Since weakening Fannie Mae and Freddie Mac could increase the costs of credit, other observers have suggested Ginnie Mae, the Home Loan Banks and other GSEs ought to be encouraged to expand their role, fostering greater competition among existing secondary markets.

Policy Proposal: Affirm GSEs as Sources of Standardization and Innovation Government supported secondary markets can use their clout to establish best practices, restrictions and pricing standards. For example, in 2001 Fannie Mae and Freddie Mac will wrap over $7 billion in subprime loans, promising these loans do not contain provisions harmful to consumers.[48] Their role should add transparency to the market, reducing opportunities for unscrupulous lenders to take advantage of consumers. Other niche lending markets, such as home improvement lending, acquisition and development finance, or manufactured housing lending, present similar opportunities to expand the reach of mortgage markets though GSE innovations. While no specific federal policies are required, policy makers ought to expect the Home Loan Banks and Ginnie Mae, in addition to Fannie Mae and Freddie Mac, to serve as leaders and stewards of the mortgage markets. Proposals to weaken these entities are unlikely to benefit consumers, but the regulatory role of HUD and the Office of Federal Housing Enterprise Oversight, discussed above, as well as the Federal Home Loan Bank board remain important to ensure public policy goals are being advanced by the GSEs.

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[47] Congress raised the limit for conforming loans to $325,000 for 2002.
[48] *Inside B&C Lending*, October 15, 2001.

V.) Expanding the Reach of Mortgage Finance Through Tax Policies

Federal income tax policies support homeownership through the mortgage interest deduction, the real estate tax deduction, the exclusion of house price appreciation from capital gains taxes, and penalty-free IRA withdrawals for first-time buyers.

The largest tax expenditures for homeownership are the mortgage interest deduction and the real estate tax deduction. Valued together at $58 billion, these two deductions amount to twice the amount allocated to all direct federal housing assistance programs in the U.S.[49] Most low-income households' do not use these deductions, however. Due to smaller loan sizes and lower property values, most lower-income families itemized deductions do not exceed the value of their standard deduction. Since the standard deduction is a fixed amount for all taxpayers in each filing status, only as incomes and itemized deductions rise does it make sense to bypass standard deduction and tax advantage of the mortgage interest and real estate deductions. As a result of the progressive nature of federal income tax rates, even if lower income owners do itemize their deductions, they receive a smaller deduction as a percentage of income than more affluent buyers.[50] Unsurprising, and estimated 90 percent of the total benefits of the mortgage interest deduction accrue to homebuyers with more than $40,000 in income.[51]

Excluding capital gains from owning a home may help reduce the need for sellers to inflate their asking prices to compensate for taxes, but offers little direct benefit to first-time buyers. The exclusion of early-withdrawal penalties on up to $10,000 of tax-advantaged savings stored in an Individual Retirement Account (IRA) for a home purchase provides a potential source of downpayment. However, only 17 percent of low-income renters under 35 have retirement accounts.[52] It is also unlikely for low-income families to have a parents or grandparentwith a well-funded IRA account.[53] Overall, current tax law does little to expand the reach of mortgage markets to low-income households. In fact, some researchers have shown the mortgage interest and real estate tax deduction are actually included in the price of homes—that is sellers, buyers and loan underwriters assume the use of these deductions in determining affordability.[54] Thus, the cost of homes is inflated, but since households with low tax liabilities cannot take advantage of these deductions, they are penalized.

Policy Proposal Overview: Tax Credits for Homeownership In rental housing, the Low Income Housing Tax Credit (LIHTC) has lead to the development of more than one million units for low-income renters since 1987. Allocated by state housing finance agencies annually through a competitive process, credits enhance the returns of project development, reducing the amount of debt needed and produce apartments affordable to low-income families. The success of the LIHTC has resulted in proposals for a similar credit for home ownership. In the last decade a number of proposals have been created, several of which have been proposed as legislation.

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[49] Some economists argue that the largest tax benefit of homeownership is the fact that imputed rent (in effect, the rent that buyers who own their home free and clear do not have to pay) is not taxed. Value estimate from Joint Committee on Taxation.

[50] Wealthier buyers tend to buy more expensive homes, which result in higher interest payments and, therefore, larger tax deductions. Moreover, the rate structure increases as incomes rise, so reducing a $1 of taxable income in a 33% marginal tax bracket ($0.33) is more valuable than a $1 off income in a 15% marginal bracket ($0.15).

[51] Richard Green and Andrew Reschovsky, "The Design of a Mortgage Interest Tax Credit: Final Report Submitted to the National Housing Institute," September 1997. See also: Green, Richard K. and Kerry D. Vandell, "Giving Households Credit: How Changes in the Tax Code Could Promote Homeownership" Center for Urban Land Economics Research, University of Wisconsin-Madison School of Business, Working Paper, January 8, 1998.

[52] Federal Reserve Survey of Consumer Finances, 1995 tabulation by Joint Center for Housing Studies

[53] 1997 tax law allows withdraws up to $10,000 each by eligible buyers, their parents and grandparents towards first-home purchase. 2000 tax laws also allow a non-refundable tax credit matching up to 50 percent of IRA savings by low-income taxpayers, which could also be tapped penalty-free.

[54] Follain, James R. and Lisa Strurman, "The False Messiah of Tax Policy: What Elimination of the Home Mortgage Interest Deduction Promises and a Careful Look at What it Delivers" Working Paper, Syracuse University, April 17, 1998.

Tax credits to subsidize the cost of homeownership can either be provided directly to homebuyers or they can be provided to lenders and investors who pass through the benefits of the credit to homebuyers. Credits provided directly to homebuyers are theoretically more efficient since a financial intermediary will not absorb part of the subsidy. However, it is difficult to design an individually-based tax credit that is not available to all taxpayers who qualify under the terms of the tax credit. Such open-ended tax credits tend to be considerably more expensive from a government revenue standpoint, and expenditures tend to be difficult to predict and control. More importantly, a tax credit is of no value to an individual with little or no income taxes due, unless the credit is refundable (meaning tax payers could receive a check from the Internal Revenue Service in the amount of the any unapplied credit). However, refundable tax credits are generally dismissed by policymakers due to fraudulent activity experienced under previous tax credit policies. As a result, most tax credit proposals are designed to provide a fixed value annually, and are provided to corporations and investors with sufficient tax liabilities to use a credit. The LIHTC is allocated per capita and administered by state or federal agencies, primarily to corporate investors.

Policy Proposal: Second Mortgage Tax Credit for Homeownership One proposal is to create a lender-based tax credit used to subsidize second mortgage loans to cover closing costs and downpayments (second liens are second in line to collect in the case of default). As long as loan-to-value ratios are low, the first mortgage lender is protected from losses even if real estate values decline, much as they would using mortgage insurance. Allocating agencies could auction off per capita amounts of tax credits to lenders agreeing to originate 30-year, low-interest-rate second mortgages. If affordable homes sell for \$100,000, each second mortgage might be for 22 percent of the home's appraised value, or \$22,000 to cover a 20 percent downpayment and two-percent closing costs, leaving an 80 percent loan-to-value first mortgage.[55] The tax credit reduces the lender's annual tax bill by an amount over ten years that offsets a below-market interest rate on the second mortgage. By reducing the amount of the first mortgage to below 80 percent of appraised value, borrowers do not need to pay for mortgage insurance, reducing monthly payments on the first mortgage. This proposal helps first-time homebuyers overcome income barriers while also addressing a lack of savings for homeownership.

However, second mortgages have drawbacks. Such a loan would require lenders to develop new underwriting and portfolio modeling capacity, as well as create new documentation. There is also no consistent secondary market on a national scale for second mortgages. The market rate of return for such loans is difficult to ascertain given the paucity of these loans currently. Since the credit makes up the difference between affordable and market rates, valuing the credit may initially be difficult. Using two mortgages also adds transaction costs, each requiring disclosures, processing and loan servicing. Since downpayment and closing cost loans in a second position are riskier than other loans, additional oversight and capital requirements will be required of lenders. While other federal programs, as well as market-driven products, have certainly proven administrative mechanisms can be developed, this implies some time for the program to evolve. Beyond problems faced by lenders, some borrowers may struggle to manage two separate mortgage payments. Unlike mortgage insurance, the second mortgage cannot be canceled after combined loan-to-value ratios are reduced to conforming levels, nor will a premium refund be available (both loans could be refinanced into a conventional loan, but the costs of refinancing may be prohibitive).

Second lien loans for downpayments and closing costs have been used, albeit somewhat cyclically, in the past, however, so some market experience is in place. Moreover, the home equity lending market has substantial experience with second lien markets, and private placement secondary markets for downpayment and closing cost loans currently exist at a small scale. A credit enhancement at the individual loan or loan pool level, likely from FHA or private mortgage insurance, could help standardize this market into mainstream financial channels. It is likely many bidding lender pools would include nonprofit lenders or CDFIs, many with substantial experience making and servicing downpayment and

[55] Michael Collins, Eric Belsky and Nic Retsinas, "Towards a Targeted Homeownership Tax Credit" Working Paper, Center for Urban Studies of the Brookings Institution, 1999.

closing costs loans. From 1998 to 2000, for example, nonprofits in the NeighborWorks® network issued more than $46 million of these loans, leveraging nearly $1.3 billion in private lender first mortgages. Reaction by lenders and housing agencies to this proposal has been mixed. Mortgage insurers have most resisted the concept because it will likely displace existing insurance products.

Policy Proposal: First Mortgage Tax Credit for Homeownership Another approach for a lender-based tax credit is to use credit proceeds in the form of prepaid points to buy-down the interest rate on a first mortgage. For example, a $100,000 house might have 20 points of interest rate write-down, bringing an 8 percent interest rate down to 4 percent by paying off $20,000 of interest up front (assuming the loan is pre-paid in 10 years).[56] Lenders would receive a one-time tax credit, in addition to below-market rates of interest and return of principal. Lenders would have to factor prepayment and default probabilities into their bid for a credit, and could also sell their credits to other parties. By lowering interest costs, this credit provides a subsidy similar to the Mortgage Revenue Bond program, without issuing long-term tax-exempt debt, but potentially providing much deeper interest rate subsidies.

This proposal reduces interest costs on a single home mortgage, but might not reduce downpayment and closing costs. Without a high loan-to-value ratio, buyers will need to make larger downpayments, creating wealth barriers to homeownership. The first mortgage amount will likely need to be raised above appraised value to finance closing costs, creating a total loan-to-value ratio of 102 percent or more. Like higher LTV MRB-backed mortgages, these loans will likely rely on FHA or other mortgage insurance. Also like MRBs, however, due to below-market rates, the impact of mortgage insurance premiums on affordability will be reduced. This proposal would use existing mortgage application and servicing systems, unlike a second mortgage tax credit. The one-year term of this credit also provides for efficient administration and oversight. Like the second mortgage tax credit, this proposal is another innovative example of how the tax code can be improved to promote low-income homeownership.

[56] Joe Birbaum and Geoffrey Cooper, "Revisiting Tax Policy," *Mortgage Banking* Vol. 61, #2 November 2000.

SECTION 4: EDUCATING AND PROTECTING CONSUMERS ENGAGED IN MORTGAGE AND HOME EQUITY MARKETS

Balancing Risks of Homeownership Policies with Consumer Welfare

Buying and owning a home is a riskier proposition for families than renting. Buyers take on enormous debts, sign 30-year mortgage contracts, and become responsible for the maintenance costs of their home. Because foreclosure can devastate a family's economic and social standing, as well as destabilize neighborhoods, making sure families have sufficient personal financial management skills is more than an ancillary issue. Consumers infrequently apply for loans and typically do not understand the complexity of the mortgage transaction. Lenders and real estate professionals, in contrast, engage in these transactions frequently. This presents an information asymmetry between parties in the transaction. Loan applicants, especially first-time buyers, rely on information provided by others. Due to the wide variety of loan products and pricing structures, comparisons of loan terms, fees and requirements are difficult. Consumers often cannot evaluate if the loan they have been offered is a "good deal." Even after closing on a home, new homeowners often need help in understanding any recourse they might have, as well as how and when to refinance their mortgage or sell their home. As homeownership is expanded to more low- and very-low income people, public policy must insure buyers understand their rights and responsibilities. Financial education provided by community organizations in partnership with financial institutions can help families enter the mainstream financial sector, successfully find the best deal and a fair loan, as well as increase their capacity to handle financial emergencies.[57]

Fair Lending

Federal law requires all would-be homebuyers be treated equally by real estate agents, lenders, appraisers, and insurance brokers. Fair lending referrals to the Department of Justice and enforcement of these laws, however, are uneven. Recent research suggests minorities may still face discrimination due to differential treatment individually or in terms of disparate impact collectively.

Minority mortgage applicants continue to be rejected at much higher rates than white applicants. According to 2000 Home Mortgage Disclosure Act (HMDA) data, conventional home purchase loan denials rates were 22 percent for white applicants, 31 percent for Latino applicants and 45 percent for African-American applicants. Studies show the income and employment history of applicants, the type of property involved, as well as credit quality can explain some of this differential, but some remain. Evidence is not definitive due to a lack of a national controlled study, but still suggestive that minorities face significant hurdles.[58]

The potential for discrimination exists at several points in the homebuying process, from the home search, to the loan application and approval process, to the type of loan terms actually provided. Differential treatment discrimination might be found not only when a minority applicant is rejected and a similar non-minority applicant is approved, but also when a minority borrower receives less favorable loan terms, fees or pricing than a comparable non-minority applicant. Similarly, disparate impact discrimination is found when an otherwise color-blind lending policy in practice disadvantages a larger share of minorities than non-minorities, controlling for other factors.

Policy Proposal: Continue Fair Lending Efforts, Examinations and Enforcement Outreach and advertising can dramatically impact minority borrowers perceptions of lenders. Conventional lenders should increase outreach efforts in minority areas and with community-based partners to attract minority

[57] Sherrie L.W. Rhine, Maude Toussaint-Comeau, Jeanne M. Hogarth, and William H. Greene, "The Role of Alternative Financial Service Providers in Serving LMI Neighborhoods," working paper from *Changing Financial Markets and Community Development*, Federal Reserve System's Second Community Affairs Research Conference, Washington, D.C. April 5-6, 2001.

[58] Margery Austin Turner and Felicity Skidmore, *Mortgage Lending Discrimination: A Review of Existing Evidence*, September 1999.

applicants, and offer competitive loan products. Regulatory agencies should continue to provide incentives for such outreach efforts, as well as CRA credit for participation in subsidy or guarantee programs for minority borrowers or in targeted neighborhoods. Regulators should also enhance quantitative examination analysis with loan records as part of fair lending reviews. Regulators also should increase their scrutiny of the terms and conditions offered by lenders to test for discriminatory pricing. Analyzing the use of credit scores, loan pricing and terms, including points, fees, financing of lump sum insurance premium payments, balloon payments, and prepayment penalties will help diagnose actions on behalf of institutions, subsidiaries or individual underwriters. Finally, automated underwriting systems should be closely monitored over time for any evidence of unequal treatment.

Consumer Disclosure

The Truth In Lending Act (TILA), Home Ownership and Equity Protection Act (HOEPA), and Real Estate Settlement Procedures Act (RESPA) are intended to ensure that consumers obtain standardized information and clear direction during mortgage-financed home purchase transactions. TILA is administered by the Federal Reserve under Regulation Z and requires consumers to receive standard documents to make comparisons between the cost of a loan to other loans, including finance charges and the annual percentage rate (which includes the amortization of closing costs). TILA also provides consumers a three-day right of rescission for mortgage loans, and requires truthful advertising of loan terms, costs and fees.

HOEPA was created in 1994 in response to reports of fraudulent lending, amending TILA for high-cost mortgages, defined as those with rates 8 percentage points above comparable Treasury securities, or loans with fees and points exceeding 6 percent of the loan amount.[59] HOEPA requires a disclosure form to accompany high-cost loans explaining to borrowers they are about to enter a contract with high costs, and that they need not complete the transaction. The disclosure also highlights to the borrower their home could be taken if they fail to comply with these loan terms. HOEPA loans are prohibited from containing certain prepayment penalties, increased interest rates in default, balloon payments in the first 5 years, and negative amortization. Recently approved new HOEPA rules also prohibit loan flipping--a lender cannot refinance another HOEPA loan to the same borrower in a 12 month period without proving it is in the borrowers best interest. Lenders also must document the borrower's ability to repay the loan and disclosure if optional insurance and other fees are included in the loan or payments.

RESPA is administered by HUD’s Regulation X and requires pre-closing disclosure of costs related a potential mortgage transaction. Using a “good faith estimate,” as well as a settlement statement (form HUD-1 or HUD-1A) all parties to the transaction receiving a fee are disclosed. RESPA also prohibits kickbacks, referrals and fees among brokers, lenders, appraisers, title companies, insurers and agents. In 2000, HUD fielded more than 900 RESPA-related complaints, approximately one-third involving kickbacks and other questionable payments. In October 2001, HUD clarified REPSA requires disclosure of the specific services to be performed by the broker, a statement of whether the broker is acting as an agent for the borrower, and the amount of total compensation, including any yield spread premium.[60] HUD also restated its policy that excessive and unreasonable fees are illegal under RESPA because they are unreasonable and not a payment for a bona fide service. Finally, HUD is dedicating additional resources and personnel to support RESPA enforcement, as well as enhanced RESPA enforcement coordination between HUD and the major Federal banking regulators (Federal Deposit Insurance

[59] In December 2001 the Federal Reserve Board issued new HOEPA rules with lower thresholds and added restrictions.

[60] Yield spread premiums allow borrowers to pay less at the time of settlement, but pay a higher monthly payment over the life of the mortgage. The broker pays the upfront costs instead, and then recoups these costs by selling the mortgage to an investor at a higher interest rate. Yield spread premiums can be abused when a broker persuades borrowers to accept a higher rate without lower upfront costs. HUD's policy is yield spread premiums are legal if the broker actually performs services for the homebuyer, and the compensation received is related to the value of the services performed. Disclosure is especially important when borrowers may be paying yield-spread premiums.

Corporation, Comptroller of the Currency, National Credit Union Administration, Office of Thrift Supervision and the Federal Reserve).[61]

Related to these "retail level" policies, are wholesale level disclosures. The Home Mortgage Disclosure Act (HMDA) provides the industry and regulators with data to monitor financial institutions lending practices. Lending institutions submit their loan application records, which are compiled and distributed by the Federal Financial Institutions Examination Council (FFIEC). Institutions are exempt if their assets are less than $31 million (for FY 2001), if mortgage loans are less than 10 percent of their lending, or fewer than five loans are made in a metropolitan area. Institutions report the race, gender and income of loan applicants as well as the property location (census tract), the type and amount of the loan, and if the lender approved, rejected, denied or originated the loan application.

Policy Proposals: RESPA/TILA/HOEPA Modifications Proposals have been suggested to amend RESPA and TILA to make information more accessible consumers.[62] For creditors and settlement-service providers, the TILA and RESPA rules can be complicated and may pose liability risks, however, and efforts to simplify or reform these regulations have been hotly contested.[63] Existing RESPA and TILA regulations protect buyers to an extent, particularly by disclosing loan terms and conditions, and highlighting high cost loans under HOEPA. At a minimum, these documents should be improved by enhancing definitions and increasing clarity, including multi-lingual forms. Given changes in the market, and the need to better protect consumers, a renewed effort to revise disclosure laws may be warranted.

RESPA and TILA could be improved so that information on these disclosures is simpler, more reliable and provided earlier in the transaction. For example, RESPA could be amended to allow lenders to bundle all fees for a transaction into one fixed price. Borrowers could then shop around for the best rate of low interest rates and fees. Another proposal related to TILA is requiring lenders to disclose to borrowers all of the products a lender and its subsidiaries offer. Recently, consumer advocates have voiced concerns that marginal mortgage loan applicants are regularly "referred down" to high-cost subprime subsidiaries, but rarely are consumers "referred up" to prime products. Requiring all lenders to post rate sheets for all available loan products might be one way to help consumers recognize their menu of options. Likewise, some subprime lenders are accused of not reporting current loans to credit bureaus, out of fear good-paying borrowers will attract prime-priced lenders looking to refinance higher-priced loans profitable to the originating lender. This is a practice most lenders have disavowed, but might merit legislative action to end this practice.

One option under RESPA is to begin systematic collection of HUD-1 and HUD-1A settlement statements (HUD-1 forms involve buyers and sellers, HUD-1As cover single party transactions—typically for a new home). Like other data, HUD could establish a central depository for these data, allowing participants in the market to establish benchmark costs and fees. Such data also would create opportunities for HUD and other researchers to analyze anomalies and trends that could diagnose predatory practices.

Policy Proposals: Disclosure Several changes proposed to Regulation C, implementing the Home Mortgage Disclosure Act, might well enhance the utility of these data. Lenders could be required to report applications in rural areas, as well as add interest rate (APR) and loan fee information. Subprime and manufactured housing loans could be flagged in the same way FHA loans are identified. Also, loan applications taken over the phone and Internet could be required to report race, income, and gender of the applicant. The Federal Reserve is also currently examining modifications to HMDA, which may include some degree of these changes. If approved, the ability of lenders, communities and federal agencies to analyze discriminatory and predatory lending practices will increase. By expanding the number of institutions required to report under HMDA, and adding richer detail, greater understanding and analysis

[61] 24 CFR Part 3500 *Federal Register*, Vol. 66, No. 202, October 18, 2001
[62] See special issues of *Journal of Real Estate Finance and Economics,* 2001
[63] On October 15, 2001, as this document was in its final stages, HUD announced a series of new reforms on this topic.

of the market will be possible. While opponents argue HMDA regulations are burdensome for smaller lenders, or lenders with a small volume of mortgage lending, today's computerized database and electronic reporting technology have largely reduced the costs of disclosure.

Consumer Education and Counseling

Homebuyer education programs were begun in the 1960's and 1970's, in response to rising foreclosures, particularly among FHA borrowers.[64] Provided by local governments, nonprofit organizations, housing agencies, lenders, mortgage insurers and real estate agents, the industry is still nascent. Recently, viewed in the context of raising overall financial literacy—from public school curriculum on personal finance, to group classes provided by faith-based organizations, to public awareness campaigns on using consumer credit, there has been increasing interest in homebuyer education as a method to prepare families to take on the responsibilities of a mortgage and a home.

Homebuyer education ranges from workbooks handed out by real estate agents, to advice and information given out on the telephone, to formalized group classes, informal homebuyer clubs and even intensive one-on-one counseling. Each potential buyer has unique needs, but few standards exist concerning how to provide homebuyer education and counseling (in general, counseling refers to one-on-one or small-group services, and education to self-guided or classroom instruction). Services usually occur before the purchase, or ideally even before a family begins to search for a home, but often after a purchase contract is signed. Counseling may also be provided post-purchase, however, to help families maintain their home, refinance, take out home improvement or reverse mortgages, or to manage delinquencies.

Recent groundbreaking research by Freddie Mac demonstrates that pre-purchase homebuyer counseling and education has a measurable, positive impact on loan performance. Face-to-face counseling, as opposed to that provided by a workbook or telephone, reduces defaults by up to 34 percent, controlling for other factors.[65]

Expanding homebuyer education is problematic, however. Many buyers do not want to take time to sit in classes or prepare workbooks before looking for a home and mortgage. Taking part in education and counseling can slow down the buying process, potentially jeopardizing a purchase offer. Real estate agents, sellers and lenders may discourage education or counseling for this reason. Provision of homebuyer education and counseling is also expensive – typically $100 to $300 depending on the length, intensity and content. Many borrowers, especially first-time borrowers, lack cash resources to pay such a fee. Moreover, finding a qualified provider of homebuyer education and counseling can be difficult.

The national capacity of the nonprofit homebuyer education and counseling delivery system is not large enough to serve even a fraction of the approximately 1 million lower-income first-time homebuyers nationally each year. Best estimates are 120,000 to 150,000 individuals receive pre-purchase education though HUD-related programs—a small fraction of homebuyers annually.

Potential buyers need a trusted, third-party to help them assess their options and select the best home and loan product for their situation. Nonprofits, while not immune, are less likely to be driven by demands of market forces into pushing biased information in an attempt to sell a product. It is apparent lenders and borrowers, who benefit most directly from counseling, might be better targeted as sources of funding for counseling than the federal government. Lenders counter that the market is too competitive to allow for such costs, and many buyers simply cannot afford to pay. Stylized estimates modeled in Table

[64] See: George W. McCarthy and Roberto G Quercia, "Bridging the Gap Between Supply and Demand: The Evolution of the Homeownership Counseling Industry" Report # 00-01, Research Institute for Housing America, 2000.

[65] Abdighani Hirad and Peter Zorn, "A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling" Freddie Mac, May 21, 2001.

8 show lender and buyer expected gains from counseling. Borrowers who default often lose their home, have ruined credit for years, and suffer from emotional stress. Neighborhoods with defaulted homes endure vacant units, with incumbent issues of neglect, as well as volatile values as foreclosed units are sold. There is a general public good generated by helping borrowers avoid default.

HUD support for housing counseling, provided under Section 106, has increased to almost $25 million annually, but is spread among more than 1,200 agencies, one-third direct to 350 HUD-approved providers, one-third to national intermediary umbrella organizations and one-third to state housing finance agencies. These funds do not cover even a majority of counseling costs, and also erect limitations to counseling providers accepting additional fees. Some nonprofits using these grants suggest that HUD's administration and restrictions are too cumbersome to warrant applying for funds.

Table 8

Estimation of Value of Home Buyer Counseling			
	No Counseling	Counseling	Difference
House	$100,000	$ 100,000	-
Loan	$94,289	$94,289	-
Default Probability (FHA Cumulative Claim Rate)^	5.00%	3.50%	1.50%
Default Loss Lender (23% balance)	$21,686	$21,686	-
Default Loss Borrower (6% balance)	$5,657	$5,657	-
Expected Loss Lender P*Loss	$1,084	$759	$325
Expected Loss Borrower P*Loss	$283	$198	$85

Counseling reduces probability of default 30%, approximate magnitude in Hirad and Zorn study.
^ FY 2000 Actuarial Review, 2001 Projected Cumulative Claim Rate

Policy Proposal: HUD Housing Counseling Funding (Section 106) HUD's Section 106 counseling budget is small relative to the market, small relative to HUD's budget, and should be increased. However, administration of these funds needs improvement. Counseling funds are currently used for all types of assistance, including advice on finding an apartment and applying for reverse mortgages. A dedicated line for pre- and post-purchase education will help expand the reach of the program. HUD regulations prohibiting clients from paying a fee, and prohibiting lenders and real estate agents from partially covering fees for homebuyer services, should also be changed. Tripartite payments from the consumer, public sector and private sector are consistent with the distribution of benefits education and counseling create. HUD might even explore a matching grant mechanism to leverage private sector contributions, or a sliding scale fee based on the income of the counseled family.

Policy Proposal: Creating Incentives for Counseling In the late 1990's, FHA allowed buyers to reduce mortgage insurance premiums in exchange for taking a course and attending counseling. That option was eliminated in the most recent FHA premium reductions, however. Counseling providers have suggested this discount strongly encouraged customers to seek pre-purchase services. Reducing interest rates or mortgage insurance premiums may be justified given counseling's role in reducing the risk of default. However, these discount programs do incur costs that may reduce the numbers of homebuyers who can be served by a fixed amount of insurance in the near term. Buyers mandated to take counseling may face timing and accessibility issues, as well, that will delay the buying process and frustrate borrowers, sellers, real estate agents and lenders. Such requirements may also precipitate use of low-quality telephone or home study services, which have proven much less effective in reducing delinquency. Creating incentives for homebuyer counseling by offering discounts to borrowers in FHA and RHS programs, as well as state housing agency mortgage-revenue bond products, might help stimulate maturation of the industry, however.

Policy Proposal: Mainstreaming Counseling into Home Sales Another avenue for encouraging homebuyer education would be a modification of RESPA to include counseling as a dedicated line item on HUD-1 settlement forms. This change will help promote transparency and institutionalize counseling into the home-buying process, particularly if combined with proposals to collect and disseminate HUD-1 data nationally. Modifications of HUD-1 forms are often slow and controversial however, and the definition of each cost often is debated in court. Homebuyer education might occur a year or more before a home sale closing; clear boundaries of what costs should be included for expenses incurred, and from how far back, will be required. Documenting the type, provider and costs of counseling, however, will help establish benchmarks for the industry.

Related to this proposal is encouraging all potential first-time homebuyers to attend homebuyer education classes before they search for a home or sign a purchase contract. Likewise, during the three-day right of rescission period granted under TILA, borrowers should be directed to home buying counseling agencies.

Policy Proposal: Financing Counseling Costs Another option is to permit counseling fees as an allowable cost for mortgage loans, exempt from the HOEPA regulations, up to a set amount (perhaps $300 to $500, depending on the market). This fee would provide agencies with funds to counsel families they are serving, including required travel costs in sparsely populated areas. Such a program would slightly increase interest costs to low-income borrowers, as costs would be spread out over the term of the loan, but expand the ability of providers to capture revenue and build capacity.

Policy Proposal: Support and Expansion of Counseling Entities Many communities simply lack qualified providers of education and counseling. Using state and local agencies, HUD could enhance the delivery system for homebuyer education. State housing finance agencies could expand direct provision of services, as well as develop statewide networks of nonprofit providers. Public Housing Agencies could fund homebuyer education efforts, especially, but not restricted to, households in Family Self Sufficiency and Section 8 homeownership programs. More homebuyer education providers could also be included in local allocations of HOME and CDBG, with an emphasis on the development of new providers in areas with no homebuyer programs. Federal support for the Neighborhood Reinvestment Corporation, Catholic Charities, AHECI, Housing Partnership Network, National Urban League, the Council of La Raza and other national intermediaries could also focus as much on developing providers as supporting existing ones.

Policy Proposal: Establish Quality Standards Given the enormous variation in services, quality standards for homebuyer education are an important issue. HUD began certification of counseling programs in the 1970's, but primarily as a screen to determine eligibility to apply for funds. Standards for curriculum and program quality have been set by national umbrella organizations, such as AHECI and Neighborhood Reinvestment Corporation, but the industry is fragmented into for-profit and non-profit provider networks. Federal standards, which allow for local flexibility, might help promote uniformity. Oversight and enforcement of such standards should not create barriers to expanded services. Similar to other industries, standards should be clear to the consumer, and compliance predominately voluntary. State housing agencies might play an important role in establishing and enforcing standards, especially in their role as a funder of state homebuyer education and counseling programs. A multi-agency task force should be established to examine the homebuyer education industry and issue provisional standards defining the minimum criteria for a quality pre-purchase education program.

Policy Proposal: Require Counseling Several proposals have been drafted in response to predatory lending suggesting certain "high cost mortgages" under HOEPA, with rates, fees and terms that are difficult for borrowers to understand or manage, should require counseling prior to closing. Since borrowers tapping these loans are likely to be more at risk than other borrowers, this seems an appropriate triage of education and counseling services. However, these borrowers may be least likely to afford to pay for such services, and requiring counseling may pressure providers to offer the fastest and lowest-cost services (which may not be of the appropriate quality or intensity).

Predatory versus Aggressive Lending

Concerns have been mounting over the behavior of so called "predatory lenders" who target homeowners and offer mortgages with high rates, unfavorable terms and unfair fees. Such lenders misrepresent or obscure details of the loan, or target borrowers for repeated refinancing at higher rates or fees simply to generate lender profits as opposed to benefit the borrower. Recent news accounts of mortgage borrowers being harmed by unscrupulous lenders certainly have captured the attention of policy makers and industry. The idea that lenders might jeopardize a person's home by layering on debt that cannot be repaid is generally agreed to be unfair, but defining which loans and lenders are inappropriate is less straightforward. Predatory practices might be roughly grouped into five categories:

(1) Loans that charge higher interest rates than the risk level involved;

(2) Loans with higher fees for services than is standard relative to the service provided to the customer, including fees charged for multiple, successive refinancing of a loan by the same lender over a short period of time which result in no net gain for borrowers;

(3) Loans that bundle financial products that offer little comparative value to consumers;

(4) Loans that are underwritten with debt-to-income and debt-to-asset values that exceed levels a borrower can reasonably expect to repay;

(5) Prepayment penalties, balloon payments, and mandatory arbitration clauses, in combination with other practices, can also be used to entrap borrowers in high-cost loans.

Loans with high interest rates, particular fees or terms may actually reasonably account for added risks and costs, and may be in the best interest of borrowers. For example, subprime loans, which carry higher interest rates, are more likely to refinance when interest rate decline. Investors in these notes are returned their principal at a time when rates or return on alternative investments are relatively low. This increases investor risk, the returns they demand and ultimately the cost of these loans. Only loans that take advantage of customers to achieve supernormal profits are properly labeled predatory. Some have blamed lax state and federal enforcement for the spread of predatory practices. Many of the fraudulent of misleading practices used by predatory lenders are already regulated or illegal. However, other practices are not illegal, and in fact what some lenders might view as fair risk-based pricing or effective consumer marketing is perceived by some advocates as de facto predatory lending.

Despite the high level of inquiry involved, it has been challenging to agree on what specific combination of practices are defined as being predatory, and likewise hard to estimate the number of loans or lenders that might be involved. Some states and localities have passed limits on loan terms, but their ultimate power to regulate lending is debatable. Aggressive lending by some lenders in these states decreased after these laws were passed, leading some to wonder if these regulations went too far. A growing number of lending professionals speculate national regulations and standards are required for regional and national financial institutions to operate efficiently, but are leery of the impact of national regulations similar to anti-predatory lending laws passed in some states and localities. Preserving aggressive practices that legitimately expand credit for marginal borrowers, while prohibiting predatory practices, is a delicate balance. The mortgage industry has largely claimed practices deemed predatory are already illegal.[66] By and large, mortgage industry-backers suggest, the market is self-regulating driven by a need to preserve the reputation of institutions. Preserving aggressive practices that legitimately expand

[66] See: Kathleen C. Engel, Patricia A. McCoy ,"The Law And Economics Of Remedies For Predatory Lending," Paper for *Changing Financial Markets and Community Development,* Federal Reserve System's Second Community Affairs Research Conference. April 5-6, 2001.

credit for marginal borrowers, while prohibiting predatory or discriminatory practices, is a delicate balance.

Policy Proposals: Education, Enforcement and Balanced Regulation In June of 2000, a task force set up by HUD and the Department of Treasury published a report, "Curbing Predatory Home Mortgage Lending". Based on a series of forums and research, recommendations were made for new legislation and regulation in four areas:

(1) Consumer literacy and disclosure.

- Increase access to counseling for HOEPA loan applicants
- Amend RESPA and TILA to make information more accessible consumers, including accuracy standards for Good Faith Estimates
- Increase reporting requirements, and number of lenders, reporting under HMDA

(2) Prohibition of harmful sales practices.

- Reduce loan flipping through increased restrictions on successive loan refinancing.

(3) Restrict abusive terms.

- Establish maximum debt to income ratios and residual income guidelines.
- Lower HOEPA interest rate triggers, include more fees in the HOEPA threshold, and lower minimum fee triggering HOEPA provisions.

(4) Adapt oversight to market conditions and structure.

- Expand HOEPA to include contractors, appraisers, and other actors in real estate transactions

HUD, the Federal Reserve and other agencies are implementing many of these proposals, and a number of legislative responses have been drafted (see Appendix Table XX). Many states have created legislation to regulate predatory practices locally, creating a complicated web of restrictions increasing costs to lenders operating in multiple markets. A new national law could reduce overall compliance costs and simplify practices. Federal regulators might also work to review interpretations of existing regulations and further enhance enforcement in cooperation with state and local authorities to improve enforcement and improve consistency. Substantive new protections that target abusive lending practices should not unduly interfere with the flow of credit or narrow consumer's options in legitimate transactions, however. Efforts by industry to develop and adhere to standards are promising. Agreements among financial institutions and secondary markets to prohibit the financing of up-front credit insurance, limit back-end prepayment penalties, and cease use of mandatory arbitration clauses are positive steps. Lenders should also address steering by making sure that borrowers receive the lowest-cost loan for which they qualify, including minimizing direct and indirect fees. Borrowers also should have increased opportunities to receive pre-purchase homebuyer education. Meanwhile, competition in mortgage markets, led by GSEs and FHA, should be focused on communities and populations with limited options currently. Congress should continue to monitor this issue in order to ensure recent gains in homeownership are not undermined by irresponsible or inequitable lending practices.

Individual Development Accounts and Promotion of Financial Literacy

Many households lack savings and financial literacy skills. Individual Development Accounts (IDAs) reward the monthly savings of working-poor families, who often are trying to buy their first home. This reward is provided through the use of matching funds that typically come from a variety of private and public sources. Similar to 401(k)s, IDAs make it easier for low-income families to build financial assets. More importantly, participants typically also receive valuable financial education and counseling.

IDA programs exist in over 250 communities, serving at least 5,000 people. Many states have included IDAs welfare reforms or have passed legislation fostering the their use. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act allows states to include IDAs in welfare reform plans, and the use of Temporary Assistance to Needy Families (TANF) funds for IDA match. The Assets for Independence Act of 1998 authorizes HHS to administer a 5-year demonstration of IDAs.

Demonstration program results show very low-income families actually save at a higher rate than the less-poor, with an average savings of $900 annually. Program costs are as much as 2.7 times the amount deposited, although returns to scale and experience may decrease costs slightly over time. A programs with a standard design and low costs is possible, similar to Individual Retirement Accounts, but programs designed to aid very-low-income families need to offer more comprehensive services costly oversight.[67]

Related to IDAs is the Treasury Department's First Accounts program, part of the CDFI Bank Enterprise Awards (BEA).[68] This program provides low-income households access to low-cost bank accounts provided by private institutions. Combined with financial literacy education, these accounts become ideal complements for IDA programs.

With increased funding and favorable changes to welfare regulations, a greater number of community-based non-profit organizations should be able to apply for funding through the HHS and start up programs. IDA's are emerging as an important incentive for learning economic skills and also help overcome the wealth barriers to owning a home.

Policy Proposal: IDA Tax Credit Recent proposals have been levied suggesting a 100 percent tax credit to financial institutions to provide 1:1 matches up to $500 per qualified individual per year saving in an IDA. Since few lower-income households have enough tax liability to use a tax credit themselves, these proposals focus on tax subsidies for financial institutions, which may have sufficient tax liability to value a credit. Like other tax credits, this would need to be a capped and allocated credit, presumably through the CDFI fund, similar to the New Markets Tax Credit.

The cost of administering a match program, as well as monitoring the use of funds and client adherence to program regulations should not be under-estimated, however. IDA programs must develop systems to track clients and their funds over many years. Some portion of families will violate terms of the program, and recapture rules will be required. While it is important to promote further innovations in IDA programs operated by states, foundations and nonprofits, these pilot programs are likely to need more time to evolve.

Employer Assisted Homeownership

Another avenue for engaging potential homebuyers are employers. Pilot programs nationally have shown employer assisted homeownership could be an effective vehicle for helping meet the housing needs of working families and for stabilizing neighborhoods. Employer assisted housing (EAH) includes referrals, homebuyer education, downpayment assistance and even investments in the development of housing. Employers who help subsidize the housing costs of their workers use the program as a recruitment tool and to build a more stable work force. Employers who invest in housing in targeted neighborhoods use these programs to improve the quality of life of their customers, employees and the surrounding community. Yet, most corporations are unaware of other employers who have programs, as well as the benefits perceived by employers engaged in EAH programs. There is a dearth of information of the benefits of EAH, as well as on the programmatic details of how to establish a program.

Policy Proposal: EAH Information Dissemination Federal grants to outside intermediaries, or programs delivered through existing federal agencies, could provide information, referrals and

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[67] Mark Schreiner, Michael Sherraden, Margaret Clancy, Lissa Johnson, Jami Curley, Min Zahn, Sondra Beverly, Michal Grinstein-Weiss, "Asset Accumulation in Low-Resource Households: Evidence from Individual Development Accounts" Paper for *Changing Financial Markets and Community Development,* Federal Reserve System's Second Community Affairs Research Conference. April 5-6, 2001.

[68] http://www.ustreas.gov/cdfi/programs/bea/pdf/01_firstaccounts.pdf

publications to help employers develop EAH programs. It is possible private sector trade associations could work in partnership to document and disseminate information, as well.

Policy Proposal: Special Tax Rules for EAH Federal tax laws and corporate accounting rules do not provide incentives for employers who might otherwise offer housing assistance to their employees or surrounding communities.[69] In the few cases when employers have offered employers below-market rate loans for the purchase of a home, the accounting for expenses has been complicated. One approach would be to allow the differential between the rate the corporation receives and a benchmark rate set by law, to be treated as an expense that can be used to offset taxable income. Such a regulation will be challenging to craft, however, as the risk and interest rate appropriate to each loan or investment will vary. Another option is to allow EAH to be a qualified option under "cafeteria" tax-free benefit plans. Existing tax laws allow employees to select from a menu of health care and other benefits up to a maximum value annually, all of which is not taxed as income. By allowing EAH to be added to the menu employees would have the flexibility to forego other benefits and opt for EAH benefits instead. A variant of this approach is to expand the cafeteria benefit cap for employer-assisted housing uses. With an increased amount of tax-exempt benefits more employers and employees may be willing to participate. Determining how and when an employer might be allowed to use this option, however, would likely require highly-detailed regulations. Another tax approach is to create a new allocated corporate tax credit to partially offset the cost to employers of providing EAH benefits to their employees under certain circumstances. The eligibility rules and allocation system would again be quite complicated. While all of these tax changes might prove powerful tools to leverage private sector support of targeted homeownership programs, altering tax rules to allow EAH as part of existing cafeteria benefit plans might be enough to inspire corporate interest, without much cost to the federal government.

Balancing Below Market Rate Mortgages with Need for Tap Future Home Equity:

One of the innovations by nonprofits and local governments to promote low-income homeownership in recent decades has been the advent of deeply subsidized, very low-interest rate mortgages. While small in number nationally, with rates sometimes as low as zero percent and terms exceeding 30 years, these loans are far more supportive of affordable payments than any products available from the private sector. Yet, media accounts of borrowers with these loans refinancing to much higher rate loans are undoubtedly true. Low-income families often struggle to manage consumer loan debts or need cash for emergencies, and therefore tap into their home equity. In December 2001, the Federal Reserve considered banning the refinance of lower-rate loans, but determined such an outright ban would limit the ability of needy families to access home equity. While this appears to be a sound decision, financial institutions should examine these borrowers and the limited choices available to them. Innovative, small-scale programs could offer carefully designed second mortgages or debt consolidation loans, combined with enhanced levels of disclosure and borrower education or counseling. Nonprofits and local governments originating deeply-subsidized loans should also require counseling as a condition of subordinating to a home equity loan, and monitor borrowers making referrals as needed to desirable lenders and products. This is an issue that warrants continued monitoring by regulators and national advocates of sustainable homeownership.

Related to this issue are financial companies appearing to take advantage of consumers trying to get control of their debt. There are many legitimate options available for consumers facing difficult debt burdens. Consumer Credit Counseling Service (CCCS) agencies are non-profit organizations dedicated to budget and credit education and counseling, funded by creditors and customers. In general, these agencies provide high-quality advice and services to customers within clear standards of practice. Yet newer firms, many with highly-paid executives, enormous marketing budgets and exclusive relationships

[69] It should be noted government, universities and religious organizations often provide housing benefits to employees. The tax treatment of these benefits varies based on the relationship and institution type (Parsonage allowances, for example, are tax-exempt for clergy).

with high-cost lenders, have evolved.[70] These firms are regulated by states, but often operate without much scrutiny. In addition to setting standards for pre-purchase counseling, federal and state regulators should also closely monitor post-purchase credit counseling, particularly that provided by for-profit companies, or via puppet nonprofits of lenders.

[70] Schmidt, Christopher H., Heather Timmons, John Cady. "A Debt Trap for the Unwary." *Business Week*. Oct. 29, 2001.

SECTION 5: DEVELOPING AND PRESERVING THE SUPPLY OF AFFORDABLE UNITS SUITABLE FOR HOMEOWNERSHIP

Developing New Affordable Units for Homeowners

Even if financial or information barriers that might frustrate low-income renter households from buying a home can be overcome, households may still be constrained by a lack of adequate housing units at an appropriate sales price in a desired location.

Because of the fixed costs involved in building new houses, and the relatively attractive profit margins involved in building higher-value homes, very few affordable owner-occupied homes are being produced today. First-time buyers cannot afford the price of new single-family units or condominiums, instead left to purchase existing units, many of which are of declining quality. A very small number of units are developed using mortgage revenue bonds or FHA-insured loans, often in combination with subsidies from the CDBG or HOME programs, but overall federal support for developing a supply of owner-occupied units is meager.

Using one set of mortgage underwriting assumptions, only 44 percent of all owner-occupied units in 1999 were valued in a range that would be affordable to a household earning 80 percent or less of area median income (Table 9). Focusing only on new units added to the housing stock from 1997 to 1999, using the same assumptions, 540,000 units were affordably priced, two-thirds of which are manufactured units.[71] Overall, very few affordable units are being created today for low-income homebuyers.

Table 9

Affordable Owner-Occupied Units By Age (in thousands)

	Built Last 2 Years	Total
Total Units	1,830	68,780
Unaffordable Value Units	1,290	38,400
Affordable Value Units	540	30,381
…Affordable Manufactured Units	375	5,535
Affordable as Percent of Total	30%	44%
Manufactured as Percent of Affordable	69%	18%

Source: 1999 American Housing Survey, author's calculations.
Note: approximately 1.1 million mobile units are defined as rental units and excluded from this table.

Policy Proposal: Single Family Development Tax Credit According to the National Association of Homebuilders, approximately 100,000 to 120,000 units are built annually by private developers at sales prices below $100,000. One explanation for the lack of private sector homebuilders developing affordable homes is the so called "appraisal gap" that occurs when the costs of development exceed what fair market values will support. Except when subsidies bridge the gap between development costs and market values, housing suitable for homeownership is not being developed.[72]

In rental housing, Low Income Housing Tax Credit (LIHTC) subsidizes the development costs gaps; using the equity from selling tax credits to investors makes developing units in targeted areas economically feasible. One proposal, developed in part by the Bush Administration, suggests a new homeownership tax credit. This new tax credit is similar to the LIHTC, in the sense that developers would compete to receive tax credit allocations from state housing finance agencies. Credits would be used to cover the gap between total development cost of developing, or substantially rehabilitating, a unit and the fair market value of the property. Unlike the LIHTC, this would be a one-year tax credit, only

[71] Michael Collins, David Crowe and Michael Carliner, "Supply Side Constraints to Home Ownership," Joint Center for Housing Studies of Harvard University Low-Income Home Ownership Symposium, November 2000.

[72] Another factor limiting the creation of new affordable owner-occupied homes are regulations, including federal requirements for lead-paint abatement or energy efficiency, and local code and zoning laws. These regulations add to the fixed costs of developing units, making the development of affordable units less viable in the marketplace.

homes in low-income census tracts would be eligible. As proposed, each state would receive annual tax credits amounting to $1.75 per capita for use only in that year. Tax credits of up to 50 percent of the cost of the home, but could not be used to reduce the price of the home below market values.

Like the LIHTC, close project monitoring of homeownership credit projects will be required. The value of this credit will rely on two crucial numbers, market value and total development costs. Since market values cannot be determined by capitalizing rents, as it is with the rental credit, careful appraisals of market value will be needed. While it is possible formulaic automated appraisal systems could be used, in markets with few comparable sales, appraisals may be difficult. Also, determining a fair total development costs could also be problematic. Total development costs may be inflated with higher-cost projects than otherwise warranted.

Although designed as an urban revitalization tool, the development of the scattered site purchase-rehabilitation tax-credit projects, with the greatest potential to revitalize neighborhoods may be unlikely under this tax credit. Homeownership tax credits will most efficiently be used to develop larger-scale projects in one location. As a result, developers will likely prefer to build new units on subdivided parcels, rather than renovate existing units. Given spatial limitations, tax-credit units may be concentrated in low-income areas, or stimulate development of new units in housing markets with an existing over-supply of units.

While this proposal warrants further analysis and refinement, it is an example of an innovative way federal tax policy could spur the development of affordable units suitable for homeownership.

Policy Proposals: Expand Existing Programs HOME block grant funds can be used for purchase, rehabilitation, or new construction, as well as direct housing subsidies to families. Over $1.8 billion HOME funds are allocated each year among states, localities, and local governments, which is matched by $450 million in local public or private funds. Designed to be locally-controlled, state housing finance agencies receive 40 percent of total HOME funding, and localities receive 60 percent, based on an allocation formula. The program has proven an important tool for creating affordable homeownership opportunities, however. HOME subsidized an estimated 5,500 new units suitable for homeownership each year and nearly one in three homebuyers assisted by HOME earns 50 percent or less of area median income.[73] To continue affordability HOME-assisted owner-occupied units sold within 15 years must be purchased by another HOME-eligible family, or else the seller must repay a portion of the HOME subsidy if they violate these restrictions. HOME has proven a valuable program to promote low-income homeownership, and could be expanded. HUD could re-focus training, research and reporting on how HOME is best used to develop and redevelop units suitable for homeownership, as well as review regulations stipulating specific building standards and materials which serve to inflate total development costs.

One small, but effective program for developing affordable homeownership units is self-help housing. Administered by HUD, RHS and often associated with the extensive network of nonprofit agencies affiliated with Habitat for Humanity, self-help requires homebuyers to participate in the construction of their homes, creating greater pride of ownership, facilitating home maintenance skills, and providing lower-cost units. Approximately 65 percent of the labor needed to build is the buyer's "sweat equity," allowing them to purchase the house at a more affordable cost. Self-help borrowers have exceptional track records – RHS default rates for self-help, for example, are lower than other 502 loans. Some new homeowners have even used construction skills learned through building their home to get other jobs. Administration of these projects is expensive, and buyers need extensive support, however. Nationally, fewer than 10,000 homes are constructed under various self-help initiatives annually. HUD, RHS and state and local housing agencies could evaluate an expansion of these programs, in partnership with local community groups and Habitat for Humanity. In rural markets, tribal lands and other hard-to-develop

[73] HUD HOME data (ten year cumulative), 2001.

areas, this approach may increase the supply of affordable units while also helping support sustainable homeownership for low-income families.

Manufactured Housing's Critical Role

Manufactured homes, labeled mobile homes by the Census, are built to National Home Construction and Safety Standards (the HUD-code). These units are built in a factory, on a chassis with wheels, and have a seal certifying the unit meets national uniform housing code performance requirements. HUD-code factory-built units can save 20 percent of the development costs of a site-built home. There are other forms of factory-built housing, such as modular and panelized construction, but these designs are not built to the national "HUD-code" but rather to local codes, often called Uniform Statewide Building Code (USBC) Building Officials Code Administrators (BOCA). These forms of factory-built housing also provide costs savings, but not at the scale of HUD-code units.

There are over 8 million manufactured, HUD-Code units in the U.S., representing two-thirds of affordable added to the stock in recent years (Table 6 and Appendix Table J) and a growing portion of all new housing. Unsurprisingly, 67 percent of whom have incomes below 80 percent of the area median. A substantial share of the growth in low-income homeownership evidenced in the 1990s has been driven by manufactured homebuyers (Appendix table G).

The manufactured home industry began in the 1930s, and grew rapidly in the 1960s and 1970s. In 1976, legislation was passed to bring standards and quality controls to the industry, including the HUD-code and factory certification. Nevertheless, nearly 3 million older manufactured units are still in the occupied housing stock (Table 10). Many of these older units are of low quality, poor design and are placed in unsightly trailer parks. However, after 1980, and particularly in the 1990s, the manufactured home industry has evolved to deliver an increasingly quality product aimed at competing with entry-level site built units. The majority of units placed after 1995 are "double-wide," that is two chassis placed side by side (see Appendix Table K). More units are placed on larger lots owned by the occupant and titled as real estate than in the past. Recent innovations in design include two-stories and attached garages, are a much more viable structure type for urban-infill developments. Many stereotypes and perceptions continue in this market, however, which fuel treatment of manufactured housing units in public policy, development and mortgage finance.

Table 10

Housing Units Occupied Year Around in 1999 by Year Built/Placed

Year Built	Non-Manufactured ("Mobile")	Manufactured	Total	Share Manufactured Per Year	Cumulative Manufactured Stock
Pre 1920	8,833,045	-	8,833,045	0%	
1920s	4,961,698	-	4,961,698	0%	
1930s	5,692,148	37,505	5,729,653	1%	37,505
1940s	7,408,183	16,257	7,424,440	0%	53,762
1950s	12,188,783	102,806	12,291,589	1%	156,568
1960s	13,623,507	601,451	14,224,958	4%	758,019
1970s	18,504,284	2,106,798	20,611,082	10%	2,864,817
1980s	13,237,179	1,519,002	14,756,181	10%	4,383,819
1990s	11,546,313	2,400,130	13,946,443	17%	6,783,949
Total	**95,995,140**	**6,783,949**	**102,800,000**	**7%**	**7%**

American Housing Survey, 1999

The financing system manufactured housing can be segmented into two categories: (1) for those buyers placing their unit on owned-land, often titled as conventional real estate, and (2) those who buy a unit and place it on leased land.[74] Many low-income buyers, especially those living in leased-land communities, finance their home with installment personal property, or chattel loans. Until very recently, few banks, savings and loans, or credit unions have been willing finance manufactured homes as real estate, except in cases where land is owned or a land lease is in place with a length longer than the mortgage loan term.[75] Lenders are also reluctant to provide financing for the purchase of an existing manufactured home, especially if it has been moved from its original location. The potential mobility of these units (although rarely exercised), and the fact tenants on leased land have little protection from eviction, has hampered the development of affordable loan products. Lax underwriting practices of the 1990's, combined with the collateral risks, and the borrower characteristics common in low-income markets, have resulted in many lenders refusing to finance manufactured housing loans. Stereotypes related to class bias also are pervasive as "poor people in trailer parks" continue to be judged derogatorily by local officials, real estate professionals and lenders. Nevertheless, occupants of existing units have limited potential to build equity if they cannot finance the repair, replacement or re-sale of their homes.[76]

In 2000, the Manufactured Housing Improvement Act was passed to mandate improvements in the installation process, protecting consumers and reducing risks for lenders. The new law potentially reduces the collateral risk lenders face that a unit may be improperly installed or placed on a faulty foundation. While there is hope the new law may signal a future marked by greater innovations in design and finance, in recent years many manufactured housing lenders and developers have experienced record high delinquencies and repossessions. The next decade will prove if these growing pains can be resolved to form a market that better serves low-income families.

Policy Proposal: Encouraging GSE Participation in Manufactured Housing Lending Fannie Mae and Freddie Mac have traditionally not supported a secondary market for manufactured housing loans classified as personal property. New products are being introduced for tenants of land-lease communities that, under specific circumstances, allow borrowers to access credit as real estate loans. Other products, including products for developers of manufactured housing communities, are also being developed, but progress has been slow. HUD should encourage both Fannie Mae and Freddie Mac to expand products for HUD-code structures used owner-occupied housing—a market dominated by lower-income borrowers in underserved areas. Congress could also reaffirm that the GSE charters allows the financing of personal property loans, and continue to include provisions supporting manufactured housing as part of low-income homeownership policy.

Policy Proposal: State Classification of Owner-Occupied Manufactured Units as Real Estate In most states, manufactured units may be classified as real estate. However over a dozen states do not permit HUD-code units on leased-land to be legally defined as real estate.[77] As a result, FHA and other mortgage programs cannot legally participate in mortgage loans on manufactured units in these states. States should be encouraged to carefully review the impact of these legal classifications on borrowers. Without changes to state laws, federal policy actions will be moot.

Policy Proposal: Reinvigorate FHA Title I and II Manufactured Housing Programs FHA Title I can guarantee loans for manufactured homes, for manufactured homes and the property on which they are located, or for just manufactured home lot purchases. FHA Title II can be used where the home is

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[74] Leased land historically has been called a "trailer park." Given new units are not called trailers and rarely are moved, the terms leased-land "community" or leasehold "estate" or preferred. While these units are a blend of owning a unit and renting land, the Census classifies these households as homeowners in its statistics. Classifying occupants who do not own the manufactured home lot as renters lowers in 1999 American Housing Survey homeownership rate from 67% to 64%.

[75] In 2001, Freddie Mac created a loan product for leased-land units, stipulating the lease term must be 5 years greater than the mortgage term. Fannie Mae offers a similar product requiring a ten year differentials. Rates 3% or more below chattel loans.

[76] Contrary to popular belief, manufactured homes can and do appreciate in value at similar rates to site-built homes, particularly when land is owned, units are well designed and properly installed.

[77] Washington, Montana, Nevada, Utah, Nebraska, Missouri, Arkansas, Mississippi, Florida, South Carolina, West Virginia, Maryland, New Jersey, Connecticut, Wisconsin, and Minnesota did not recognize these units as of 1999.

permanently placed on land and treated like real estate. These programs are used for fewer than 10 percent of all manufactured home placements in a given year, however, despite FHA's emphasis on serving low-income borrowers. Inefficient administration of these programs, low loan limits, and other restrictions create barriers few lenders are willing to confront. HUD could streamline both programs, increase loan limits and encourage use of these products for purchase, re-purchase, refinance and home improvement lending. FHA's recent increases in insurance premiums and lender standards might begin to revive the struggling, negative cash flow program.[78] Ginnie Mae issued a limited number of 'eagle' certifications allowing lenders to receive a Ginnie Mae guarantee in the secondary market in the 1980s. Few lenders use Ginnie Mae's programs today, in part because of regulations put in place to stem high losses in the past decade. Yet, competition FHA lenders would be enhanced Ginnie Mae once again supported this. FHA might investigate if the Title loan programs are the most appropriate mechanism to serve borrowers purchasing HUD-code homes. A non-conditional insurance, similar to the 203b program, may be called for given changes in the marketplace. As more community banks and mortgage companies enter this market and responsibly underwrite loans, recent boom and bust cycles could be dampened if FHA provided a consistent source of credit with clear and effective standards.[79] FHA and HUD need to allocate more staff and resources to explore options for supporting this segment of homeownership. HUD should appoint a new deputy assistant secretary for Manufactured Housing and establish a mandate to focus on manufactured housing finance.

Policy Proposal: Revise FHA Programs for Manufactured Housing Developments At the developer level, owners of land-lease communities also lack access to credit for new "communities," or estate developments, and for replacing infrastructure. FHA regulations regarding guarantees for loans developing manufactured home communities similar to multifamily development programs – the only federal programs involved in the finance of communities – are out of date. The loan limits are low and the application process is inefficient. Too often, FHA local office staff, lenders and other actors in the transaction will not consider manufactured home projects due to a lack of clarity on allowable uses and inflexible processing systems. FHA needs to review these programs to enhance their utility, train HUD staff and lenders, and clarify regulations allowing the use of these programs for the development of manufactured home communities.

Policy Proposal: Revise RHS 502 Programs to Allow Manufactured Housing RHS 502 direct loan and guarantee programs will support manufactured housing loans, but requires that the home and land be included in one loan financed as real property, and that the home be purchased from approved dealer-contractors. Very few of these loans are made annually, despite the preponderance of manufactured units in rural areas. The program could be modified to allow personal property loans in specific circumstances, including re-sales of existing units and replacement of existing manufactured homes with new units, rather than simply newly placed homes and real estate. RHS could also review its concerns about authorized dealers and installers given new federal legislation and improved state regulations. RHS should work closely with HUD and FHA to revise these programs and improve the ability of programs to serve the borrowers in the manufactured home market.

Policy Proposal: Clarify Allowable Use of Manufactured Units Design advances have proven manufactured units can be used in urban infill developments. In addition to savings due to production techniques and lower materials and labor costs, factory-built units dramatically reduce security costs and speed up the development process. Explicitly, few prohibitions exist to using manufactured units in urban areas, but local administrators and developers often discourage the use of HUD-code units in affordable

[78] 24 CFR Parts 201 and 202 in the *Federal Register,* Vol. 66, No. 216, November 7, 2001 increased the Title I and II premium to 100 basis points and increased asset requirement for lenders/dealers.

[79] In 2000, the securitization of manufactured housing chattel loans half to previous year's levels; despite only a 20 percent drop in shipments. Some industry analysts suspect the differential in loan volume is made by local lenders, although it is unclear if these are real estate loans or unsecuritized chattel loans.

housing projects. Making clear in the administrative rules of existing affordable housing programs (HOME, CDBG, LIHTC) that manufactured units are allowable may help overcome resistance.

Policy Proposal: Encourage Cooperative Ownership of Leasehold Estates Nearly three million families live in manufactured homes sited in land-lease communities where they pay a monthly ground rent to a landlord. Landlord quality is uneven in any rental housing market, but none more than in manufactured housing. Tales of frequent rent increases, little or no infrastructure maintenance and excessive rules governing what tenants can and can not do are common. Unfortunately, the ground lease arrangement is ripe for exploitation because, unlike an apartment building, the landlord extracts rent but is not responsible for any maintenance to the individual resident-owned housing units. Moreover, it is difficult and expensive to move a manufactured home (typically $3,000-5,000), essentially tying low-income and wealth occupants to a site. In some cases, tenants of estates have collectively purchased their community as a cooperative. These resident-owned communities allow owners to have control of their community, acquire long-term site commitments and have transformed their homes into real assets. Several states have laws providing residents the right of first refusal as leased-land communities are placed on the market. Currently, New Hampshire has forty-four cooperative manufactured housing parks, California has over a hundred, and Florida has nearly five hundred. Despite the challenges of management and finance, the benefits of this ownership structure are significant. State laws offering right of first refusal are important, as are local intermediaries and sources of capital for financing these ownership structures. States could be encouraged to pass right of first refusal laws, and HUD, FHA and the GSEs could develop programs to support these cooperative financing arrangements.

Policy Proposal: Developing and Supporting Trailer Replacement Programs Millions of existing manufactured units are in the housing stock in deteriorated condition. Many were placed before 1976 HUD-code reforms; others placed in more recent years, but poorly installed or maintained. Many of these units need to be replaced in the near future. Several innovative programs have explored ways to swap dilapidated mobile homes and trailers for more modern manufactured or modular units. Other programs have attempted to maximize the scrap value of aging units. Replacing aging units with better-designed and fairly-financed housing will help improve the aesthetics of many communities, as well as provide families with safer, more stable housing with increased opportunities for wealth-building.

Acquisition and Redevelopment of Units Suitable for Owner-Occupants

The process financing the production of new homes has several distinct stages, beginning with capital for the acquisition of real estate, then capital to fund development, and finally capital to finance construction. After completion, long-term permanent financing takes over. Acquisition finance is a fairly well established market, borrowers seeking capital development and construction have little collateral in the project, carry high risks. Many lenders do know how to underwrite and manage the risks of development and construction lending, however. But those lenders lack any systematic route to sell these loans in the secondary market. Currently held in portfolio, these loans also carry high interest rates. If the secondary market could provide liquidity and lower-cost capital to the construction lending market, the production of single-family units suitable for homeownership could grow.

Policy Proposal: Finalize FASIT Regulation An existing structure, the Financial Asset Securitization Investment Trust (FASIT), provides a vehicle for securitizing construction, development and other types of loans. FASITs are similar to Real Estate Mortgage Investment Conduits (REMICs) in tax treatment, facilitating a pool of loans being packaged as mortgage-backed securities. The Treasury Department, however, never issued regulations for FASITs. Issuing these regulations could potentially spur a needed secondary market for construction and development loans.

Policy Proposal: Enhance the Market for Construction and Development Lending Federal programs could support the evolution of construction and development lending. FHA could insure individual loans, or provide a credit enhancement to a pool of loans. Similarly, state housing finance agencies could expand lending outside of permanent-only or construction-to-permanent structures. The Federal Home Loan Banks, through the Mortgage Partnership Programs, as well as other GSEs, could also construction and development loan secondary markets. These strategies have the potential to decrease costs and increase liquidity, especially for urban in-fill projects where the financing is a significant constraint to development.

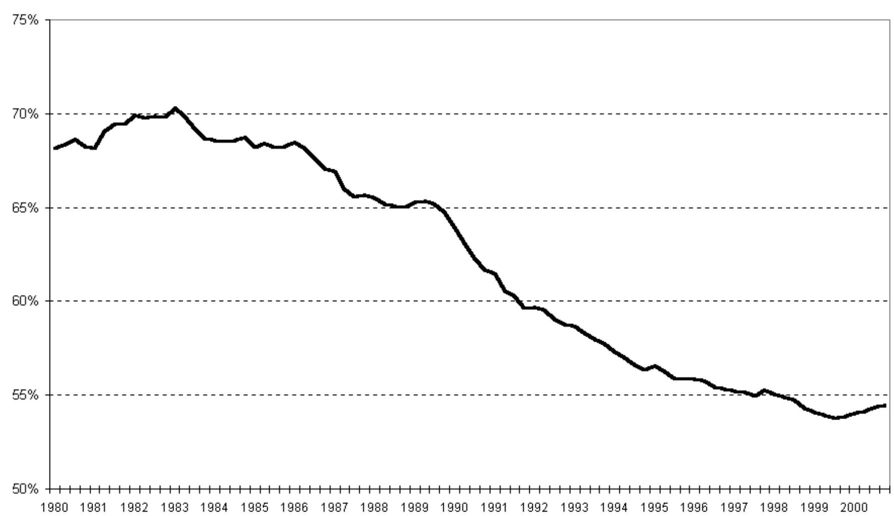
Preservation of Homeownership and Units Suitable for Owner-Occupants

An estimated $136 billion is spent annually by homeowners on residential maintenance, repair and improvement.[80] Home improvement, repair and remodeling ensure owner-occupied homes continue to provide housing that keeps up with modern standards of quality and design.

Home improvement loans typically require inspections and irregular draws on the loan amount as work is completed—requiring regional or national lenders to find local oversight. These loans also include risks of construction, including shoddy work or fraudulent contractors. Unfortunately, home improvement lending has become an entry point for predatory lending practices, by lenders and contractors serving as loan brokers. These financial and reputation risks, combined with the relatively high fixed-transaction costs of small loans, have reduced the number of lenders willing to administer these loans. Most lenders today prefer to make home equity loans, or unsecured consumer loans, because these loans are easier to manage.

Financing repairs and improvements with home equity is efficient for many borrowers. But many first-time buyers in the last decade have lower-incomes, small savings and made low downpayments. Home equity as a share of house value has been declining for the last decade (chart). First-time buyers often purchase lower cost, older homes, which are likely to require repairs or improvements in order to continue as viable units (Appendix Table H and I). For borrowers without home equity, consumer loans or credit cards, which typically carry higher rates and less flexible terms than home equity loans, are the only option.

Higher Leverage: Home Equity as a Share of House Value is Declining



Source: Federal Reserve Flow of Funds of Accounts, Table B. 100.

Moreover, borrowers seeking to finance a combination of acquisition and renovation work for distressed units typically face loan limits (based on estimates of the value of the completed work) below the total costs of conducting such work. Scarce capital for these high loan-to-value loans, combined with high transaction costs, limit the use of these loan products.

Policy Proposal: Revise Title I Home Improvement Lending Under the Title I program, FHA's oldest program, lending institutions make loans to finance eligible property improvements. More than 35

[80] "Remodeling Homes for Changing Households," Joint Center for Housing Studies, Harvard University, 1999.

million property improvement loans have been backed by FHA, peaking in the 1950's with nearly 1 million loans a year. Today fewer than 20,000 Title I loans are backed annually. The design and the management of the program are criticized for having too many restrictions, loan limits that are too low, and generally being slow and difficult to use. Title I loans can be made directly to borrowers from lenders, or through dealers, where lenders provide financing but the loan is originated by a home improvement contractor. Few lenders will process or originate these loans in either form, in part due to even high administrative costs. Title I has been criticized for allowing undue agency risk; unethical borrowers, lenders and contractors can defraud FHA with false claims or projects. FHA has sought to mitigate these risks, however, with recently released regulations.[81] FHA should also consider increasing Title I loan limits from $25,000 to $50,000 and reduce the administrative hurdles involved with the program. FHA could also make the insurance full-faith-and-credit, instead of being a conditional insurance, allowing FHA to force lenders to buy back a loan, even after a claim is paid. FHA's role in the market could help establish oversight and underwriting rules, however, which might help Ginnie Mae to re-enter this market.

Policy Proposal: Revise MRB Home Improvement Lending Mortgage revenue bonds may be used for home improvement finance, but are limited to $15,000, a maximum unchanged since the MRB law was first passed. By expanding tax-exempt bonding authority to high loan-to-value home improvement lending and acquisition-improvement, lenders will have access to lower-cost capital. While such capital does not reduce the fixed costs of making or servicing these loans, the reduced interest rates will allow the consumer to borrow more, including fees and points related to originating the loan. Moreover, combined with FHA, as many MRB-backed loans are, the financing options for low-equity borrowers could be greatly expanded. As such, the limit on MRB home improvement loans ought to be linked to the Title I loan level.

Policy Proposal: Enhance Secondary Market Role in Home Improvement Lending If secondary market entities played a stronger role in home improvement lending, interest costs would likely be reduced. Secondary markets to targeted high loan-to-value home improvement lending and acquisition-improvement would also increase liquidity and affordability in these markets. The GSEs should be encouraged to develop products in this arena, and affordable housing goals should recognize the added risk and necessary role of these loans in preserving low-income homeownership.

Preserving Homeownership for the Disadvantaged Homeowner

Homeownership policy needs are not restricted to the conversion of renters to owners, but also include insuring homeowners successfully maintain their homes and remain current on mortgage, insurance and property tax payments. Of nearly 70 million home-owning families, 27 million, representing more than 57 million people, have with incomes below 80 percent of area median. To the extent these households lack assets and income, they often struggle to afford mortgage payments, home repairs, taxes and other housing expenses. Of these 27 low-income owners, 9.4 million are 70 years of age or older, and as the population ages in coming years, this number, and the needs of homeowners will likely rise. Successful homeownership involves not only support for first-time homebuyers, but also for existing owners to maintain and preserve the asset in which they invested. Moreover, as unemployment rates and income stability increase, and mortgage delinquencies rise in softer economic times, enhanced supports are needed to preserve gains in homeownership and the assets homes help families accrue.

RHS direct subsidy programs and local HOME allocations can provide support for exist homeowners struggling to meet monthly payments or repairs. These programs are critical for the millions of low-

[81] Disbursements on dealer loans must be made either to the borrower only or jointly to the borrower and contractor, a telephone interview must be held with the borrower before funds are disbursed, dealer and lender net worth requirement were increased, and premiums were raised from 0.5 percent to 1 percent. 24 CFR Parts 201 and 202 in the *Federal Register,* Vol. 66, No. 216, November 7, 2001.

income families, especially elderly individuals in aging housing units, who have successfully qualified for their first mortgage, but face hurdles of making payments or maintaining a safe and healthy home.

Policy Proposal: Developing a Preservation Focus Just as policy makers, lenders, real estate professionals and community advocates have promoted expanding homeownership, an effort needs to be focused on making sure existing homeowners, lower-income, minorities, elderly and disabled, have access to services, loan products and advice they need to stay in their homes. Financial literacy, home maintenance training, energy efficiency and weatherization programs are likely to see increased demands in coming years. Likewise small repair projects, accessibility improvements and improved coordination between health care and housing will be required as more homeowners age. While not a specific proposal for any one agency or sector, the housing industry and housing advocates need to emphasize the importance of balancing resources for promoting first-time homeownership with strategies designed to preserve homeownership.

Re-focusing on Placed-Based Revitalization

Homeownership can have a powerful impact on neighborhoods. Homeowners stay in a community up to four times longer than renters, establishing roots and social networks. By joining community organizations, volunteering and even taking part in improvement activities like gardening, owners are a force for neighborhood improvement.[82] Increasing investment in a neighborhood by owner-occupants can be a signal of confidence to other neighbors and the general marketplace. Building and renovating single-family units also has the potential to change the look of a neighborhood. Numerous HOPE VI projects across the nation have demonstrated innovative development packages can be created to increase homeownership rates in targeted areas. Programs in other cities also have used homeownership as a tool to reinvigorate neighborhoods, often relying on partnerships between the public sector, private developers and nonprofit organizations.[83] Community development strategies have moved away a focus on providing affordable rental housing to encouraging mixed-income, well-designed projects, with a balance of rental and homeownership. Such projects maximize the potential for asset building as property value appreciate. Yet, the coordination, planning and pooled resources required for such project are rare.

Policy Proposal: Comprehensive Homeownership Strategies As other communities design revitalization programs centered on homeownership, it is becoming clear a revitalization impact depends on more than just owner-occupancy. Several factors appear to be significant. First, programs need to be geographically concentrated to have an impact on supply or demand for housing in a neighborhood. One hundred new homebuyers in a 1,000 square block area is unlikely to have an impact on choices and confidence in the market; 10 new homebuyers on one block might. Second, homebuyer programs should not forsake physical improvements, such as appropriate facades and landscaping, in a quest for affordability. By focusing on improving the aesthetic environment of a neighborhood, existing property owners will be more likely to make further investments in an area. Third, homebuyer counseling and lending programs should not consider the goal to be for every customer to buy a home, but rather help families prepare to own and maintain a home, as well as manage a mortgage. By focusing on resident self-management and leadership, the neighborhood becomes a place where families want to choose to live. Fourth, homebuyer programs seeking to revitalize neighborhoods should encourage and seek out a diversity of new and existing residents. Stable neighborhoods include families of various income levels, racial backgrounds and age ranges. By making a neighborhood attractive to many groups of residents, the potential homebuyer market for an area expands significantly, as does an area's cultural attributes and political clout. Fifth, revitalization strategies must recognize neighborhood image is crucial in real estate markets. By involving real estate professionals, lenders and the media in outreach efforts, a

82 Denise DiPasquale and Edward L. Glaeser, “Incentives and Social Capital: Are Home Owners Better Citizens?” Joint Center For Housing Studies Working Paper Series W97-3, 1997.

83 See Charles J. Orlebeke, *New Life at Ground Zero: New York, Home Ownership, and the Future of American Cities,* 1997.

neighborhood's image can be improved, generating demand for the area. While not a comprehensive list, the impact of rising homeownership rates will be leveraged to the extent these components are in place.

SECTION 6: OPPORTUNITIES IN THE NEW MILLENNIUM FOR HOMEOWNERSHIP POLICIES

This paper has attempted to provide an overview of issues related to homeownership policy. While not a thorough description of every federal policy, issues identified through interviews, focus groups, and comment letters to the Millennial Housing Commission are outlined. Five barriers to homeownership are described: income, wealth, credit, information and supply, each of which is addressed by existing policies, but require further attention. Proposals for new or modified policies are grouped into three general categories: (I.) expanding the reach of mortgage markets for sustainable homeownership; (II.) educating and protecting consumers engaged in mortgage and home equity markets; and (III.) production and preservation of units suitable for affordable homeownership. To these ends, the Millennial Housing Commission should consider the following 10 priorities:

1. Create a new tax credit to support homeownership.

The existing tax code provides little support for low-income homebuyers. A flexible new tax credit should be created, allocated by state housing agencies for either pre-paid mortgage points for deeply-subsidized loans or to bridge appraisal gaps in the development of owner-occupied homes. All credits would be taken in one year only, the year in which the project is completed or loan is originated. The total amount could carried-over up to 3 years if tax liabilities in the base year do not exceed the amount of the credit. Credits could also be transferable if the credit purchaser has insufficient tax liabilities. Only first-time buyers below 80 percent of area median income using HUD-income adjusted guidelines would be eligible beneficiaries, regardless of location.

Tax-credit loans could not be pre-paid except in the case of a sale, and loans would not be assumable. Units developed with an appraisal gap tax credit are sold to income qualified owner-occupant buyers. Violations of these rules would be subject to a recapture of the tax credit from the investor, for up to ten years. Using the supply-side credit, market values would need careful appraisals if no comparable sales exist. Using the demand-side credit, lenders would be required to underwrite loans within clear guidelines regarding minimum and maximum ratios, as well as home purchase price.

This credit provides state agencies with flexibility to address the issues facing buyers in a particular market. Allocating agencies in tighter markets could focus on building supply; agencies softer markets could work on stimulating demand. Both credits would use similar requirements and processes. It is unlikely this new credit will substitute or undermine the existing rental LIHTC due to differences in the term and risk, as well as the nearly unlimited appetite of investors seeking tax relief.

2. Revise the statutes of the Federal Housing Administration (FHA) to increase its flexibility and ability to serve low-income homeowners and communities.

FHA is at risk of becoming a dinosaur in the market place. Proposals suggesting FHA could be restructured as a more independent agency, as it was prior to 1968, deserve serious review. Freeing FHA from the miasma of HUD's procurement and personnel regulations, however, is not a cure-all. FHA also needs Congress to grant it increased flexibility to experiment with private sector partnerships. While FHA can absorb risk better than any private market player, it has not proven nimble at pricing its products, streamlining originations, or managing properties in default. Private sector institutions have nearly perfected fast and efficient systems to handle all of these tasks. FHA has begun to "outsource" many of its functions to private contractors, but the structure of these relationships places oversight burdens on FHA and creates few incentives for contractors to outperform contractual requirements. By entering into true partnerships, where risks and revenues and shared, FHA could take advantage of the operational efficiencies of the private sector. In addition to greater efficiency, private partners may open up new delivery channels not served by the handful of lenders originating the majority of FHA-endorsed loans currently.

Improving the speed of FHA services and minimizing the harm caused by ineffective disposition efforts may justify these partnership structures even if they reduce federal revenues compared to the present structure.

3. **Expand support for homebuyer education and counseling.**

Lenders, borrowers and communities benefit from consumers being better informed of their rights and responsibilities in the mortgage transaction. Support for homebuyer education and counseling from the federal government is crucial to the expansion of this practice. HUD's counseling budget is small relative to the market, small relative to HUD's budget, and should be increased. However, administration of these funds needs improvement. HUD regulations prohibiting clients from paying a fee, and prohibiting lenders and real estate agents from partially covering fees for homebuyer services, should also be changed. A matching grant mechanism leveraging private sector contributions and sliding scale fees should also be established.

Disclosure of the provider and cost of education should be included on HUD-1 settlement documents. As much as possible, the provision pre-purchase counseling should be mainstreamed into the home-buying process. Counseling should also be required in some circumstances, such as borrowers seeking high-cost loans. HUD and state housing agencies should work to build the capacity the delivery system for homebuyer education with grants and other support for nonprofits and other providers. Other programs, especially state housing finance agencies, should be directed to review opportunities for integrating reasonable incentives for consumers and industry to include counseling and education in the home buying process, including discounts in rates and fees. Fees for counseling should be an allowable cost that can be financed into a mortgage, and such fees should not count against HOEPA limits. Finally, HUD, the Federal Reserve Board and other federal agencies should work together to establish minimum standards for homebuyer counseling and education.

4. **Expand tax-exempt mortgage revenue bond (MRB) programs used by state housing finance agencies.**

Mortgage revenue bonds have proven an effective tool for expanding the reach of mortgage markets, increasing affordability and allowing more flexible underwriting, targeted to lower-income first-time homebuyers. Legislation should be passed changing the loan limit regulations to become a multiple of HUD area median incomes, or another simply administered formula, automatically adjusted over time. The so-called "ten-year rule" should also be repealed, allowing more mortgages to be issued under the existing private activity bond cap.

5. **Expand data collected under HMDA.**

Lenders should be required to report applications in rural areas in HMDA, as well as add interest rate (APR), loan fees and other information that will allow a closer assessment of disparities in approvals and pricing. Subprime and manufactured housing loans could be flagged in the same way FHA loans are identified. The value of having additional information is likely to outweigh the costs of reporting.

6. **Improve treatment of manufactured housing in financial and real estate markets.**

The manufactured home industry has evolved in the last decade, despite some considerable growing pains, to deliver an increasingly quality product that meets the needs of consumers. Five actions will improve access of manufactured homeowners and buyers to capital markets. First, Congress should affirm Fannie Mae and Freddie Mac can purchase manufactured home loans classified as personal property, require these GSEs to support a secondary market in such loans, and direct HUD to establish performance goals for manufactured home loan purchases. Second, FHA manufactured housing loan programs need to be improved and promoted. Loan limits and terms need to be revised and Ginnie Mae needs to approve more issuer/servicers or instruct existing issuers to issue and service manufactured home loans. Third, RHS loan programs should be revised to allow personal property loans for re-sales of existing manufactured homes and replacements of existing manufactured homes. Fourth, barriers to placing manufactured units in urban or other developments should be reduced, including federal subsidized affordable project. Finally, those states that do not recognize manufactured homes on leased land as real estate to change their laws, as well as to offer tenants in leased-land communities the right of first-refusal for purchase upon the sale by a landlord.

7. Improve home improvement lending for low-wealth homebuyers.

Borrowers without home equity need affordable sources of home improvement loans to sustain homeownership. FHA Title I should be simplified, loan limits should be increased from $25,000 to $50,000 and making the insurance full-faith-and-credit, instead of a conditional insurance, should be explored. Likewise, mortgage revenue bonds should be revised for use in home improvement finance. Loan limits should be linked to Title I, and use of the program should be encouraged by state housing agencies.

8. Encourage GSEs—including Fannie Mae, Freddie Mac, the Federal Home Loan Banks and Ginnie Mae—as a significant source of innovation in the mortgage market.

These GSEs should use their power in the secondary market to increase standardization in markets, especially subprime lending, home improvement lending, acquisition and development finance, and manufactured housing lending.

9. Revise consumer disclosure and protection laws to better inform homebuyers of their rights, responsibilities, and options.

A renewed effort is needed by HUD and the Federal Reserve to revise RESPA and TILA so that disclosures are simpler and more reliable, and so closings are more cost-efficient. HUD should also establish a central depository for HUD-1 settlement form data, using the data to establish benchmark costs and fees, as well as to analyze anomalies in practices. TILA should also be revised to require lenders to disclose to borrowers all of the products a lender and its subsidiaries offer, to help marginal mortgage loan applicants know if they are being tracked into high-cost subprime subsidiaries or loan products.

10. Promote Financial Literacy, including the use of IDAs and First Accounts by local entities.

To the extent extending homeownership to low- and very-low income people is a priority, correlated issues of banking, personal financial management and education policy cannot be ignored. Housing policy and programs need to focus on strategies for teaching economic literacy and helping families manage their homes. IDAs and First Accounts help lower-income families establish traditional banking relationships and improve their credit ratings and should be expanded, particularly through state programs, foundations and nonprofits.

SECTION 7: CONCLUSIONS

Buying a home is typically the largest and most complicated financial commitment most households ever make. Would-be first-time buyers face a series of hurdles before they can become successful homeowners. From finding a unit in a desirable location to qualifying for a mortgage, many first-time buyers lack information, are intimidated or even misled. These hurdles work in combination, especially among low-income and minority populations, to continue to keep homeownership out of reach for portions of society.

American housing policy has developed many successful programs to support the development of affordable rental units, as well as subsidies for low-income renters. Fare fewer federal policies are targeted to low-income homeowners or potential homeowners. The largest existing federal policy supporting homeownership is the personal income tax deductibility of mortgage interest and real estate taxes, but it is poorly targeted toward helping the families least likely to buy homes into the market. Tax exempt financing of mortgage revenue bonds has proven a powerful tool to provide below-market rate mortgage products targeted to first-time homebuyers. However, because many buyers require credit enhancements which add costs to monthly payments, such as mortgage insurance, many first-time buyers still need deeper interest rate subsidies than typically can be offered by mortgage revenue bonds.

The Federal Housing Administration (FHA) has helped million of homebuyers by providing government insurance guarantees to lenders making loans to qualified buyers. Yet, FHA's market and role is shifting as private sector lenders have created innovative ways to reach underserved markets.

The impact of federal policies supporting the expansion of access to credit, such as the Community Reinvestment Act (CRA) and Fair Housing Act, should not be underestimated. Combined with oversight of government-sponsored entities, Fannie Mae, Freddie Mac and the Federal Home Loan Banks, these institutions have power to establish and shape entire markets. Even federal regulations regarding consumer protection and disclosure, such as RESPA, TILA HMDA, and HOEPA, provide needed transparency and accountability to homeownership transactions.

Currently, too few first-time homebuyers receive pre-purchase education and counseling, but recent research indicates existing programs providing support for such services are crucial for sustainable homeownership. Ensuring current and potential homebuyers have objective and accurate information to make decisions of crucial to their success.

Although homes are being constructed in record numbers, the market is increasingly bifurcated between high cost site-built homes and more affordable manufactured homes. Manufactured homes offer great potential for low-income homebuyers, but programs serving this market need to be revised to better protect consumers, as well as provide loans at lower costs.

Recent increases in mortgage loan delinquencies and bankruptcies reaffirms the concept that programs and policies must focus not just on getting families into homeownership, but creating successful lifetime homeowners. Similarly, policies that support the preservation and improvement of the owner-occupied stock need to be supported to ensure the continuance of a quality supply of units. Moreover, many production programs neglect to consider the potential for broader neighborhood and community improvement.

As the Millennial Housing Commission considers its housing policy recommendations, homeownership, from mortgage finance, to consumer education and protection to production and preservation, is a central, but complicated issue. Despite the concerns that exist, the U.S. has been remarkably successful in helping two out of every three families become homeowners. With revisions to existing policies, and a few new programs, the Commission can help even more families pursue the American dream of homeownership.

APPENDIX TABLES:

TABLE A: Homeownership by Education

Homeownership Rates by Race and Education Level			
	All Married Households Under Age 50		
	Less Than 12th Grade	**High School Graduate**	**Bachelors of Higher**
White	67.1%	81.7%	86.6%
African American	48.9%	61.8%	66.8%
Native	44.9%	58.6%	60.7%
Asian/Pacific	47.1%	67.0%	61.4%
Other	20.4%	55.0%	61.2%
Latino *	40.8%	51.8%	69.1%
Any respondent stating of Hispanic origin is considered Latino regardless if another race was indicated			
Source: 1999 American Housing Survey, author's tabulations			

TABLE B: FHA Portfolio Profile

FHA Portfolio July 2001			
	Loans	Value	% change from prior year
Single Family Insured	6,633,241	$498.8	-2.4%
Multifamily Insured	14,705	54.2	0.9
Title I Property Improvement Insured	184,696	2.6	-23.8
Title I Manufactured Housing Insured	53,835	1.3	-15.8
Single Family Notes *	1,067	-	-89.4
Multifamily Notes *	1,541	2.6	-6.1
Title I Notes *	39,133	.5	-7.8
Single-Family Properties (FHA owned)	29,713	2.6	-19.6
Multifamily Properties (FHA owned)	62	.2	0.9

** Assignment programs*
Source: FHA Commissioner's Report <www.hud.gov>

TABLE C: Legislative Proposals Regarding Predatory Lending 2000-2001

Bill *(Congressional Session)*	**Target(s) for Amendments**	**Prohibitions** (example)	**Requirements** (example)	**Other**
H.R. 1051 *(107 Cong)*	HOEPA	Limits prepayment penalties; prohibits balloon payments on HOEPA loans; - prohibits any credit insurance or single premium products; lower HOEPA interest rate trigger	Consumers receive warnings on the risks of HOEPA loans, the need for credit counseling and a list of local certified credit counselors.	Provides increased reparations for consumers and enforcement of consumer protections; prohibits mandatory arbitration.
H.R. 2531 *(107 Cong)*	HOEPA, TILA, HMDA	See above; Also, coercion of appraisers; prohibits underwriting without regard to ability to pay.	APR, points and fees in HMDA; Expanded HMDA coverage; Requirement for counseling for HOEPA	Makes lender/creditor liable for mortgage brokers actions; prohibits mandatory arbitration.
H.R. 3901 *(106 Cong)*	TILA, HOEPA, HMDA	Prepayment penalties; negative amortization; single premium credit life insurance.	APR in HMDA	Excludes participation of high-cost loans from MBS pools; sets forth penalties for noncompliance
H.R. 2405 *(106 Cong)*	TILA, HOEPA	Prepayment penalties; negative amortization; single premium credit life insurance, mandatory arbitration.	Lowers APR threshold	
H.R. 4250 *(106 Cong)*	TILA, HOEPA	See above	See above	Strengthens civil penalties for consumers.
S. 2415 *(106 Cong)*	TILA	See above. Prepayment penalties within first 24 months.	Additional disclosures.	
H.R. 4213 *(106 Cong)*	RESPA, TILA		Itemization of all charges imposed on buyer/sellers.	Requires disclosure of mortgage broker fees and compensation.

TABLE D: Secondary Market Sales by Institution Type

Type of Seller Institution 1995	Fannie Mae	Freddie Mac
Mortgage Company	68.0%	58.9%
Thrift	17.7%	24.0%
Bank	11.1%	16.3%
Other	3.3%	0.7%
Source: HUD analysis of GSE loan-level data on single-family one-unit mortgages. Both home purchase and refinance mortgages are included.		

TABLE E: Mortgage Insurance

Year	**FHA**	**PMI Certificates**	**Total**	**Percent FHA**
1980	381,169	392,808	775,957	**49%**
1981	224,829	334,565	561,375	**40%**
1982	166,734	315,868	484,584	**34%**
1983	503,425	652,214	1,157,622	**43%**
1984	267,831	946,408	1,216,223	**22%**
1985	409,547	729,597	1,141,129	**36%**
1986	921,370	585,987	1,509,343	**61%**
1987	1,319,987	511,058	1,833,032	**72%**
1988	698,990	423,470	1,124,448	**62%**
1989	726,359	365,497	1,093,845	**66%**
1990	780,329	367,120	1,149,439	**68%**
1991	685,905	494,259	1,182,155	**58%**
1992	680,278	907,511	1,589,781	**43%**
1993	1,065,832	1,198,307	2,266,132	**47%**
1994	1,217,685	1,148,696	2,368,375	**51%**
1995	568,399	960,756	1,531,150	**37%**
1996	849,861	1,068,707	1,920,564	**44%**
1997	839,712	974,698	1,816,407	**46%**
1998	1,110,530	1,473,344	2,585,872	**43%**
1999	1,246,433	1,455,403	2,703,835	**46%**
2000	891,874	1,236,214	2,130,088	**42%**
Source: HUD US Housing Markets				

TABLE F: Homebuyer Location

Share of First Time Homebuyers by Income and Metro Status *Percent of total first-time buyers in income range (row)*						
	Central City		**Suburb**		**Nonmetro**	
	1985	**1999**	**1985**	**1999**	**1985**	**1999**
< 30% AMI	21%	33%	46%	43%	33%	24%
30.1 - 50% AMI	21%	28%	47%	53%	32%	19%
50.1 - 60% AMI	23%	29%	48%	56%	29%	15%
60.1 - 80% AMI	21%	29%	55%	54%	24%	16%
80.1 - 100% AMI	22%	28%	55%	51%	22%	21%
100.1 - 120% AMI	19%	29%	57%	56%	25%	15%
120% AMI +	26%	26%	55%	54%	19%	20%
Total	23%	28%	54%	53%	23%	19%
Tabulations of American Housing Survey by David A. Vandenbroucke, HUD						

TABLE G: HMDA Purchase Loan Volume by Lender Type

1-4 Unit Home Purchase Loans (in thousands) All Loans					
Lender Type	**1993**	**2000**	**Percent Growth**	**Net Increase**	**Share of growth**
Conventional Prime	1,695	2,581	**52%**	886	**69%**
FHA/RHS/VA	651	763	**17%**	112	**9%**
Subprime	31	236	**661%**	205	**16%**
Manufactured Housing	37	120	**224%**	83	**6%**
Total	**2,414**	**3,700**	**53%**	**1,286**	**100%**

Purchase Loans to Borrowers Below 80% of Area Median Income					
Lender Type	**1993**	**2000**	**Percent Growth**	**Net Increase**	**Share of growth**
Conventional Prime	331	563	**70%**	232	**50%**
FHA/RHS/VA	245	346	**41%**	101	**22%**
Subprime	8	82	**925%**	74	**16%**
Manufactured Housing	21	75	**257%**	54	**12%**
Total	**605**	**1,066**	**76%**	**461**	**100%**
Note: only for MSAs, as defined by boundaries as of 1990 Census.					
Loans to borrowers <80% AMI anywhere and loans to anyone in LMI areas (where LMI area is defined by tract median income to MSA median as of 1990 census).					
Source: Joint Center for Housing Studies tabulations of 1993 and 2000 HMDA data.					

TABLE H: Age of Homes Purchased by First-Time Buyers

Age of Homes Percent of Total by Decade - First Time Buyers					
	All	Very Low Income (Less than 50%)	Low Income (51% to 80%)	Moderate Income (81% to 120%)	High Income (Over 120%)
Pre 1920	10.3%	13.8%	10.0%	10.0%	8.1%
1920	12.6%	15.1%	13.0%	13.0%	10.5%
1930	9.4%	13.1%	10.4%	8.1%	7.2%
1940	16.2%	18.3%	17.6%	15.9%	14.3%
1950	14.0%	12.8%	14.1%	13.6%	14.9%
1960	8.1%	7.5%	8.0%	8.0%	8.6%
1970	12.3%	9.1%	12.4%	12.6%	14.4%
1980	6.7%	3.9%	6.0%	6.8%	8.9%
1990	10.4%	6.5%	8.5%	12.1%	12.9%
Source: 1999 American Housing Survey, author's tabulations					

TABLE I: Units Purchased by First-Time Buyers

Units Recently Purchased (1997 to 1999)		
	All First-Time Buyers	First-Time Buyers with Incomes Below 80% of Area Median
Median Value	$ 90,000	$65,000
Median Decade Built	1970	1960
Percent Inadequate	5.6%	8.3%
Percent Manufactured Homes	14.2%	20.6%
Percent Single family	90.5%	89.7%
Unit Average Square Footage	1,729	1,493
Source: 1999 American Housing Survey, author's tabulations		

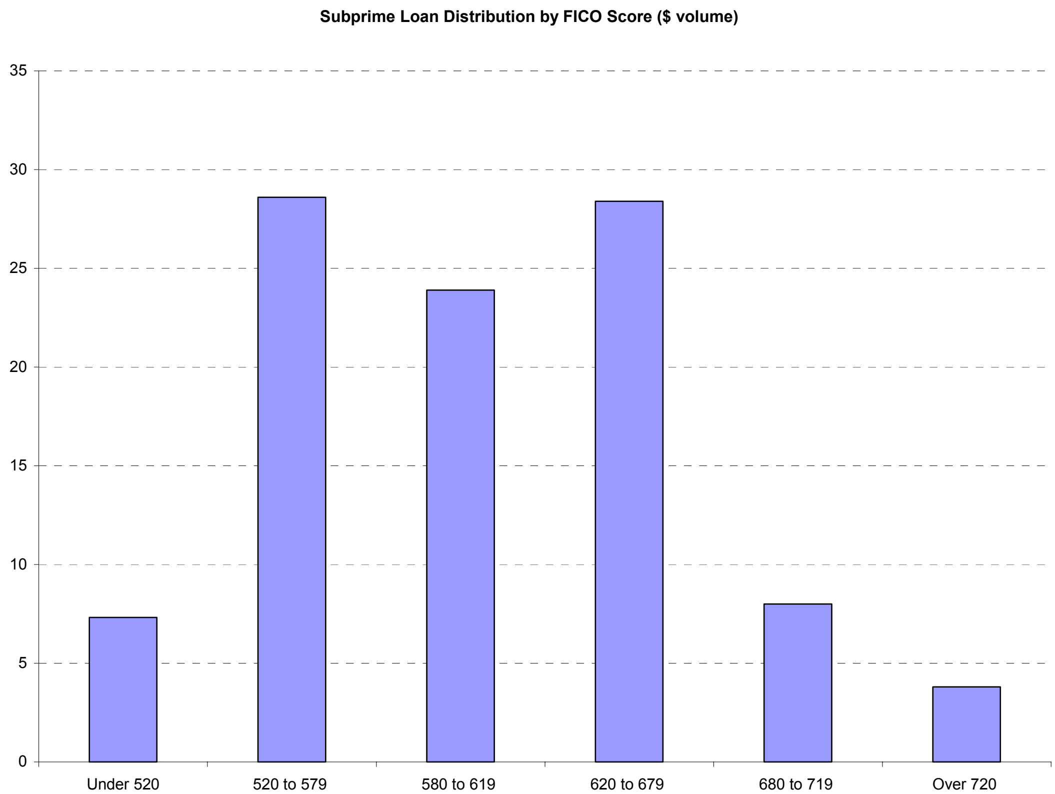
TABLE J: Homeownership Rates by Income and Region, Manufactured Housing Share

	1997			1999		
All Regions	Owner-Occupied Units (000)	Homeowner-ship Rate	Percent Mobile Homes	Owner-Occupied Units (000)	Homeowner-ship Rate	Percent Mobile Homes
< 50% Area Median	16,622	47%	8.4%	15,517	48%	8.7%
50-80% Area Median	10,753	60%	8.1%	11,338	59%	7.2%
80-120% Area Median	13,142	74%	7.0%	12,791	72%	7.6%
120% or more	24,958	88%	3.1%	29,134	88%	3.6%
Northeast	-			-		
< 50% Area Median	3,190	44%	4.2%	2,911	44%	4.3%
50-80% Area Median	1,904	56%	3.7%	1,872	53%	3.2%
80-120% Area Median	2,429	72%	3.1%	2,361	71%	2.4%
120% or more	4,716	87%	1.0%	5,497	86%	1.4%
Midwest (North Central)	-			-		
< 50% Area Median	3,956	50%	5.9%	3,854	52%	6.9%
50-80% Area Median	3,056	65%	7.5%	3,039	65%	5.4%
80-120% Area Median	3,658	80%	4.2%	3,413	79%	5.7%
120% or more	6,229	92%	2.1%	7,259	92%	2.1%
South	-			-		
< 50% Area Median	6,599	53%	12.6%	5,953	52%	12.8%
50-80% Area Median	3,747	62%	11.4%	4,246	62%	11.1%
80-120% Area Median	4,431	73%	11.9%	4,588	72%	12.5%
120% or more	8,868	88%	4.7%	10,400	88%	6.2%
West	-			-		
< 50% Area Median	2,877	38%	8.1%	2,799	39%	8.1%
50-80% Area Median	2,046	54%	7.3%	2,181	52%	6.3%
80-120% Area Median	2,623	70%	6.2%	2,430	65%	6.4%
120% or more	5,145	84%	3.1%	5,991	85%	3.1%
Source: 1997 and 1999 American Housing Surveys						

TABLE K: Placements of Manufactured Units 1994 and 1999 by Region

	2000				1999			
US Total	**Total**	**Single**	**Double**	***% Double***	**Total**	**Single**	**Double**	***% Double***
Titled as Personal Property	260,000	140,000	116,000	*45%*	274,000	105,000	167,000	*61%*
Titled as Real Estate	27,000	7,000	19,000	*70%*	54,000	13,000	40,000	*74%*
Percent Real Estate	*9%*	*5%*	*14%*		*16%*	*11%*	*19%*	
Not Titled	4,000	2,000	2,000		10,000	4,000	7,000	
Total Placements	291,000	149,000	137,000	*47%*	338,000	122,000	214,000	*63%*
Northeast								
Titled as Personal Property	14,000	8,000	16,000	*114%*	11,000	3,000	7,000	*64%*
Titled as Real Estate	2,000	1,000	1,000	*50%*	3,000	1,000	2,000	*67%*
Percent Real Estate	*13%*	*11%*	*14%*		*21%*	*25%*	*22%*	
Not Titled	0				0	0	0	
Total Placements	16,000	9,000	7,000	*44%*	14,000	4,000	9,000	*64%*
Midwest								
Titled as Personal Property	45,000	26,000	19,000	*42%*	39,000	15,000	24,000	*62%*
Titled as Real Estate	8,000	2,000	6,000	*75%*	12,000	3,000	10,000	*83%*
Percent Real Estate	*15%*	*7%*	*24%*		*23%*	*16%*	*29%*	
Not Titled	0	0	0		1,000	1,000	1,000	
Total Placements	53,000	28,000	25,000	*47%*	52,000	19,000	35,000	*67%*
South								
Titled as Personal Property	165,000	96,000	67,000	*41%*	194,000	81,000	112,000	*58%*
Titled as Real Estate	10,000	4,000	6,000	*60%*	27,000	8,000	19,000	*70%*
Percent Real Estate	*6%*	*4%*	*8%*		*12%*	*9%*	*14%*	
Not Titled	3,000	1,000	1,000		7,000	3,000	5,000	
Total Placements	178,000	101,000	75,000	*42%*	229,000	93,000	135,000	*59%*
West								
Titled as Personal Property	36,000	11,000	24,000	*67%*	30,000	6,000	24,000	*80%*
Titled as Real Estate	7,000	1,000	6,000	*86%*	11,000	1,000	10,000	*91%*
Percent Real Estate	*16%*	*9%*	*20%*		*26%*	*14%*	*29%*	
Not Titled	0	0	0		1,000	0	1,000	
Total Placements	44,000	11,000	30,000	*68%*	43,000	7,000	35,000	*81%*

FIGURE A: Subprime FICO Scores



Source: Office of Thrift Supervision Analysis of Mortgage Information Corporation Data