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FOREWORD

HAS THE MORTGAGE PENDULUM SWUNG TOO FAR? REVIVING ACCESS TO MORTGAGE CREDIT

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Abstract: In the wake of the financial crisis, mortgage lending to lower-income and minority borrowers overcorrected and has not recovered. Although homeownership is a riskier investment than previously realized, still it remains a proven path to increased wealth on balance for lower-income households. There are a number of reasonable reforms that could achieve greater access to credit while containing default risk. These include strategies to reduce down payments safely and to keep monthly payments manageable, combined with fixed-rate loans. Prepurchase counseling is important to preparing applicants for the financial demands of homeownership and strengthening their credit histories, while rapid foreclosure prevention counseling can reduce foreclosures dramatically for borrowers who miss payments. In addition, larger, structural changes to the lending industry, mortgage regulation, and housing finance are needed to remove artificial institutional barriers to the flow of responsible credit. In the short term, these include countercyclical rules to minimize credit bubbles and investor reforms to alleviate lenders' liability concerns for inadvertent misrepresentations and minor underwriting errors affecting loans. In the longer term, mortgage finance could be re-envisioned to integrate housing counselors, real estate professionals, and economists into the mortgage supply chain to produce better borrowing decisions at favorable pricing. Closing the circle, ensuring an adequate supply of affordable rentals would give lower-income households the flexibility they need to make the right housing decisions for their personal circumstances at each stage of their lives.

INTRODUCTION

Starting in 2007, the United States experienced a sharp decline in home mortgage originations, leading to a serious overcorrection of credit. The situation is slowly improving, with mortgage originations on the upswing since first

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quarter 2014 in total dollar volume. (US Mortgage Originations). Nevertheless, lenders are still too risk averse and millions of lower-income and minority households who would normally qualify are unable to get mortgages.

Why should we care that the mortgage pendulum swung too far? Obviously, the homeownership proposition has become more freighted since the financial crisis of 2008. The collapse in home values and the ensuing wave of foreclosures were a shocking reminder of the financial risks that come with homeownership and the mortgage debt that most people incur to acquire a home. Yet despite those risks, the evidence shows that purchasing a home remains a powerful path—many would say the most powerful path—to building wealth for families of modest means. (Herbert, McCue & Sanchez-Moyano 2016, 6–7).

This symposium issue asserts that society needs to redouble its commitment to access to mortgage credit while doing it smarter. The challenge going forward is to expand mortgage financing to underserved, creditworthy borrowers while boosting the success rate of mortgages for borrowers, lenders, and communities.

In this issue, a talented array of housing finance experts diagnose the obstacles to affordable lending today and propose innovative solutions for making mortgage credit more sustainable. Although progress has been made to date (particularly in the area of consumer protection), much more needs to be done. Fortunately, there is a wealth of new data from pilot projects around the country on better ways to underwrite and deliver mortgages and to prepare new homeowners for the financial demands of owning homes. Our symposium authors report on a number of those findings and propose new policies to expand the opportunities for successful homeownership. Their recommendations span the entire lending process, from loan products, counseling, and underwriting to servicing, the business model of lending, and broader macroeconomic and environmental factors. In this foreword, I preview and comment on the contributions to this issue by the symposium authors.

This symposium issue grows out of a conference titled *Has the Mortgage Pendulum Swung Too Far?*, held by the Rappaport Center for Law and Public Policy at Boston College Law School on September 30, 2016. I am especially grateful to the Rappaport Center's founders, Jerry and Phyllis Rappaport, for their heartwarming encouragement and generous support. Many others generously gave of their time and effort to make the conference and this symposium issue possible. Above all, we thank Elisabeth Medvedow, the Executive Director of the Rappaport Center, Professor Michael Cassidy, the Center's faculty adviser, Vincent Rougeau, the Dean of Boston College Law School, Hillary Bylicki, John Gordon, Judy Yi, the superb Brittany Campbell and the other outstanding student editors of the *Boston College Journal of Law & Social*

Justice, Judy Jacobson at the Massachusetts Housing Partnership, and our symposium speakers and commentators.

I. Tight Mortgage Credit and the Declining Homeownership Rate

Where does access to mortgage credit stand today? The total annual dollar volume of home mortgage originations sharply declined when the housing bubble burst starting in first quarter 2007. But since then, residential mortgage lending in the U.S. has improved in overall terms for the last three and a half years. Originations staged a recovery in first quarter 2014 and have been on the rise ever since. (US Mortgage Originations).

However, total origination volumes do not answer the question posed by this symposium, which is the extent to which historically underserved customers, including lower-income households and minorities, are able to get mortgage loans. In the opening article, Laurie Goodman tackles that issue by constructing an index that measures the level of risk assumed by residential lenders pre- and post-crisis. (Goodman 2017, 237, 252). The index gauges the market's appetite for risk by comparing the risk levels of home mortgage originations during and after the crisis with those in 2001–2002, when lending standards were reasonable. According to Goodman, lenders' risk appetite plunged beginning in 2007. By second quarter 2016, the mortgage market was assuming less than half the credit risk it took on in 2001. (*Id.*, Figure 3).

This tightening has been so pronounced, Goodman warns, that "[m]any loans are not being made that should be" made. (*Id.*, 238). In earlier work, she and colleagues estimated that up to 6.3 million more mortgage loans would have been made between 2009 and 2015 if the credit standards prevailing in 2001 had been used. (Goodman, Zhu & Bai 2016). Households with FICO scores[1] below 700 have been especially hard hit by the credit crunch and mortgages have become next to impossible to secure for most applicants with FICO scores below 660. (Bhutta 2015, 291; Goodman 2017, 239). Because Hispanic and nonwhite households have lower credit scores, wealth, and incomes on average than non-Hispanic white households, today's tight credit conditions disproportionately hurt people of color.

This credit contraction helped depress the U.S. homeownership rate to its lowest level in fifty years. (Federal Reserve Bank of St. Louis). In their contribution to this issue, Jonathan Spader and Christopher Herbert document the decline in U.S. homeownership that accompanied the tightening of mortgage credit. (Spader & Herbert 2017, 267–68). In the mid-1980s, the national homeownership rate began a long climb from 63.9% in 1985 to a high of 69.2% in 2004, before slumping to 63.7% in 2015. (Federal Reserve Bank of

[1] "FICO scores" refer to Fair Isaac Corporation credit scores.

St. Louis). Although the U.S. population became older and more racially and ethnically diverse over this period, Spader and Herbert find that these demographic shifts had relatively little effect on the drop in homeownership. Instead, they conclude, evictions due to foreclosure, macroeconomic trends, swings in the availability of mortgage credit, and possibly household attitudes contributed to the homeownership boom and bust.

The homeownership trends that Spader and Herbert document have serious implications for the racial wealth gap. From 2002 to 2015, the homeownership gap between black and white households widened. (Spader & Herbert 2017, Figure 1). Goodman is concerned that the gap will become worse, based on her prediction that the homeownership rate will continue to decline. Spader and Herbert agree that a further decline is possible, in part due to the continued foreclosure backlog and lagging home purchases by young adults. If homeownership continues to fall, the largest adverse impact will fall on minority households, particularly black families, according to all three authors.

II. Factors Contributing to Barriers to Credit

To summarize, mortgage credit tightened sharply during the Great Recession, most heavily affecting minority households. In some ways, this contraction in credit is paradoxical. One might have expected the volume of home loans to grow post-2008, when interest rates fell to historic lows and lower housing prices made homes more affordable. (Quercia & Riley 2017, 315). Despite these favorable home-buying conditions, the opposite occurred.

So what explains this credit contraction and its effect on underserved groups? Multiple factors are at work, including continued uncertainty over the path of housing finance reform. The job of untangling these various factors will continue for years. As part of that effort, this symposium issue examines several major reasons for the drop in access to home loans, including the backlog of foreclosures, impaired credit, reduced originations to young adults, risk aversion by consumers and lenders, and the obsolete business model of for-profit mortgage lenders.

A. The Role of Foreclosures and Slow Household Formation by Young Adults

Although initial research has been done on demand-side factors in the recent decline in mortgage originations, those dynamics are not well understood. Neil Bhutta (Bhutta 2015, 295) finds some evidence of lower consumer demand for home mortgages post-crisis. Spader and Herbert explore two factors that may have demand-side implications, one being the high rate of residential foreclosures after the housing market's collapse and the other being the reduced number of originations to younger households.

1. Foreclosures

According to estimates by Spader and Herbert, foreclosures resulted in the ouster of 4.8 to 5.8 million homeowners between second quarter 2005 and first quarter 2015. They conclude that foreclosures accounted for at least half of the decline in homeownership over that ten-year period.

What is uncertain is the extent to which these foreclosures translated into lower demand for home mortgages. Some of the borrowers foreclosed on may have lost their desire for future homeownership and reverted to renting long-term. Their exit from the homeownership market would reflect reduced demand for mortgage loans. Other borrowers who went through foreclosure may have remained interested in buying another home, but could not qualify for a mortgage for several years due to damaged credit histories and credit scores. (Brevoort & Cooper 2013, 761). To the extent that tighter lending standards blocked their eligibility for loans even once their credit improved, that would be a supply-side effect.

Regardless of the relative contribution of supply-side and demand-side factors, Spader and Herbert's findings about the magnitude of foreclosures and their role in last decade's homeownership rate decline are disquieting, particularly given the disruption and damage that foreclosures inflict. For affected households, foreclosures result in eviction, lost wealth, and frequently also dislocations in schooling and in health. (Been et al. 2011, 410; Bucks & Bricker 2013, 7–8; Burd-Sharps & Rasch 2015, 14; Currie & Tekin 2015, 86; Manturuk et al. 2017, chs. 2–3). Affected lenders and investors will probably sustain losses and may face insolvency. Foreclosures further impose heavy negative externalities. On a local level, foreclosures depress neighboring property values and increase crime (Rogers & Winter 2009, 456, 457), while nationally, large-scale foreclosures jeopardized the nation's financial stability in 2008. (Campbell 2013, 4–5). By illuminating the pernicious effect of foreclosures on homeownership, the authors remind us of the importance of curbs on reckless credit and housing price bubbles, particularly now that memories of the 2008 financial crisis are rapidly fading.

2. Falling Mortgage Originations to Younger Adults

Spader and Herbert also report that households under 35 had the largest drop in home purchases of any age group between 2005 and 2015. In their view, foreclosures do not explain what happened to that age group, which is not particularly surprising because many of these individuals were still too young to buy homes when the housing boom peaked in 2005. Instead, other factors explain younger adults' delayed entry into homeownership. Symposium author Edward Kane points to the poor employment prospects of many young adults after 2008, the trend toward later marriage and childbearing, and the uptick in younger adults who are living with their parents at home as reasons for younger people's depressed home mortgage rates. (Kane 2017, 296). Rising student debt may have had an effect as well. (Mezza et al. 2016, 20).

B. Lender Constraints

There has been much more research on the supply-side reasons for the contraction in credit. This issue highlights three of those reasons: concerns on the part of lenders about liability exposure, rising servicing costs, and the antiquated business model of for-profit mortgage lending.

1. Lender Concerns About Legal Exposure and Servicing Goals

Laurie Goodman asks the question, why did credit to low- and moderate-income consumers become so tight? In her view, the problem is that lenders placed further credit overlays on top of the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and Federal Housing Administration (FHA) credit standards.[2] Goodman identifies three reasons why lenders became so conservative in the current business climate. First were buyback claims by investors for breach of representations and warranties on loans. Second were concerns about open-ended liability to the U.S. government under the False Claims Act for misrepresentations in FHA loans. Finally, lenders became concerned about the mounting costs of servicing distressed loans. To avoid these problems going forward, lenders made a decision to restrict loans to the safest borrowers and scoured those loans to make sure that the transactions are free from errors.

In an effort to encourage lenders to relax their grip on credit, Fannie Mae, Freddie Mac, and FHA have taken steps, which Goodman describes, to reduce originators' liability exposure and to reduce servicers' cost of servicing delinquent loans. Fannie Mae and Freddie Mac have made substantially more progress than FHA in both respects, however. As a result, lenders remain wary of making FHA loans and some lenders have exited the FHA market altogether. This pullback represents a particular blow to applicants with weaker credit profiles because FHA loans are specifically intended to accommodate their need for low down payments and flexible underwriting at a cheaper price than Fannie or Freddie loans.

Goodman's critique engages the larger and as-yet unresolved debate over the wisdom of civil and criminal liability for misrepresentations in mortgage lending. Edward J. Kane takes the opposite view from Goodman, who is concerned about over-deterrence and a pullback in affordable credit when lenders

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[2] After 2008, the overwhelming proportion of home mortgage originations in the United States consisted of Fannie Mae, Freddie Mac, and FHA-insured mortgages.

are punished for inadvertent errors. (Kane 2017, 297–98). Kane argues, in contrast, that mortgage fraud laws are so weak that they "invite[] mortgage professionals to lie." He would amend the laws against mortgage misrepresentations to relax the required showing for civil and criminal intent. Specifically, where mortgage professionals provide false information while acting in a professional capacity and receiving compensation for their services, Kane would impose liability where those professionals "knew or should have known" that the information was false.

2. The Broken Business Model of Banks

Symposium author Lisa Davis points to separate problems driving the decline in mortgages by big banks to low- and moderate-income households, which are inefficiencies and excessive costs in the mortgage supply chain. (Davis 2017, 303–05). Currently, she explains, the origination costs to banks for mortgages of $100,000 or less are too high to make those mortgages profitable. Expensive marketing costs and commissions are partly to blame, plus the obsolete, paper-based technology used by the home mortgage industry. Further, there is no communication channel along the chain that incorporates the risk mitigation offered by housing counselors at the origination phase into secondary market pricing. The rest of her article envisions what a modern mortgage supply chain would look like, as I discuss below.

3. Did New Federal Regulations Play a Role?

Some observers have questioned whether the new mortgage regulations mandated by the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank) contributed to the contraction in credit. The earliest of those rules, most notably the ability-to-repay and qualified mortgage rule promulgated by the Consumer Financial Protection Bureau, did not take effect until January 2014. (Consumer Financial Protection Bureau 2013, 6408). However, all of the decline in mortgage credit preceded the rule's effective date and mortgage credit actually increased the year the rule went into effect. (Goodman 2017, Figure 3). Economists who have examined the issue have not found significant evidence that the Dodd-Frank mortgage lending rules further tightened credit, either to lower-income households or otherwise. (Bhutta & Ringo 2014; Goodman et al. 2014).

To summarize, the impact of foreclosures on the homeownership rate suggests that foreclosures played a role in the contraction of home loans, although the exact pathways of that effect are uncertain. Lending fell to young adults for other reasons. Meanwhile, lenders became cautious in lending in part due to legal liability concerns and in part due to higher servicing costs. The outdated supply chain in mortgages also helps explain the reduction in mortgage loans to lower-income households. There is no substantial evidence, however, that the new federal mortgage lending standards that went into effect in January 2014 contributed to the tightening of credit.

The increased paucity of credit to underserved borrowers intensified discussions about how to reverse that trend, consistent with safe and sound lending. In the next section, I survey a range of proposals by our symposium authors to expand sustainable lending to lower-income homeowners.

III. Techniques to Expand the Credit Box

The pullback in credit to creditworthy minority and lower-income borrowers has accelerated the search for ways to open up the credit box responsibly. Policy analysts have advanced proposals in that regard ranging from discrete aspects of the mortgage lending process to broader market reforms. For instance, ongoing debates over the fate of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the future respective roles of the federal government and the private sector in housing finance have yielded proposals for increased affordable lending through secondary market reforms. (Housing Finance Reform Incubator). In the immediate term, policymakers have instituted reforms to ease lenders' heightened risk aversion in response to investor demands to buy back defective mortgages, as Laurie Goodman describes.

There has also been renewed attention to origination reforms to increase lower-income lending. Some proposals have embraced less common loan products, such as shared appreciation mortgages designed to replace down payment requirements (Caplin et al. 2008, 6) and 15-year fixed-rate mortgages that enable households to build equity more quickly. (Arnold 2014; Pinto 2014). Alternative credit scoring models are being devised for consumers with thin credit files. (Baer et al. 2013). Still other efforts have focused on flexible lending standards designed to expand credit safely. Some of these programs predate the 2008 financial crisis by decades and provide a rich laboratory of experimentation, as our authors discuss.

A. Flexible Underwriting Models

Around the country, community development financial institutions (CDFIs) and other community organizations have worked for years to develop flexible yet responsible underwriting models for borrowers with limited income or less than pristine credit. These models are tailored to the specific needs of lower-income borrowers, including low down payment requirements, payment shock protections, homeowner counseling, and most importantly, manageable payments. With funding from foundations including the Ford

Foundation, some of these models have now been tested over the full business cycle, allowing analysis of what works and what does not.

In their article, Roberto G. Quercia and Sarah Riley describe lessons from one of the nation's leading affordable lending programs, the Community Advantage Program (CAP) spearheaded by the Self-Help Credit Union in Durham, North Carolina. (Quercia & Riley 2017, 317–19). CAP and its predecessor made over 46,000 30-year fixed-rate mortgages with low down payments at near-prime interest rates to low- and moderate-income borrowers between 1983 and 2010.

In a companion article, Clark L. Ziegler, Elliot Schmiedl, and Thomas Callahan identify the determinants of success in the Massachusetts ONE Mortgage Program, which is another well-respected community development mortgage program serving lower-income and minority households. (Ziegler, Schmiedl & Callahan 2017, 349–54). Since 1992, the ONE Mortgage Program and its predecessor[3] have funded almost 20,000 home purchases through low down payment mortgages at favorable interest rates across Massachusetts. The following discussion examines the features of those programs in more detail and their effect on default rates.

1. Affordable Payments

From its inception, the ONE Mortgage Program has placed top emphasis on lowering the monthly payment obligations of borrowers. This had two purposes: to expand the number of eligible borrowers and to reduce default risk. ONE Mortgage has been able to achieve lower monthly payments through two techniques. First, the Program and its lenders offer interest rate discounts and subsidies. Second, the risk management architecture of the Program is structured to dispense with the need for private mortgage insurance. Due to these features, ONE Mortgage loans with subsidies have initial monthly payments that are up to 25% cheaper than those on Federal Housing Administration (FHA) mortgages.

First-time Massachusetts homebuyers earning no more than the area median income (which was $90,590 in Massachusetts in 2016) qualify for the ONE Mortgage Program. All borrowers in that Program receive a 30 basis point interest rate discount over the life of the loan. In addition, borrowers who make less than 80% of the area median income qualify for an interest rate subsidy, funded by the Commonwealth of Massachusetts, which further reduces monthly payments for the first seven years of the loan. Borrowers do not have to repay the subsidy until the sale or transfer of the home and owe 0% interest upon repayment.

[3] This foreword refers to the current Program and its predecessor together as the ONE Mortgage Program.

The ONE Mortgage Program also ensures affordability by relieving borrowers of the need to pay costly mortgage insurance. Instead, the Program manages the default risk of its borrowers through a loan loss reserve funded by the Commonwealth of Massachusetts and a 20% risk retention position by participating lenders. This 20-80 risk-sharing arrangement, combined with the fact that originators usually retain the servicing and hold ONE Mortgages in portfolio, give participating lenders a distinct financial stake in the success of those loans.

As I will shortly discuss, this structure has had an impressive track record in reducing the risk of foreclosure and liquidation. Expanding the model outside of Massachusetts and to a broader array of lenders, however, poses challenges. Lenders have to be willing to charge lower-income borrowers favorable prime rates and to grant a further 30 basis point discount. Lower origination costs, as Lisa Davis discusses, would help achieve this calculus. In addition, a proven record of careful underwriting and low losses would give lenders the confidence to reduce their pricing. Here, the ONE Mortgage Program, like the CAP Program, has been able to generate that type of record through data-driven analysis of its delinquency and foreclosure rates by university researchers.

Other aspects of the Massachusetts model might deter more rigid lenders. Most mortgage lenders are heavily dependent on secondary market financing, which the ONE Mortgage Program does not contemplate. Bank lenders elsewhere might be willing to hold loans in portfolio in order to earn Community Reinvestment Act (CRA) credit, and many of them do in Massachusetts. However, nonbank lenders—who now account for over half of mortgage originations (McCoy & Wachter 2017a) and who do not owe duties under CRA—will likely be less willing. Finally, Laurie Goodman's reports of lender backlash to put-back requests raises the question of how many lenders nationally would agree to a 20% risk retention provision.

That said, the ONE Mortgage Program embodies a highly creative approach to manageable payments that can be and has been replicated, at least by banks, when combined with strong CRA incentives and government-funded loan loss reserves. As I now discuss, the Program combines this structure with careful underwriting standards to further ensure that the borrowers can afford their loans.

2. Underwriting Criteria

In recent decades, the borrower characteristics with the strongest value in predicting credit risk have been loan-to-value ratios, debt-to-income ratios, and credit scores. (Goodman 2017, 236). Precautionary savings are another safeguard against default. (Quercia & Riley 2017, 321). Because no one of these factors is dispositive, it is possible to trade one characteristic off against another in order to balance underwriting flexibility with default risk. This insight propelled advances in automated underwriting and also has been used to expand the credit box.

One of the most important ways that the CAP and ONE Mortgage Programs have expanded mortgage credit for lower-income borrowers has been through a minimum down payment requirement of 3% for loans on single-family homes. This low down payment requirement is critical to expanding eligibility, because most potential applicants have such low assets that a traditional down payment requirement of 10% or 20% would prevent them from buying homes. (Center for Responsible Lending 2012). At the same time, the thin equity cushion backing these loans increases default risk.

In response to this default concern, the CAP Program reports that despite the low down payments of most CAP borrowers (with median loan-to-value ratios at origination of 97%), borrowers who experienced negative equity on their mortgages when housing prices fell starting in 2007 generally did not default. Instead, most CAP borrowers who did default experienced liquidity problems, such as due to job loss during the Great Recession. This suggests that low down payment loan programs can be safely used when combined with careful underwriting, savings cushions, and alternative employment opportunities in the event of job loss.

In their article, Ziegler, Schmiedl and Callahan provide insight as to how the ONE Mortgage Program offsets the inherent default risk in low down payments with relatively conservative underwriting criteria. In order to qualify, all applicants must have a minimum credit score of 660 for loans on condominiums and single-family homes.[4] Borrowers seeking to buy either type of property must also meet a housing-to-income ratio cap of 36% and a debt-to-income ratio cap of 43%. Applicants who exceed a housing-to-income ratio of 33% and a debt-to-income ratio of 38% must further have at least three compensating factors, which can include a higher credit score, at least two months of reserves, stable employment, or a housing payment shock post-purchase of no more than 20%.[5]

As I discuss below, the ONE Mortgage Program was tempered by the financial crisis and its response is instructive. Based on that experience, in January 2010, the Program raised its minimum credit score requirement from 620 to 660.[6] In addition, the Program lowered its maximum housing-to-income ratio from 38% to 36% and its maximum debt-to-income ratio from 45% to

[4] The ONE Mortgage Program has an alternative underwriting test for borrowers with a thin credit history.

[5] Housing payment shock refers to the difference between an applicant's monthly housing payment pre-purchase and the prospective housing payment post-purchase.

[6] The Program even made a few early loans to borrowers with credit scores in the high 500s.

43%. Today, new ONE Mortgage borrowers have an average credit score of 738, which is fairly demanding and puts them squarely in prime territory. These standards have tightened eligibility for the Program, but paid dividends in lender confidence and low foreclosure rates. Meanwhile, the Program works closely with customers with blemished credit to improve their credit records so that they can later qualify for home loans.

3. Loan Product

One of the strongest messages by the contributors to this issue is that the right loan product is essential to making safe loans. In her analysis of risk levels in mortgage originations from 2001 through 2015, for instance, Goodman finds only a slight uptick in borrower risk from 2001 to 2007, even though the total risk undertaken by outstanding mortgages increased substantially over that period. She attributes that upswing in total risk mostly to the rapid expansion of nontraditional, riskier loan products, including non-fully amortizing loans, loans with forty-year amortization schedules, and hybrid adjustable-rate mortgages with short reset periods.

The experience of the CAP and ONE Mortgage Programs confirms her finding. As I later discuss, the CAP Program had much lower default rates than subprime loans even though CAP borrowers and subprime borrowers had similar credit profiles (with CAP borrowers having a median credit score at origination of 681 during the study period). Based on this, Quercia and Riley emphasize the importance of CAP's principal mortgage product—fixed-rate loans at near-prime rates—in reducing default risk. Similarly, the ONE Mortgage Program in Massachusetts attributes its favorable default rate record to its decision to only offer fixed-rate mortgages.

4. Homebuyer Education and Counseling

High-touch education and counseling are a further technique used by the ONE Mortgage Program and the CAP Program to reduce default risk. All ONE Mortgage homebuyers, for instance, must participate in pre-purchase and post-purchase counseling to prepare for homeownership. In pre-purchase counseling, the Program encourages participants to improve their credit profiles, having concluded from experience that this approach ensures better repayment than loans to borrowers with weaker credit scores.

Both the ONE Mortgage Program and the CAP Program put high importance on rapid outreach to distressed borrowers. In the ONE Mortgage Program, any borrower who becomes 30 days or more delinquent is automatically referred to foreclosure prevention counseling. The Program's sponsors credit this early intervention for the Program's low foreclosure rate. Similarly, the CAP Program offered foreclosure prevention counseling to borrowers who were 45 days delinquent or more. (Ding, Quercia & Ratcliffe 2008, 322). This counseling was associated with better repayment and lower foreclosure rates. (*Id.* at 318; Quercia & Riley 2017, 328–29).

In contrast with these two Programs, traditional mortgage lending by bank and nonbank lenders do not regularly incorporate pre-purchase or post-purchase counseling. Lisa Davis cites this omission as one reason why conventional lenders fail to adequately serve lower-income borrowers and proposes a new model to remedy the problem, which I describe below.

B. Outcomes

Affordable lending operates within tight constraints, posing tradeoffs between broader access to credit and higher default risk. These tradeoffs raise concerns about losses to lenders and investors as well as the effect of foreclosures on borrowers. As our authors report, the ONE Mortgage Program and the CAP Program managed these competing considerations successfully, even when severely tested by the 2008 financial crisis.

1. Loan Performance

The underwriting, loan product, and risk management models just discussed enabled the ONE Mortgage Program and the CAP Program to report successful loan performance rates, even in the wake of the 2008 financial crisis. Since 2008, for instance, the ONE Mortgage Program had a 30+ day delinquency rate of about 1 to 2 percentage points above that for prime loans and significantly below the delinquency rates for FHA loans and all home loans in Massachusetts. Meanwhile, the foreclosure rate for ONE Mortgage loans has clocked in at an impressive 1.9%, which is at or below the foreclosure rate for all prime loans in Massachusetts. The Program has achieved this record despite low down payments and interest rates on its mortgages.

Similarly, Quercia and Riley report on longitudinal studies that evaluated default rates for CAP Program mortgages. During the recent financial crisis when default rates spiked, CAP loans performed as well as FHA loans and significantly better than prime adjustable-rate loans and subprime loans of all types. Only prime fixed-rate loans outperformed CAP loans during this period.

2. Financial Gains to Borrowers

In their article, Quercia and Riley also evaluate the wealth-building potential of CAP loans. CAP borrowers were not immune from the volatility in housing prices during the housing boom and bust that culminated in the 2008 financial crisis. Nevertheless, among the CAP borrowers surveyed who had sold their homes, 89% sold for what they originally paid or more, while 11%

lost money on their sales. The median gain on sale was $26,000, while the median loss on sale was $10,000. By the end of 2012, the CAP borrowers surveyed had a median net worth of $70,000, with home equity accounting for 23% of total net worth and retirement accounts accounting for another 40%. Meanwhile, comparable renters surveyed had a median net worth of $11,000 in 2012. That year, fully 70% of the CAP borrowers surveyed had retirement accounts, compared with only 40% for comparable renters. From this and similar findings, Quercia and Riley conclude: "CAP homeowners accumulated considerably more wealth than similar renters during the study period and were more likely to hold investment assets other than home equity." (Quercia & Riley 2017, 324). In addition to confirming home-buying's wealth-building potential (Herbert, McCue & Sanchez-Moyano 2016, 6–7), this suggests that homeownership may be further correlated with diversified wealth gains across multiple asset classes, at least for credit programs that are thoughtfully designed.

IV. Bringing Affordable Mortgage Models to Scale

One of the most pressing challenges for affordable lending programs by non-profits and community development financial institutions (CDFIs) lies in bringing those programs to scale. We have seen that the risk management structure of the ONE Mortgage Program does not fit the normal business model of commercial mortgage lenders, most of whom originate for sale to the secondary market. Meanwhile, standardization demands by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") and political controversies surrounding their conservatorship and the solvency of the Federal Housing Administration (FHA) have placed other, serious limitations on the replication of programs such as ONE Mortgage and the Community Advantage Program (CAP) nationwide.

In her contribution to this issue, Lisa Davis makes the further point that the community development sector is still a cottage industry and not well integrated into the secondary market. Marketing costs and commissions make it too expensive for big banks to satisfy demand by creditworthy lower-income households for mortgage loans. (Davis 2017, 303, 305).

To address these issues, Davis describes a new vision for reorganizing affordable lending that is designed to expand responsible credit to qualified low- and moderate-income borrowers. One major objective is to reduce origination costs. Davis would accomplish that by providing outreach and marketing through the existing housing counseling system instead of the costly marketing structure of loan officers and brokers used by banks and mortgage brokers. To further reduce costs, she would shift the marketing of home loans to a technology platform where applicants could apply online. This same technology platform would replace the current paper-based system for loan production and connect housing counseling agencies to CDFIs and secondary market buyers.

A related aspect of her proposal would integrate housing counseling with the loan production process and link counseling agencies all the way through to investors. This way, the risk reduction benefits of counseling could be reflected in secondary market pricing. In this new supply chain, housing counseling agencies would refer loan applicants to CDFIs or credit unions, which would originate mortgages at reduced cost. As Davis explains, there are already two initiatives along these lines—one by the NeighborWorks Organization Shop Program and the other by the National Mortgage Collaborative in tandem with the CDFI Springboard—that are seeking to create a national marketplace of CDFIs, incorporating housing counselors, to create a wholesale conduit for home loans.

In addition to cost reduction and an improved supply chain, Davis' proposal has two more benefits that are key to the success of affordable lending. Housing counselors would finally have assurances of private compensation through fees paid by originators or wholesale lenders. That compensation would provide a way, in turn, of delivering professional housing counseling at scale—along with its proven risk reduction benefits—to lower-income homebuyers.

V. Broader Macroeconomic and Environmental Considerations

In the last segment of this issue, we turn to broader macroeconomic and housing market factors that encourage or retard responsible access to credit. These considerations have received short shrift in policy discussions so far. Three of the articles in this issue bring needed attention to this topic.

Susan Wachter and I argue that better access to credit for ordinary households depends on reducing the boom-bust cycles that plague home prices and housing finance. (McCoy & Wachter 2017b, 362). During the easy credit phase of the cycle, lenders extend excessive numbers of mortgage loans with heightened credit risk. Later, after the bubble bursts and default rates spike, banks become overly cautious in lending, both to preserve capital and out of fear of put-back exposure on future loans. This contraction in credit is so severe that even creditworthy consumers with modest incomes cannot count on getting loans. That is the situation we find ourselves in today.

This volatility undermines healthy access to credit and building wealth. (Herbert, McCue & Sanchez-Moyano 2016, 1). In the aftermath of a mortgage bubble and the inevitable recession, millions of homeowners may lose their homes to foreclosure—some due to reckless loans and others due to unemployment—leaving them worse off financially than before. Damaged credit will block them from qualifying from another mortgage for at least several years. Meanwhile, tight lending standards will cause other aspiring homeowners who do have good credit to be turned down for loans, denying them the chance to build home equity. Current borrowers who hold onto their homes will suffer falling home values unless they can ride out the recovery and do not live in areas in long-term decline. Because homeownership historically has been the most powerful engine of wealth for lower-income and minority families, these peaks and troughs exacerbate the wealth gap.

Wachter and I propose addressing cyclicality through a three-pronged approach. First, society needs to agree that safe and affordable credit, not maximum loan volumes, is the top policy goal. Second, policymakers need to root out market and regulatory practices and policies that exacerbate swings in the housing finance cycle. Finally, regulators should expand their use of countercyclical tools to modulate the highs and lows of the mortgage cycle. These tools—which include the ability-to-repay rule promulgated by the Consumer Financial Protection Bureau (Consumer Financial Protection Bureau 2013, 6408), countercyclical capital provisions, and countercyclical loan loss requirements—are in place but have not been implemented across the board.

Quercia and Riley similarly highlight broader design considerations that can help shield borrowers against market booms and busts. Their analysis of Community Advantage Program (CAP) loans shows that the houses that weathered the housing price decline the best were less expensive, single-family homes located in wealthier neighborhoods with somewhat older housing stock. Thus, the authors recommend that affordable homeownership programs identify modestly priced homes in these neighborhoods for homebuyers' consideration. To guard against employment shocks, they also counsel homebuyers to search in communities with stable and diverse job opportunities. The timing of purchases similarly matters, in their view. Consumers should be especially cautious about home purchases at the top of the market or when they plan to sell in a few years. Lenders can reinforce this caution by modifying their underwriting models to expand credit when owner-occupied homes are undervalued compared to rents and to tighten it when owning is costly compared to renting. Finally, Quercia and Riley advocate post-purchase counseling and specialty servicing, which have been proven useful in avoiding defaults and resolving defaults at lower cost.

Unlike McCoy and Wachter's recommendations, which are aimed at Congress and federal regulators, the policy proposals advanced by Quercia and Riley require decentralized local implementation by real estate and lending professionals. For instance, housing counselors and real estate agents would be pivotal to matching potential homebuyers with homes in appropriate communities. Housing counselors would also be a crucial source of trusted advice about the timing risks of any purchase.

Training tens of thousands of realtors and counselors to advise on appropriate neighborhoods and communities would be a challenge. Teaching housing counselors to predict real estate bubbles while they are inflating (which economists do not even do well) would pose even greater difficulty. At the very least, this would necessitate a "more robust framework" of the type that Quercia and Riley envision, involving "the participation of a variety of stakeholders, including not only the lender but realtors, economists and other market analysts, specialty servicers, and financial educators and counselors." (Quercia & Riley 2017, 329).

The financial incentives of market actors would also have to be realigned to comport with the recommendations put forward by Quercia and Riley. Would realtors have the right financial incentives to guide lower-income homebuyers toward cheaper homes in richer neighborhoods? Would lenders facing stiff competition be willing to tighten credit when home purchases are becoming costly relative to rents? The traditional competitive dynamics of housing booms and busts tell us otherwise: i.e., lenders will relax credit, not tighten it, during housing bubbles (Levitin & Wachter 2015, 1250; Wachter 2016, 211) unless forced to scale back by regulators.

Nothing in this diminishes the importance of the recommendations made by Quercia and Riley. What it does suggest, however, is that careful thought needs to be given to a fuller set of incentives and institutional and legal arrangements if their proposals are to come to life. The same is true for Davis' proposal for lenders to pay housing counselors, which could revive some of the perverse incentives faced by mortgage brokers pre-crisis if not properly designed.

We close our issue with remarks by our symposium keynote speaker, Michael A. Stegman, who steps back and reminds us that homeownership finance is just one part of the larger ecosystem of residential shelter. (Stegman 2017, 395–96). Homeownership and rental housing, he states, "are two sides of the same coin" and "pressures and problems in one have implications for the other." (*Id.*, 396). Recent experience shows that when eligibility requirements for home mortgages become too tight, demand for rental housing rises. According to the Harvard Joint Center on Housing Studies, the last ten years ushered in 9 million additional renters, which was the largest increase in one decade on record. (Joint Center for Housing Studies 2016, 25). Even though the amount of rental units is expanding, demand for affordable rentals has outstripped supply, and over 60% of apartments in the top 11 metropolitan areas are too expensive for the average renter. (NYU Furman Center 2015, 15).

Stegman criticizes federal budgetary policy for overspending on homeownership subsidies, especially given the fact that rental families, on average, make only about half the income of families headed by homeowners. (Miller 2014). There are a number of tried and trusted policies that could substantially reverse the rental gap and ameliorate homelessness for a relatively modest budget outlay if expanded. Based on this set of research findings, Stegman recommends increasing the Low-Income Housing Tax Credit to build 350,000 to 400,000 more affordable rental housing units over the next ten years; ending chronic homelessness through greater funding for rapid rehousing and longer-term housing vouchers; granting mobility vouchers to assist impoverished families to move to wealthier neighborhoods where jobs and good schools are more available; and increasing carrots and sticks to cities and states to reduce regulatory hurdles to affordable rental housing.

CONCLUSION

Now, with the benefit of hindsight, we know that homeownership is a riskier investment than previously realized. Still, homeownership remains a proven path to increased wealth on balance for lower-income households. The task, then, is to expand mortgage credit to qualified, underserved households while increasing their chance of repayment and successful homeownership.

That job appears daunting, now that lenders and investors have become gun-shy of affordable lending. But in reality, there are a number of reasonable reforms that could achieve greater access while containing default risk. In this symposium issue, some of the nation's leading experts in housing and mortgage finance advance proposals to achieve these twin goals.

Chief among these are underwriting changes to open up the credit box while minimizing default risk. These include strategies to reduce down payments safely and to keep monthly payments manageable. Several authors highlighted the importance of pre-purchase counseling in preparing applicants for the financial demands of homeownership while strengthening their credit histories. Similarly, rapid foreclosure prevention counseling has been shown to reduce foreclosures dramatically for borrowers who miss payments. The authors further stress the importance of the fixed-rate loans in making safe mortgages. Using these lending models, it is possible for lenders to reach further down the income and credit spectrum while maintaining an acceptable level of default risk.

Several of the authors proposed larger, structural changes to the lending industry, mortgage regulation, and housing finance to remove artificial institutional barriers to the flow of responsible credit. In the short term, these include countercyclical rules to minimize credit bubbles and investor reforms to alleviate lenders' liability concerns for inadvertent misrepresentations and minor underwriting errors affecting loans. More boldly, several of the authors advanced a new vision of mortgage finance, in which housing counselors, real estate professionals, and economists would be integrated into the mortgage supply chain to produce better borrowing decisions at favorable pricing. Closing the circle, ensuring an adequate supply of affordable rentals would give lower-income households the flexibility they need to make the right housing decisions for their personal circumstances at each stage of their lives.

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