The Daily Dish

A Lost Decade

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Eakinomics: A Lost Decade

Housing and housing policy has shaped my career. My first published professional paper was on tax policy and housing. I testified as Congressional Budget Office (CBO) Director in the aftermath of the accounting scandal at Fannie Mae. I was policy director for the John McCain presidential campaign, which cleverly chose its run to coincide with the aftermath of the bursting of the housing bubble, the financial crisis, and the onset of the Great Recession. And I served (a term I use loosely) as a commissioner on the Financial Crisis Inquiry Commission (FCIC), which investigated the roots of the crisis. I've retained an avid interest in the direction of housing and housing finance policy.

A bit over 10 years ago, on March 18, 2008, the Federal Reserve engineered the takeover of the failing investment bank, Bear Stearns. Its collapse was among the sparks that lit the financial crisis and imminent collapse of the huge housing Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. Fannie and Freddie ended up in conservatorship by the Federal Housing Finance Agency (FHFA) and virtually every onlooker expected a broad re-thinking of housing finance in the United States and deep reforms (or even the winding down) of Fannie Mae and Freddie Mac. Much to everyone's surprise, they remain in conservatorship 10 years later and there has been no legislation addressing housing finance.

But conservatorship need not mean suspended animation. Even if lawmakers did not prioritize making laws that would ensure that another housing crisis of the same origin never happened again, you might expect that the conservator would have done everything to diminish the taxpayers as a backstop and made the requirements for securing government-backed mortgages stricter. You'd be wrong.

This isn't to say that *no* policymaking has been done in the area of housing finance. In fact,

there has been a great deal of housing finance policymaking affecting Fannie Mae and Freddie Mac since the crisis. Take for example, the Home Affordable Refinance Program (HARP), which was introduced by FHFA in 2009 to allow homeowners with decreased property values to refinance their homes into better terms. In other words, homeowners are allowed to keep the same amount of risk on the books of FHFA, backed by the taxpayers, but are paying less interest into the program – not really a step in the right post-crisis direction. Then there's HARP's sibling, the Home Affordable Modification Program (HAMP), also introduced in 2009, which does essentially the same thing. Instead of a full refinance, the terms of the loan are modified to suit the homeowners' ability to repay.

Laws were passed that defined a federal "qualified mortgage" as one having a debt-to-income ratio (DTI) of no more than 43 percent. These DTI rules were put in place to limit the riskiness of loans receiving federal backing. This should have ended one cause of the financial crisis – underqualified borrowers taking out high-dollar mortgages for overvalued properties for which they eventually were unable to repay. The arbitrary 43 percent DTI is debatably not the best way to prevent another housing crisis, but it at least was a good place to start. It gave lenders and federal agencies a bright line at which to draw creditworthiness. Unfortunately, in the past few years, creditworthiness has become less and less of a priority at the FHFA and the GSEs.

Since housing finance reform never really built up much steam in Congress, FHFA decided to take matters into its own hands and use the GSEs as its own vehicles of policymaking. Just last year the GSEs raised their DTI limits to 50 percent, meaning, with exceptions, if you're bringing in $4000/month, you're allowed to take out a mortgage that will cost you $2000/month. That's up from the 45 percent DTI it had been raised to just a few years prior. So, in sum, FHFA and the GSEs are circumventing Congress to make their own rules as to the definition of creditworthiness, which has a direct correlation to the amount of risk placed on the agencies that back these mortgages – and on the taxpayers that fund that backing.

There are other examples, but the morals are twofold and simple. There is a lost decade in reforming the system of housing finance in the United States. And during that decade, FHFA has become lost and turned back toward the dangerous policies that led us to the crisis in the first place. If Congress isn't going to undertake GSE reform, it should use its oversight powers to ensure that FHFA and the GSEs don't put us right back in the danger we were in 10 years ago.