

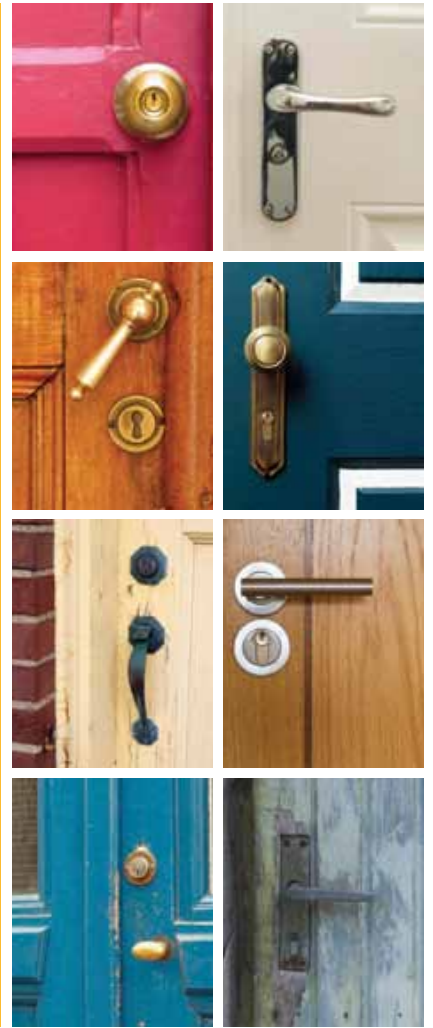


Economic Policy Program

Housing Commission

Housing America's Future:

New Directions for National Policy



February 2013



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DISCLAIMER

This report is the product of the BPC Housing Commission with participants of diverse expertise and affiliations, addressing many complex and contentious topics. It is inevitable that arriving at a consensus document in these circumstances entailed compromises. Accordingly, it should not be assumed that every member is entirely satisfied with every formulation in this document, or even that all participants would agree with any given recommendation if it were taken in isolation. Rather, this group reached consensus on these recommendations as a package.

The findings and recommendations expressed herein are solely those of the commission and do not necessarily represent the views or opinions of the Bipartisan Policy Center, its founders, or its Board of Directors.

Housing Commission

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Seated L-R: Former U.S. Representative Rick Lazio (R-NY), Former U.S. Senator Mel Martinez (R-FL), Former HUD Secretary Henry Cisneros, Former U.S. Senator Christopher S. "Kit" Bond (R-MO), Former U.S. Senator George J. Mitchell (D-ME) at the launch of the BPC Housing Commission, October 26, 2011.

Letter from the Co-Chairs

We formed the Housing Commission to help set a new direction for federal housing policy. More than five years after the collapse of the housing market, it is now all too apparent that current policy, and the institutions that support it, are outdated and inadequate.

This report, the culmination of a 16-month examination of some of the key issues in housing, provides a blueprint for an entirely new system of housing finance for both the ownership and rental markets. Under this new system, the private sector will play a far greater role in bearing credit risk and providing mortgage funding, and taxpayer protection will be a central goal. We also propose a new, outcome-oriented approach to the distribution of federal rental subsidies that responds to the housing needs of our nation’s most vulnerable households and rewards providers who demonstrate strong results at the state and local levels with increased flexibility in program administration. The report highlights how our nation’s burgeoning senior population and dramatic demographic changes will present new challenges and opportunities for housing providers in communities throughout the country.

Over the years, Republicans and Democrats have worked together to establish policies to address the diverse housing needs of the American people. After World War II, for example, Republican Senator Robert Taft worked with President Truman to remedy a national housing shortage and respond to the housing needs of America’s returning veterans with the Housing Act of 1949. Two decades later, President Johnson and Everett Dirksen, the Republican Senate Leader from Illinois, worked collaboratively to pass the Fair Housing Act of 1968. Both parties came together again to pass the Tax Reform Act of 1986, which created the Low Income Housing Tax Credit. There is a simple explanation for this history of bipartisanship: Americans of all political backgrounds intuitively understand that ensuring access to decent, suitable, and affordable housing is a goal worth striving for, and one that our country must never abandon. The commission follows this bipartisan tradition.

We wish to express our gratitude to our fellow commissioners who have labored long hours, and made many sacrifices, over the past 16 months. It has been a great privilege to work with this distinguished group of Americans, and their dedication to solving some of the most perplexing issues in housing has been an inspiration to us.

The challenges we face in housing are so great and so urgent, that new ideas and approaches must be brought to the policy table. It is our hope that our work will contribute to the dialogue and help further the housing policy reform debate.

CHRISTOPHER S. "KIT" BOND

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Executive Summary and Recommendations

Our nation's numerous and urgent housing challenges underscore the need for a review of federal housing policy. Since the collapse of the housing market in 2007, the federal government has stepped in to support the vast majority of all mortgage financing, both for homeownership and rental housing. At the same time, rental demand is increasing in many regions throughout the United States, and the number of renters spending more than they can afford on housing is unacceptably high and growing. These developments are taking place against a backdrop of profound demographic changes that are transforming the country and our housing needs. These changes include the aging of the Baby Boomers, the formation of new households by members of the "Echo Boom" generation (those born between 1981 and 1995), and the growing diversity of the American population.

In many respects, our housing system is outdated and not equipped to keep pace with today's demands and the challenges of the imminent future. The Bipartisan Policy Center (BPC) launched the Housing Commission in October 2011 to develop a new vision for federal housing policy that provides a path forward during this period of great change. This report, the centerpiece of an ongoing effort by the Housing Commission to examine key issues that together form the basic elements of a resilient housing system, proposes:

- A responsible, sustainable approach to homeownership that will help ensure that all creditworthy households have access to homeownership and its considerable benefits.
- A reformed system of housing finance in which the private sector plays a far more prominent role in bearing credit risk while promoting a greater diversity of funding sources for mortgage financing.
- A more targeted approach to providing rental assistance that directs scarce resources to the lowest-income renters while insisting on a high level of performance by housing providers.
- A more comprehensive focus on meeting the housing needs of our nation's seniors that responds to their desire to age in place and recognizes the importance of integrating housing with health care and other services.

In preparing the recommendations that follow, an overarching goal of the commission was to ensure that the nation's housing system enables individuals and families to exercise choice in their living situations, as their needs and preferences change over time. While today's challenges are great, the opportunity to create a new system that expands the range of housing options for individuals and families is even greater.

Reforming Our Nation's Housing Finance System

A successful housing finance system should maximize the range of ownership and rental housing choices available at all stages of our lives. Meeting our nation's diverse housing needs requires a strong and stable system of housing finance. This system, when functioning at its full potential, offers millions of Americans and their families the opportunity to choose the type of housing that best responds to their individual situations. The mortgage boom and bust has rocked the system on which the United States has relied for more than 75 years and has forced a reevaluation of the government's role in supporting mortgage credit and how this role should be structured. Private, risk-bearing capital in the mortgage market has shrunk dramatically, while the tremendous uncertainty surrounding the future of our housing finance system has greatly limited consumers' choices, particularly for creditworthy borrowers seeking to obtain a mortgage. In response to this recent unraveling and subsequent uncertainty, the commission proposes a blueprint for a new system of housing finance that will support homeownership and provide for a vibrant rental housing market.

Key Policy Objectives

The private sector must play a far greater role in bearing credit risk. Greater federal intervention was necessary when the market collapsed, but the dominant position currently held by the government is unsustainable. Today, the government supports more than 90 percent of single-family mortgages through entities such as Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Housing Administration (FHA) as well as roughly 65 percent of the rental mortgage market. Reducing the government footprint and encouraging greater participation by risk-bearing private capital will protect taxpayers while providing for a greater diversity of funding sources. A durable housing

finance system must provide open access to lenders of all types and sizes, including community banks and credit unions. It must also serve as wide a market as possible and assure consumers fair access to sustainable and affordable mortgage credit.

While private capital must play a greater role in the housing finance system, continued government involvement is essential to ensuring that mortgages remain available and affordable to qualified homebuyers. The commission recommends the establishment of a limited, catastrophic government guarantee to ensure timely payment of principal and interest on qualified mortgage-backed securities (MBS). This guarantee should (1) be explicit and fully paid for through premium collections that exceed expected claims (with a safe reserve cushion); (2) be triggered only after private capital in the predominant loss position has been fully exhausted; and (3) apply only to the securities and not to the equity or debt of the entities that issue or insure them.

As part of this rebalancing, the commission proposes the winding down and ultimate elimination of Fannie Mae and Freddie Mac after a multiyear transition period. The business model of these government-sponsored enterprises (GSEs)—publicly traded companies with *implied* government guarantees and other advantages—has failed and should not be repeated. During the transition period, the Federal Housing Finance Agency should continue its efforts to reduce the size of the GSE portfolios and move the GSE pricing structure closer to what one might find if private capital were at risk. Congress should also gradually lower the GSE loan limits to allow larger loans to flow to the private sector.

Through the gradual reduction in loan limits to pre-crisis levels, the commission also supports a more targeted FHA that returns to its traditional mission of primarily serving first-time homebuyers.

The Structure of the New System

The commission proposes to replace the GSEs with an independent, wholly owned government corporation—the “Public Guarantor”—that would provide a limited catastrophic government guarantee for both the single-family and rental markets. Unlike the GSEs, the Public Guarantor would not buy or sell mortgages or issue MBS. It would simply guarantee investors the timely payment of principal and interest on these securities. The model endorsed by the commission is similar to Ginnie Mae, the government agency that wraps securities backed by federally insured or guaranteed loans. Other than the Public Guarantor, all other actors in this new system—originators, issuers of securities, credit enhancers, and mortgage servicers—should be private-sector entities fully at risk for their own finances and not covered by either implicit or explicit government guarantees benefitting their investors or creditors.

In the new system, the limited catastrophic guarantee of the Public Guarantor would only be triggered after all private capital ahead of it has been exhausted. The government would be in the fourth-loss position behind (1) borrowers and their home equity; (2) private credit enhancers; and (3) the corporate resources of the issuers and servicers.

The Public Guarantor will have significant standard-setting and counterparty oversight responsibilities. These responsibilities include (1) qualifying institutions to serve as issuers, servicers, and private credit enhancers; (2) ensuring that these institutions are well-capitalized; (3) establishing the guarantee fees to cover potential catastrophic losses; (4) ensuring the actuarial soundness of two separate catastrophic risk funds for the single-family and rental segments of the market; and (5) setting standards (including loan limits) for the mortgages backing government-guaranteed securities. With respect to rental finance, the Public Guarantor would also have the authority to underwrite multifamily loans directly and would be

responsible for establishing an affordability threshold that would primarily support the development of rental housing that is affordable to low- and moderate-income households.

Meeting our nation's diverse housing needs requires a strong and stable system of housing finance.

Obstacles to the Housing Market Recovery

The commission has identified a number of regulatory obstacles that are restricting mortgage credit and inhibiting the housing market's recovery. These obstacles include overly strict mortgage lending standards; the lack of access to mortgage credit for well-qualified self-employed individuals; uncertainty about the extent of “put-back” risk for mortgage lenders; the demand for multiple appraisals and the use of distressed properties as market comps; the application of FHA compare ratios; and the uncertainty related to pending mortgage regulations and the implementation of new rules.

To overcome these obstacles, the commission recommends that the President of the United States direct the Department of the Treasury, in coordination with the various federal banking agencies, to assess the impact of current and pending regulatory requirements on the affordability and accessibility of mortgage credit. The Treasury Department should develop a plan to align these requirements as much as possible to help get mortgage credit flowing again. A top official within the Treasury Department or in the White House should be tasked with day-to-day responsibility for coordinating the implementation of this plan.

The Continuing Value of Homeownership

Homeownership will continue to be the preferred housing choice of a majority of households. According to research performed for the commission, the national homeownership rate is likely to remain above 60 percent for the foreseeable future. Millions of Americans continue to see homeownership as a critical cornerstone of the American Dream with benefits well beyond the financial investment. This sentiment is especially strong within the growing Hispanic community.

Despite the collapse of the housing market, the commission strongly believes that, when responsibly undertaken, homeownership can produce powerful economic, social, and civic benefits that serve the individual homeowner, the larger community, and the nation. A combination of proper regulation, adequate liquidity, and the right incentives in the private market can help ensure that homeownership remains a vital housing and wealth-building option. When coupled with reasonable down payments, solidly underwritten, fixed-rate mortgages—as well as straightforward adjustable-rate mortgages with clear terms and limits on adjustments and maximum payments—can also open the door to homeownership and its benefits for individuals with modest wealth and incomes.

Housing counseling can improve prospective borrowers' access to affordable, prudent mortgage loans, especially for families who otherwise might not qualify or who may experience other barriers to conventional lending. Four key elements are necessary: (1) a strong counseling infrastructure; (2) clear standards; (3) an understanding of the proper role for counselors; and (4) the adoption of best practices for integrating counseling into the mortgage market. The commission supports continued federal appropriations for housing counseling and recommends that all stakeholders who benefit from a borrower's access to

counseling services be expected to contribute to the cost of the service.

Affordable Rental Housing

The nation's 41 million renter households account for 35 percent of the U.S. population. In the coming decade, the number of renters is likely to grow significantly as members of the Echo Boom generation form their own households for the first time and as members of the Baby Boom generation downsize from their current homes. Growing pressure for rental housing may push rents further out of reach for the low-income households that are least able to afford it. Our nation's housing system should aim to minimize the trade-offs these households often face when seeking affordable housing—in terms of neighborhood quality, access to good jobs and high-performing schools, and spending on other essentials like health care and nutritious food.

Federal Assistance Falls Far Short of What's Needed

Nationally, a majority of extremely low-income renter households spend more than half of their incomes on housing. For the most part, renters live in housing that meets basic quality standards. However, nearly half of renters at all income levels report paying more than 30 percent of their income for rent—the federal standard for housing affordability. Among extremely low-income renters (those with incomes at or below 30 percent of area median income), the situation is far worse. Nearly 80 percent of these lowest-income households report spending more than 30 percent of their income for rent, and nearly two-thirds spend 50 percent or more.

There are far more extremely low-income renters than available units they can afford.

Federal housing assistance meets only a fraction of the need. Federal assistance programs currently help approximately five million low-income households afford housing.

Growing pressure for rental housing may push rents further out of reach for the low-income households that are least able to afford it.

However, only about one in four renter households eligible for assistance actually receives it. Because demand so far outstrips supply, these scarce rental subsidies are often allocated through lengthy waiting lists and by lotteries.

Responding to the Crisis

The commission recommends that our nation transition to a system in which our most vulnerable households, those with extremely low incomes (at or below 30 percent of area median income) are assured access to housing assistance if they need it. Assistance should be delivered through a reformed Housing Choice Voucher program that, over time, limits eligibility to only the most vulnerable families.

The commission recommends increasing the supply of suitable, affordable, and decent homes to help meet both current and projected demand. To achieve this goal, the commission recommends:

- Expansion of the Low Income Housing Tax Credit (LIHTC) by 50 percent over current funding levels and the provision of additional federal funding to help close the gap that often exists between the costs of producing or preserving LIHTC properties and the equity and debt that can be raised to support them.
- Additional federal funding beyond current levels to address the capital backlog and ongoing accrual needs in public housing to preserve the value of prior investments and improve housing quality for residents.

The commission recommends federal funding to minimize harmful housing instability by providing short-term emergency assistance for low-income renters (those with incomes between 30 and 80 percent of area median income) who suffer temporary setbacks. This assistance, delivered as a restricted supplement to the HOME Investment Partnerships program, could be used to help cover payment of security deposits, back rent, and other housing-related costs to improve residential stability and prevent homelessness.

These recommendations, if fully implemented, would help to meet the needs of an additional five million vulnerable renter households and contribute to the elimination of homelessness—through production, preservation, and rental assistance.

The commission recommends a new performance-based system for delivering federal rental assistance that focuses on outcomes for participating households, while offering high-performing providers greater flexibility to depart from program rules. The commission proposes a new performance-based system that will evaluate housing providers' success in five key programmatic areas: (1) improving housing quality; (2) increasing the efficiency with which housing assistance is delivered; (3) enabling the elderly and persons with disabilities to lead independent lives; (4) promoting economic self-sufficiency for households capable of work; and (5) promoting the de-concentration of poverty and access to neighborhoods of opportunity. Providers that achieve a high level of performance across these five areas should be rewarded with increased flexibility to depart from standard program rules, while substandard providers should be replaced. The federal government spends tens of billions of dollars annually to support the nation's valuable infrastructure of publicly and privately owned rental housing. Neither landlords nor program operators who fail to provide tenants with homes and services of reasonable quality should benefit from this investment.

Funding the Solutions

In light of today's difficult fiscal environment, the commission recognizes that a transition period will be necessary before these recommendations can be fully implemented. The commission therefore recommends that its approach for meeting the needs of the nation's most vulnerable households be phased in over time.

The commission supports the continuation of tax incentives for homeownership, but as part of the ongoing debate over tax reform and budget priorities, the commission also recommends consideration of modifications to these incentives to allow for increased support for affordable rental housing. The commission is aware of the difficult issues that will need to be addressed in the coming years to balance federal budget priorities. The federal government currently provides substantial resources in support of housing, the majority of which is in the form of tax subsidies for homeownership. The commission supports the continuation of tax incentives for homeownership—recognizing the importance of this tax policy to homeowners in the United States today. The commission notes that various tax benefits provided to homeowners, including the mortgage interest deduction, have been modified over the years. In the ongoing debate over tax reform and budget priorities, all revenue options must be evaluated. In that context, the commission recommends consideration of further modifications to federal tax incentives for homeownership to allow for an increase in the level of support provided to affordable rental housing. Any changes should be made with careful attention to their effects on home prices and should be phased in to minimize any potential disruption to the housing market. A portion of any revenue generated from changes in tax subsidies for homeownership should be devoted to expanding support for rental housing programs for low-income populations in need of affordable housing.

The Importance of Rural Housing

The U.S. Department of Agriculture (USDA) bears primary responsibility for administering housing assistance in the nation's rural areas that, under the current definition used by USDA, are home to one-third of the U.S. population.

Overall, rural areas tend to have higher poverty rates and lower incomes, so although housing costs are often lower than in other parts of the country, a substantial portion of rural households spend an unsustainable share of income on rent or mortgage payments. USDA offers both rental housing and homeownership programs to enable lower-income residents of rural areas to afford high-quality homes.

The commission supports current approaches to the administration of housing support in rural areas. More specifically, the commission recommends that housing assistance in rural areas continue to be delivered through USDA and the standards currently used to define "rural areas" maintained through the year 2020.

The commission also recommends enhancing the capacity of USDA providers to serve more households. Modest incremental funding for the Section 502 Direct Loan program, in particular, would enable USDA to provide homeownership assistance to more low-income rural households at relatively low cost. In light of recent elevated delinquency rates, however, the commission believes that any additional federal support for the Section 502 Direct Loan program should be conditioned on a thorough program evaluation. USDA providers should also be provided with resources to improve the delivery of technical assistance and the technology used to process loans, collect data, and monitor program performance.

Aging in Place: A New Frontier in Housing

The aging of the population will necessitate major changes in the way we operate as a nation, including in the housing sector. While the number of Americans aged 65 and older is expected to more than double between 2010 and 2040, we are still largely unprepared to meet the needs of the overwhelming numbers of seniors who wish to “age in place” in their own homes and communities. Industry groups have begun to educate their members about ways to improve the safety of existing homes through relatively simple modifications, and the importance of applying universal design principles in the construction of new homes. States and localities have also risen to the challenge, targeting programs to deliver health care and other supportive services to the naturally occurring retirement communities where older residents are aging in place.

The commission recommends better coordination of federal programs that deliver housing and health care services to seniors. The U.S. Department of Housing and Urban Development (HUD) and the Department of Health and Human Services (HHS) should jointly identify and remove barriers to the creative use of residential platforms for meeting the health and long-term care needs of seniors. In evaluating the costs of housing programs that serve frail seniors, Congress and the Office of Management and Budget should identify and take into account savings to the health care system made possible by the use of housing platforms with supportive services.

We are still largely unprepared to meet the needs of the overwhelming numbers of seniors who wish to “age in place” in their own homes and communities.

The commission supports better integration of aging-in-place priorities into existing federal programs and urges a more coordinated federal approach to meeting the housing needs of the growing senior population. The scope of the U.S. Department of Energy’s Weatherization Assistance Program should be expanded to include home assessments and modifications for aging in place. In addition, steps should be taken to provide effective guidance to ensure consumers understand the mechanics of reverse mortgages, including the risks and benefits of these products. A White House conference could bring together top federal officials and key players in the private and public sectors to draw national attention to the issue of senior housing and to catalyze development of a coordinated approach to aging in place.



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Chapter 1. Introduction: Our Nation's Housing

Our homes are where life among family and friends is centered and nurtured. They are the backbones of our communities—where our children prepare to go to school, where we form attachments with our neighbors, and where we participate in civic life. Our homes are the very platforms from which our lives develop. Increasingly, we have come to understand that our homes and the communities in which they are located are also important determinants of specific outcomes: early childhood development and health; access to quality educational opportunities; and our ability to reach stable, good-paying jobs. As the population ages and as we stay longer in our homes, where we live will increasingly affect how critical medical and social services are delivered and will shape the quality of seniors' lives.

Owning a home has been a strong aspiration since at least the mid-20th century, when the postwar economic expansion, new government support for veterans and working families, the construction of new highways, and suburban development created opportunities for families to buy a home at an affordable monthly cost. Over the next 50 years, many families not only enjoyed the security that homeownership offered, they also accumulated wealth through the pay down of mortgage principal and long-term home price appreciation. America's homes financed millions of college educations, retirements, and medical and other necessities. The divide between those families with significant net wealth and those without was marked most clearly by whether or not a family owned a home of its own. Unfortunately, not all Americans shared in this prosperity, as homeownership rates for minority families have consistently lagged behind those of white households.

During the same period, national policy focused on eliminating slums and blight and constructing in their place new, affordable rental homes. Over time, our success at removing blight and slums outpaced our ability to replace the lost housing, and market forces that drove up the cost of rental housing accelerated the loss of affordable rental

homes in many communities. A very high percentage of renters today, primarily those with modest incomes but also increasingly more economically secure households, are forced to spend large shares of their income on rent.

Housing is also a critical driver of the U.S. economy. For generations, our nation has looked to housing as a source of economic vitality and growth. Statistics like “sales of new and existing homes” and “multifamily starts” have become key indicators of national economic performance. When these indicators are trending upward, it generally means the U.S. economy is on the march; when they are trending downward, the economy is often in trouble. What is clear is that a stable, vibrant housing market directly translates into more jobs, higher family incomes and household wealth, and a stronger, more prosperous nation. It is equally clear that a strong economy with robust employment and income growth is the surest way to support strong housing markets throughout the country. When these elements lag and families cannot keep pace with the rising costs of a home, all parts of the housing sector suffer, with impacts reverberating throughout the economy.

The unprecedented collapse of the housing market that began in 2007 has undermined our confidence in the system built over the last 75 years. In the wake of regulatory and market failures that enabled the growth of unsafe and unstable mortgage products and an unsustainable increase in house prices, that system is in disarray. The impact of the collapse is still being felt today, as millions of families have lost their homes, trillions of dollars in household wealth have vanished, and scores of communities remain decimated by foreclosures. The federal government's conservatorship of Fannie Mae and Freddie Mac—the institutions established by Congress to ensure a stable supply of mortgage financing through the sale of mortgage-backed securities—has cost the taxpayers tens of billions of dollars to date.¹ And mortgage credit continues to elude millions of creditworthy borrowers as very tight credit practices have become the norm.

At the same time, the demographics of the United States are changing in transformative ways. As a society, we are becoming older, more likely to delay marriage and childbearing, and more racially and ethnically diverse. Members of the Echo Boom generation (those 62 million Americans born between 1981 and 1995) are also beginning to strike out on their own, many leaving the homes of their parents for the first time to form their own households. These changes will profoundly impact housing demand and the types of housing that Americans will need and want in the coming decade. Developing an effective response to these demographic changes will be a great challenge for policy makers and housing practitioners, and a valuable opportunity for a fundamental rethinking of our nation's housing system.

Recognizing the need for action and a new vision to guide federal housing policy, BPC launched the Housing Commission in October 2011 to examine the many challenges in housing today and to advance a coherent national strategy in response. As a result of this effort, we are more convinced than ever that housing must assume a more prominent place on the national policy agenda. A nation that can offer a broad range of affordable housing options to its citizens will be stronger and better poised to compete on the global economic stage. A stable housing finance system will support housing consumption and investment, which in turn will be a vital source of new jobs, economic activity, and tax revenue for all levels of government. In short, restoring our nation's housing sector is a necessary precondition for America's full economic recovery and future growth.

Housing Commission Principles

The commission developed the following five principles as the foundation for its deliberations and recommendations:

A healthy, stable housing market is essential for a strong economy and a competitive America.

The economy will not reach its full potential without a robust housing sector that is supported by a strong and stable system of housing finance. In the post–World War II era, the United States has suffered through 11 recessions,² and new homebuilding and housing-related

construction have often led the way to economic revitalization.³ Likewise, the recent housing and mortgage crisis demonstrated that an unstable housing finance system can hurt not only housing, but, through our increasingly integrated banking and finance system, the entire global economy. A good quality of life for the nation's workforce and population, based on safe and secure homes and communities of opportunity, is critical to the global competitiveness of our national and regional economies.

The nation's housing finance system should promote the uninterrupted availability of affordable housing credit and investment capital while protecting American taxpayers.

Tens of millions of American families have benefited from the stability and affordability provided by the U.S. housing finance system and its traditional support of a variety of mortgages, including sustainable, long-term home financing. The commission received a wealth of testimony calling into question the availability of certain consumer-friendly products, including the long-term prepayable fixed-rate mortgage, absent some level of government intervention. The commission believes that the government role in the housing finance system can be structured in a way that narrowly circumscribes taxpayer risk of loss, while promoting the goals of stability and affordability.

The Changing Demographics of America

The United States is fortunate to have a growing population fueled by both natural increase (net births over deaths) and immigration. According to projections of the U.S. Census Bureau, the national population will likely increase from 310 million in 2010 to nearly 334 million in 2020.⁵ By mid-century, the Census Bureau projects that the U.S. population will exceed 400 million.⁶ As the population grows, the demand for new and upgraded housing will grow as well. The production of new housing units as well as the preservation and renovation of existing units, both owner-occupied and rental, should be a major dynamic force in the overall national economy.

Against this backdrop of population growth, three important demographic trends will help shape the housing landscape: the aging of the Baby Boom population, the formation of new households by members of the Echo Boom generation, and the increasing diversity of the general population as members of minority groups (particularly Hispanics) make up a greater percentage of total households.⁷

The Baby Boom Generation

We live in a time when medical and other technological advances make it possible for more Americans to enjoy longer, more productive lives. This development, while certainly welcome, challenges our country to ensure that our existing and future housing stock can support healthy living by older Americans. This challenge will only grow as the Baby Boom generation matures.

The United States should reaffirm a commitment to providing a decent home and a suitable living environment for every American family.

This commitment, first articulated in the Housing Act of 1949 and repeated in subsequent federal legislation, should be embraced as an essential aspiration of an economically dynamic and just society. Housing policy should recognize the importance of community, economically diverse neighborhoods, and access to education, nutritious food, transportation, and other services, as well as aim to break up concentrations of poverty. Despite our current economic problems, the United States remains one of the wealthiest countries

in the world and should have a housing system commensurate with this status.

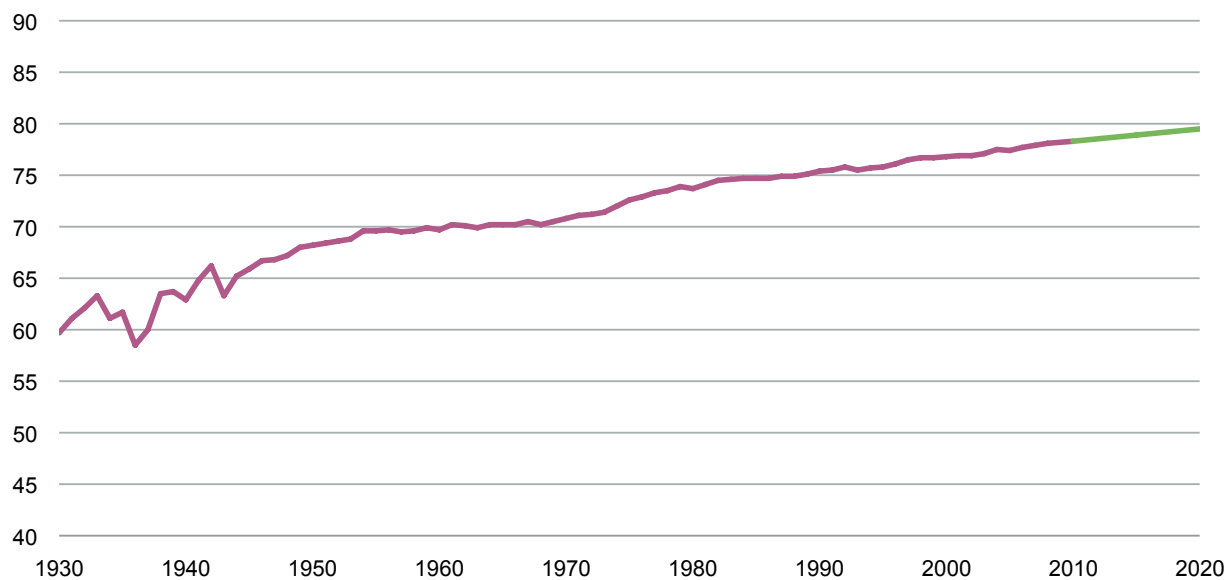
The primary focus of federal housing policy should be to help those most in need.

As our nation's leaders continue their efforts to restrain federal spending and reduce our national debt, it is clear that federal resources for housing will be significantly constrained for the foreseeable future. These limited funds should be deployed in a more targeted and efficient manner to first help the most vulnerable households, including the more than 600,000 people sleeping on the streets, in shelters, or in their cars because they cannot afford a home.⁴

Federal policy should strike an appropriate balance between homeownership and rental subsidies.

Owner-occupied housing and rental housing are complementary—not competing—components of a housing system that serves individuals and families at all stages of life. The support the federal government devotes to housing through direct outlays and tax subsidies should be allocated in a manner that reflects differences in the circumstances, needs, and preferences of households throughout the life cycle.

Chart 1-1: Life Expectancy at Birth in the United States, 1930 to 2008 with Projections through 2020



Sources: 1930–2008 data from Elizabeth Arias, “United States Life Tables, 2008,” *National Vital Statistics Reports* 61, no. 3 (2012); 2010–2020 projections from U.S. Census Bureau, “Table 104. Expectation of Life at Birth, 1970 to 2008, and Projections, 2010 to 2020,” *Statistical Abstract of the United States: 2012* (131st Edition) (Washington, D.C.: 2011).

Between 1946 and 1965, the Baby Boom added approximately 78 million individuals to the U.S. population, making Baby Boomers one of the largest demographic cohorts in U.S. history.⁸ The oldest members of this group, those born in 1946, first joined the senior population (those aged 65 or older) in 2011 and are the vanguard of what is likely to be an explosion in the number of older Americans.

According to Census Bureau projections, the aging of the Baby Boom generation will cause the number of seniors to grow by 30 million over the next 20 years to 72-million strong, accounting for approximately 20 percent of the national population, up from 13 percent today. Among seniors, the number of people aged 85 or over is also

expected to grow, from 4.2 million in 2000 to more than 9 million in 2030.⁹

Health challenges often become more complex with age. More than half of Americans aged 75 or older have some difficulty with vision, hearing, mobility, or activities related to personal care and independent living.¹⁰ Yet many older Americans have a strong desire to remain in their current homes and communities as they age, even though their existing homes may not be fully equipped with the features necessary for independent living and access to supportive services may be limited. This desire to “age in place” will challenge seniors and their children to renovate and remodel existing homes in response to health care and

safety needs or seek out affordable rental options within their communities to accommodate a desire to downsize.

Housing affordability is also a serious problem for many seniors. Most older Americans own their homes. Those with fixed incomes or limited resources may struggle to cover the sometimes unpredictable costs associated with homeownership such as utility bills, property taxes, and expenses related to home repair and upkeep.¹¹ Among senior renters, 70 percent spend at least 30 percent of their income covering housing costs.¹² Paying too much for housing leaves seniors with inadequate income to pay for medications, healthy food, and other necessities. This trade-off in turn jeopardizes their health, potentially leading to increased health care costs, hospitalization, and nursing-home placement. Federally assisted housing is an important resource for the low-income senior population. More than one-third of the five million HUD-assisted households are headed by an individual who is at least 62 years of age.¹³ Today, however, the number of low-income seniors in need of such assistance greatly exceeds the available subsidies. *See Chapter 6, Aging in Place: A New Frontier in Housing.*

The large share of elderly households that receives HUD assistance also illustrates another hard truth about the U.S. housing subsidy landscape: While the non-elderly (and non-disabled) tenants that HUD assists are in a position to use their stable housing as a platform to improve their incomes and eventually exit the program, these elderly tenants will continue to need subsidies as their incomes are relatively fixed and unlikely to go up over time. As their numbers grow, it will become even more important to think creatively about the use of scarce housing assistance in ways that maximize impact for all households.

The Echo Boomers

The Echo Boom generation, a cohort of approximately 62 million individuals born between 1981 and 1995, will be the major force fueling demand for rental housing in this decade (2010 to 2020), particularly in expensive urban housing markets where the cost of homeownership is already high. According to projections prepared by the Urban Institute, between five million and six million new renter households will form through 2020, with almost all of that increase reflecting new household formations among Echo Boomers.¹⁴

Echo Boomers are more racially and ethnically diverse than the Baby Boomers. They are also largely single and childless. As of 2009, only 21 percent of Echo Boomers were married, compared with approximately 50 percent of Baby Boomers at the same stage of life. In addition, only 20 percent of Echo Boomers have children in their homes compared with 30 percent of Baby Boomers when they were the same age.¹⁵

Echo Boomers have attained higher levels of education than members of previous generations, with more than half (54 percent) having completed at least some college education.¹⁶ In particular, female Echo Boomers have reached levels of educational achievement that far exceed the levels attained by the women of previous generations.¹⁷ These educational experiences should enhance the long-term financial position of the Echo Boomers while raising earnings expectations.

The Great Recession's impact on Echo Boomers has been significant. Despite higher educational attainment, young households are struggling with high unemployment. Many young adults also carry high levels of credit card and student loan debt that may delay the decision to form new households and may affect, at least in the short term, the type of housing they seek. Not surprisingly, during the latter

half of the last decade, many young adults delayed forming their own households. Instead, some decided to live with parents or share housing with roommates. As a result, growth in the number of new households declined from an average of 1.2 million annually from 2000 to 2007 to an average of only 568,000 annually from 2007 to 2011.¹⁸ As the job market improves, new household formation by the Echo Boomers will likely increase as this pent-up demand is released.

While the Echo Boomers will fuel rental demand in the near- to mid-term, during the decade that follows 2020, large numbers of Echo Boomers will likely transition from rental housing to homeownership. In many communities, Echo Boomers will play a leading role in absorbing owner-occupied single-family housing that has been released into the market by Baby Boomers who have either downsized to more suitable housing, moved in with their children, transitioned into nursing homes and assisted-living facilities, or passed away. This process of housing absorption by the Echo Boomers will be critical to the ongoing vitality and stability of local housing markets, particularly those with large numbers of Baby Boomer households.¹⁹

The Increasing Diversity of the American Public

According to Harvard's Joint Center for Housing Studies, about 70 percent of the 11.8 million net new households that form in the United States between 2010 and 2020 will be headed by members of minority groups, with much of this growth attributable to Hispanic households.²⁰ By 2020, minority households are projected to constitute one-third of all U.S. households and a growing share of the younger renter population.²¹

Despite the disproportionate impact of the recent housing crisis on minority homeownership and wealth, many members of the African American and Hispanic communities continue to aspire to homeownership, with Hispanics accounting for a significant share of new-owner households.²² As the Hispanic share of the overall population grows, there may be a greater need for structural accommodations to the housing stock in light of the large families and multigenerational households common in the Hispanic community.²³

The recession substantially slowed the pace of immigration to the United States. For the first time in recent memory, growth in the foreign-born population slowed in the 2000s, and growth in the number of foreign-born households appeared to stall as the recession unfolded. These developments contributed significantly to the overall decline in new household formations. As the economy improves, immigration will likely have a significant impact on the housing market, especially in gateway cities like New York, Los Angeles, Miami, and Houston. Households headed by foreign-born individuals are more likely to live in high-density areas and multifamily rental housing, especially soon after arrival, and to settle in communities where others from their home countries already reside.²⁴ In addition, many medium- and smaller-sized cities find their immigrant communities growing in response to federal resettlement programs as well as work opportunities and family connections in those cities.

Housing and the Economy: The Challenge and the Opportunity

Historically, housing has been a key driver of the U.S. economy. Housing contributes to our nation's gross domestic product (GDP) through investment in residential properties (both single-family homes and multifamily buildings) and through private consumption of home-related goods and services, such as new appliances and furniture, landscaping, and home repair. According to one estimate, the construction of a typical 100-unit multifamily development creates 80 jobs directly (through construction) or indirectly (through the supply chain), plus another 42 jobs in a range of local occupations as a result of construction workers spending their wages.²⁵ Similar economic benefits apply to single-family construction as well as renovation activity.²⁶ Construction and renovation also generate tax revenue for states and localities, helping to support the provision of essential public services.

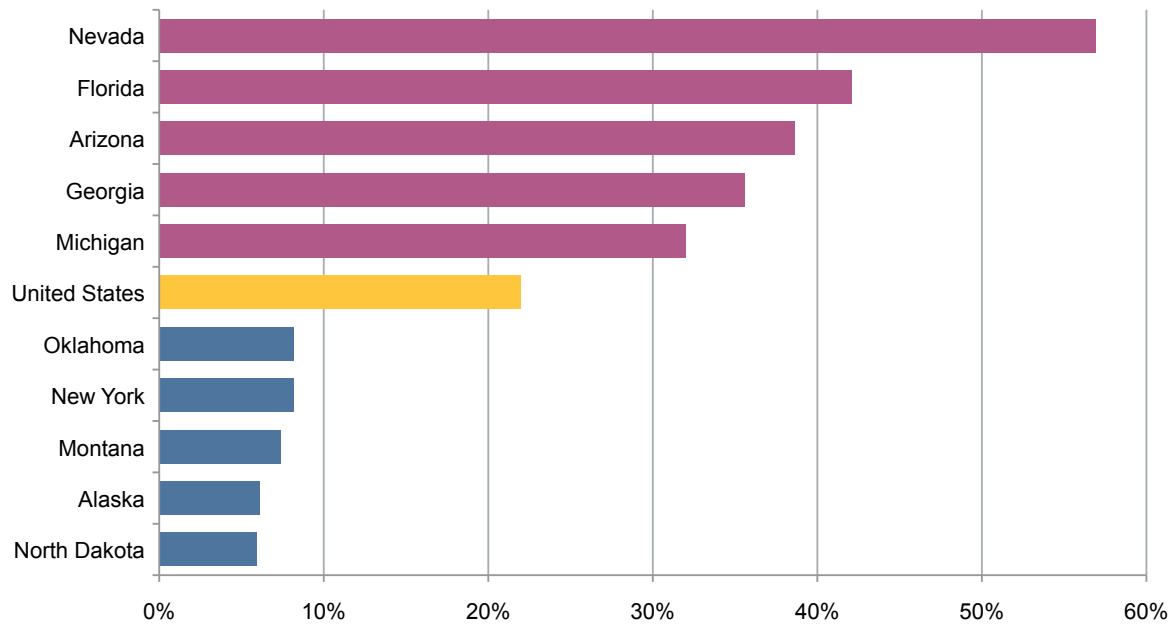
During the past four decades, the contribution of housing to national GDP through both residential fixed investment and consumption of services has averaged between 17 to 19 percent.²⁷ Today, housing's contribution stands at slightly more than 15 percent,²⁸ largely because of a significant decline in fixed investment in home construction and remodeling. This decline is a major reason why the recession and its damaging effects have lingered for so long. According to some estimates, if residential fixed investment reflected its historical average, the current rate of economic growth could double.²⁹

In the decades preceding the housing market's collapse, homeownership was also the dominant means by which millions of American families accumulated household wealth. Through the "forced savings" of a monthly mortgage payment, families were generally able to build up equity slowly over time, ultimately transforming their homes into their most important and valuable asset. Whether the

American people will continue to view homeownership as an effective way to build household wealth remains to be seen. What is clear is that our country's economic situation would be vastly improved with the re-establishment of a housing market in which home prices remain stable and gradually appreciate over time and a resolution of those local markets where large numbers of homeowners are underwater on their mortgages, owing more than their homes are currently worth.

In recent months, we have witnessed a welcome pick-up in sales of new and existing homes after these sales dropped to historic lows. Nevertheless, for the immediate future, it is likely that the market for single-family homes will continue to be troubled, as the backlog of foreclosures and the nearly 11 million households who are underwater on their mortgages have a strong dampening effect on market values.³⁰ This dampening effect will likely be most pronounced in those states where the housing market took the biggest climbs during the boom years and the steepest drops after the market's collapse.

In addition, even though mortgage rates are at historic lows and home prices have dropped by as much as 30 percent in some markets, the credit needed to purchase a home is scarce and hard to attain. This credit scarcity particularly affects low-wealth households who are more likely to be African American and Hispanic.

Chart 1-2: Share of Residential Properties in Negative Equity, 2012 Third Quarter

Source: CoreLogic, "CoreLogic Reports 1.4 Million Borrowers Returned to "Positive Equity" Year to Date Through End of the Third Quarter 2012." January 17, 2013.

While the homeownership market faces some difficult challenges at least for the foreseeable future, the rental housing market has picked up steam in many urban areas throughout the United States. In these markets, rental vacancy rates are declining and rental costs are increasing. Yet today, an astonishing one in two rental households is *already* cost-burdened, paying more than 30 percent of household income on rent and utilities. In fact, more than one-quarter of all renters bear severe cost burdens, allocating 50 percent or more of their incomes to rent.³¹ Unless action is taken, rising rents will put additional affordability pressures on these households as they struggle to make ends meet. In the coming decade, demand for rental housing is likely to be strong and sustained, fueled in large part by new household formation among Echo

Boomers. The production of new affordable multifamily rentals, which dropped dramatically following the collapse of the housing market, will need to keep pace with this growth in demand.

The United States cannot respond effectively to these challenges unless and until it has a world-class system of housing finance that supports both the single-family and multifamily sectors and a coherent and balanced federal approach to assuring decent, affordable homes for the most vulnerable households. Meeting our nation's future housing needs will depend upon a steady and sufficient supply of capital to support a wide variety of participants in the housing market—first-time homebuyers, those seeking to refinance their mortgages, private mortgage originators,

seniors who wish to stay in their homes and age in place, low-income renters, the owners and developers of large multifamily rental projects, and the mom-and-pop owners and managers of small rental properties.

Housing and Environmental Sustainability

Efforts to restore housing's traditional role in the U.S. economy must be accompanied by a commitment to reducing household energy costs and advancing national energy goals. Energy use associated with residential buildings accounts for some 21 percent of the nation's overall energy use, and the greenhouse gas emissions of a typical home are double that of the average vehicle.³² Accordingly, efforts to improve the energy efficiency of both existing and newly constructed homes can contribute significantly to the national goals of reducing greenhouse gas emissions and improving energy security. Given the additional energy and greenhouse gas emissions associated with long car trips, these goals can further be advanced by increasing the share of homes developed in walkable neighborhoods near public-transit stations and in other areas where households can meet more of their transportation needs through walking, biking, public transit, or shorter car trips. These approaches are additive³³ and together can help reduce household expenditures for transportation and utilities, which already consume a significant share of the budgets of low- and moderate-income households.

Why Housing Is Important: It's All About People

Of course, the economics of housing tells only part of the story. Housing is important because it is first and foremost about meeting the basic needs of people.

Housing is shelter, and more.

Like food and clothing, it is a necessity of life. But a burgeoning body of research is also showing us that housing that is stable, affordable, of good quality, and located in neighborhoods that provide opportunities and services is the foundation for many other benefits that accrue to both the individual and the broader community.

Access to stable, affordable, and well-located housing can improve educational outcomes.

Stable, affordable housing can be a platform for better educational outcomes. When children move frequently from one school to another, they tend to do less well in school and disrupt the educational environment for others.³⁴ Stable, affordable housing can help to improve educational achievement by reducing the frequency of unwanted moves. Affordable housing strategies that help low-income families access low-poverty neighborhoods or communities with high-performing schools can also contribute to positive educational outcomes.³⁵ Better educational performance, in turn, may lead to greater employment opportunities, higher incomes, and a boost to national wealth and productivity.

Quality, affordable housing helps improve the health of children, older adults, and others and can be a platform for more effective delivery of health care services.

Housing that combines the attributes of stability and good quality promotes positive physical and mental health outcomes for children and adults alike.³⁶ Well-constructed and maintained housing can substantially reduce children's risk of lead poisoning and respiratory ailments, like asthma, as well as exposure to toxic substances, such as pesticides, radon, and carbon monoxide.³⁷ Well-equipped housing, with working smoke detectors and window guards, can also reduce the risk of injury or death.

Stable housing also enhances the impact of a variety of health and treatment services, improving outcomes and saving public funds. As we age, for example, housing can serve as a platform to support the more effective delivery of services, particularly for seniors who need these services to live independently. Housing that is co-located with or near service providers can yield significant savings and efficiencies by allowing older adults to age in place, thereby delaying or avoiding the need for much more costly institutional care that can draw heavily upon limited state and federal resources.³⁸ While additional research is needed, it is increasingly clear that modest interventions and services delivered through seniors' housing can reduce emergency-room visits and the severity of illnesses, which translates to lower health care costs for seniors and public and private insurers.³⁹

Stable housing also improves the ability of individuals with chronic illnesses to maintain a consistent treatment regime⁴⁰ and provides a context within which health care services may be more effectively delivered. For example, permanent supportive housing—i.e., stable subsidized housing linked with treatment and other services—has been shown to be effective in improving the impact of services and in ending homelessness.⁴¹ Rigorous studies of homeless people with HIV-AIDS, mental illness, and chronic alcoholism have shown that, when people lack housing, services are not effective and have to be frequently repeated, whereas outcomes are significantly better for similar groups placed in permanent supportive housing.⁴² Further, for such high-need populations, cost savings may accrue, both from the reduction in service utilization and improvement in effectiveness, as well as from the reduced use of acute-care services, such as shelter, transitional housing, hospital emergency rooms, and jails.⁴³

Housing affordability is also a critical part of this equation: If household budgets are consumed by mortgage or rental costs, then fewer resources remain to secure nutritious

food, pay for prescription medication, and access regular medical care.

The New Fiscal Reality

To complement our housing finance system, the federal government deploys substantial fiscal resources to support housing through an array of direct spending, tax subsidies, and credit-enhancement programs. For example, the Section 8 Housing Choice Voucher and Project-Based Rental Assistance programs provide a subsidy to assist some 3.4 million low-income households⁴⁴ in covering their rental housing costs, and through them support the property owners and investors whose capital is critical to maintaining this housing stock. The federal tax code encourages private investment in the construction, preservation, and rehabilitation of affordable rental housing through the Low Income Housing Tax Credit program, while the mortgage interest deduction and the deduction for state and local property taxes aim to promote homeownership. And the insurance and guarantee programs of the FHA, the U.S. Department of Veterans Affairs (VA), and the Rural Housing Service of the U.S. Department of Agriculture have helped millions of American families gain access to affordable mortgages over the past decades. Together, the federal government devotes more than \$180 billion annually through these and other initiatives to help meet the diverse housing needs of the American people.

The commission recognizes that our nation's unsustainable debt burden is the dominant, overarching issue in Washington today. This new fiscal reality has the following implications for federal housing policy:

- First, every federal housing program must be evaluated on a forward-looking basis, with attention to how effectively it responds to the housing needs of today and tomorrow rather than those of the past.

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- Second, federal housing programs must operate on a more efficient basis and deliver services in a more effective manner, leveraging to the maximum extent possible the resources of the private and nonprofit sectors as well as state and local governments.
 - Finally, the commission recognizes that any proposals for increased spending must be offset either by reductions in federal outlays, savings from systems' reforms, and/or through the adoption of new revenue sources.

The hallmark of a successful housing system is whether it offers affordable and secure housing options to Americans at *all* stages in their lives—the young graduate looking for

an affordable rental as she enters the workforce, the newly married couple in the market for a starter home, the single mother seeking a house with more space for her two active teenagers, and the retired widower who cannot imagine living anywhere but in the same “Cape Cod” and in the same community he has called home for more than 40 years.

We live in times of great turmoil and uncertainty for millions of Americans, particularly for those at the lower end of the income scale. So, it is our view, too, that a housing system earns the mantle of success only if it adequately meets the changing needs of the nation.



Economic Policy Program
Housing Commission



Chapter 2. The Continuing Value of Homeownership

For generations, millions of American families have aspired to purchase and live in a home they can call their own. This aspiration is so tightly woven into our nation's cultural fabric that owning a home has become synonymous with achieving the American Dream and joining the nation's middle class.

Research shows that homeownership has positive impacts on the stability of communities as families support and nurture their homes and surrounding neighborhoods.⁴⁵ Homeownership has also been linked with increased civic engagement, higher voter turnout, enhanced home maintenance, and reduced crime rates.⁴⁶ Moreover, homeownership, and the stability afforded by homeownership, has been linked with positive behavioral outcomes and educational achievement among children.⁴⁷

For many families, purchasing a home is also the most critical investment decision they ever make. Through the forced savings of a monthly mortgage payment and as a result of house price appreciation, homeownership has enabled millions of families to build up equity over time, which has usually translated into greater household wealth and more financial security. For many households, a home is their primary asset and homeownership represents their single greatest wealth-building opportunity. Over the years, millions of homeowners have sensibly leveraged the equity in their homes to send their children to college, start a new business, pay for health care and other emergency costs, and meet their retirement needs.

Dating back to the Homestead Acts of the 1860s, the federal government has promoted land ownership and homeownership as ways to spur personal and community investment. Subsequent policies—such as the establishment of the Federal Home Loan Bank system, the creation of the FHA and VA mortgage insurance programs, and the establishment of Fannie Mae and Freddie Mac—were designed with this same goal in mind. In many

respects, these policies helped to build a resilient and broad middle class in which assets were shared across generations, contributing to financial stability and social mobility as well as stronger communities.

As outlined in Figure 4-2 on page 107, the federal government has also historically supported homeownership through specific tax subsidies. In 1986, for example, Congress protected mortgage borrowers by retaining their ability to deduct interest payments on mortgages while eliminating such deductions for all other forms of consumer debt. These tax subsidies remain the most significant form of financial support for housing in the federal budget.

The collapse of the housing market in 2007, however, has led many to question the elevated status of homeownership in American society. This reassessment is understandable in light of the hundreds of thousands of families who have lost their homes to foreclosure and is essential if we are to avoid repeating the mistakes of the past. As part of this reassessment, the commission recommends the adoption of policies that can accommodate the changing demographic profile of new households described earlier in this report, striking a balance between support for homeownership and renting, and prioritizing such support to help those with the greatest needs in both sectors.

Learning from Past Mistakes

The housing boom and bust generated an economic downturn from which the nation has yet to recover. Some analyses have attributed the root cause of the downturn to the push for homeownership and fix the blame principally on policies to support homeownership. A complete and correct analysis would recognize that overly exuberant home buying provided an important stimulant, but would place it in the context of a wide range of factors that converged to create a global crisis. These factors include:

- A credit bubble formed as a result of excess capital surpluses built up by China and the large oil-producing nations.
- New Wall Street securitization instruments that used complex hedging strategies and generated massive global demand both for mortgage-backed securities and for subprime mortgages to go into these securities, and the decisions by credit-rating agencies to grant top ratings to tranches of subprime mortgages.
- The emergence of abusive and predatory mortgage products that required no documentation and no down payments, as well as the activities of unqualified borrowers who exploited opportunities and submitted false or inadequate credit information.
- The relaxation of underwriting standards by major banks and mortgage lenders in order to compete for market share with new subprime products.
- Fannie Mae and Freddie Mac's drive to recapture market share lost to securitization of subprime and other nonprime mortgages, which led them to relax underwriting standards and take on risk for which they were not prepared.
- Regulatory failure caused in part by a maze of government oversight agencies with overlapping jurisdictions and, in some instances, no regulatory authority.

Because of the scale and importance of the nation's housing market, these factors and others converged to create a boom of massive proportions and a bust of historic impact. The point of this litany of convergent forces is not to assess blame or to oversimplify complex interactions but to encourage a complete diagnosis so that policy recommendations and corrective measures address the problems effectively. It would be erroneous and damaging to misread the origins of the crisis, to attribute it solely

to the expansion of homeownership during a period of economic growth, and as a result, to unduly curtail support of homeownership for households that can responsibly assume the obligations of a mortgage.⁴⁸

Of course, at the end of the day, prudent underwriting is the essential ingredient of a system of responsible, sustainable homeownership. During the housing boom, a major factor contributing to the abandonment of prudent underwriting was the mistaken belief shared by actors across the mortgage chain—lenders, borrowers, regulators, and investors—that home prices were inalterably heading upward. Many borrowers took out short-term mortgages that were structured with large payment shocks at the end of the term, believing that ever-increasing home prices would allow them to refinance before rates reset. When house prices declined, however, refinancing was no longer an option for many households, who found themselves locked into mortgages they could no longer sustain. In addition, as the housing bubble expanded, far too much emphasis was placed on owning a home as an investment asset and as a fast track to acquiring wealth, leading some to assume unsustainable levels of debt in the hopes of making a quick gain or out of fear they would be left behind if they did not act. Contributing to an already unsustainable situation, many homeowners took out Home Equity Lines of Credit to cover other expenses, leaving them with little to no home equity when home prices dropped.

At the same time, practices like “reverse redlining” and steering families into riskier mortgage products (such as adjustable-rate mortgages and loans with high prepayment penalties) led to higher default rates, especially within the Hispanic and African American communities. Research shows that many of the families who did default on these loans had good credit, a decent income, and everything else necessary to qualify for a traditional long-term, fixed-rate loan, but instead were steered into exotic and costly mortgages they did not fully understand and could not

afford.⁴⁹ The regulatory system failed to properly monitor and regulate these practices. Uneven regulation left mainstream banks heavily supervised while mortgage finance companies and subprime lenders acted in a largely unaccountable manner. Even regulated institutions acquired subprime and other nonprime businesses in an attempt to share in the market's seemingly endless growth.

Homeownership Remains the Preferred Housing Choice of Most Americans

Despite these experiences, the commission strongly believes that homeownership can produce powerful economic, social, and civic benefits that serve the individual homeowner, the larger community, and the nation. The key is to ensure that mortgage borrowers understand their obligations and are well-positioned to fulfill them and that lenders underwrite loans based on the borrowers' ability to repay. When coupled with reasonable down payments, solidly underwritten fixed-rate mortgages—as well as straightforward adjustable-rate mortgages with clear terms and limits on adjustable and maximum payments—can open the door to homeownership and its benefits for individuals with modest wealth and incomes.

Lenders and investors have tightened their credit standards significantly since the collapse of the housing market. The Consumer Financial Protection Bureau (CFPB) and a collection of other federal agencies are considering a number of regulations called for in the Dodd-Frank Act to create and regulate effective underwriting practices. However, the pendulum has swung too far from the excesses of the pre-bust era, and today's credit box is tighter and more restrictive than underwriting practice and experience justify. The commission cautions against well-meaning regulations that may go too far and end up reducing credit to consumers. Going forward, a combination

of proper regulation, adequate liquidity, and the right incentives in the private market can help ensure that homeownership remains a vital housing and wealth-building option. *See Text Box, Developing Sound Principles of Regulation, page 53.*

Getting Homeownership Right

In a study of 46,000 low-income homeowners, researchers at the University of North Carolina's Center for Community Capital found that more than 95 percent of these homeowners—who received traditional 30-year, fixed-rate mortgages between 1999 and 2009 through Self Help Credit Union's Community Advantage Program—were continuing to make mortgage payments at the end of the decade, despite the collapse of the housing market. The default rate for these loans—made to households with a median income of \$30,000 who often put down less than 5 percent on their home purchase—was less than one-quarter the default rate of the subprime loans that they might otherwise have received (although higher than rates for prime loans without the program's features). The researchers found that mortgages to low-income households that are well-serviced and correctly structured and avoid risky features—such as no documentation of income or assets, high upfront fees, prepayment penalties, teaser rates, and balloon payments—perform quite well and lead to both sustainable homeownership and sound business opportunities for lenders.⁵⁰

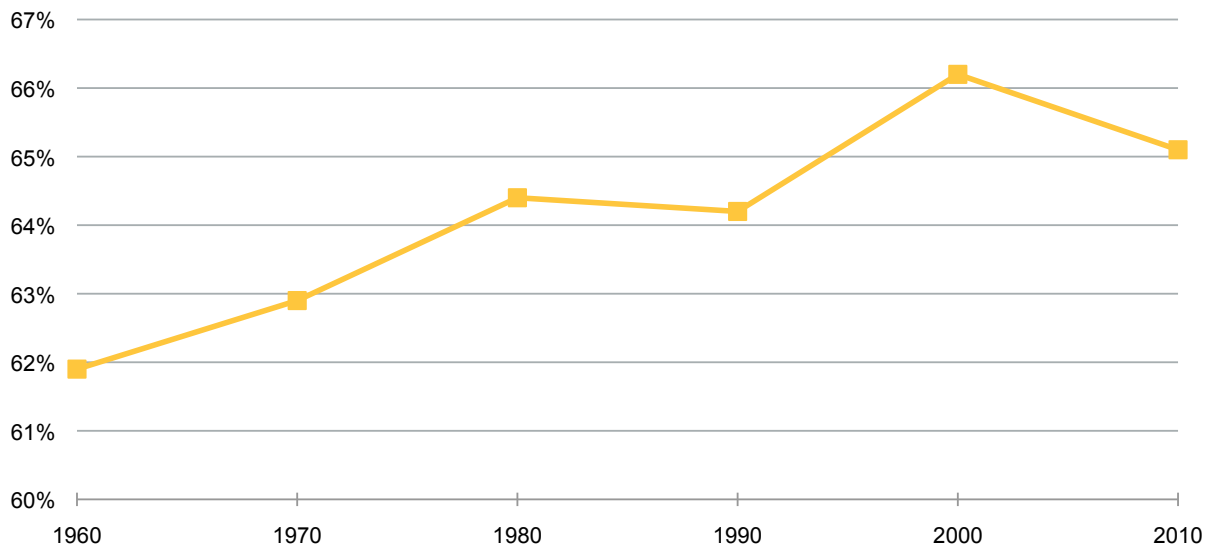
In addition, homeownership remains a strong aspiration for millions of Americans. Surveys indicate that an overwhelming majority of Echo Boomers hope to purchase a home someday.⁵¹ Other research shows that Americans continue to see homeownership as a critical cornerstone of the American Dream with benefits well beyond the financial investment. This sentiment is especially strong within the rapidly growing Hispanic community.⁵²

Since the collapse of the housing market, the homeownership rate has fallen from 67.3 percent in 2005 to 64.6 percent in 2011.⁵³ Yet, according to research performed by the Urban Institute that assesses a number of projected demographic scenarios, the overall national homeownership rate is unlikely to fall below 60 percent at any time before 2030 and is more likely to be higher than 60 percent.⁵⁴ A homeownership rate in excess of 60 percent is generally consistent with the rate that existed over the past 50 years (see Chart 2-1). For the foreseeable future, homeownership will continue to be the preferred housing choice of a majority of American households.

Closing the Homeownership Gap

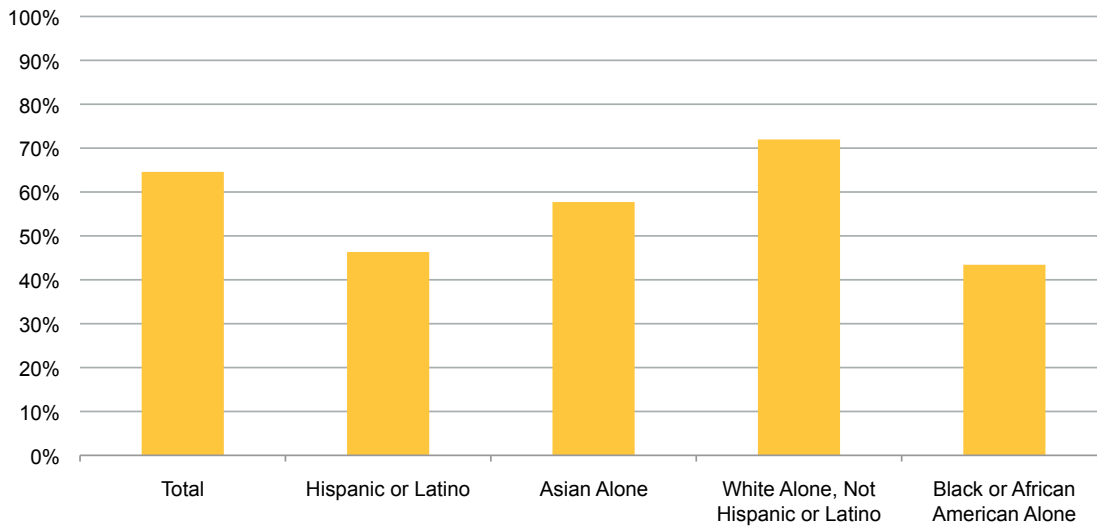
As we look to the future, we must ensure that the opportunities and substantial benefits of homeownership are available to all members of our society who are prepared to assume the responsibilities of being a homeowner. Homeownership rates today continue to be dramatically dissimilar across racial and ethnic groups and income bands (see Charts 2-2 and 2-3). In 2011, the homeownership rates for Hispanics and African Americans were considerably lower than the homeownership rate for the overall population. This gap hampers economic prosperity and the growth of a stable and secure middle class. As our country grows more diverse, with members of today's minority groups accounting for an increasingly larger share of the national population, ensuring that the opportunity for homeownership is open to all creditworthy households is more important than ever.

Chart 2-1: National Homeownership Rate, 1960 to 2010



Sources: Homeownership rates, 1960 to 1990, from William S. Chapin, *We the Americans...Our Homes* (Washington, D.C.: U.S. Department of Commerce, 1993), 3. Homeownership rates, 2000 and 2010, from U.S. Census Bureau, "DP-1: Profile of General Demographic Characteristics: 2000" and "DP-1: Geography-United States: Profile of General Population and Housing Characteristics: 2010," *Decennial Census* (Washington, D.C.: 2001 and 2012).

Chart 2-2: National Homeownership Rate by Race and Ethnicity, 2011

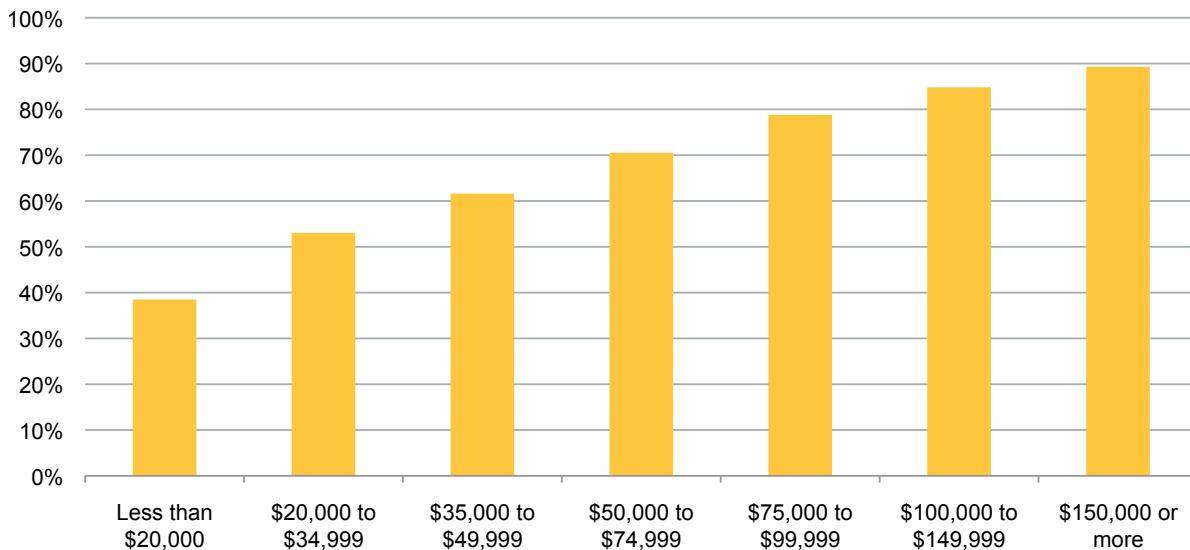


Source: U.S. Census Bureau, "B25003. Tenure," *American Community Survey* (Washington, D.C.: 2012).

Over the years, the federal government has made significant efforts to ensure that access to credit is available without regard to one's racial or ethnic background. The Fair Housing Act of 1968 and the Equal Credit Opportunity Act of 1970 prohibited discrimination in housing and lending. The Home Mortgage Disclosure Act of 1975 gave the public an opportunity to monitor the activities of regulated lenders in

the home mortgage market. In 1977, Congress passed the Community Reinvestment Act requiring financial institutions to meet the credit needs of consumers in the communities where they are chartered, consistent with safe and sound financial practices. Homeownership rates were also a central focus of the presidencies of Bill Clinton and George W. Bush. Both challenged the markets to better serve minority homebuyers.

Chart 2-3: National Homeownership Rate by Income, 2011



Source: U.S. Census Bureau, "B25118. Tenure by Household Income in the Past 12 Months," *American Community Survey* (Washington, D.C.: 2012).

The Potential for Homeownership Growth in Majority-Minority Jurisdictions⁵⁵

The Joint Center for Housing Studies of Harvard University projects that “minorities will account for more than 70 percent of net household growth in 2010–20.” By 2011, there were already five majority-minority jurisdictions in the country: Hawaii (77.1 percent minority), the District of Columbia (64.7 percent), California (60.3 percent), New Mexico (59.8 percent) and Texas (55.2 percent). In estimates released in the summer of 2012 by the U.S. Census Bureau, the data showed that just over half (50.4 percent) of the nation’s population under age one are minorities. While much growth is occurring in the American South and West, parts of the Pacific Northwest are also seeing significant changes. The potential for growth in homeownership in each of these communities is largely untapped, considering the currently low homeownership levels among these populations.

As the nation seeks to expand homeownership opportunities, certain principles should guide our policies:

- First, a new and reinvigorated commitment to homeownership requires a strong vibrant housing finance system where creditworthy borrowers can get a mortgage, along with responsible lending practices and a stable regulatory regime that provides clear rules of the road for mortgage lenders and borrowers.
- Second, we must support a production system capable of constructing homes that will be affordable and suitable for the millions of households who will seek to become homeowners for the first time.
- Third, housing counseling and education must be a central component of any strategy to expand homeownership opportunities, particularly as a means of preparing first-time homebuyers for the financial and other responsibilities of homeownership.

- Fourth, mortgage lending, zoning, and land-use policies should support new forms of homeownership that can lower costs and preserve affordable homeownership opportunities over time.

The commission also supports the continuation of tax incentives for homeownership, but recognizes that, in the ongoing debate over tax reform and budget priorities, all revenue options will be evaluated. See page 104 for further discussion of the commission’s views on federal support for housing.

The remainder of this chapter sets forth the case for an enhanced national capacity for housing counseling and identifies emerging approaches to homeownership that merit further study and support. Chapter 3 outlines a redesigned housing finance system that can support new housing production and meet the mortgage credit needs of the American people.

The Power of Housing Education and Counseling

The Housing Counseling Assistance Program administered by HUD was established in 1968 and has traditionally enjoyed bipartisan support. Over time, funding has steadily increased, and the scope of the program has broadened to focus on providing education and advice to first-time homebuyers, renters, seniors, and homeowners facing foreclosure. Financial institutions and counseling organizations have developed partnerships as a result of the program, and policy makers are incorporating counseling in their rules and regulations. Over the last decade, the Housing Counseling Assistance Program has adapted to a dynamic housing market by increasing its capacity and sophistication. Today, housing counselors have experience in mortgage origination, loss mitigation, reverse mortgages, homeless counseling, and tenant rights, and they have

a track record of providing objective information and guidance.

Current policy recognizes the importance of counseling for especially vulnerable borrowers. Counseling is already required as a condition to obtaining a reverse mortgage through the FHA's Home Equity Conversion Mortgage program, and the Dodd-Frank Act requires counseling for borrowers seeking to refinance into high-cost loans, as defined by the Home Ownership and Equity Protection Act. Dodd-Frank also elevated counseling's importance by creating a new Office of Housing Counseling within HUD.

The commission believes that housing counseling can improve prospective borrowers' access to affordable, prudent mortgage loans, especially for families that otherwise might not qualify or who may experience other barriers to mainstream lending. There is a wide public benefit from investment in housing education and counseling programs, and the commission therefore supports continued federal appropriations for housing counseling, and recommends that stakeholders who benefit from a borrower's access to counseling services be expected to contribute to the cost of the service. To achieve this vision, four key elements are necessary: (1) a strong counseling infrastructure; (2) clear standards; (3) an understanding of the proper role for counselors; and (4) the adoption of best practices for integrating counseling into the mortgage market.

Counseling Infrastructure

Technology and product development, human capital, brand awareness, and support are key aspects of the housing counseling network. Online technology allows counselors to better evaluate the financial circumstances of each borrower and homeowner.⁵⁶ And new technology and infrastructure developed in the wake of the housing market's collapse have increased counselors' efficiency and

ability to respond to an increasingly complex marketplace, allowing counselors to reach clients in greater numbers than ever before and in more remote locations. HUD-approved housing counseling agencies can either connect with HUD directly or work through a national or regional intermediary. National intermediaries provide leadership that strengthens the counseling field and improves the quality and professionalism of counseling services. For instance, they help pool funds, broker partnerships, seed programs, and train counselors. The public campaigns that have brought record numbers of homeowners to housing counselors through the National Council of La Raza's Independent Foreclosure Review hotline and the Homeownership Preservation Foundation's Hope hotline are good examples of expanded capacity, structure, and coordination provided by intermediaries.

The vast majority of HUD-approved housing counseling providers are community-based nonprofits. Community-based organizations located in the neighborhoods they serve have established relationships with local leaders and have their pulse on community needs. They are often the first point of contact for struggling families. Many of these organizations bring a cultural competency that is critical when reaching underserved minority and immigrant populations.

Standards

HUD supports a network of nearly 2,700 agencies that, since 2005, has assisted more than 13.4 million households as they make decisions about their future housing.⁵⁷ The HUD Housing Counseling Handbook defines and guides the services provided by these agencies, all of which report activity annually and are subject to performance reviews every two years.

Intermediaries are responsible for ensuring that the organizations they fund comply with HUD standards, as laid out in the HUD Handbook. Intermediaries work

closely with their networks to train new staff on proper counseling materials, technology, reporting requirements, and management techniques. This model not only ensures that HUD standards are implemented but also helps organizations remain stable over time. Should a HUD intermediary's grantee fail an audit, funding for their entire network would be jeopardized.

The National Counseling and Homebuyer Education Committee, hosted by NeighborWorks America, has developed additional industry standards for homeownership counselors and educational professionals. These standards have been endorsed or adopted by more than 700 national and local counseling agencies and funders across the country and include professional and ethical standards beyond those called for in the HUD Handbook.

Role of Counselors

As independent third parties, counselors offer unbiased information and advice to homebuyers, renters, victims of predatory lending, and families facing a financial emergency. While counselors can facilitate learning in groups, increasingly, they are providing one-on-one coaching, which has been shown to be a more effective way to generate positive outcomes for households in underserved communities. This approach allows private questions to be answered, and gives the counselor the opportunity to evaluate and develop tailored solutions for each family's unique circumstances.

Housing counselors have three critical roles in supporting and advancing homeownership for the underserved:

- Advisor to prospective homebuyers.
- Counselor to homeowners struggling to make payments.
- Coach to those not yet ready for homeownership but in need of advice about affordable rental options or other financial counseling.

Counselors coach clients to understand how lenders make loan decisions and can help prospective buyers or renters determine their monthly threshold for housing-related expenses. Homeowners who receive pre-purchase counseling exhibit substantially lower delinquency rates. For example, among a group of 40,000 Freddie Mac loans, the borrowers who received one-on-one or classroom style counseling were on average between 20 and 40 percent less likely to ever experience a serious delinquency than their peers who did not attend counseling sessions.⁵⁸

Counselors can also be an ally in the event of an unexpected financial change and can start the conversation with a lender about ways to help struggling homeowners. For example, borrowers who received counseling under the National Foreclosure Mitigation Counseling program, created in the wake of the foreclosure crisis, were twice as likely to obtain a loan modification and 67 percent more likely to remain current on the mortgage nine months later as compared with their counterparts, who received a modification without the assistance of a counselor.⁵⁹

While the HUD Housing Counseling Assistance Program is best known for its homeownership efforts, its most important contribution may be helping prospective buyers understand when it is *not* the right time for them to purchase a home. In light of the large number of households exiting homeownership, counseling agencies have seen an uptick in demand for rental counseling and financial coaching—a new line of service that helps households build credit, set up bank accounts, and engage in financial planning. People experiencing homelessness also utilize housing counseling programs as they transition into a viable rental arrangement. As the number of renter households increases, there is a unique opportunity to capture data on the impact and value of this form of counseling.

Integrating Counseling into Mortgage Delivery

Despite the success of housing counseling and the growing sophistication of the industry, its effectiveness is limited by its scale and positioning in relation to the rest of the mortgage industry. Promising partnerships between the counseling field and lenders have emerged, but more could be done to build upon these models. Lenders, investors, and regulators could provide counseling incentives for borrowers on the margins of creditworthiness. For example, one idea that has been discussed is for FHA to offer an insurance discount for those borrowers who receive counseling.⁶⁰ Clearly, such programs would have to be tested before scaling and priced consistent with risk- and capital-management principles.

Lenders and others can require counseling for certain products. For example, the Federal Home Loan Banks' homeownership set-aside programs include counseling as a required condition for eligibility. A study conducted by the Federal Home Loan Banks on foreclosures within its homeownership programs between 2003 and 2008 found that only 1.7 percent of homebuyers assisted by those programs requiring counseling (1,177 of 70,163 participants) entered the foreclosure process.⁶¹ These programs are designed to assist lower-income and first-time homebuyers, yet the foreclosure rates reported by the Home Loan Banks were notably better than rates reported for prime loans through conventional mortgage programs. Clearly, as indicated by the numbers, homeownership counseling works.

Regulators are also seeing the promise of housing counseling. The CFPB recently proposed a rule that will require all lenders to provide a list of federally approved counseling agencies to a consumer who applies for any mortgage loan within three business days. A second proposed rule, under the Truth in Lending Act, would require a lender to confirm that a first-time borrower

received counseling from a federally approved agency before making them a "negative amortization" loan in which the mortgage principal owed increases over time.

Many observers are concerned about the extent to which mortgages will be accessible and affordable to underserved market segments in the future. Housing counseling can and should play an important role as a credit enhancer, mitigating the risk of lending to borrowers on the margins of creditworthiness. Counseling organizations can also serve as a reliable pipeline of households for whom a slow and steady approach to homeownership is prudent. Thanks to the infrastructure created by HUD, the counseling field will be able to maintain its depth and capacity. The HUD Housing Counseling Assistance Program is an excellent example of an effective and highly functional public-private partnership that should be thought of as a credit enhancer and important entry point for underserved communities to achieve homeownership.

Innovations and Opportunities in Homeownership

In the coming decades, millions of Americans will continue to find value in homeownership and seek to become homeowners for the first time. In recent years, a number of innovative ownership models have been introduced to help make homeownership more affordable and accessible.

Shared Equity and Land Trusts

Growing numbers of "hybrid" homeownership models, variously known as "shared-equity" or "limited-equity" models, combine lower up-front costs for consumers with features that keep home prices affordable for subsequent buyers. For example, some shared- or limited-equity programs give the lender a right of purchase upon sale of the home, at a price determined using a formula that provides the seller with modest appreciation while keeping

costs affordable to the next buyer. These programs can involve community land trusts with nonprofit sponsors who own the land under the properties. Either through covenants on individual deeds for homes, or through continued ownership and lease-back of the land by the sponsor, these trusts incorporate a long-term affordability goal by limiting the sales prices of homes over time. There are also well-established models of limited-equity cooperatives in multi-unit buildings where the terms of the cooperative limit appreciation to a set amount.

Land trusts using lease-back provisions can be particularly attractive for local governments that have acquired abandoned homes or for employer-assisted housing programs using land the employer owns. Another advantage of land trusts is the continuing participation by the sponsoring organization in the ongoing life of the community and the transfer of properties. There is recent evidence that owners in such trusts were less susceptible to subprime and predatory refinancing loans and performed better than other, comparable households through the mortgage bust and foreclosure crisis.⁶²

These programs serve a succession of buyers over time, making effective use of scarce funds and helping to maintain homeownership at affordable levels. Many have demonstrated significant success but have not yet been taken to scale. These models deserve further support and study as alternatives that could help build effective and sustainable homeownership opportunities.

Manufactured Homes

In many parts of the country, and particularly in rural areas, manufactured homes are a significant and often overlooked source of affordable housing. Access to affordable,

sustainable conventional financing for these homes remains a serious obstacle for buyers, particularly for manufactured homes placed on rented land.

Given the characteristics of those now entering the homeownership market for the first time, policy makers should give continued attention to ways to increase the availability of affordable, long-term mortgage financing for manufactured homes and should re-examine those policies that may unnecessarily restrict the ability of first-time buyers to purchase these homes.

The Formula for Sustainable Homeownership

Whatever the vehicle may be, the formula for sustainable homeownership is clear: the broad availability of prime, fixed-rate mortgage financing—as well as straightforward adjustable-rate mortgages with clear terms and limits on adjustments and maximum payments—combined with counseling and financial education for those who may need it. Add to this mix a regulatory system that is vigilant and sufficiently equipped to address misconduct in the marketplace.

One other ingredient is absolutely essential: a strong, vibrant system of housing finance that can ensure a steady flow of affordable mortgage funds to prospective homeowners and those seeking to refinance. Following the recent housing market crash and the ongoing challenges that creditworthy prospective homebuyers face in accessing mortgage credit, a sound housing finance system will be of primary importance to support and sustain homeownership going forward.



Economic Policy Program
Housing Commission



Chapter 3. Reforming Our Nation's Housing Finance System

Meeting our nation's diverse housing needs will require a strong and stable system of housing finance. This system, when functioning at its full potential, can offer millions of Americans and their families the opportunity to choose the type of housing that best meets their unique needs. Whether it is the recent graduate entering the workforce, the working couple with children seeking to purchase a home for the first time, the young single looking for an affordable apartment in the central city, or the retired widower hoping to downsize from his three-bedroom home, it is the housing finance system that helps transform these aspirations into concrete realities. A successful housing finance system maximizes the range of ownership and rental housing choices available to us at all stages of our lives.

In many respects, the housing finance system is also a key part of the economy's plumbing, a complex series of financial pipes and drains through which capital flows to both the single-family and rental segments of the housing market. Without the liquidity provided by this system, mortgage lending would be scarce and more expensive, new homebuilding would stall, the construction of new apartment units and preservation of existing units for our nation's burgeoning renter population would slow down, and our economy would suffer.

Our nation's housing finance system is complex, varied, and global in scope. As Figure 3-1 below demonstrates, it consists of banks, thrifts, mortgage brokers, and other originators of mortgage loans; organizations that service the loans on behalf of the originators; public and private institutions that buy the loans and then pool them into securities; and institutional and individual investors who purchase these securities in the secondary market.

A key feature of our housing finance system is the critical role of securitization. By taking loans off the balance sheets of banks and other mortgage originators, the securitization process frees up additional capital for mortgage lending. It also shifts some of the risks inherent in the mortgages to the investors in the mortgage-backed securities who are willing to assume these risks in return for a yield that may be higher than that of other investments. In this way, securitization helps circulate funds from a variety of domestic and international sources into the mortgages that finance housing for millions of American families.

Our housing finance system is the largest in the world, with almost \$10 trillion in single-family mortgage debt outstanding⁶³ and \$825 billion in mortgage debt outstanding in the multifamily sector.⁶⁴ To put these figures

Figure 3-1: Simplified View of the Single-Family Housing Finance System

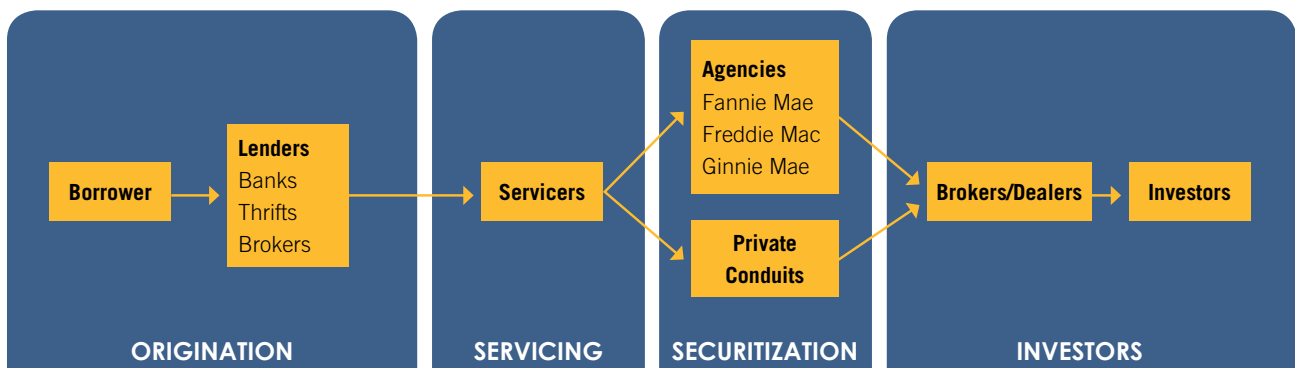
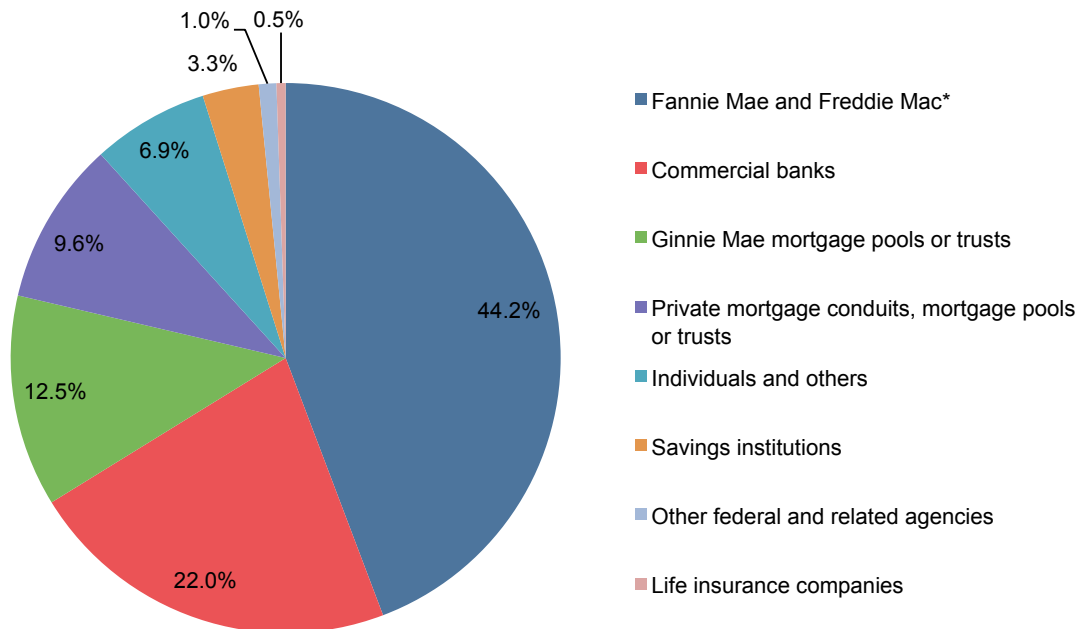


Chart 3-1: Holders of Mortgage Debt Outstanding, 2012 Third Quarter

*As of 3Q 2012, Fannie Mae and Freddie Mac reported approximately \$4.64 trillion in mortgage loans on their consolidated balance sheets, of which \$502 billion was held in portfolio, and the balance (\$4.1 trillion) was in mortgages held by third parties, principally in mortgage-backed securities that were guaranteed by the companies.

Sources: Board of Governors of the Federal Reserve System, Economic Research and Data, "Mortgage Debt Outstanding (1.54)," December 7, 2012; Fannie Mae, *Form 10-Q*, p. 100, November 7, 2012; and Freddie Mac, *Form 10-Q*, p. 129, November 6, 2012.

in perspective, the size of the U.S. single-family mortgage market exceeds the entire European market and is nearly six times larger than that of the United Kingdom, which is home to the world's second-largest single-family market.

The sheer size of the U.S. mortgage market requires that we retain diverse sources of mortgage credit. In 2006 and 2007 the amount of outstanding mortgage debt exceeded the total value of all assets held by U.S. banks. Today, outstanding mortgage debt nearly equals the total value of the assets on

banks' books and is held by a diverse array of entities and institutions (see Chart 3-1). For the foreseeable future, there is simply not enough capacity on the balance sheets of U.S. banks to allow a reliance on depository institutions as the sole source of liquidity for the mortgage market. Given the size of the market and capital constraints on lenders, the secondary market for mortgage-backed securities must continue to play a critical role in providing mortgage liquidity.

Historical Context: The Path to Today's Housing Finance System

The Great Depression was a watershed period in the history of housing in the United States. Up until the mid-1930s, residential mortgages generally had short terms (usually three to ten years), variable interest rates, and featured “bullet” payments of principal at term. Borrowers would normally refinance these loans when they became due or pay off the outstanding loan balance. At the time, large down payments were common, and mortgages typically had very low loan-to-value (LTV) ratios of 60 percent or less.⁶⁵ The homeownership rate, however, was significantly lower than it is today—around 45 percent, compared with 64.6 percent—as fewer families had the financial wherewithal to enter into mortgages with these more stringent terms. Homeownership was generally reserved for the wealthy or, in rural areas, for those who lived on and farmed their land.

As the Great Depression swept the nation, housing values declined by as much as 50 percent. Banks that held the mortgages on these homes refused to or were unable to refinance when the loans came due. Thousands of borrowers then defaulted, having neither the cash nor the home equity available to repay the loans. The consequence was a wave of about 250,000 foreclosures annually between 1931 and 1935.⁶⁶

In response to these events, the federal government established the Federal Home Loan Bank system in 1932 to increase the supply of mortgage funds available to local financial institutions and to serve as a credit reserve. Two years later, in 1934, the government created the FHA to help stabilize the mortgage market through its insurance programs. By insuring only mortgages that met certain limits on the maximum principal obligation, interest rate, LTV ratio, and loan duration, the FHA helped set the foundation for the modern standardized single-family mortgage.⁶⁷ In 1944, the government established the VA loan guarantee program,

similar in approach to the FHA loan-level insurance programs but targeted to helping military veterans and their families secure homeownership. In the years following World War II, the homeownership rate rose steadily, from 43.6 percent in 1940 to 55 percent in 1950 and to 66.2 percent in 2000, as measured by the Decennial Census.

In addition to ownership housing, the FHA also provides credit support for multifamily rental housing through a separate reserve fund first established by the National Housing Act of 1938. The FHA's authority to support multifamily housing was not widely exercised until the 1960s when several programs were created to encourage the construction and preservation of rental housing for moderate-income households.⁶⁸

In 1934, the government also authorized the FHA to create national mortgage associations to provide a secondary market to help mortgage lenders gain access to capital for FHA-insured loans. Only one such association was established, when the FHA chartered the Federal National Mortgage Association in 1937. In 1968, the Federal National Mortgage Association was partitioned into two separate entities—the Government National Mortgage Association, or Ginnie Mae, which remained in the government, and Fannie Mae, which became a privately owned company charged with the public mission of supporting the mortgage market by purchasing conventional (i.e., non-government-insured) mortgages. Until the 1980s, Fannie Mae carried out its mission by issuing debt—first as a government agency and after 1968 as a government-sponsored enterprise (GSE)—and using it to buy mortgages from their originators. In 1970, the secondary market grew with the creation of Freddie Mac, which was initially owned by the Federal Home Loan Banks and, with passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, reorganized as a private, for-profit corporation with a charter similar to that of Fannie Mae.⁶⁹

Over the years, Fannie Mae, Freddie Mac, and Ginnie Mae helped bring greater transparency and standardization to both the single-family and multifamily housing finance system, which has lowered mortgage costs. By setting clear benchmarks for loans eligible for securitization, the three institutions also helped improve the overall credit quality of the system. Moreover, by linking local financial institutions with global investors in the secondary market, they helped expand access to mortgage credit.

However, the companies' role was a sore point for the lending industry almost from the start. Acting as a giant thrift, Fannie Mae profited from the spread it earned between its cost of funds, which was lower than other private companies because of its government ties, and the interest rates on mortgages. The creation of the first MBS by Ginnie Mae in the 1970s led Fannie Mae and Freddie Mac, and then private Wall Street firms, to engage in securitization. Depositories viewed Fannie Mae as a competitor for balance-sheet lending, and, after MBS became the prevalent funding source, private-sector competitors likewise saw the GSEs as unfairly competing with them in the securities markets. Both institutions did enjoy a number of benefits because of their unique charters, including a line of credit with the U.S. Treasury, exemptions from certain state and local taxes, which provided favorable treatment for their portfolio business, and most importantly, an *implied* government guarantee of their securities as well as their own corporate debt. In return, the charters restricted Fannie Mae and Freddie Mac only to residential mortgage finance in the United States, and the companies were expected to support mortgage markets throughout all market cycles, an obligation that did not apply to other fully private investors or guarantors.

In the wake of the Savings and Loan crisis in 1989, Congress imposed new capital requirements and strengthened the GSEs' mission requirements. But the pressure to deliver returns to shareholders, along with the

mistaken view shared by actors throughout the mortgage market that housing prices would continue to rise without interruption, encouraged Fannie Mae and Freddie Mac to leverage their businesses to unsustainable levels. With insufficient capital buffers, both institutions suffered catastrophic losses when the housing market collapsed and the credit markets froze, leading to their conservatorship by the government in 2008.

Notably, during the housing crisis, the multifamily businesses of Fannie Mae and Freddie Mac continued to generate a profit for both institutions, as the default rates on their multifamily loans were substantially lower than the loans in their single-family portfolios. It is also worth noting that the 12 Federal Home Loan Bank cooperatives, which were designed to provide countercyclical liquidity for U.S. mortgage and housing market participants, remained a reliable source of liquidity for their more than 7,700 member institutions during the crisis. The Home Loan Banks provide a reliable flow of funds and liquidity to local lenders for housing and community development through advances funded by debt the banks issue and collateralized by mortgages or mortgage bonds exchanged by members in return for the advances. In late 2008, while other sources of credit froze, Federal Home Loan Bank advances increased by \$400 billion (reaching \$1 trillion) as the Home Loan Banks continued to support their members' participation in the housing market.

Despite our current difficulties, households in the United States have enjoyed a wider range of mortgage financing options than those in most other nations of the world. For instance, the most common mortgage product in the United States—the long-term, fixed-rate mortgage—is relatively rare in other countries where shorter-term and variable-rate mortgages are the norm.⁷⁰ The long-term, fixed-rate mortgage has been a tremendous boon to consumers who are provided with cost certainty and protection from the risks associated with fluctuating interest rates. The process

The Long-Term, Fixed-Rate Mortgage

Over the past several decades, the American people have benefited greatly from the wide availability of long-term, fixed-rate mortgage financing, most notably in the form of the 30-year fixed-rate mortgage. The 30-year fixed-rate mortgage provides a long amortization period that helps to keep monthly payments low and provides certainty to borrowers by protecting them against interest rate volatility over the life of the loan. While in recent years interest rates have fallen to historic lows and have remained low for a sustained period, rates will inevitably rise, perhaps significantly, making mortgage financing more expensive. A long-term, fixed-rate mortgage protects against these fluctuations and gives borrowers a clear sense of their monthly repayment obligations and the assurance that this obligation will not change dramatically over time.

The 30-year fixed-rate mortgage also enhances the stability of housing finance for the borrower. Long-term, fixed-rate mortgages shift interest-rate risk from borrowers to lenders and investors in mortgage-backed securities who are generally more sophisticated and better equipped to manage this risk than the average borrower household.⁷¹ The presence of a government guarantee in the secondary market ensuring that investors will be paid even if borrowers default on their loans has eliminated much of the credit risk from these investments, thereby making them attractive to investors looking for instruments that are sensitive only to interest rate risk. In the absence of such a government guarantee, it is highly unlikely that private financial institutions would be willing to assume both interest rate *and* credit risk, making long-term, fixed-rate financing considerably less available than it is today or only available at higher mortgage rates.

The 30-year fixed-rate mortgage has enabled millions of Americans families to achieve their dreams of homeownership. The commission endorses product choice and strongly believes this type of mortgage product should continue to be available to a broad universe of qualified borrowers.

of securitization has played an instrumental role in setting the standards for these mortgages and making them widely available on affordable terms for millions of American families. By taking individual mortgages—inherently illiquid and difficult-to-price assets—and combining them with millions of other loans in stable securities based on cash flows from a broadly diversified portfolio of assets, securitization has opened the residential finance market to investors who otherwise could not participate in this market. The flow of cash has helped fuel one of the most stable, transparent, and efficient capital markets in the world and assured American consumers of a steady and reliable source of mortgage credit.

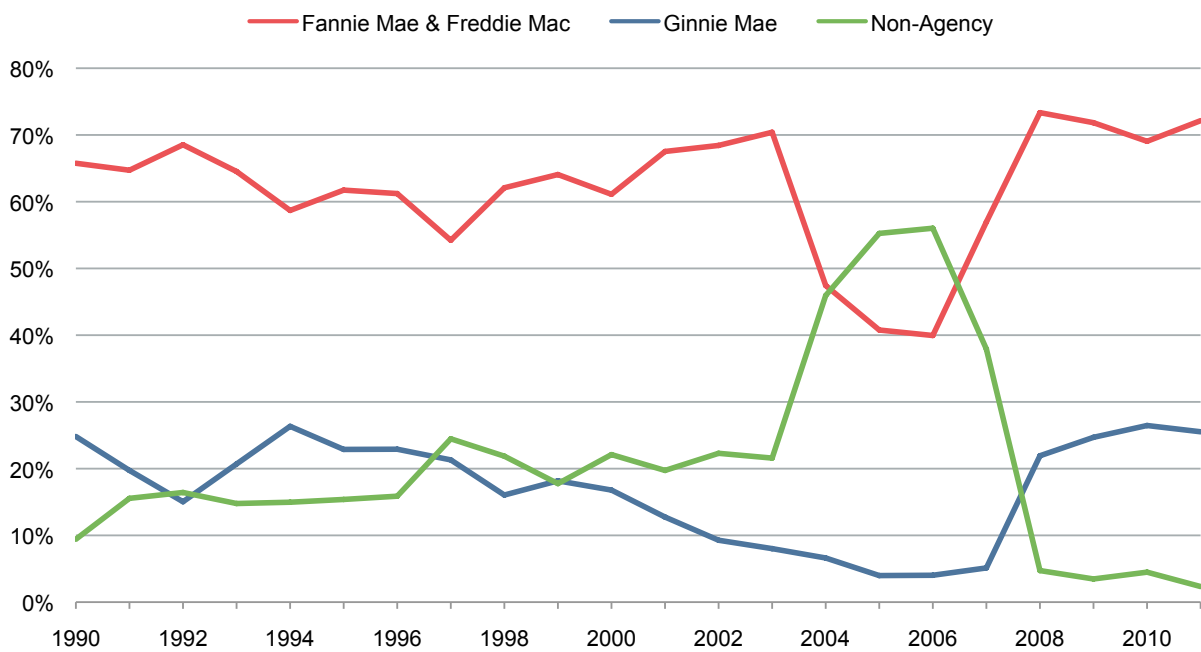
Single-Family Housing Finance Trends

In the wake of the collapse of privately funded and nongovernment-insured mortgages, the federal government has emerged as a dominant presence in the housing finance market, a role it has played before when private capital has fled the mortgage market. As Charts 3-2 and 3-3 show, the federal government currently insures and guarantees the largest share of mortgage-backed securities and assumes the major portion of credit risk in the U.S. mortgage market.

In 2011, securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae (with credit insurance from the FHA and the VA) constituted 97 percent of all MBS, with non-agency funds less than 3 percent. By comparison, Fannie Mae, Freddie Mac, and Ginnie Mae accounted for 78 percent of the MBS market in 2000, with non-agency funds at 22 percent. The chart also shows that government and GSE shares of MBS remained relatively steady through the 1990s, a period of strong economic growth and stable interest rates.

Chart 3-2: Mortgage-Backed Securities – Market Share, 1990 to 2011

Funds for MBS, share of market by source, selected years					
	1990	1996	2000	2006	2011
Fannie Mae & Freddie Mac	65.76	61.22	61.11	39.95	72.14
Ginnie Mae	24.82	22.91	16.79	4.02	25.52
Non-Agency	9.42	15.87	22.11	56.03	2.33



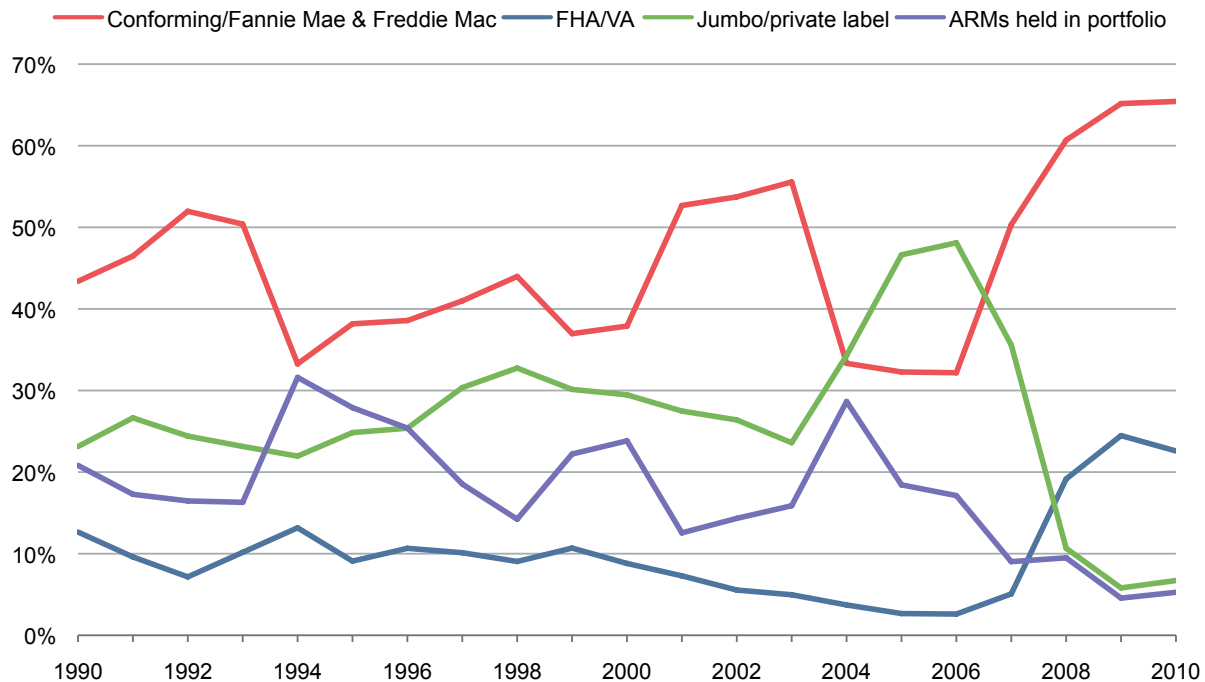
Source: Bipartisan Policy Center tabulations of data from Inside Mortgage Finance, "Mortgage and Asset Securities Issuance," *Inside MBS & ABS*.

The same general situation is true for all mortgage originations (whether originated to be held in portfolio or sold into the MBS market). Chart 3-3 shows that, in 2010, private-sector-related originations including jumbo loans, loans originated for private-label securities, and adjustable-rate mortgages (ARMs) to be held in portfolio constituted

only 12 percent of originations (compared with 53 percent in 2000 and 44 percent in 1990), while FHA/VA loans and Fannie Mae and Freddie Mac conforming loans constituted 88 percent of originations (versus 47 percent in 2000 and 56 percent in 1990).

Chart 3-3: Mortgage Originations by Product, 1990 to 2010

Mortgage originations by product share of market by source, selected years					
	1990	1996	2000	2006	2010
Conforming/Fannie Mae & Freddie Mac	43.4	38.6	37.9	32.2	65.4
FHA/VA	12.7	10.7	8.8	2.6	22.6
Jumbo/private label	23.1	25.4	29.5	48.1	6.7
ARMs held in portfolio	20.8	25.4	23.8	17.1	5.3



Source: Bipartisan Policy Center tabulations of data from Inside Mortgage Finance, "Mortgage Originations by Product" and "ARM Securitization by MBS Type."

While there are nascent signs that we have turned a corner, the U.S. system of single-family housing finance continues to face serious challenges as significant problems related to the Great Recession persist. Sustained high unemployment, an unprecedented collapse in house prices—especially in certain highly affected states and metropolitan areas—the

large volume of foreclosures, and a prolonged foreclosure process in some states continue to stand in the way of a full market recovery.

Further, while in most of the country the cost of buying a home has never been more affordable, stringent underwriting requirements prevent many would-be borrowers from taking

advantage of these conditions. As illustrated in Chart 3-4, borrowers' credit scores at origination have increased by 40 to 50 points since 2001.

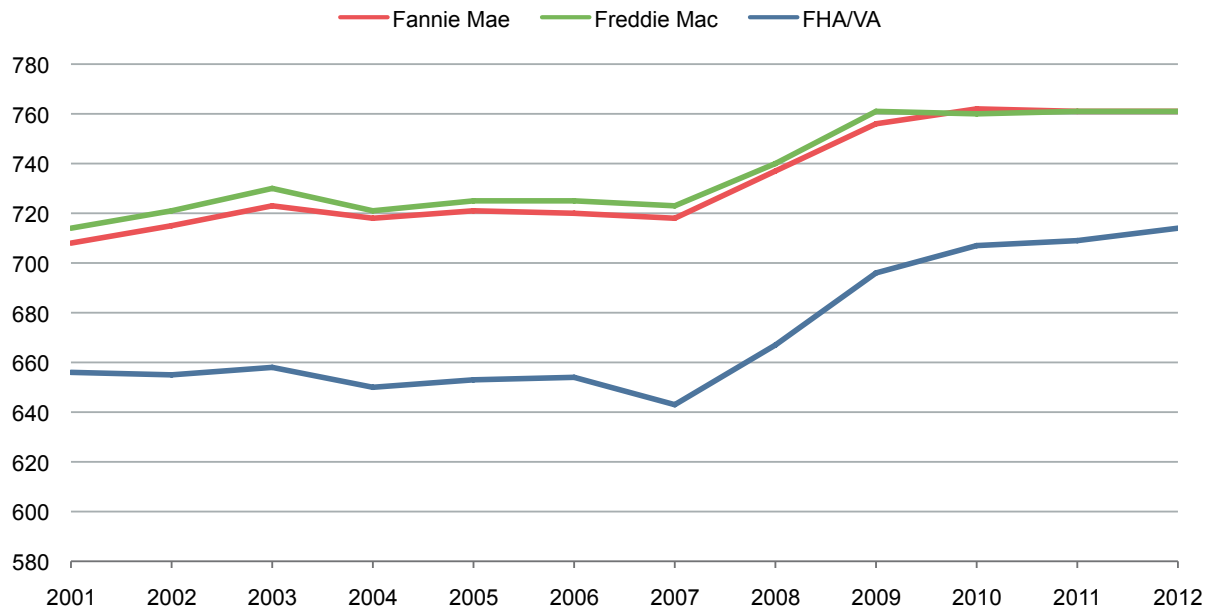
Today, a number of obstacles prevent a return to the conditions that prevailed in the late 1990s—before lax underwriting infiltrated the system and contributed to the crisis—and stand in the way of qualified borrowers accessing mortgage credit. Unprecedented investor demands placed on originators and sellers of mortgages have caused lenders to be increasingly cautious when considering new mortgage applications, and sales of new and existing homes remain well below historic levels going back several decades.

Obstacles to Market Recovery

The commission has identified the following obstacles that are making it difficult for qualified borrowers to obtain a mortgage and are therefore impeding a full market recovery:

- 1. Overly strict lending standards.** Sales of new and existing homes remain well below historic levels going back several decades. Observers attribute the decline in home sales, in part, to unnecessarily rigid down payment, debt-to-income, and credit score requirements that were imposed in the aftermath of the housing market's collapse.⁷² Restoring the appropriately conservative underwriting standards in place before the housing bubble, with their focus on the overall creditworthiness

Chart 3-4: Borrower FICO Score at Origination



Note: FICO scores are one of several metrics used to measure creditworthiness and range from a low of 300 to a high of 850. As of September 2012, 37.6 percent of the U.S. population had a credit score above 750, and 46.5 percent had a credit score below 700. See: Rachel Bell, "FICO Scores Reflect Slow Economic Recovery," *FICO Analytics Blog*, September 8, 2012.

Source: CoreLogic, 1010Data, Amherst Securities Group.

of the borrower, could help to improve the health of the housing market.

2. Lack of access to credit for well-qualified self-employed individuals.

Self-employed borrowers face unique obstacles to providing income documentation and meeting other criteria required to qualify for a mortgage under current underwriting standards. Adjustments to these criteria could be made to acknowledge these limitations and provide access to credit while ensuring that lenders do not take on unnecessary risk.

3. Put-back risk. Fannie Mae, Freddie Mac, and the FHA hold lenders liable for representations and warranties associated with loans purchased by the agencies for a finite amount of time following origination. In the event of a default during that period, lenders may be required to buy back the delinquent loan. This retained risk is an important tool for ensuring that loan originators comply with the credit terms promulgated by the three agencies. But, uncertainty surrounding the circumstances around which this “put-back” option will be exercised has dampened lending and caused some lenders to impose additional requirements, or lender overlays, to existing agency underwriting criteria in order to further insulate themselves from potential liabilities.

Guidance issued by the Federal Housing Finance Agency (FHFA) effective January 2013 helps to address some of these concerns by clarifying “lenders’ repurchase exposure and liability,” including promising earlier review of loans and providing relief from representations and warranties following 36 months of consecutive on-time payments.⁷³ While this guidance is an important start, and provides partial relief, several factors limit its effectiveness in stimulating new lending. For example, when determining lender eligibility for relief from put-back risk, the new framework takes into consideration borrower performance over a period of up to 60 months following acquisition of the loan by Fannie Mae and Freddie Mac.

Some have argued that the 36-month and 60-month timeframes are too long, and any delinquencies beyond the first year following origination are likely to reflect changes in borrower circumstances (rather than the borrower’s position at origination). In addition, the guidance does not apply to mortgages originated in 2012 or prior years and thus does little to relieve banks’ concerns about exposure from these loans. Close attention should be paid to lenders’ evolving practices and adjustments to these new guidelines. It is critical that regulators strike the right balance between giving lenders assurance that their liability is limited when selling loans into securities and ensuring that credit guarantors have the right tools with which to enforce their credit standards.

4. Appraisals. The sales price of distressed or foreclosed homes—whether disposed of through one-off deals or bulk sales—tends to be substantially lower than traditional (non-distressed) sales, often as a result of the increased time and risk associated with distressed sales, differences in the condition of the property, and the seller’s interest in completing the transaction. However, distressed property sales continue to be recorded and used as comps in appraisals of non-distressed (retail) properties, a practice that depresses local home values and impacts would-be homebuyers’ ability to secure financing. In some markets, demand for multiple reappraisals, sometimes just days before closing, also introduces substantial uncertainty into the home-buying process and can derail sales and disrupt the plans of homebuyers and sellers. To remedy this situation, Fannie Mae, Freddie Mac, and FHA could refuse to accept distressed sales as valid comps, forcing a reassessment of non-distressed properties. In markets that do not have sufficient sales volume to allow comps to be calculated without the inclusion of distressed sales, an alternative approach might be to require an addition to the value of a distressed sale based on the difference between the local market index of distressed sales versus retail sales.

5. Application of FHA compare ratios. An FHA “compare ratio” provides an indication of a lender’s loan performance relative to other FHA lenders in a particular market. For example, if a lender has a compare ratio of 50, its default rate on FHA loans is only half the default rate for all lenders in that area. On the other hand, a ratio of 150 would mean that the default rate is one-and-a-half times that of other FHA lenders in the area. A high compare ratio may result in an enforcement action against a lender with the lender losing the ability to close FHA loans. Lenders with relatively high compare ratios typically attempt to lower the ratio by imposing tighter underwriting standards, which in turn has a cascading effect on other lenders in the area who must resort to similarly restrictive lending practices in order to maintain their relative position. While compare ratios serve as a useful analytical tool, the current application of the ratios may have the effect of tightening credit by FHA lenders to creditworthy borrowers. FHA should reconsider the way in which compare ratios are applied to ensure they do not unduly restrain credit and provide an accurate reflection of lender performance—both in originations and in servicing practices—in the current market.

6. Uncertainty related to pending regulations and implementation of new rules. In the past few months, several important federal rulemakings related to the U.S. mortgage market have been finalized while other proposed rules are still pending. These new and pending rules have the potential to significantly affect home finance in the United States. Lenders report that uncertainty as to their impact has led them to exercise caution and pull back on new mortgage originations for all but the lowest-risk borrowers. In addition, the potential impact of Basel III on the housing finance market is significant and not fully understood or appreciated. Policy makers deserve a much fuller understanding of how the current regulatory environment impacts mortgage lending

as well as how the various regulatory initiatives now under consideration interact with each other.

In light of the seriousness of the current situation, the commission suggests that the President of the United States direct the Department of the Treasury, in coordination with the various federal banking agencies, to inventory these regulatory initiatives and assess their current and likely future impact on the affordability and accessibility of mortgage credit. The Treasury Department should report back to the President without delay not only with this assessment, but also with a plan to align these requirements as much as possible to help get mortgage credit flowing again. A top official within the Treasury Department or in the White House should be tasked with day-to-day responsibility for coordinating the implementation of this plan.

Over the longer term, the future of the primary and secondary mortgage markets is even more uncertain. Many proposals put forth to date have laid out detailed plans for reform, but have failed to consider the fundamental underlying question: “What kind of housing system do we want?” In the following section, we set forth a longer-term vision and structure for a redesigned system of housing finance in which the federal government remains an active participant, but the private sector plays a far greater role in bearing credit risk.

Taking Stock – Lessons Learned from the Housing Crisis

The recent crisis exposed major deficiencies in our system of housing finance. At the height of the bubble, excess liquidity overwhelmed the system as traditional underwriting standards were abandoned and mortgage credit became widely available to large numbers of borrowers who were ill-prepared to assume these obligations. In some instances, the obligations were not disclosed to borrowers in a fully transparent manner that would have allowed for an assessment of a mortgage's true cost.

At the same time, private lenders substantially underpriced the risk of mortgage credit, while government regulators failed to keep pace with and adequately monitor new private-sector lending, securitization, and hedging practices. This regulatory failure extended to the operations of Fannie Mae and Freddie Mac, the two giant institutions now under government conservatorship. Both institutions also significantly underpriced mortgage credit risk and used the implied guarantee of government support to increase their leverage to unsustainable levels.

As we design a housing finance system for the future, we should be mindful of the lessons learned over the past decade. These lessons include:

Prudent mortgage loan underwriting is the foundation of a sound system of housing finance. Prudent underwriting is the single most effective way to mitigate risk in the system, while ensuring that mortgage credit flows easily to those who can afford it. In making decisions to extend credit, lenders should assess a borrower's ability to repay a mortgage loan based on such traditional factors as income, assets, current debt, and credit history. The interests of lenders, borrowers, and investors should be aligned to assure that all parties are at risk when underwriting is not based on prudent factors. But while underwriting standards became too lax in the years leading up to the foreclosure crisis, the pendulum has now swung too far in the opposite direction. Returning to the underwriting standards that prevailed in the marketplace before the housing bubble started, and then maintaining those careful but reasonable standards, would help restore balance to the system.

See Chart 3-5 for an illustration of the relatively low default rate over time for loans originated in 2000.

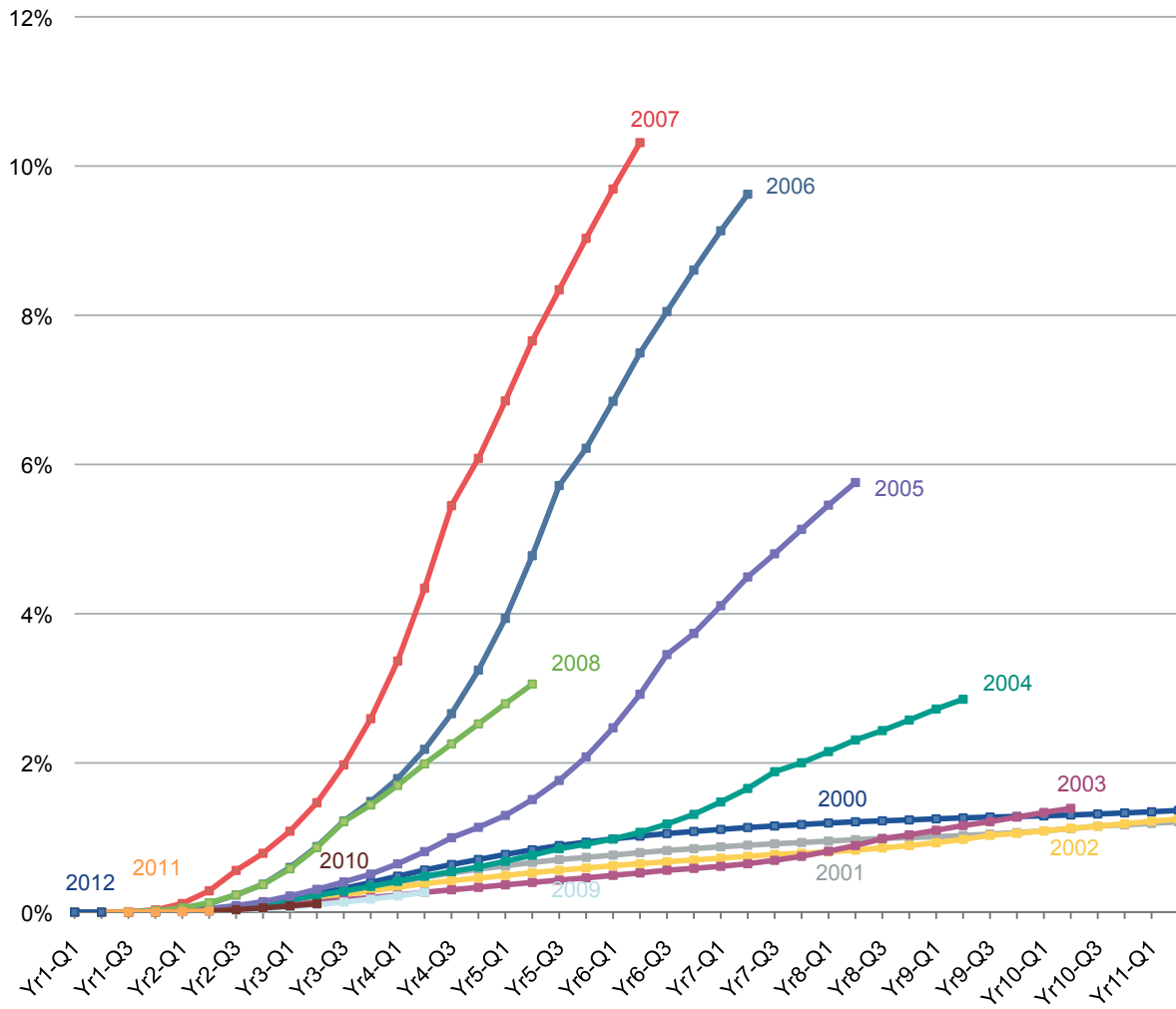
Home purchase education and counseling must become a central component of the mortgage process. As the housing bubble expanded, too many families believed they were entering into affordable mortgages when, in fact, these mortgages were unsustainable by any reasonable measure. Financial education and counseling, particularly for first-time homebuyers, may have helped some of these families avoid this mistake.

Government oversight of the housing finance system is essential to ensuring continued stability in the housing market. In the years leading up to the housing crisis, some private lenders made the system less stable by transferring risk to borrowers through mortgage products with shorter durations, adjustable rates, higher costs, and less-than-transparent terms. To prevent a recurrence of this behavior, the government has an important role to play in monitoring developments in the market on a real-time basis; ensuring transparency; establishing clear rules of the road, so lenders understand the standards they need to meet and the penalties for failing to do so; and protecting consumers, investors, and the market's ongoing stability.

Any government support for the housing finance system should be explicit and appropriately priced to reflect actual risk. Looking ahead, the government's support for the housing finance system—whether through insurance at the loan level or guarantees in the secondary market for mortgage-backed securities—should be designed with taxpayer protection as a critical goal.

Our housing finance system must be resilient enough to weather the inevitable periods when the housing market takes a downward turn. As the housing bubble expanded, many lenders, borrowers, and investors made the fatal error of convincing themselves that the market was heading in only one direction: up. Of course, this view ignored the cyclical nature of the housing market in which home prices have historically gone both up and down. A

Chart 3-5: Fannie Mae Cumulative Default Rates of Single-Family Loans by Origination Year



Note: Fannie Mae and Freddie Mac use different approaches to track loan performance: Freddie Mac calculates the cumulative rate of loans from a given book year that have proceeded to foreclosure, transfer, or short sale and resulted in a credit loss; whereas Fannie Mae includes in its cumulative default rates loans that have been liquidated through channels other than voluntary pay-off or repurchase by lenders, including foreclosures, pre-foreclosure sales, sales to third parties, and deeds in lieu of foreclosure. Despite these differences in methodology, performance data by book year is similar across both entities, with loans originated in 2000 and acquired by Fannie Mae having a 1.36 percent cumulative default rate, compared with a 1.10 percent foreclosure transfer and short-sale rate at Freddie Mac.

Source: Fannie Mae

redesigned system of housing finance must contain safeguards that will allow the market to remain stable and continue as a source of mortgage liquidity, even when these counter-cyclical periods occur.

A redesigned housing finance system should also adhere to sound principles of regulation. See *Text Box, Developing Sound Principles of Regulation*, page 53.

Recommendations for the Single-Family Housing Finance System

The current structure of the single-family housing finance system was largely patched together to keep mortgage credit flowing during the crisis. Almost all of the credit risk in the system is currently borne by the federal government, and a large portion of this government support is delivered through the conservatorship of Fannie Mae and Freddie Mac. Dynamic and flexible reform is needed, over a multiyear period, with a smooth transition to this new system in which private capital takes on a larger share of the credit risk.

The increase in the role for private capital would be accomplished in two ways. First, a gradual reduction of the loan limits for government-guaranteed mortgages would help to rebalance the distribution of mortgages held in the purely private market and those covered by a government guarantee. Ultimately, we anticipate that fewer loans will be eligible for a government guarantee. Second, the commission's recommendations call for the elimination of the Fannie Mae and Freddie Mac model over an appropriate phase-out period—replacing them with a new government entity, the “Public Guarantor,” which would provide a limited and explicit government guarantee for catastrophic risk for certain mortgage-backed securities. Adequately capitalized private credit enhancers would bear all losses ahead of the government guarantee.

Similar to the model currently employed by Ginnie Mae, lenders approved by the Public Guarantor would issue mortgage-backed securities that would be placed into designated monthly pools for which the Public Guarantor would provide a common framework, or shelf.⁷⁴ Private issuers would decide whether to retain or sell off the servicing rights associated with loans backing the MBS and choose how to cover the credit risk, including through arrangements with well-capitalized private credit-enhancing

institutions. As noted above, private credit enhancers of MBS would bear the predominant loss risk in the event of a market downturn, while the Public Guarantor would provide a wrap for the timely payment of principal and interest by the servicers of the MBS (similar to the wrap presently provided by Ginnie Mae) and bear the catastrophic risk in the event of borrower default and the failure of the private-sector credit-risk bearers. Servicers would look first to the private credit enhancers for reimbursement of advances on defaulted mortgages. Only upon failure of a private credit enhancer would the government guarantee be triggered.

The commission's proposed model includes a continued, but limited, role for the federal government to guarantee MBS to ensure mortgage market liquidity and stability, with a large role for private capital to assume credit risk and shield taxpayers from exposure to credit losses. The overall structure of the new model is intended to avoid the re-creation of a small number of entities viewed as “too big to fail” or as enjoying an “implied guarantee.” Our new model clearly delineates the respective roles of the government and the private sector, and establishes a clear expectation that private firms suffer the consequences of poor business decisions by losing their capital, with no bailout for private shareholders or bondholders. The government would cover losses from an account pre-funded by payments of a separate catastrophic guarantee fee, but only after private credit enhancers have exhausted their own capital and reserves. The Public Guarantor must play a strong role as regulator of the new system, including establishing sound prudential standards for private-sector entities and structures that are permitted to participate in this system as originators, servicers, or credit risk bearers.

The following sections provide more detail on the policy objectives underlying this proposal, outline the key functions for this new structure for single-family housing finance, illustrate how the various elements of the system work together, and discuss the importance of a dynamic flexible

transition and some type of countercyclical buffer. The goal is to create a redesigned housing finance system that will continue to support the opportunity for homeownership and access to mortgage credit for creditworthy borrowers in all communities across the country. These proposals for single-family housing finance, taken together, set forth the commission's primary recommendations related to continuing homeownership as an ongoing, viable choice for the nation's housing consumers.

Policy Objectives

In order to meet the nation's housing finance needs and to provide access to mortgage credit for qualified borrowers, the future system of single-family housing finance should have five primary policy objectives:

The elimination, phased out over an appropriate period of time, of Fannie Mae and Freddie Mac.

The model of a private company with publicly traded stock and an implicit government guarantee did not work. Fannie Mae and Freddie Mac should be phased out and replaced with a new Public Guarantor, described below.

A far greater role for the private sector.

The private sources of capital that are available today would continue in this new redesigned housing finance system. These sources of capital include a private secondary market for mortgages (private-label MBS without any government guarantee), jumbo loans originated and held in portfolio or sold by private lenders, adjustable-rate mortgages originated and held in portfolio by private lenders or sold into the secondary market, and other product offerings outside of the government guarantee. Competition among banks of all sizes and a regulatory environment that encourages community banks, credit unions, and smaller financial institutions to originate and hold loans and participate in the secondary market, are all essential elements in this system.

While lenders should be able to originate and hold adjustable-rate and fixed-rate mortgage loans in portfolio, backed by appropriate capital, a strong private secondary market is essential to an adequately liquid housing finance system. In recent years, the amount of outstanding mortgage debt has equaled or exceeded the total value of assets held by U.S. banks. Funds available through the banking system must be supplemented with additional sources of capital (e.g., securitization) to create the capacity to meet the demand for mortgage credit.

A continued but limited role for government-guaranteed MBS.

While private capital must play a greater role in the single-family housing finance system, including in the market currently dominated by government-guaranteed MBS, a government-guaranteed secondary market is essential to ensuring adequate liquidity. Even in 2006, when private-label securitization was at its peak, non-agency funds (many of which were backed by unsustainable mortgages) constituted only 56 percent of the market. Moreover, absent government involvement, the To-Be-Announced (TBA) market—which provides a forward commitment market for consumers, lenders, and investors—might be unable to function, and many of the benefits associated with the standardization of mortgage products would be lost. See *Text Box, The To-Be-Announced (TBA) Market*, page 52.

Moving forward, however, the government guarantee that wraps or covers MBS must be fully funded and its scope limited to protect taxpayers. Key characteristics of this new government guarantee include:

- *Applies only to catastrophic risk.* The government guarantee is triggered only after private-sector entities in the predominant loss position have fully exhausted their own equity capital to make timely payment to compensate MBS issuers for credit losses.

- *Is explicit and actuarially sound.* The government guarantee is fully funded and premium collections exceed expected claims (with a safe reserve cushion).
- *Applies only to mortgage-backed securities.* The government guarantee would not cover the equity or debt of the entities that issue or insure MBS.

The To-Be-Announced (TBA) Market

The TBA market was established in the 1970s with the creation of pass-through securities at Ginnie Mae. It facilitates the forward trading of MBS issued by Ginnie Mae, Fannie Mae, and Freddie Mac by creating parameters under which mortgage pools can be considered fungible. On the trade date, only six criteria are agreed upon for the security or securities that are to be delivered: issuer, maturity, coupon, face value, price, and the settlement date. Investors can commit to buy MBS in advance because they know the general parameters of the mortgage pool, allowing lenders to sell their loan production on a forward basis, hedge interest rate risk inherent in mortgage lending, and lock in rates for borrowers.

The TBA market is a benchmark for all mortgage markets—it is the reference by which other mortgage markets and products are priced. It is also the most liquid, and consequently the most important, secondary market for mortgage loans, enabling buyers and sellers to trade large blocks of securities in a short time period. The liquidity comes through homogeneity and fungibility, and through the government guarantee of Fannie Mae, Freddie Mac, and Ginnie Mae.

Access to safe and affordable mortgages for borrowers in all geographic markets through complete economic cycles, without discrimination, bias, or limitations not based on sound underwriting and risk management.

The housing finance system should be designed to support liquidity for a wide range of safe and sustainable mortgages to low- and moderate-income households without regard to race, color, national origin, religion, sex, familial status, or disability, consistent with sound underwriting and risk management. To help achieve this objective, all participants in the housing market should support and reaffirm the principles of the Fair Housing Act of 1968, as amended. *See Text Box, Principles for Access to Credit, page 66.*

A continued but more targeted role for the Federal Housing Administration (FHA).⁷⁵

The FHA has traditionally been an important provider of mortgage liquidity to first-time homebuyers and borrowers with limited savings for down payments. As we have seen over the past few years, it also plays a critical role in ensuring the continued flow of credit during periods of economic crisis. While its expansion was appropriate to keep credit flowing during the recent downturn, the role of the FHA in the single-family mortgage market should contract as the market recovers. Tools for achieving such contraction and returning FHA to its traditional role could include lower loan limits and increased insurance premiums.

These five policy objectives provide the framework for the more detailed recommendations that follow. However, before outlining the specific elements of our recommendations, the commission wishes to stress the importance of the broad policy objectives. Details are obviously very important, but we do not want to get lost in them. The first essential step to reforming our nation's housing finance system is achieving bipartisan consensus on the fundamental objectives we are trying to achieve. The commission recognizes there may be sound alternative approaches to achieving the same objectives.

Developing Sound Principles of Regulation

The following principles are fundamental to an appropriately regulated system of single-family housing finance.

All stages of the process should reinforce the obligation of the mortgage borrower to pay back the mortgage debt and the consequences of failing to do so, and the responsibility of lenders to underwrite loans based on the ability of the borrower to repay them. A fundamental principle of the residential mortgage finance system is that borrowers have a legal and moral obligation to repay the debt and that the lender has the right to take possession of its collateral if the loan is not repaid. The obligation to repay does not diminish when the value of the underlying collateral goes down.

Credit standards should be prudent and based on sound performance-based underwriting. This principle attempts to strike a balance between prudent underwriting and current market conditions in which many quality borrowers do not have access to affordable mortgage credit. Household formation in the next decade will be dominated by households whose members are more likely to be racial or ethnic minorities, have lower income, lack family wealth for down payments, and have less family experience with homeownership. The mortgage system needs to assess credit risk with appropriate attention to compensating risk factors, historical performance of standard loans, and a greater understanding of nontraditional employment, credit, and family structures and experiences that are likely to be more prevalent with the rising population of new households. With appropriate disclosure, lenders should be able to use risk-based pricing to serve borrowers who have a blemished credit record in some areas and otherwise might not qualify for a loan.

National standards for mortgage origination and servicing for all mortgage assets intended for securitization are essential. Since mortgage-backed securities are sold into and traded in national markets, the assets that make up those securities should be subject to rigorous national standards.

All participants in the housing finance system should have a financial stake in the performance of mortgages and/or mortgage-backed securities for an appropriate period of time. All participants in the mortgage process (from sales to origination to servicing to securitization) share a financial stake in the loan and its performance.

Lenders, investors, and regulators should have access to sufficient mortgage data in order to assess and price risk, and mortgage consumers should be provided with clear disclosures and certainty in mortgage terms. Disclosure alone will not fully protect consumers from abuses. The average mortgage consumer can sometimes be overwhelmed with information and disclosures, often at the last stage of seeking a loan, which can impede a proper understanding of mortgage terms. In addition, in some cases, the availability of only a limited number of mortgage variables at the outset of a trade can actually serve to enhance liquidity without significantly detracting from investors' ability to understand and price risk. Despite these qualifications, access to data on the pricing, sales, and ownership of securities and transparency in markets is critical to sound oversight and public accountability.

Key Functions

In this redesigned system of single-family housing finance, at least four key functions must be performed after the origination of a mortgage. These functions are (1) securitization; (2) servicing; (3) credit enhancement; and (4) government guarantee for catastrophic risk.

1. Securitization. The process of securitization requires some entity or entities to issue the mortgage-backed securities. The issuers of securities can either be the lenders who originate the loans or other private institutions that buy loans from lenders and issue securities backed by these loans.

2. Servicing. The mortgage servicer is the company to which the borrower sends the mortgage payment. Besides collecting mortgage payments from borrowers and making the timely payment of principal and interest to MBS investors, the servicer is responsible for working with the borrower in case of a delinquency or default, negotiating the workouts or modifications of mortgages, and conducting or supervising the foreclosure process when necessary.

3. Credit enhancement. One of the most important elements of any new system is to ensure that private capital takes the predominant loss credit risk, and truly stands ahead of a government guarantee, and to carefully design and

set capital and other requirements so that private entities are equipped to withstand even a severe downturn in the housing market through the use of private credit enhancers.⁷⁶ Private credit enhancers either carry risk on their balance sheets, with appropriate offsetting capital, or transfer the risk to capital market participants. Credit-enhancement options include well-capitalized mortgage insurance, capital market mechanisms where the appropriate amount of capital required to withstand severe losses is reserved up front, or a premium-funded reserve model, where a premium-funded reserve is established.

4. Government guarantee for catastrophic risk. A government guarantee for catastrophic credit risk would cover the timely payment of principal and interest on certain MBS only in the event that the private sector credit enhancer can no longer fund its obligation to reimburse the MBS servicer for credit losses on the pool of mortgage loans underlying the MBS. As noted above, such a guarantee would be explicit and paid for by premiums based on sound actuarial analysis. The guarantee would apply only to the MBS and would not apply to the equity or debt of the private institutions that issue them or to any insurers of the loans or credit enhancers. Further, a new or existing public entity would be established to maintain the standards for the limited government guarantee and to collect the premiums for a guarantee reserve fund.

In this redesigned system, a single entity could fulfill more than one of these functions: For example, an issuer of securities could choose to retain servicing rights for the loans backing the MBS. However, in order to obtain “sale treatment” for accounting purposes (discussed below), issuers would not provide credit enhancement. Instead, they would engage separate, well-capitalized private institutions to take responsibility for the predominant credit risk associated with the loans that collateralize the MBS.

Securitization—Approved Issuers

As noted above, the commission recommends a model similar to Ginnie Mae, where approved lenders are the issuers of mortgage-backed securities. The functions of an issuer of securities include:

- *Obtain certification from the Public Guarantor* that it is qualified to issue MBS based on such factors as (a) ability to meet credit and capital standards and cover all of the predominant loss risk through a separate well-capitalized credit enhancer, and (b) capacity to effectively pool mortgages and compete in the housing market.
- *Ensure that the guarantee fee is paid for* and collected from the borrower along with all other fees (e.g., the cost of predominant loss risk protection) and fully disclosed to the borrower as a part of originating the mortgage.
- *Issue the mortgage-backed securities* and, where appropriate, sell the MBS to investors through the TBA market. (The originator of the mortgage can either be the issuer, if approved, or can sell the mortgage to another approved issuer. The originator can also keep the servicing rights, if approved for this function by the Public Guarantor, or sell the servicing rights to another approved institution.)
- *Retain responsibility for representations and warranties* under the terms specified by the Public Guarantor.

In order to achieve “sale treatment,” so the MBS will not be reported in the issuer’s financial statements, the issuer must engage a third-party private credit enhancer. (In the context of a securitization transaction, “sale treatment” is an accounting term used to indicate that the seller of the now-securitized loans no longer reports the loans on its balance sheet.) This determination will require a judgment by the accounting profession that the expected loss in normal economic cycles has been transferred to the private credit enhancer and the Public Guarantor, these counterparties

have the capacity to handle the credit risk, and the issuer and servicer of the security will not be required to set aside capital to cover such risk.

Under the commission's proposal, an approved issuer of MBS (generally the originator of the mortgage loan) should be able to "de-recognize" transferred loans from its balance sheet — that is, achieve sale accounting under U.S. generally accepted accounting principles. In addition, servicers operating as they do today should not have any duty to "consolidate" the loans that they service and the private credit enhancers should be able to manage any consolidation requirement without any detriment to the economics of the structure.

Servicing

Servicers will need to be qualified by the Public Guarantor. Responsibilities of a servicer include:

- *Make timely payment of principal and interest* should the borrower be unable to do so. The servicer will advance the timely payment of principal and interest out of its own corporate funds and will be reimbursed by the private credit enhancer at the time the amount of the loan loss is established.⁷⁷
- *Work with the borrower* on issues related to delinquency, default, and foreclosure and advance all funds required to properly service the loan.

If the original issuer sells the servicing rights to another institution, all obligations move with the servicing to the new servicer, except the obligation for representations and warranties. In the event that a servicer fails, its servicing obligations will be transferred to a new servicer by the Public Guarantor. Losses due to default will continue to be covered by the private credit enhancer.

Credit Enhancement

The proposed single-family housing finance system depends on credible assurance that private institutions will bear the predominant credit risk, will be capitalized to withstand significant losses, and will provide credit that is generally unrestricted with little leverage. As such, private credit enhancers will bear the credit risk on the MBS they have guaranteed until they go out of business or have met their full obligation, as defined by the Public Guarantor, to stand behind their guarantee. Private credit enhancers will generally be single-business, monoline companies and will be required to:

- *Provide regular reports to the Public Guarantor* on the nature of the credit enhancement, who holds the risk, the amount and nature of the capital they hold, and other measures of credit strength. These measures would include a quarterly stress test to determine that available capital is adequate, with a "capital call" to assure there are sufficient reserves to protect the government guarantee from being tapped except in extreme cases.
- *Establish underwriting criteria* for the mortgages and mortgage pools they will be guaranteeing beyond the baseline underwriting criteria established by the Public Guarantor.
- *Reimburse servicers for their timely payment of principal and interest and other costs* at the time the amount of the loan loss is established. This reimbursement is paid out on a loan-by-loan basis until the private credit enhancer runs out of capital and goes out of business.
- *Establish and enforce servicing standards* (in conjunction with national servicing standards) in order to assure that the interests of the private credit enhancer and servicer are fully aligned. If these contractual standards are violated, the private credit enhancer will have the power to transfer servicing to another servicer.

- *Provide credit enhancement with standard, transparent, and consistent pricing to issuers of all types and sizes*, including community banks, independent mortgage bankers, housing finance agencies, credit unions, and community development financial institutions.
- *Meet credit enhancement requirements* through one or a combination of the following options: (1) well-capitalized private mortgage insurance at the loan level for any portion of the loan where specific capital requirements are established and the servicer and/or Public Guarantor has the ability to demand margins if there is an adverse move in house prices; (2) capital market mechanisms where the amount of capital required to withstand severe losses is reserved up front, either through a senior/subordinated debt model with the subordinated piece sized to cover the predominant risk or approved derivatives models using either margined Credit Default Swaps or fully funded Credit Linked Notes;^a and (3) an approved premium-funded reserve model, where a premium-funded reserve is established, either fully capitalized at the outset or where the reserve builds over time. In all cases, the Public Guarantor will carefully monitor capital requirements to avoid arbitrage, ensure that real capital is set aside up-front, and maintain the alignment of interests among all participants (issuers, servicers, and private credit enhancers) with the new limited government guarantee.

These approaches to meet capital requirements are designed to ensure that private capital will stand ahead of any government guarantee for catastrophic risk.⁷⁸ The

essential question will be where to draw the line between predominant loss and catastrophic loss—often referred to as the attachment point. The Public Guarantor will determine this attachment point and establish the minimum capital levels required to survive a major drop in house values resulting in significant mortgage losses. The Public Guarantor will require any private credit enhancer to have sufficient capital to survive a stress test no less severe than the recent downturn (e.g., a home price decline of 30 to 35 percent, which would correspond to aggregate credit losses of 4 to 5 percent on prime loans).

Government Guarantee for Catastrophic Risk

Under this proposal, the Public Guarantor would guarantee the timely payment of principal and interest on the MBS, but this guarantee would be triggered only after all private capital has been expended. Like Ginnie Mae, the government would be in the fourth loss position behind (1) borrowers and their home equity; (2) private credit enhancers; and (3) corporate resources of the issuers and servicers.^b The government guarantee would be explicit, fully funded, and actuarially sound, and the risk would apply only to the securities and not to the equity and debt of the entity or entities that issue and/or insure them. The functions of the Public Guarantor would include:

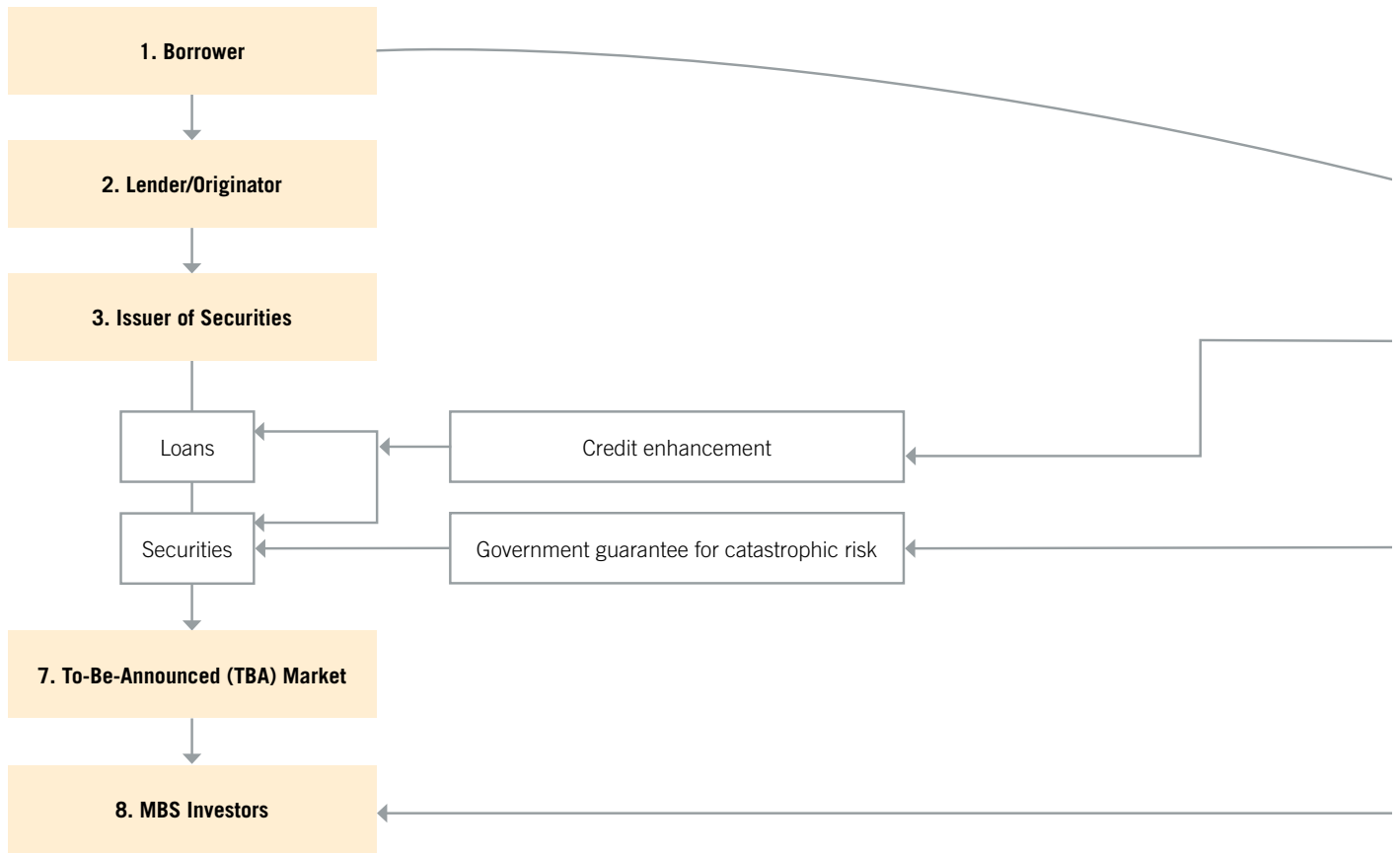
- *Guarantee investors the timely payment* of principal and interest on MBS.
- *Establish the level of capital* necessary to ensure that private-sector participants in the housing finance system (issuers, servicers, and private credit enhancers) are all properly capitalized.

a. A “credit default swap” is a transaction designed to transfer the credit exposure of fixed income products between parties. In a credit default swap, the purchaser of the swap makes payments to the seller up until the maturity date of a contract. In return, the seller agrees to pay off a third party debt if this party defaults on the loan. In this way, the purchaser of the swap receives credit protection, while the seller guarantees the creditworthiness of the debt. A “credit linked note” is a security with an embedded credit default swap that allows the issuer of the security to transfer a specific credit risk to investors. Source: Investopedia.

b. To be clear, the issuer and the servicer do not bear direct credit risk. That risk is borne by the private credit enhancer. However, the issuer and the servicer do bear other risks that help to shield the government from loss. The issuer is responsible for representations and warranties, and the servicer is responsible for the timely payment of principal and interest to investors out of corporate resources (as is currently the case with Ginnie Mae), although the servicer should eventually be reimbursed for this payment by the private credit enhancer.

-
- *Provide one common shelf* for the sale of government-guaranteed securities to offer greater liquidity for the market as well as establish an equal playing field for large and small lenders.
 - *Establish a single platform* for the issuing, trading, and tracking of MBS. With multiple private issuers, this platform could provide greater uniformity and transparency, and therefore lead to greater liquidity. For example, in October 2012, the FHFA laid out a plan to build a single securitization platform to serve Fannie Mae, Freddie Mac, and a post-conservatorship market with multiple issuers. This single platform could serve as the securitization framework for the Public Guarantor and operate as a public utility, providing an established infrastructure for MBS guaranteed by the Public Guarantor or for private issuers of MBS. Development of this platform could build on the extensive intellectual and technological assets of Fannie Mae and Freddie Mac as they are phased out, providing taxpayers with a long-lasting dividend on the significant funds invested to support the GSEs' obligations after 2008.
 - *Create and enforce uniform pooling and servicing standards governing the distribution of mortgage proceeds and losses to investors and ensuring compliance with relevant federal tax laws.* The Public Guarantor could build on the work already begun by FHFA to develop a model pooling and servicing agreement.
 - *Encourage loan modifications when a modification is expected to result in the lowest claims payment on a net present value basis.* The Public Guarantor should require participants in the new government-guaranteed system to structure and service securities in a way that would facilitate such loan modifications.
 - *Establish the guarantee fees (g-fees)* to be collected from the borrower to cover the operating costs of the Public Guarantor and to offset catastrophic losses in the event of a failure of the private credit enhancer and/or servicer failure. A reserve fund would be established for catastrophic risk that will build over time. (Other fees paid by the borrower would go to the issuer and the private credit enhancers to compensate them for issuing the securities and covering the predominant loss. These fees would be set by the private sector, but monitored by the Public Guarantor.)
 - *Ensure access to the government-guaranteed secondary market on full and equal terms* to lenders of all types, including community banks, independent mortgage bankers, housing finance agencies, credit unions, and community development financial institutions. The Public Guarantor must ensure that issuers of securities do not create barriers using differential guarantee-fee pricing or other means to unfairly restrict or disadvantage participation in the government-guaranteed secondary market.
 - *Ensure the actuarial soundness of the fund* through careful analysis and the use of outside expertise, and report to Congress regularly regarding the financial condition of the fund.
 - *Qualify private institutions* to serve as issuers of securities, servicers, and private credit enhancers of MBS. The Public Guarantor will have the power to transfer servicing or credit enhancement to another servicer or credit enhancer (without compensation to the original servicer or credit enhancer) if it appears the government guarantee is put at risk. The Public Guarantor will also have the power to disqualify an issuer, servicer, or a private credit enhancer if it determines that requirements and standards are not met. (Although the Public Guarantor does not stand behind these private institutions nor does it cover their debt or equity, it would have resolution authority.) Ensuring the common alignment of incentives among all private entities serving as counterparties to the Public Guarantor will be essential to protecting taxpayers.

Figure 3-2: Flow of Mortgages



- *Establish loan limits, under the direction of Congress, so that the loans backing the government-guaranteed MBS will be limited based on the size of the mortgage and any other criteria Congress may prescribe.*
- *Set standards for the mortgages that will be included in the MBS, including baseline underwriting criteria, permissible uses of risk-based pricing, and clear rules of the road related to representations and warranties.*
- *Specify standards for mortgage data and disclosures.*

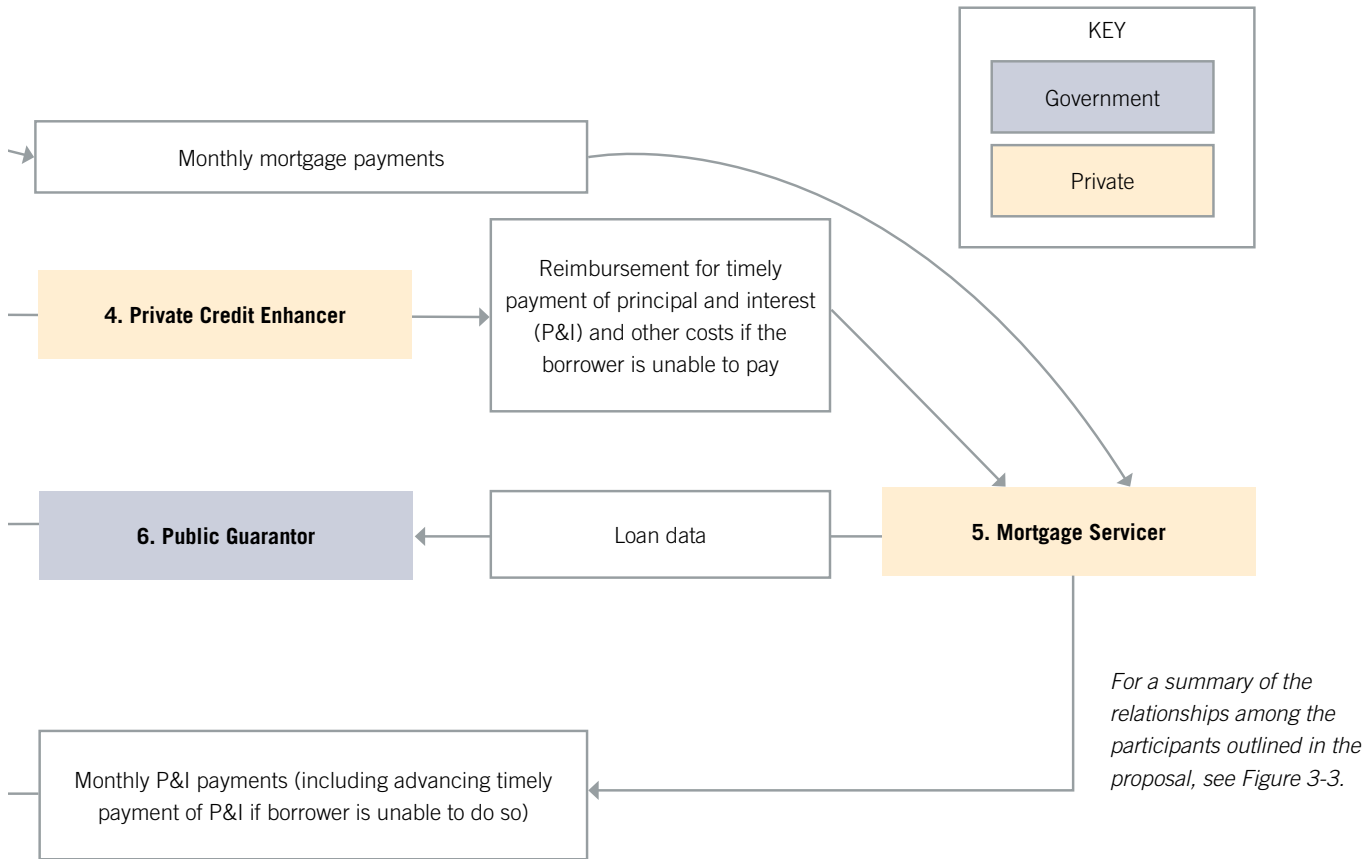
How Will This New System Work?

A number of parties and institutions will be involved in this new housing finance system. They include (1) borrowers; (2) lenders/originators; (3) issuers of securities; (4) private credit enhancers; (5) mortgage servicers; (6) a Public Guarantor; (7) the TBA market; and (8) MBS investors. Figure 3-2 provides a schematic of the proposal showing the flow of mortgages from the borrower to the investor. The

steps involved in the process are outlined below with the text matching the numbers found on Figure 3-2.

1. Borrower. The borrowers—Mr. and Mrs. Jones—are buying a new house and need a mortgage. They approach a local financial institution, XYZ Savings Bank.

2. Lender/Originator. XYZ Savings Bank meets with Mr. and Mrs. Jones (by phone or in person). After a preliminary discussion where they provide basic information, authorize a credit check, and discuss and decide on the terms of the mortgage, the loan officer provides them with a conditional approval and locks in a mortgage rate for a specific period of time. (The lender locks in the rate through the TBA market where an investor will provide them a forward commitment to purchase the mortgage as a part of an MBS.) XYZ Savings Bank then continues with the borrower to underwrite the mortgage, taking into consideration the standards established by the private credit enhancer and



the Public Guarantor. The XYZ Savings Bank funds the loan and puts it on its balance sheet temporarily. In connection with the loan's securitization. The bank will "de-recognize" the loan (remove it from its balance sheet). (XYZ Savings Bank could choose to sell the servicing rights to another lender.)

3. Issuer of Securities. XYZ Savings Bank has been approved by the Public Guarantor to be an issuer of securities. XYZ Savings Bank prepares the loan to be part of a security and eventually pools the loan with other loans and issues the MBS, selling it to an investor through the TBA market. (If it had not been approved as an issuer, XYZ Savings Bank would have needed to sell the loan to an approved issuer who would then pool Mr. and Mrs. Jones' loan with other mortgage loans.) The issuer is compensated for issuing and selling the security.

4. Private Credit Enhancer. Before the loan is approved and closed, XYZ Savings Bank (as the issuer) must line up

a private credit enhancer to cover the predominant loss credit risk—in this case, with ABC Private Credit Enhancer. The Public Guarantor has approved ABC Private Credit Enhancer based on its experience and ability to meet specific capital requirements and other credit standards. ABC Private Credit Enhancer can provide for the credit enhancement in a variety of ways. Multiple parties could also provide the credit enhancement as arranged by the issuer and approved by the Public Guarantor. The private credit enhancer will receive an ongoing fee for providing this enhancement.

5. Mortgage Servicer. The lender/originator can either keep or sell the servicing. In this case, XYZ Savings Bank decides to sell the servicing of Mr. and Mrs. Jones' loan to SERV Servicing, which has already been approved by the Public Guarantor. When SERV Servicing purchases the servicing from XYZ Savings Bank, it assumes all of the obligations of XYZ Savings Bank (with the exception of the representations and warranties under the loans in the MBS pool). As the

servicer, SERV Servicing will work with Mr. and Mrs. Jones to assure the timely payment of principal and interest. As long as SERV Servicing stays in business, it will be responsible for working with Mr. and Mrs. Jones on issues related to delinquency, default, and foreclosure. In the event of a delinquency or default, it will make the timely payments of principal and interest and then look to ABC Private Credit Enhancer for reimbursement.

6. Public Guarantor. The Public Guarantor provides one shelf for all securities and issuers of securities, oversees the process as the regulator, and qualifies the issuer, the servicer, and the private credit enhancer. It has established

a fund to guarantee catastrophic risk and sets and collects premiums for the fund—in this case, premiums are collected each month through SERV Servicing. It also ensures that the fund is actuarially sound.

7. To-Be-Announced (TBA) Market. The loan to Mr. and Mrs. Jones is delivered as a part of a security issued by the XYZ Savings Bank to an investor—in this case, The Invest Co.—utilizing the protocol outlined in the TBA market and agreed to by the savings bank and the investor.

8. MBS Investors. The Invest Co. secures delivery of the MBS issued by XYZ Savings Bank, protected at three levels—the commitment of the servicer to provide timely

Figure 3-3: Summary of Relationships Among Housing Finance System Participants

	LENDERS/ ORIGINATORS	MORTGAGE SERVICERS	ISSUERS OF SECURITIES	PRIVATE CREDIT ENHANCERS
FUNCTION(S)	Originate mortgages (includes mortgage bankers, large and small banks, credit unions, and other financial institutions)	Collect mortgage payments from borrower Bear the servicing risk and provide timely payment of principal and interest if borrower is unable to do so Look to private credit enhancer to reimburse those timely payments of principal and interest and other costs at the time of claims submission Work with borrower on issues related to delinquency, default, and foreclosure	Originate mortgages or purchase mortgages from other lenders Issue securities backed by these mortgages Secure private credit enhancement as appropriate and obtain sale treatment	Bear predominant loss credit risk that applies at the loan level or the pool level (and therefore must be well capitalized) Reimburse servicer for the timely payment of principal and interest and other costs if borrower is unable to pay Transfer servicing, when needed, to another servicer with the coordination and approval of the Public Guarantor
PUBLIC/ PRIVATE SECTOR (GOVERNMENT ROLE)	Private sector	Private sector	Private sector	Private sector
FINANCIAL IMPLICATIONS	The originator will include all fees in the cost of the mortgage (including the g-fee to cover servicing risk and credit risk, as well as the fees to the private issuers and credit enhancers to cover their costs)	The servicer receives fees for servicing the loan and bearing the servicing risk	The private issuer is compensated for issuing and selling the security	The private credit enhancers will receive fees for bearing the predominant loss credit risk

payment of principal and interest, the private-sector guarantee provided by the ABC Private Credit Enhancer, and the guarantee for catastrophic risk provided by the Public Guarantor. Although The Invest Co. appreciates and benefits from the guarantee provided by ABC Private Credit Enhancer, its willingness to buy the MBS is largely based on the government wrap and the liquidity that comes from the large volume of standardized securities (including the Jones' loan) that are issued on the single MBS platform managed by the Public Guarantor.

PUBLIC GUARANTOR (GUARANTEE FOR CATASTROPHIC RISK)

Guarantee catastrophic risk and establish an insurance fund

Assure the actuarial soundness of the fund

Establish and approve the guarantee fees (g-fees) to be collected

Supervise and approve issuers of securities and private credit enhancers to assure they have the capacity to bear the predominant loss credit risk

Qualify servicers

Transfer servicing to another servicer or credit enhancement to another private credit enhancer, without compensation, if it believes the government guarantee is put at risk

Public sector (new government entity or enhanced Ginnie Mae)

According to some estimates, the total costs of all the fees (g-fee and fees to the lenders, issuers, and private credit enhancers) could add in the range of 60 to 80 basis points to the cost of a mortgage

Mortgage Rates in the New System

While the new housing finance system described above will minimize taxpayer risk, this protection will come at the cost of higher mortgage rates for borrowers. Three factors will contribute to the added costs:

1. The new housing finance system calls for a far greater role for the private sector in mortgage finance, with private capital taking the predominant loss risk and standing ahead of a limited government guarantee. Private credit enhancers will charge a fee to cover the cost of private capital to insure against the predominant loss if a mortgage default occurs.
2. The Public Guarantor will charge an unsubsidized fee to cover catastrophic risk should a private credit enhancer be unable to fulfill its obligations to investors.
3. The Public Guarantor will be structured as an independent, self-supporting government corporation that finances its activities through an operating fee.

The borrower will indirectly pay for all three of these activities through a g-fee that is included in the mortgage rate.

Analysis by Andrew Davidson & Co., Inc. using two research methods and a pool of nearly 5,000 conforming loans originated in 2012 (which has a broader cross section of loans than the universe of Freddie Mac and Fannie Mae loans as a whole) provides a range of estimates of the possible costs of the commission's recommendations.^c Utilizing this pool of loans, Davidson & Co. estimates the g-fees paid by a borrower with no mortgage insurance (MI) will range from 59 to 81 basis points. This includes (1) the credit charges for the private sector to set aside capital to

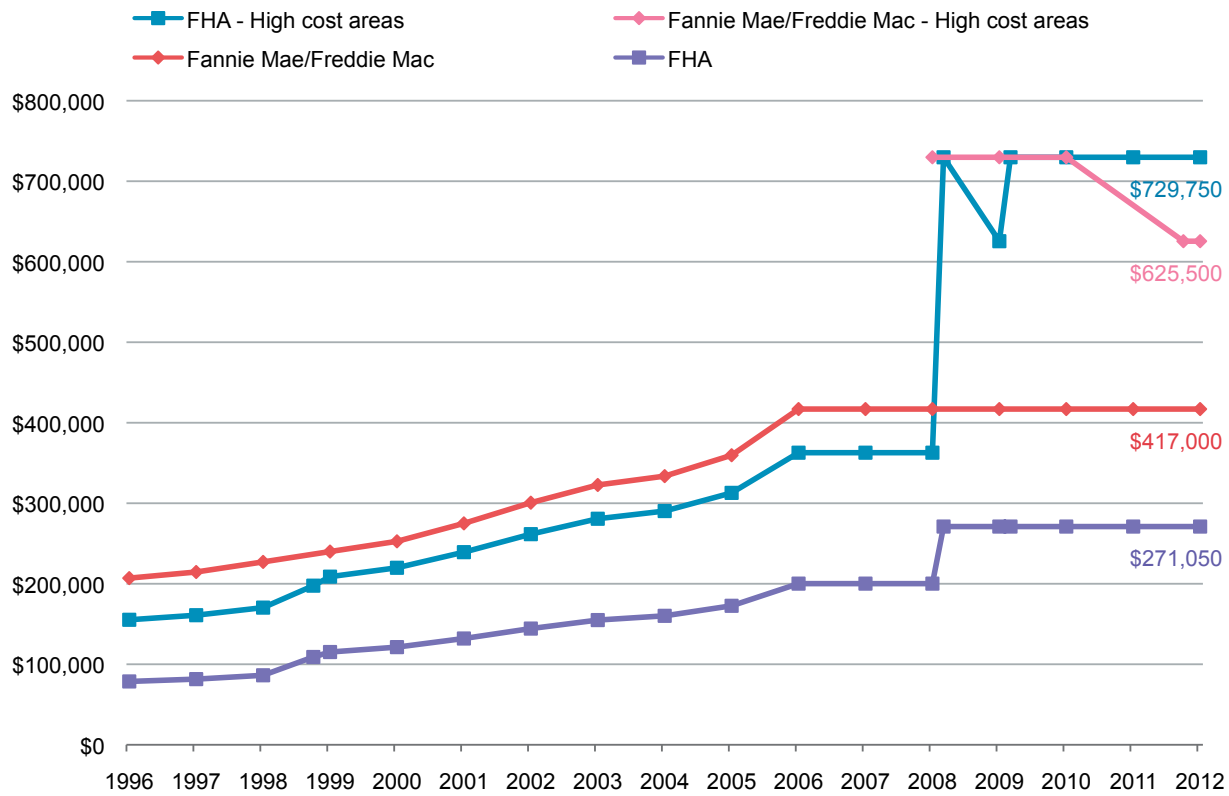
cover possible losses and a risk adjusted return—assuming no MI—estimated to be in the range of 45 to 67 basis points; (2) 8 basis points set aside for catastrophic risk to cover the limited government guarantee; and (3) 6 basis points to pay for the operating costs of the Public Guarantor.

By comparison, g-fees for mortgages currently guaranteed by Fannie Mae and Freddie Mac are in the range of 50 basis points (including a 10 basis point charge paid to the U.S. Treasury to pay for the payroll tax deduction), and the borrower has to pay for MI if the loan-to-value (LTV) ratio is above 80 percent. Given the very high quality mortgages currently served by the GSEs, the range of estimates in the Davidson & Co. study suggests—even accounting for the MI expenses—that the current g-fee may not need to rise for these high quality loans. However, the study does suggest that mortgage rates may need to increase by approximately 25 basis points if credit is extended to a wider group of borrowers than currently served by the GSEs (which now have average FICO scores of 760 and LTV ratios of 68 percent). Depending on market conditions and the credit quality of the mortgage pool, g-fees could be higher or lower. Also, increases in g-fees could be partially (or fully) offset by the fact that these MBS would have an explicit full faith and credit guarantee. This analysis is consistent with reviews conducted by others, including the Federal Housing Finance Agency, which have suggested that housing finance reform will entail higher mortgage rates.

These estimates assume a relatively stable housing market with modest growth in house prices as their base case. However, during weak economic periods of falling home prices or greater market uncertainty, the market price for credit guarantees would be higher. In addition, the modeling work found that while the g-fees for the private sector to set aside capital to cover predominant loss across the entire sample pool, including the higher-risk segments, appear to be relatively moderate, these estimates mask considerable variation across borrowers, depending on

c. Andrew Davidson & Co., Inc., has prepared a working paper on this topic that provides the details of their analysis. See *Modeling the Impact of Housing Finance Reform on Mortgage Rates* found on the BPC Housing Commission website at www.bipartisanpolicy.org/housing.

Chart 3-6: FHA and Fannie Mae/Freddie Mac Loan Limits



Sources: U.S. Department of Housing and Urban Development Mortgage Letters on Federal Housing Administration maximum loan limits, 1996 to 2012; Fannie Mae, "Historical Conventional Loan Limits," December 31, 2011.

risk characteristics such as FICO scores and LTV ratios. For example, Davidson & Co. found that the credit cost for borrowers with FICO scores greater than 750 and LTV ratios below 80 percent could be less than 25 basis points a year, while the credit costs for borrowers with FICO scores below 700 and LTV ratios greater than 90 percent could be more than 10 times higher.

Transition

A dynamic, flexible transition is essential to the development of a redesigned system for single-family housing finance. The intent of the transition, especially at the outset, is to move toward a general policy direction rather than an absolute goal. After Congress has adopted a new model, an extended period of time (five to ten years) will be needed to unwind the single-family operations of Fannie Mae and Freddie Mac in an orderly fashion and rebalance capital flows as the private sector steps in and the government

footprint becomes smaller. A dynamic problem-solving approach, where the design of a new housing finance system is based on lessons learned during the transition, will ensure that policy choices evolve in response to the changing realities of the marketplace.

The transition to the new system could be greatly facilitated by continued utilization of existing capabilities (e.g., process, skilled staffing) within Fannie Mae and Freddie Mac. These scalable, proven platforms for securitization have been developed over many years, and the familiarity and systems connectivity of mortgage market participants to these systems and processes might facilitate an orderly transition to the new system. In addition, the TBA market (the most liquid fixed-income market in the world) should be maintained in a new system to ensure a smooth transition and retain liquidity.

During this transition period, several mechanisms, or policy dials, could be applied to help reduce the size of government involvement in the single-family mortgage market. A gradual reduction in the maximum loan limits for Fannie Mae, Freddie Mac, FHA, and VA mortgages should serve as the primary policy dial to assist in this transition and will provide an indication of the private market's appetite for unsupported mortgage credit risk and valuable feedback on the development of the new system. A gradual approach will minimize market disruptions and safeguard against the sudden potential loss of access to mortgage credit. Chart 3-6 outlines the evolution of these loan limits since 1996.

Other policy dials have also been set in motion. The FHFA has recently increased the g-fees charged by Fannie Mae and Freddie Mac, in order to help move the government pricing structure closer to the level one might expect if mortgage credit risk were borne solely by private capital, making the private market more competitive. Changes to the terms of Treasury's treatment of Fannie Mae and Freddie Mac announced in August 2012 accelerate the reduction in their portfolios, from the 10 percent annual reduction called for in the Senior Preferred Stock Agreements between the FHFA and Treasury to 15 percent annually. In addition, FHFA has announced its intention to begin experimenting with single-family MBS structures to allow a portion of the credit risk currently held by Fannie Mae and Freddie Mac to be sold to the private sector.⁷⁹ Although only first steps, experimentation along these lines will enable greater private-sector involvement and set the stage for the transition to the new system.

Another major action that would encourage a greater role for the private sector in the housing finance system would be clarifying the rules of the road going forward. Despite the promulgation of CFPB's final rules on Qualified Mortgages and mortgage servicing, regulatory uncertainty continues to hold back private-sector involvement. The pending rule

regarding Qualified Residential Mortgages (QRM), along with other outstanding questions related to the Dodd-Frank legislation, must be resolved for the private sector to return to the mortgage market in a more robust manner.

Subject to lessons learned during the transition period, the commission expects that the single-family housing finance system of the future will have three distinct segments:

1. Mortgages that are not covered by any government guarantee (including loans held in portfolio and private-label MBS) would comprise a substantial share of the overall market.
2. The market share of mortgages insured or guaranteed by FHA, VA, and USDA would return to pre-crisis levels.
3. Mortgages covered by the new, limited government guarantee provided by the Public Guarantor would make up the balance.

As noted above, gradually reducing maximum loan limits would be the primary policy dial to help achieve this eventual distribution. After a suitable transition period, the commission recommends that the loan limits for the two government-guaranteed markets be established for each metropolitan area using a formula that takes into account the median house price in that area. Future policy choices by the administration and Congress will determine the actual loan limits, but looking at historical loan limits before the crash, for many areas these loan limits might be in the range of \$150,000 to \$175,000 for the share of the market served by FHA, VA, and the USDA, and in the range of \$250,000 to \$275,000 for the share of the market served by the Public Guarantor (see Chart 3-6).

Countercyclical Buffer

During severe economic downturns, the limited government guarantee for catastrophic risk should help provide for the continued availability of mortgage credit because the

government wrap will assure investors that the MBS will be repaid and the government will stand behind the credit risk. If credit-risk protection is no longer available through private credit enhancers, or if the price for such credit-risk coverage is too high, then Congress could adjust the loan levels for the FHA and VA insurance and guarantee programs, thus allowing the two institutions to expand their activities as they did during the recent crisis. In addition, the Public Guarantor should be given the authority to price and absorb the predominant credit risk for limited periods during times of severe economic stress in order to ensure the continued flow of mortgage credit. The Public Guarantor would be required to notify the Treasury Department, the Federal Reserve, and the chairs of the appropriate congressional committees before any action is taken to absorb predominant credit risk.

Under the model proposed by the commission, neither the Public Guarantor, FHA, VA, nor Ginnie Mae would have retained portfolios. The absence of these retained portfolios raises concerns about the availability and liquidity of mortgage credit during downturns when demand for mortgage-backed securities or the liquidity with which to purchase these securities could fall precipitously, as happened in 2008 to 2009. Therefore, federal policy should be clear on how mortgage liquidity would be managed in such circumstances. One alternative is through monetary policy and Federal Reserve actions in the market. During the 45-year history of Ginnie Mae in which it had no retained portfolio, the presence of a “full faith and credit” guarantee as well as Federal Reserve and Treasury purchasing authority have preserved ample liquidity in Ginnie Mae bonds through numerous credit crises, including the most recent one. Such policies should be established in advance of any crisis and should be understood by all market participants in order to forestall any issues that could raise the cost of housing and homeownership unnecessarily.

A Final Note about the Federal Housing Administration and the Single-Family Housing Market

Since its creation during the Great Depression, the Federal Housing Administration has periodically been called upon to act as a stabilizing force within the single-family housing market. When the oil-patch crisis in the mid-1980s roiled housing markets in Texas, Oklahoma, and Louisiana, the FHA stepped into these markets to provide much-needed liquidity.⁸⁰ When the national housing market collapsed in 2007, the FHA was a critical stabilizing force, with FHA market share of mortgage-purchase originations rising to more than 45 percent in 2010. The commission believes that, without the FHA's support for the housing market during this period of crisis, our nation's economic troubles would have been significantly worse. The FHA has also traditionally been an important source of mortgage credit for first-time homebuyers and borrowers with low wealth or home equity. Over the past decade, the share of FHA borrowers who are first-time homebuyers has hovered around 80 percent. During the same period, a significant percentage of FHA borrowers had incomes below 80 percent of area median income; many were minority families.

Looking ahead, the commission envisions an FHA that continues to play these two vital roles: serving as an important stabilizing force for the market, ready to be called upon in the time of crisis, and acting as an important gateway to homeownership for those families with more limited means.

The most recent independent audit of FHA, however, contained troubling news: It estimated that at the time of the audit, FHA's single-family mortgage insurance fund had a long-term shortfall of \$16.3 billion, yielding a capital reserve ratio of *negative* 1.44 percent, far below the statutorily required ratio of 2 percent. (The FHA has \$30.4 billion on hand to settle insurance claims as they come in. However, according to federal budget rules, the agency must hold

Principles for Access to Credit

The mortgage finance system must create a stable, liquid market that finances safe and affordable mortgages for borrowers in all geographic markets through complete economic cycles, without discrimination, bias, or limitations to access that are not based on sound underwriting and risk management. To achieve these goals, the commission recommends the following principles:

1. The government-guaranteed secondary market for mortgage-backed securities should be designed to support liquidity to a wide range of safe and sustainable mortgages to low- and moderate-income households without regard to race, color, national origin, religion, sex, familial status, or disability.⁸¹ To help achieve this objective, the business practices of MBS issuers benefiting from a government guarantee should be fully consistent with the requirements of existing fair lending laws, including the Fair Housing Act and the Equal Credit Opportunity Act. The Public Guarantor should assure that it supports liquidity for lending consistent with the Community Reinvestment Act (CRA) and that it supports primary lenders' efforts to meet their requirements under the CRA or other, similar requirements imposed by their regulators. The Public Guarantor, in consultation with prudential regulators, should have the ability to limit or prohibit an issuer's eligibility to access the guarantee.
2. The transparency of the government-guaranteed secondary market is critical to ensuring that this market is functioning without discrimination or bias. MBS issuers should report annually to the Public Guarantor on their total production guaranteed by the Public Guarantor for the previous year providing information similar to that required of mortgage originators under the Home Mortgage Disclosure Act. To the greatest extent practicable, MBS issuer data should be made available to the public in an accessible form and on a timely basis that facilitates independent review and analysis.
3. The Public Guarantor should report annually to Congress on the composition of its own total insured portfolio and the individuals and communities it serves. This report should (a) identify communities whose credit needs the Public Guarantor believes are being underserved, (b) explain what factors may be inhibiting access to credit there, and (c) make recommendations on how to expand access to credit in a prudent manner in these communities. To help ensure there is no segmentation of the government-guaranteed secondary market for reasons unrelated to sound underwriting and risk management, this report should also provide detailed demographic and credit-profile comparisons of FHAVA/USDA borrowers with those borrowers served in the remaining portion of the market.
4. The Public Guarantor should have a role to play in encouraging responsible innovation and broad market participation by facilitating liquidity for private lenders to develop and test new mortgage products that adhere to prudent, safe standards but have not yet been seasoned or adopted broadly enough to allow for securitization. The Public Guarantor should routinely share information on innovations available in the private market with lenders and MBS issuers.
5. Neither the Public Guarantor nor MBS issuers should be subject to numerical housing goals or quotas. Such measures could distort the prudent application of the government guarantee.
6. Access to the government-guaranteed secondary market must be open on full and equal terms to lenders of all types, including community banks, housing finance agencies, credit unions, and community development financial institutions. The Public Guarantor should neither create nor permit barriers to lenders using differential guarantee-fee pricing or other means to unfairly restrict or disadvantage participation in the government-guaranteed secondary market.

enough capital to cover all expected claims over the next 30 years, which would require an estimated \$46.7 billion. That leaves a long-term shortfall of \$16.3 billion.) According to the audit, loans insured prior to 2010 are the prime source of stress on the insurance fund, with \$70 billion in future claims payments attributable to the FY 2007–2009 book of business alone. Seller-funded down-payment-assisted loans, now prohibited by federal law, were responsible for the largest share of FHA losses. It is unclear at this time whether the FHA will require a drawdown of federal funds to subsidize its single-family insurance fund. FHA has taken a number of remedial steps, including raising annual insurance premiums and other policy changes to increase revenue and reduce losses, and Congress is considering legislation to achieve similar objectives. And according to the independent audit, FHA loans insured since 2010 are of high quality and profitability.⁸²

The recent developments surrounding FHA only underscore the urgency of what the commission has proposed—that far more risk-bearing private capital must flow into our nation's housing finance system. A system in which private risk-bearing capital is plentiful will help reduce the pressure that is sometimes placed on the FHA to act as the mortgage-credit provider of last resort and allow it to perform its traditional missions more effectively and at lower risk to the taxpayer.

Recommendations for Rental Housing Finance Reform

Today, about 35 percent of all U.S. households rent. In many markets, rental housing offers more affordable housing options for low-income and moderate-income families. Indeed, about nine in ten rental units are generally affordable to those households making the median income in the areas in which they live. As explained later in this report, however, rental housing is becoming increasingly unaffordable, particularly for those at the lower end of the

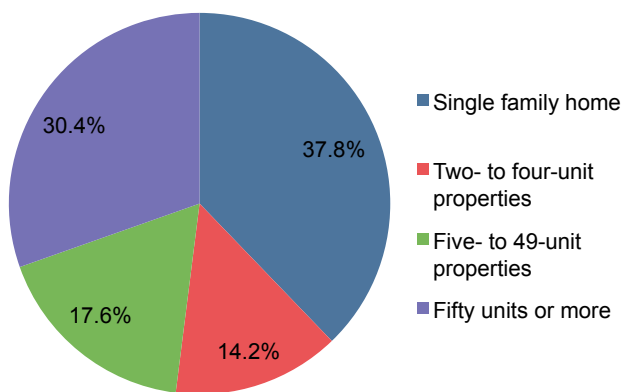
income spectrum. A strong rental housing finance system can help to ameliorate this urgent problem and will be critical to meeting our country's future housing needs. Given the changing demographics of American households, the drop in homeownership following the collapse of the single-family housing market, and the higher hurdles consumers will face in obtaining mortgage credit in the near future, supporting policies that enable owners of rental property to sustain these homes and renters to afford them has become more critical than ever.

Finance is just as vital to rental housing as it is to housing occupied by homeowners. Rental developers need financing to build properties and property owners need it to buy, repair, rehabilitate, and preserve rental housing. The cost and availability of credit to support the rental sector is important to maintaining a supply of rental housing adequate to meet the demand for it, and because rental markets are competitive, credit costs and availability influence the rents that landlords charge.

The Key Segments of the Rental Market

Despite the popular perception that most renters live in large properties with many units, about half of renters in 2001 (the most recent year for which property-level data is available) lived in properties with fewer than five units (Chart 3-7). In fact, four in ten lived in single-unit properties. With the recent shift toward renting more single-family homes as homeownership rates have fallen, the share of renters living in rentals with fewer than five units has likely increased modestly.

Chart 3-7: Proportion of Rental Units by Size of Property



Source: Joint Center for Housing Studies of Harvard University tabulations of U.S. Department of Housing and Urban Development and U.S. Census Bureau, *Residential Finance Survey: 2001*, Census 2000 Special Reports, CENSR-27 (2005).

These one- to four-unit properties are treated as single-family properties by the finance system and are financed through the single-family divisions of Fannie Mae, Freddie Mac, and FHA. Bank regulators consider them single-family properties when establishing underwriting guidelines and setting capital requirements. These smallest rental properties pose unique financing challenges. The performance of loans to these properties and the reasons for differences in performance between single-unit rentals, two-unit rentals, and properties with more units is not well understood. This is especially true of the large number of foreclosed single-family homes that are being converted to rentals in the wake of the housing bubble. Whether these properties will become long-term rental assets or return to the for-purchase market when homeownership financing becomes more readily available and purchase demand increases, is also not known. This uncertainty makes designing effective rental financing approaches even more challenging.

The rental housing finance system in place today is primarily geared to serve multifamily properties—those with five or more units. These account for about half of all rentals, and much more is known about the performance of loans to these properties. Most of the discussion and recommendations that follow address this segment of the rental housing stock. Following the financial market conventions, we will refer to these properties and their finance as “multifamily.”

The Federal Role in Supporting Multifamily Lending

The federal government helps to provide liquidity to multifamily rentals in normal times and is a crucial backstop in times of stress. When private lenders all but exited the market during the financial crisis, the federal role in rental housing finance expanded dramatically. With rental markets rebounding, private capital is once again increasing its exposure to credit risk from multifamily lending. While these are promising signs that rental finance is on the mend, federal support from Fannie Mae, Freddie Mac, and FHA remains essential to the recovery process and the market’s long-term stability.

The mortgage debt outstanding for multifamily rental properties currently amounts to an \$825 billion market, the vast majority of which supports refinancing.⁸³ Multifamily rental housing has historically been financed by a variety of private sources and by Fannie Mae, Freddie Mac, and FHA. Banks, thrifts, and insurance companies have all been important participants, using combinations of their own balance sheets and securities, along with other private sources like pension funds. A multifamily private-label commercial mortgage-backed securities (CMBS) market emerged in the 1990s and grew through the early 2000s, but shut down by 2009 in the wake of the financial crisis. Unlike the agency CMBS market supported by the federal government, the private-label CMBS market has neither explicit nor implicit federal backing. Like its single-family counterpart, this private-label securities market suffered at

Current participants in the rental housing finance system

A wide range of funders currently supplies capital to the rental finance system. In the private sector, banks and thrifts specialize mostly in short-term, adjustable-rate mortgages and in construction lending, while life insurance companies engage primarily in long-term, fixed-rate financing, largely for prime properties in prime locations. Fannie Mae and Freddie Mac provide mostly long-term (seven-plus years) fixed-rate refinancing, including for some nonprime properties and in nonprime locations, but do not backstop any construction lending. FHA provides long-term, fixed-rate financing through refinance loans and construction-to-permanent loans for new and rehabilitated properties, but only for properties with per-unit costs below a strict statutory cutoff. See Table 3-1 for more detail on each of these providers of credit.

Table 3-1: Multifamily Finance Providers of Credit and Terms

	Fannie Mae/ Freddie Mac	Banks and thrifts	Life insurance companies	FHA	CMBS
Financing provided	Portfolio/insured – securitized	Portfolio	Portfolio	Insured-securitized	Securitized-REMIC
Loan type(s)	Fixed rate/ floating rate	Floating rate/ construction, some fixed rate	Fixed rate and some construction and floating rate	Fixed rate/ construction	Fixed rate
Recourse or non-recourse	Non-recourse	Recourse (partial)	Non-recourse	Non-recourse	Non-recourse
Typical loan term	5, 7, 10 years	3-5 years, recently including 5-year fixed-rate loans	3-15 years	35-40 years	5, 7, 10 years
Loan-to-value ratio	Leverage up to 75-80%	Lower leverage (65- 75%)	Lowest leverage (55- 75%)	Highest leverage (80-85%)	Leverage (65- 75%)
Cost to borrower	Low priced	Low priced	Low priced	Low priced	Higher priced
Flexibility to adjust loan terms	Moderately flexible	Most flexible	Moderately flexible	Least flexible	Least flexible
Availability – borrowers and neighborhoods	Most locations; better quality borrowers	Most locations accepted with structure; wide range of borrowers	Institutional/ high quality asset locations and borrowers	Most locations and most borrowers	Conservative underwriting in flux

Source: Prepared by CWCcapital. Used with permission.

FHA, Fannie Mae, and Freddie Mac do not originate loans. Except for multifamily loans held in portfolio, Fannie Mae and Freddie Mac also do not service the loans. Instead they rely on private, specially licensed firms to perform these functions. This reliance on the private sector is a positive aspect of the present system that should be preserved and expanded.

the height of the boom from overleveraging and declining credit quality. Many CMBS issues had to be restructured and investors' returns cut as the weakened economy and bad lending practices undermined their value. In contrast, the GSE and Ginnie Mae CMBS market was stable and experienced little loss of value and, as noted earlier, grew rapidly as private capital fled.

In recent years, annual multifamily originations have swung widely from a high of \$148 billion in 2007 to a low of \$52 billion in 2009. When private capital withdrew from the market in 2009, Fannie Mae and Freddie Mac expanded to support 86 percent of multifamily loan originations⁸⁴ — nearly triple their average share in the years leading up to the crisis.

After plummeting to record lows, new apartment construction has picked up to about 225,000 units in 2012.⁸⁵ But new construction has failed to keep pace with

the growth in rental demand, driving vacancy rates down and rents up.⁸⁶ The growing demand for new multifamily rental units, fueled in part by demographic changes and more restrictive mortgage underwriting standards, lends urgency to ensuring credit continues to flow to multifamily housing.

Fortunately, strengthening rental markets have attracted renewed interest by banks, thrifts, and insurance companies. After dropping to historic lows in 2009, their participation rates in multifamily originations have started to pick up. With this return, the share of multifamily loan originations supported by Fannie Mae and Freddie Mac has fallen to 56 percent in 2011. Even private-label CMBS came back in 2011, though at a very low \$2 billion level (far short of the 2007 peak of \$36 billion).⁸⁷ Though bank balance-sheet lending especially has been picking up, overall federal support for multifamily lending remains high by historical standards.⁸⁸

Table 3-2: Share of Multifamily Loans Financed that were 60+ Days Delinquent as of December 31, 2011

Acquisition or origination year	Fannie Mae	Freddie Mac	Private label CMBS lenders	FHA lenders
2005	0.73%	0.20%	5.60%	1.19%
2006	0.66	0.25	13.63	0.66
2007	0.89	0.74	23.94	0.54
2008	1.12	0.09	4.68	2.74
2009	0.05	0.00	N/A*	5.15
2010	0.04	0.00	0.00	0.02

*In 2009, CMBS lenders did not originate any multifamily loans.

Note: While not displayed in this table due to differences in the ways in which delinquencies are tracked, life insurance companies generally experienced lower default rates than Fannie Mae and Freddie Mac from 2005–2010.

Source: Shear, William B., et al. *Fannie Mae and Freddie Mac's Multifamily Housing Activities Have Increased*. GAO-12-849. (Washington, D.C.: U.S. Government Accountability Office, 2012), 58.

In sharp contrast to their single-family operations, the multifamily businesses of Fannie Mae and Freddie Mac were profitable throughout the financial crisis.⁸⁹ In addition, the performance of multifamily loans backed by Fannie Mae and Freddie Mac was dramatically better than that of loans made through other financing channels. The worst performance was turned in by the private-label CMBS market (see Table 3-2). The underwriting standards and risk-management strategies of Fannie Mae and Freddie Mac, and to a lesser extent of FHA, clearly paid off relative to the private-label CMBS market.

Building a New Rental Housing Finance System

The commission recommends that the federal government take the following four actions with respect to building a new system for rental housing finance:

- Gradually transition the multifamily operations of Fannie Mae and Freddie Mac to a new system similar in design to that for single-family finance. The intellectual, technological, and business assets of the GSEs' multifamily businesses could be transitioned in a number of ways, including through incorporation into a new publicly operated securities platform, operation as a legacy asset of the U.S. government, or sale to private interests.
- Put in place a new catastrophic guarantee for multifamily finance predicated on the same principles as proposed for single-family finance. This new multifamily backstop would provide an explicit guarantee of the MBS issued by private issuers in return for (1) paying a fee to the Public Guarantor; (2) agreeing to assume, or arrange for other private parties to assume, predominant losses before the catastrophic guarantee is triggered; and (3) submitting to the approval, underwriting, monitoring, and capital standards established by the Public Guarantor.
- Retain but streamline FHA's multifamily insurance operations, and pare back FHA's multifamily role to the

extent that private-sector risk taking can take its place at somewhat comparable cost and enable FHA to focus on areas and products where private investment is not readily available.

- Make special provisions to better understand and support the financing needs of one- to four-unit and five- to 49-unit rentals, including review of the limitations on passive losses, consideration of treating properties made up of small scattered rentals on multiple sites as multifamily housing for finance purposes, and consideration of new financing tools for large-scale owner/operators of affordable rental properties that will increase their efficiency and ability to steward their inventory.

Each of these recommendations is discussed in greater detail below.

Gradually wind down the multifamily operations of Fannie Mae and Freddie Mac.

The commission recommends winding down the multifamily operations of Fannie Mae and Freddie Mac through a gradual transition process. This process should be undertaken at a pace that does not harm the nation's rental finance system and should not be completed until a new system of federal catastrophic guarantee support is firmly in place.

During this transition, the multifamily assets of Fannie Mae and Freddie Mac could be repositioned in a number of ways, including through incorporation into a new publicly operated securities platform, operation as a legacy asset of the U.S. government, or sale to private interests that have no special charter or implicit guarantee of their corporate equity or debt. These private firms would have to be approved by the Public Guarantor, pay a fee to help capitalize the government catastrophic risk fund, and submit to capital reserve requirements. The transition will only be complete when a wholly private system, backstopped only by a catastrophic government guarantee, replaces the liquidity functions that Fannie Mae and Freddie Mac have provided.

Put in place a new catastrophic guarantee for multifamily finance predicated on the same principles as proposed for single-family finance.

The commission has concluded that a continued—but *limited*—federal presence in rental housing finance is needed both to ensure liquidity in normal times and to guard against illiquidity during times of severe economic distress. As in the new single-family system, the commission envisions that:

- The Public Guarantor should be charged with and authorized to provide catastrophic risk insurance for multifamily CMBS in return for an explicit and actuarially sound premium charged to issuers, which is designed to cover losses (after private risk-sharers absorb predominant losses) as well as the operating expenses of the Public Guarantor.
- Private firms should be the originators, servicers, credit enhancers, and issuers of multifamily mortgages and CMBS with the government backstop of MBS limited to an explicit catastrophic guarantee. The issuer/servicers and credit enhancers should be monoline entities to ensure that the capital they have is protected against other uses.
- Except in the case of FHA-insured loans, in which the difficulty of serving the low-cost rental market justifies the government's assumption of 100 percent of the credit risk, the private sector should charge for and take a predominant share of potential losses before any government catastrophic risk insurance is triggered.
- The interests of the Public Guarantor and its private-sector counterparties should be aligned as much as possible.

Why a Government Guarantee is Necessary

The commission's support for a continued government guarantee of multifamily CMBS—built around private

risk-sharing in which the government pays out only for catastrophic losses—is rooted in the following findings:

- A government guarantee against catastrophic risk is essential to a strong and deeply liquid secondary market for multifamily loans. The guarantee would completely wrap the multifamily CMBS, thereby converting largely illiquid multifamily mortgages into liquid multifamily securities with a broad investor base. A broad base of investors, in turn, helps ensure that interest rates are competitive and that capital is sufficient to fund the demand for rental housing.
- In the absence of a government backstop, there is a serious risk that liquidity will be impaired, particularly for long-term, fixed-rate multifamily rental mortgages, but also potentially for other types of mortgage products as well (e.g., at times Fannie Mae and Freddie Mac have provided important support to the longer-term, adjustable-rate market). The financial crisis clearly exposed the potential for private capital to exit the market during periods of sharp housing corrections or disruptions in financial markets. The retreat of private capital from exposure to multifamily credit risk underscores the importance of some form of a government backstop to avoid extended periods when credit is unavailable.
- Even under normal economic conditions, Fannie Mae and Freddie Mac have been important sources of finance in nonprime locations and when investment strategies have led private investors to shed existing investments or restrict new ones.
- The availability of a government backstop for multifamily CMBS benefits borrowers by keeping credit flowing. Furthermore, having a strong secondary market for multifamily mortgages allows banks, thrifts, and credit unions—which are funded mostly by short-term deposits—to originate longer-term, fixed-rate mortgages of

seven to 30 years, which are vitally important to managing the operating costs of affordable rental housing. Finally, the option to issue government-guaranteed securities with private risk-sharing provides lenders with an additional tool to manage their capital reserve requirements.

Mechanics of the New Rental Finance System

The Public Guarantor would provide multifamily mortgage lenders with the important option of placing loans in securities and paying for government catastrophic risk on these securities. Private-sector lenders operating without this backstop can and will play a role in a reformed housing finance system and will be in a position to judge when to use this option. Participating lenders or issuers would be permitted to either retain the risk of covering predominant losses ahead of the government guarantee or arrange for a private-sector third party to provide most of the credit enhancement.

The Public Guarantor would be limited to backstopping permanent finance for leased new properties and for existing properties, and expressly prohibited from supporting construction lending just as Fannie Mae and Freddie Mac are prohibited from doing so.

Although the Public Guarantor would not guarantee securities backed by multifamily rental construction loans, banks would have the option of rolling over the initial loan for newly built rental properties to a longer-term, fixed-rate permanent loan that is eligible for secondary market sale or securitization, just as they do today with Fannie Mae and Freddie Mac. In this way, the presence of a government-backed secondary market takeout for adjustable-rate construction loans would facilitate the flow of credit to new construction in normal times as well as times of stress.

Before the crisis, the private market supplied all the construction lending for rental properties—and did so mostly without FHA insurance. During any future crisis, the

commission believes that the demand for financing for new construction would be minimal and that a reformed and strengthened FHA could keep the supply of construction finance flowing to low-cost rental housing just as it did during the previous downturn, but more efficiently and at greater scale than it managed to do in its pre-reform state.

Key Differences with the Proposed Single-Family System

The key differences between the proposed systems for single-family and rental finance lie not in the basic functions of the systems or the structure of the government guarantee but in (1) the cutoffs that would be established to ensure the Public Guarantor serves only a segment of the mortgage market and (2) the specific counterparty requirements for the two systems. Each of these differences is addressed in greater detail below.

An affordability requirement

Multifamily lending, by virtue of renter demographics and rental housing, has predominantly supported housing affordable to low- and moderate-income households. The commission recommends that the Public Guarantor establish an affordability requirement or threshold, intended to assure that the system continues to primarily support housing affordable to these households, while allowing access to the guarantee for a modest share of higher-rent units. This threshold should be neither overly generous nor unduly restrictive, to ensure a broad backstop for multifamily housing affordable to Americans with modest incomes and to avoid the overuse of the government guarantee for high-end rental properties. Compliance with the affordability requirement should be assessed using the rents established at loan origination. Compliance would be based on the issuer's portfolio of qualifying securities over a rolling two-to three-year period.⁹⁰ Issuers that fail to comply could be subject to a variety of actions, including losing approval status to do business with the Public Guarantor.

The proposed restriction of the catastrophic government guarantee to properties primarily serving low- and moderate-income residents may result in a relatively higher cost of capital for some projects at the higher end of the rental market. While the commission has concluded that this is an acceptable risk, in the event of an extreme stress to the financial system in which it is determined that private capital has fled from the market serving higher-income renters by a verifiable measure, the Public Guarantor should have the authority to extend catastrophic insurance to prudently written loans for these segments of the market until private capital returns.

Counterparty standards and requirements for multifamily lenders

As on the single-family side, the Public Guarantor would be charged with developing and periodically reviewing underwriting standards; approving the lenders, issuers, private credit enhancers, and servicers that participate in the government-guaranteed system; and maintaining minimum standards for the amount of capital that would have to be placed in reserve by private firms to cover predominant losses before the government catastrophic guarantee would be triggered. The Public Guarantor would also employ safeguards to ensure the alignment of interests of all entities serving as its counterparties.

Underwriting standards

In a new housing finance system, underwriting standards for the single-family and rental sectors would be different, just as they are now. For example, borrowers in the rental housing finance system are typically required to make much larger down payments (of 25 percent or more) than borrowers on the single-family side, a practice that would continue under the new system.⁹¹ The Public Guarantor would have the flexibility to underwrite loans directly or establish process and documentation standards it would expect its counterparty originators to follow. The Public

Guarantor would also conduct audits of its counterparties to ensure compliance.

Capital requirements

The capital that private firms would have to put at risk to cover predominant losses would be based on regular stress tests of their capital position to ensure that counterparties have adequate capital to cover their commitments. Capital reserve requirements would likely be set at different levels for rental MBS than for MBS backed by single-family loans because of the different risks they pose.

Alignment of incentives

The interests of all private entities serving as counterparties to the Public Guarantor must be tied to the long-term performance of multifamily loans, not just to the volume of loan originations and security issuances. These private entities include firms originating and servicing multifamily loans, issuing government-guaranteed securities with private risk-sharing, and sharing credit risk.

This alignment of incentives can be met using one of three methods that tie the interest of every entity in the chain to the long-term success of every mortgage loan that is ultimately backstopped by the Public Guarantor. The three methods are (1) placing capital at risk, (2) placing the franchise's ability to continue to do business with the Public Guarantor at risk, and (3) placing mortgage-servicing rights (MSRs) at risk.

The new system is designed around the first of these—putting private capital at risk and assuring one or more private entities hold capital sufficient, as determined by the Public Guarantor, to cover the predominant risk under extreme stress testing. While the issuer should be permitted to lay off most of this risk (to either a third-party mortgage insurer approved by the Public Guarantor or through a capital markets solution, such as a structured security or derivative), it should be expected to retain some portion

of the risk and reserve capital to cover it, consistent with having an option to achieve sale treatment. The Public Guarantor should be authorized to set this amount at a level it deems sufficient to make sure the interests of the issuer are aligned.⁹² In addition, issuers put capital at risk by retaining responsibility for repurchasing any loans that are found to have violated representations and warranties for a specified period of time, even if they sell their servicing rights.

It is not sufficient just to stipulate that the private counterparties hold a certain amount of capital to cover predominant credit losses. The Public Guarantor must also have the authority and be explicitly charged by Congress to monitor the capital positions of its counterparties and demand that they raise capital if they fall short of mandated levels.⁹³

The second method of aligning incentives—placing the franchise's ability to do business at risk—is a powerful tool. Businesses with operations that depend on the continued ability to do business with the Public Guarantor, and the secondary market it supports, will avoid taking actions that could cause them to lose their status as approved actors in the new housing finance system. This is why the Public Guarantor must have approval and examination authority over its counterparties.

Finally, in cases where the issuer is also the originator of the loan, the issuer should be permitted to sell its MSRs. (It would already be obligated to retain some risk.) In cases where the originator sells the loan to an issuer or acts as a broker for the issuer, however, the originator should be required to retain the MSRs. Otherwise, it would not have an ongoing interest in loan performance that would help assure the quality of the loan at origination. Unlike Fannie Mae, both life insurance companies and Freddie Mac do not demand risk-sharing by the seller and currently often require that MSRs remain with the originating lender.

Reform, strengthen, and streamline FHA multifamily programs.

Like Fannie Mae and Freddie Mac, FHA ramped up its share of loan originations to offset the flight of private capital from the housing finance system during the Great Recession. FHA's multifamily loan performance has held up relatively well under the pressure of the economic downturn, with delinquencies peaking in December 2011. Even for loans originated in 2009—by far the worst book of multifamily business for FHA—the delinquency rate of 5.15 percent is substantially below the delinquency rate of nearly 24 percent for loans originated in 2007 that resulted in the worst book of business for private-label CMBS issuers.⁹⁴

The commission believes FHA should continue to play its essential role in facilitating liquidity for the construction and refinance of rental properties with long-term, fixed-rate financing. The risks involved in this lending are perceived to be higher, and steady debt payments are often important to attract equity investment. Absent FHA's 100 percent guarantee of credit risk and the option for delivery into government-wrapped Ginnie Mae multifamily CMBS, lenders might not otherwise be able to offer these products to the owners and developers of rental properties in all parts of the country.

FHA is restricted in its activities by congressionally mandated statutory loan limits, which ensure it provides support only to properties that would typically be affordable to moderate-income households at loan origination. FHA plays a unique role in supporting this market with long-term, fixed-rate financing for new construction and rehabilitation (primarily through the Section 221(d)(4) program) and refinances of existing properties (primarily through the Section 223(f) program).⁹⁵ The combination of insuring 100 percent of the principal balance on existing, substantially rehabilitated, and new multifamily rentals—as well as offering long-term, fixed-rate financing without balloon risk,

on fully amortizing loans with amortization periods as long as 40 years and with loan-to-value ratios as high as 85 percent—has made FHA an important source of liquidity to this segment of the market.

The commission believes the FHA should remain focused on providing standardization and liquidity to the markets it currently serves, and FHA-insured mortgages should continue to be guaranteed by Ginnie Mae. However, the commission also believes the FHA's multifamily operations should be streamlined to avoid lengthy delays often associated with doing business with FHA, and its role in the market should not extend beyond that which would not otherwise be served by private capital. More specifically, the commission recommends the following:

- *Address administrative inefficiencies.* Developers and lenders have long criticized FHA for being inefficient, and causing lengthy delays and uncertainties in loan approvals. HUD has recently made great strides to improve processing times and review of new applications, and these initiatives should be continued. In addition, the non-core multifamily programs administered by FHA that do not expand liquidity of capital for housing should be reviewed, and FHA should provide a rationale for their continuation or make a case for their discontinuation to Congress.
- *Take steps to avoid the crowd-out of private capital.* FHA provides a 100 percent loan guarantee and therefore risks crowding out private capital that might be willing to stand in front of the federal government or assume all of the credit risk—even in this more-difficult-to-serve market. Therefore, FHA should periodically evaluate its market share to ensure it is not crowding out private insurers and lenders who would serve the market at a comparable cost to FHA. FHA should keep in mind that one of its public policy objectives is helping to retain existing affordable rental properties.

- *Strengthen partnerships between FHA and Housing Finance Agencies.* FHA should continue to be authorized to insure properties that receive Low Income Housing Tax Credits (LIHTC) and should explore options for improving coordination with the LIHTC and HOME Investment Partnerships programs. It should also continue to offer risk-sharing programs with Housing Finance Agencies over a range of multifamily products (provided developments meet the affordability requirements enumerated above). FHA has proven useful in helping the Housing Finance Agencies pursue affordable rental housing goals, and these agencies typically make allocation decisions involving tax credits and subsidies.

Address the unique financing needs of small multifamily rentals.

As noted above, small (one-to 49-unit) properties make up about two-thirds of all rental units, with one- to four-unit rental properties making up somewhat more than half of all rentals.

While five- to 49-unit properties are served by the multifamily finance system, the commission heard repeatedly that these smaller properties have historically been more difficult to finance with long-term, fixed-rate financing and funding from the capital markets than have the roughly 30 percent of rentals in 50-plus-unit properties.⁹⁶ For example, in 2001 not only did a smaller share of five- to 49-unit properties—compared with 50-plus-unit properties—have mortgages; less than half of the five- to 49-unit properties that did have mortgages had fixed-rate payments compared with over 70 percent for 50-plus-unit properties. In looking at the share of small properties that have a mortgage (and, among those that do, the share that have long-term, fixed-rate financing), the commission was unable to determine how much of the observed differences are a result of the debt preferences of the investors in these properties or how much they reflect structural difficulties in supplying credit to them.

However, the commission was persuaded of the need to do more to understand the market for mortgage finance for one- to 49-unit properties and explore ways to better facilitate financing to it. In a reformed system with multiple issuers of multifamily securities eligible for a government catastrophic guarantee, some of these issuers might try to serve this niche market more effectively than past efforts by Fannie Mae and Freddie Mac. The Public Guarantor should be encouraged to be responsive to private issuers who express an interest in a guarantee on small multifamily CMBS, while maintaining a policy of requiring catastrophic insurance premiums to cover potential losses after private credit enhancements are exhausted.

In addition, the commission makes the following recommendations:

- *Explore opportunities to provide financing to small scattered-site rentals on a bundled basis.* Untapped opportunities exist for the bundling of several non-contiguous properties into a single multi-site, multifamily property for the purposes of financing their development and acquisition. For example, there are private firms interested in purchasing multiple single-family homes from Fannie Mae and Freddie Mac out of their real estate-owned (REO) stock and financing the acquisition with a single multifamily mortgage. Indeed, Fannie Mae is experimenting with bulk sales of its REO properties in a related way. The Public Guarantor should have the flexibility to explore opportunities to backstop loans to properties with five or more non-contiguous, single-family or two- to four-unit buildings as a single multi-site, multifamily property for financing purposes and to assess possible benefits and unintended consequences of this approach.⁹⁷ These opportunities would include purchases to be held in land banks, which are a promising mechanism to help distressed communities strengthen their property markets.⁹⁸ To the extent that the Federal Home Loan Banks or Fannie Mae and Freddie Mac have experience with multi-site, multifamily finance, review of these activities should be undertaken to inform development of future financing products.
- *Review the impact of passive loss rules for small rental properties.* The Tax Reform Act of 1986 disallowed the practice of using losses from “passive activities”—including investment in rental properties—to offset “active income” from other, unrelated activities. The limitation on passive losses, however, permits taxpayers with incomes under \$100,000 (phased up to \$150,000) to deduct up to \$25,000 of losses from rental property that they actively manage. The limitation was intended to restrict the excessive tax benefits that contributed to overbuilding in the early 1980s (which contributed to supply overhangs into the early 1990s). However, it may also have led to declines in investment in small rental properties by individual investors—for example, a dentist who took a stake in a two-flat rental property to earn extra income. Further analysis should be undertaken to review the impact of the passive-loss rules, specifically to assess the potential to increase the number of affordable rental units by attracting greater equity into the investment market by exempting rental properties with fewer than 50 units and by indexing the \$25,000 limit to inflation.
- *Re-assess the appropriate division (or divisions) of the Public Guarantor within which to site small multifamily rentals.* In a redesigned housing finance system, the Public Guarantor should be granted the authority to decide whether it is sensible for one and/or two- to four-unit properties that contain at least one rental unit to fall within the domain of its multifamily division (which could be renamed the “rental division”) or its single-family division. The Public Guarantor should also have the authority to regulate the activities of its private issuer/servicers and credit enhancers so that they align with how two- to four-unit rental properties are handled.

- *Pursue additional research to enable improved decision-making and underwriting.* The FHFA, in conjunction with Fannie Mae and Freddie Mac, should study the loan performance of their two- to four-unit property portfolios at different points in time and simulate their performance under certain stress tests. The aim of these studies would be to identify factors that may have contributed to the poorer historical performance of these properties in terms of underwriting, valuation methods, product features, location, number of units, residence of owners, and other factors that may have contributed to higher serious delinquency rates and loss severities.

In conjunction with Fannie Mae and Freddie Mac, the FHFA should also conduct a thorough review of the experience of the two GSEs in purchasing and guaranteeing small (five- to 49-unit) multifamily rental properties in order to make recommendations about whether a future government guarantor of catastrophic risk could help facilitate a stronger secondary market for these properties and organize itself better to properly underwrite and price the risk of this lending.

Additional Recommendations

The commission examined other ways that the financing of rental housing could be improved and offers the following additional recommendations:

Facilitate partnerships with mission-driven lenders. A new system of rental housing finance should support and enhance the role of Community Development Financial Institutions (CDFIs) and other mission-driven lenders. While CDFIs typically provide pre-development and construction financing, access to long-term permanent financing—through direct issuance of securities or sale to an aggregator—would enable them to better support affordable rental housing of all sizes, including small properties. As part of these efforts, emphasis should be placed on

strengthening CDFIs' access to debt financing, including by promoting their continued membership in, and access to, advances through the Federal Home Loan Bank System.⁹⁹

Further, Congress should give immediate and serious attention to HUD's proposal to establish an FHA risk-sharing program with Housing Finance Agencies around small multifamily properties. Furthermore, HUD should build evaluation methods into the original program design.

Improve data collection. The federal government should improve its data collection and coverage for the multifamily housing finance system, including collection of information about originations, servicing, and loan performance. Better data would allow researchers and market analysts to develop a deeper understanding of activity and participants in the system, currently and over time.

Structure of the Public Guarantor

The commission envisions the establishment of a single Public Guarantor with responsibility for both the single-family and rental housing markets. The Public Guarantor would consist of two separate divisions each with responsibility for administering its own separate catastrophic risk fund. Each division would also establish its own approval standards for lenders, issuers, servicers, and private credit enhancers as well as underwriting standards, predominant loss coverage requirements, and catastrophic guarantee fees.

The Public Guarantor should be established as an independent, wholly owned government corporation. As a government corporation, the Public Guarantor will be a self-supporting institution that does not rely on federal appropriations but rather finances the two catastrophic funds and its own operational expenses through the collection of g-fees. The Public Guarantor should operate independently of any existing federal department and,

with this greater independence, should be able to respond more quickly to contingencies in the market and operate with greater efficiency in making staffing, budgeting, procurement, policy, and other decisions related to mission performance. It should be given sufficient flexibility to set compensation levels that are at least somewhat competitive with other employers within the financial services industry, and it should have the ability to appoint and compensate such outside experts and consultants as necessary to assist the work of the organization.

To ensure continuity and build on existing government capabilities, Ginnie Mae—enhanced with greater authorities and flexibilities—could assume the role of Public Guarantor. In that case, Ginnie Mae would be removed from HUD, spun out as a separate and independent institution, and given the necessary authorities so that it could successfully discharge its responsibilities as the standard-setting body for a large segment of the mortgage market. In addition to discharging its responsibilities as the Public Guarantor, the enhanced Ginnie Mae would continue on an uninterrupted basis to perform its traditional function as the guarantor of the timely payment of principal and interest on MBS backed by single-family and multifamily loans insured by the FHA, VA, USDA, and the Office of Public and Indian Housing.

The Public Guarantor should be led by a single individual, appointed by the President of the United States and confirmed by the U.S. Senate, who would serve as director. Vesting ultimate leadership authority for the Public Guarantor in a single individual should promote accountability and ease of decision-making. This individual should have a demonstrated expertise in financial management and oversight, as well as a deep understanding of the capital markets, particularly the mortgage securities markets and housing finance.

An Advisory Council to the Public Guarantor should be established, consisting of the chairman of the Board of Governors of the Federal Reserve System as chairman of the Council, along with the director of the Public Guarantor, the secretary of the U.S. Department of the Treasury, and the secretary of HUD. The Advisory Council would meet on at least a quarterly basis to share information about the condition of the national economy, marketplace developments and innovations, and potential risks to the safety and soundness of the nation's housing finance system.



Economic Policy Program
Housing Commission



Chapter 4. Affordable Rental Housing

Demand for rental housing is increasing in many regions throughout the United States, and the number of renters spending more than they can afford on housing is unacceptably high and growing. Demographic trends, described earlier in this report, clearly highlight the continued and growing role that rental housing will play in meeting the nation's housing needs, including for young adults starting out and seniors looking to scale back their home-maintenance responsibilities. Most of us will rent at some point in our lives, and many American households prefer the flexibility and convenience of rental housing. It is therefore important that an adequate supply of stable, affordable rental housing is available to meet these needs and preferences.

Our proposals for rental housing finance reform, described in the previous chapter, are designed to ensure there is sufficient mortgage liquidity to support the continued availability of rental housing that is broadly affordable for households at all income levels. In this chapter, our proposals focus on meeting the rental housing needs of the lowest-income households—helping to provide high-quality, stable housing for the most vulnerable individuals and families, and promoting positive outcomes like improved educational performance by children and better physical and mental health. We also propose reforms to the rental assistance delivery system that focus on outcomes, helping to improve the effectiveness and efficiency of housing programs and providers.

The Crisis in Affordable Housing

Housing Challenges Facing Our Nation's Renters

According to the U.S. Census, the nation's 41 million renter households account for 35 percent of all U.S. households. Compared with the U.S. population as a whole, the renter population has lower incomes, with two-thirds of renter households reporting incomes below 80 percent of the area median income (AMI) and nearly half reporting incomes below 50 percent of AMI. The median household income for renter households in 2011 was just \$30,934 compared with \$64,063 for owner occupied homes.¹⁰⁰ In other words, renters as a group earn about one-half what homeowners do.

For the most part, renters live in housing that meets basic quality standards, but nearly half of all renters report paying more than 30 percent of their income for rent, signifying a "moderate rent burden" under federal standards for affordable housing. About 25 percent of the 41 million renter households report a "severe rent burden," spending more than half of their income for housing.¹⁰¹

Terms and Definitions

The federal standard for affordable housing is that a household should pay no more than 30 percent of its income for rent. “Rent burden” is a term used to indicate the extent to which a household spends a disproportionate share of its income on rental costs.

If expenditures on housing (rent plus utilities) account for:

- 30 percent or less of their income, a household is not considered to be rent burdened.
- Between 30 and 50 percent of income, a household has a “moderate rent burden.”
- Above one-half of household income, a household has a “severe rent burden.”

These standards are general rules of thumb and do not always tell the whole story. For example, a single person may choose to take on a moderate rent burden to live in a desirable neighborhood or larger apartment without experiencing any decrease in quality of life, while a family of four may rent a single-family home in an outlying area and have no formal rent burden but very high transportation costs, leading to combined housing and transportation costs that are unaffordable.

“Low income” is a term used to indicate a household’s income level relative to other households in the same metropolitan area.

If a household has an income:

- Above 50 percent, up to and including 80 percent of the AMI, it’s a “low-income” household.
- Above 30 percent, up to and including 50 percent of the AMI, it’s a “very low-income” household.
- At or below 30 percent of the AMI, households are considered “extremely low-income.”

As Chart 4-1 shows, rent burdens vary considerably by household income.

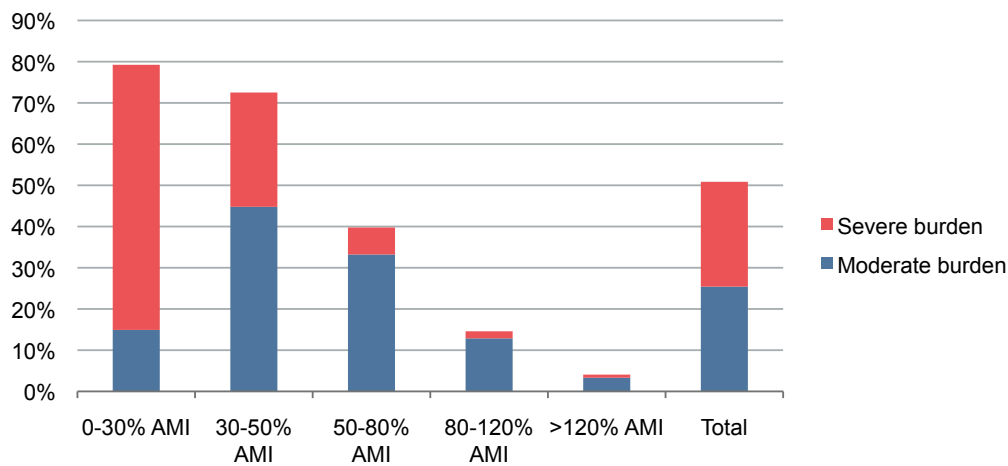
Nearly 80 percent of extremely low-income renters report a rent burden, with most—64 percent—reporting a severe rent burden. The overall incidence of rent burdens is nearly as high for the next income group—very low-income renters—but severe rent burdens are much lower for this group. The incidence of both moderate and severe rent burdens continues to fall as incomes rise, with severe rent burdens falling to 7 percent for low-income households and nearly disappearing for higher-income groups.

Chart 4-2 highlights a major reason why extremely low-income renters face such high housing cost burdens: the mismatch between the number of extremely low-income renters and the number of affordable units that are currently available to them.

In 2009, only 3.7 million rental housing units were both affordable and available to extremely low-income households—far fewer units than needed to provide affordable housing to the nation’s 10.3 million extremely low-income renter households. (HUD defines a unit as available to a particular income group when it is either vacant or occupied by a household with that income or a lower income.) This mismatch would likely be even larger if we considered only those homes located in safe, amenity-rich neighborhoods with good-performing schools and access to jobs. By contrast, low-income households and higher-income households (those with incomes above 80 percent of AMI) experience surpluses of affordable and available units, although these surpluses are in specific markets and change over time.

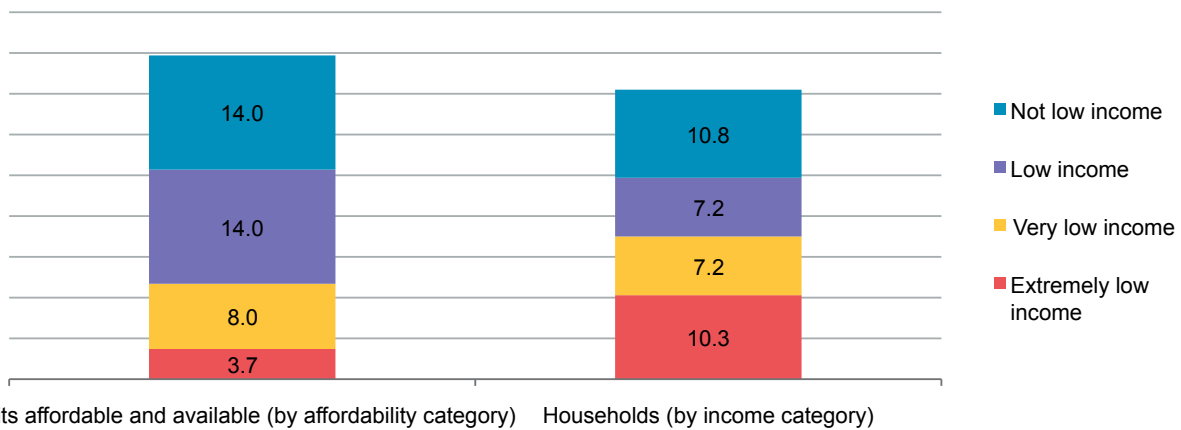
“Worst case needs” for rental housing—a statistic HUD uses to keep track of renters who do not receive housing assistance, and either pay half of their income for housing or live in severely substandard housing—grew 20 percent

Chart 4-1: Housing Cost Burdens Among U.S. Renters, 2009



Source: Steffen, Barry et al. *Worst Case Housing Needs 2009: Report to Congress*. (Washington, D.C.: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011), 28.

Chart 4-2: Rental Units and Renters, by Affordability and Income Categories (in millions, 2009)



Source: Steffen, Barry et al. *Worst Case Housing Needs 2009: Report to Congress*. (Washington, D.C.: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011), 55. Based on a chart in Danilo Pelletiere. *A Preliminary Analysis of the 2009 and 2007 Rental Affordability Gaps*. (Washington, D.C.: National Low Income Housing Coalition, 2010), 4.

between 2007 and 2009. But renter problems were on the rise before then as well, with the number of households with worst case needs growing 18 percent between 2001 and 2007. Renters paying excessive shares of income for rent and utilities often have insufficient income available to meet their basic needs for food, health care, education, and transportation—undermining child and adult health and contributing to residential instability that can, among other things, impair educational achievement and employment potential.¹⁰²

Compounding their difficulties, low-income households are often employed in low-wage or temporary jobs that are vulnerable to layoffs and reduced work hours. One study found that about 20 percent of households with children in the lowest-income quintile experience a loss of more than 50 percent of their income in any given year, with only about half of these households fully recovering the lost income within the same one-year period.¹⁰³ Unpredictable income shocks can lead to household stress and inability to plan for the future, and income volatility has been cited as a causal link to homelessness.¹⁰⁴ Without an ability to cushion the impact of this temporary loss of income, households may experience severe residential instability.

Factors Driving Increases in Renter Cost Burdens

Housing cost burdens for renters have risen dramatically in recent years, and the factors driving these increases are neither novel nor difficult to identify. Unemployment, stagnating incomes, and volatile wages for those at the low end of the income spectrum greatly compromise families' buying and saving power, leaving them with limited resources to meet basic needs such as shelter. At the same time, the supply of rental housing affordable to these families falls well short of demand, driven by the loss of affordable rentals to conversion, demolition, or other factors and an insufficient supply of rental subsidies that reduce renters' monthly housing costs. In the absence of

government support, high land prices and construction costs make it difficult for the private sector to develop non-luxury, market-rate housing.¹⁰⁵ While much of the unsubsidized yet affordable stock of privately owned housing consists of older structures that have become more affordable over time, strong competition for these units leads to higher rents and—in many markets—the upgrading of these older units to meet the needs and preferences of higher-income households.

In the past, the development of new apartments could lead renters with higher incomes to move on to updated units with more amenities, allowing older units to filter down to households lower on the income ladder. However, one of the problems inhibiting the filtering down of older rental units today to levels affordable to low-income households is the proliferation of barriers to new development or redevelopment that either prohibit certain types of development entirely or raise development costs to levels that make it economically infeasible. These barriers include local land-use regulations that restrict density directly or indirectly through the use of parking and other requirements, impose lengthy permitting or environmental review processes that may entail additional expenses in return for permits to build, or require a zoning variance to build multifamily housing developments. Other barriers include local restrictions on innovative and efficient reuse of existing properties, such as the development of accessory apartments (sometimes known as “granny flats”) or the rental of excess rooms to boarders. In some cases, these regulations are the result of Not in My Backyard, or NIMBY, sentiment, which adds uncertainties and obstacles to development.¹⁰⁶

While many of these regulations may strive to advance important policy goals, in the aggregate they increase the cost of housing and inhibit the development of new affordable rental housing by extending the development timeframe and increasing the risks associated with

development.¹⁰⁷ These regulations also prevent the construction of non-luxury rental housing that could help meet the needs of moderate-income households and allow older developments to filter down to rent levels affordable to low-income households. In addition, both federal and local regulations often discourage or inhibit the development of economically diverse, mixed-use neighborhoods that can help support educational achievement and economic mobility for low-income families.

Current Limits of Federal Rental Assistance

In all, federal rental assistance programs currently help approximately five million American households afford housing, providing critically needed shelter and stability for older adults, persons with disabilities, families with children, and other low-income individuals.¹⁰⁸ However, because of the lack of resources, only about one in four renter households eligible for federal rental assistance receives it,¹⁰⁹ resulting in an inequitable system in which housing subsidies are allocated by lottery or through ever growing waiting lists. Many of the lottery losers become residentially unstable and move frequently—at great expense to their health and their children's educational prospects. Some even become homeless.

Existing federal housing assistance programs do a good job achieving the overarching goal of reducing housing costs to levels families can afford. But given the significant remaining unmet need for rental assistance and today's fiscal challenges, the nation's rental assistance programs must achieve a higher level of performance. These programs must also more fully realize the potential of rental assistance to substantially improve the life opportunities of assisted households—for example, helping older adults to lead independent lives and work-capable households to make progress toward economic self-sufficiency, and enabling families to move to neighborhoods with greater opportunities.

Available data suggest that affordable rental housing is likely to become even more scarce in the coming years, with the production of rental housing failing to keep pace with demand.¹¹⁰ Looking ahead, the nation's demographic trends indicate that the number of renter households will increase dramatically over this decade, as Echo Boomers begin to form their own households and as Baby Boomers seek to downsize from their existing homes and into living situations with less upkeep and fewer maintenance requirements. It is estimated that the construction of at least three million new multifamily rental units will be necessary over the next ten years to meet this growing demand,¹¹¹ a target unlikely to be met without a concerted focus to help stimulate new production by the private sector. Absent this focus, rents are likely to continue to rise faster than incomes, exacerbating the nation's already significant housing affordability challenges. And without subsidies, the private sector will not be able to provide housing at a cost that extremely low-income households can afford.

Historical Context: How We Got Where We Are Today

In 1937, the federal government began to provide rental assistance to the nation's low-income households in a targeted way through the establishment of a public housing program as part of the U.S. Housing Act.¹¹² This Act established a new federal agency focused on housing, the U.S. Housing Agency (a precursor to HUD), and required the establishment of local public housing authorities to build, own, and operate housing using debt financing guaranteed and paid for entirely by the federal government. Tenants occupying the new public housing units were obligated to pay rents that covered building operating expenses, but not construction expenses.

Following World War II, the shortage of adequate housing, particularly for returning veterans, caught the nation's attention. The 1949 Housing Act, along with setting a national housing objective of “a decent home and a suitable

living environment for every American family,” authorized funding for nearly one million additional units of affordable public housing.

The late 1950s and early 1960s ushered in a wave of innovation in affordable housing, including the establishment of new programs that created incentives for private developers and investors to produce and own assisted housing with the government’s support, such as the Section 202 program for housing the elderly and the Section 23 Leased Housing Program to provide leased affordable housing in privately owned properties. The Section 236 Program, created by Congress in 1968, offered subsidies to reduce the interest rate paid on mortgages insured by the FHA in return for rent limits.

As a result of a combination of factors—including the energy crisis of the early 1970s, which drove up costs in many privately owned, federally subsidized properties; corruption; and incompetent management—in 1973 the Nixon administration declared a moratorium on all subsidized production in both HUD and the USDA rural-housing programs. The Nixon administration then followed up the moratorium with a series of proposals to overhaul the federal government’s role in rental housing assistance. Congress responded by adopting the Housing and Community Development Act of 1974, which created the Section 8 program, as a more flexible means of delivering rental housing assistance to the lowest-income households by focusing on rental subsidies to or on behalf of tenants rather than subsidies directly paid to developers. Through this program, funds were made available to support new construction, rehabilitation, and tenant-based rental assistance in existing properties. Although the 1974 Act helped to retain existing public housing units, approvals for new development were scaled back. The stock of public housing that had grown from about 150,000 units in the 1950s to over one million units in the 1970s began to decline. The 1974 Act also called for the consolidation and

restructuring of a number of federal housing programs.¹¹³

During this period, increases in rents due to escalating operating and maintenance costs and declining resident incomes meant that many residents of public housing were spending upwards of 75 percent of their incomes on rent and utilities. In response, Congress adopted, in 1969, the so-called “Brooke Amendment,” championed by Massachusetts Republican Senator Edward W. Brooke, which limited a tenant’s rent to 25 percent of income in public housing. This action, while benefiting tenants, had the effect of lowering the amount of operating capital available to cover the costs of an affordable property. HUD therefore had to provide additional capital to agencies for the maintenance and operation of public housing properties, spurring adoption of annual operating subsidies as well as separate modernization (or “capital”) funding to restore aging stock. Through the Omnibus Budget Reconciliation Act of 1981, Congress raised the minimum tenant payment required from 25 to 30 percent of income, in part to help cover operating costs.¹¹⁴ The Brooke Amendment that established the 25 percent of income limit is responsible for the income-based rent structure that exists to this day in federal housing programs.

In 1986, the Low Income Housing Tax Credit (LIHTC) program was created as part of the Tax Reform Act with bipartisan support, replacing a series of other tax subsidies that had been in place for decades to encourage investment in affordable housing. LIHTC created a new and more efficient means of developing rent-restricted, affordable housing using tax subsidies and became the primary means by which the federal government supports the development and preservation of affordable housing.

During the severe recession of the early 1980s, the problem of large-scale homelessness appeared in America’s cities for the first time since the Great Depression. In 1988, Congress passed the Stewart B. McKinney Homeless Assistance

Act (later the McKinney-Vento Act) to put homeless assistance on the national housing agenda. Funding for homeless initiatives grew rapidly thereafter through the 1990s and 2000s, and numerical goals were put in place to end chronic homelessness through coordinated and comprehensive approaches that combine housing assistance with specialized services where necessary.

In the 1990s, the devolution of federal authority in rental assistance programs that began with the 1974 Act was further reinforced through the creation of the HOME Investment Partnerships (HOME) program. This program introduced a flexible block grant to states and municipalities that builds on the existing infrastructure and partnerships between HUD and the public agencies, nonprofits, faith-

History of Homeless Assistance

For many years, homelessness was thought to be a temporary recession-related problem exacerbated by factors such as the deinstitutionalization of people with mental illness and the emerging AIDS epidemic. As a result, the interventions funded were largely short term: shelter, food, and transitional housing. HUD was the major funder, but targeted services funding was provided through a collection of homeless-specific programs at the Departments of Health and Human Services, Veterans Affairs, Labor, and Education, among others.

It soon became clear, however, that the real driver in homelessness was the lack of affordable housing and that persons with disabilities were simply the first to face the problem. By the end of the 1980s, despite a robust recovery, mass homelessness had increased and had come to affect non-disabled adults, families, and even youth. Accordingly, over time and with strong support from both Republicans and Democrats, homeless assistance was altered to include more permanent solutions, particularly housing. The first focus was on single-room occupancy housing for single adults, and this later shifted to permanent supportive housing (subsidized housing with services) for people with disabilities, based on strong research showing its cost-effectiveness.

More recently, a new housing strategy, called rapid re-housing, has emerged to assist the 80 percent of homeless people whose problem is largely economic. By negotiating with landlords; providing deposits, move-in money, and short-term rental assistance; and connecting people with services in the

community, rapid re-housing helps households that have lost their housing.

Both permanent supportive housing and rapid re-housing use an approach labeled “Housing First”—helping the homeless person to get in to housing immediately then following up with employment assistance, mental health treatment, or whatever other kinds of services are necessary to ensure that the housing is stabilized.

While HUD provides most of this funding, the VA has become increasingly involved. In partnership with HUD, it now provides permanent housing subsidies linked to services offered by the VA to high-need homeless veterans. In its new Supportive Services to Veteran Families program, it also funds rapid re-housing.

Through these programs, and in conjunction with other financing sources (including LIHTC), a significant amount of housing assistance is now being provided via homeless programs. In recent years, HUD has expanded the number of permanent supportive housing opportunities by approximately 20,000 per year.¹¹⁵ There are now some 275,000 units of permanent supportive housing.¹¹⁶ Well over one million households have been assisted with rapid re-housing funds. Republican and Democratic administrations have made commitments to solve all or parts of the homeless problem, the most recent being the Obama administration's pledge to end chronic and veteran homelessness by 2015 and family homelessness by 2020.

based organizations, and private entities in the affordable housing field. States and local governments are given wide discretion over how to use the funds to benefit low- and moderate-income households.

More recently, two federal housing initiatives—HOPE VI and Choice Neighborhoods—have helped transform the nation’s housing stock by bringing the operating practices of the 20th century to public housing in order to establish a more effective approach to supporting the lowest-income households. HOPE VI emerged from the recommendations of the National Commission on Severely Distressed Public Housing, and was first funded by Congress in 1993. HOPE VI followed a series of earlier initiatives launched by former HUD Secretary Jack Kemp, which he hoped would increase resident empowerment and quality of life in public housing. The program worked to demolish and rebuild the existing distressed public housing stock that had become synonymous with concentrated poverty and substandard conditions with lower-rise, higher-quality homes connected to services and amenities. Residential empowerment was central to the aim of the HOPE VI program, as was reducing density and promoting mixed-income communities. The Choice Neighborhoods Initiative, proposed by the Obama administration and authorized by Congress in 2011, built upon the success of HOPE VI. It aims to transform distressed communities into mixed-income places tying the importance of increased access to jobs, supportive services, and economic and educational opportunity into housing developments.

Recommendations for a Reformed Rental Assistance System

The commission strongly endorses the 1949 Housing Act goal of a “decent home and a suitable living environment for every American family.” We note that the poorest households among us are suffering tremendous burdens.

Increasing levels of poverty—particularly among children, elderly, and working families—give us a strong sense of urgency about our recommendations. Working to address these critical needs and achieve the goal laid out in 1949 is, of course, an ongoing enterprise requiring a sustained policy commitment and the dedication of adequate resources.

At this moment in our nation’s history, as our leaders work to put the federal government’s fiscal affairs in order, we believe there must be a rebalancing of federal expenditures on housing to ensure a greater focus on helping our most vulnerable households—homeless people and those with extremely low incomes—and those who are suffering a temporary loss of income or a short-term crisis that may jeopardize their housing stability. We do not believe our nation’s most impoverished families should be subject to a lottery system or spend years on a waiting list to obtain access to federal rental assistance.

Our recommendations to improve the inadequate affordable rental housing system are presented to respond to specific and urgent needs that are deeply interconnected. Implementation of the entire package of proposals put forth by the commission would be the most effective and enduring way to respond to the challenges faced by our nation’s most vulnerable households. We estimate that these recommendations, fully implemented, would help meet the needs of an additional five million vulnerable renter households—through production, preservation, and rental assistance. However, the commission recognizes that a transition period will be necessary to fully realize the specific reforms identified. These are fiscally constrained times where the resources are not readily available to fully support the needs of unassisted households, and calling for any additional spending in the current fiscal environment has its practical limits. We therefore recommend that our approach for meeting the needs of the nation’s most vulnerable households be phased-in over time, although we make these recommendations with a strong sense that action is both possible and necessary.

In order to meet the affordable housing needs of the nation's most vulnerable households and to ensure the overall quality of the housing stock, we recommend that the following five objectives guide federal housing policy:

Focus long-term rental assistance on the households with the greatest needs to help them afford decent homes.

Increase the supply of suitable, decent, and affordable homes to address both current and projected demand.

Provide short-term emergency rental assistance to assist families who suffer temporary setbacks that threaten to force them out of their homes and from which recovery can be difficult.

Reform existing rental assistance programs to improve accountability and flexibility within the delivery system, as well as outcomes for participating households.

Advance innovative programs that connect housing to other sectors like employment and education, health and human services, and transportation.

Each of these objectives is discussed in more detail below.

Focus long-term rental assistance on households with the greatest needs

We recommend the federal government increase support for the nation's most vulnerable households, in order to make progress toward the 1949 Housing Act goal of a "decent home and a suitable living environment" for all American families. More specifically, we recommend that federal rental assistance be made available to all eligible households with incomes at or below 30 percent of AMI who apply for such assistance. At the national level, 30 percent of the annual median family income ranges from \$13,650 for a one-person household to \$19,500 for a family of four.¹¹⁷ In most areas of the country, renters with incomes below this threshold simply cannot afford private-market

housing. As a result of their limited financial resources and the limited availability of federal rental assistance, nearly 80 percent of extremely low-income renters spend more than 30 percent of their income for housing and almost two-thirds spend more than half of their income for housing.

We recommend providing the expanded assistance through a reformed housing voucher program. To reduce costs, we further recommend that, as families currently enrolled in the housing voucher program turn back their subsidies due to rising household income or other factors, all newly available vouchers be issued to extremely low-income households, ensuring that voucher assistance is deeply targeted to the households with the greatest needs.¹¹⁸ Households who qualify for the program and subsequently experience increased income would not immediately lose assistance; however, these households would be expected to make an increased payment that is proportionate to their increase in income.

Helping to narrow this gap between incomes and housing costs not only directly benefits millions of extremely low-income households, it is also a practical necessity to sustain private investment in the supply of rental housing. If tenants cannot afford the economic costs of their housing, landlords may be forced to choose between two equally undesirable outcomes: defer maintenance and withhold capital investments, or "volunteer" to support the tenants by foregoing a reasonable return on their investments. The latter choice is unreasonable and unrealistic. The former can lead to deteriorated homes and distressed communities. While rental assistance is usually categorized as a social program designed to help meet the basic needs of low-income families, it is also a large-scale investment in the physical infrastructure of our communities. By closing the gap between the cost of owning and operating decent housing and the rent that extremely low-income tenants can afford to pay, rental assistance programs sustain a valuable component of our physical infrastructure that otherwise would be jeopardized.

According to an analysis prepared for the commission by Abt Associates, the estimated annual cost of providing this increased coverage is approximately \$22.5 billion.^d This is the estimated cost of providing a Housing Choice Voucher type subsidy to currently unassisted, cost-burdened renter households with incomes at or below 30 percent of AMI who would be expected to participate in such a program were it available. The estimated cost takes into consideration resources that are projected to become available, over time, as the existing voucher program shifts from serving households up to 80 percent of AMI to serving households with incomes that do not exceed 30 percent of AMI.¹¹⁹

These estimates do not take into account any potential savings resulting from fewer families becoming homeless or reduced health care costs. Further research should be conducted to assess the budgetary savings that could be generated through reductions in the number of households in need of homeless or emergency care services.

At a time when there is enormous pressure and competition for existing federal resources, we know this is an ambitious goal; however, it is one we feel is necessary to support the needs of our nation's most vulnerable households. By placing a floor under the most vulnerable households, this recommendation would have a number of immediate and profound impacts. It could, in effect, end homelessness for the vast majority of those experiencing it. Virtually all households experiencing homelessness have incomes under 30 percent of AMI, and 80 percent of those who become homeless do so almost exclusively for economic reasons.¹²⁰ For the approximately 20 percent of homeless persons with disabilities,¹²¹ stable housing would need to be combined with treatment and other services, but the affordability of the housing would effectively end their

homelessness. All vulnerable persons with disabilities and elderly households would be able to count upon stable housing. The most vulnerable and extremely low-income families with children would not face disruptions in employment or their children's education because of the lack of an affordable home.

Increase the supply of suitable, decent, and affordable homes

Our nation has developed a stock of nearly five million subsidized rental homes that provide quality affordable housing, including units funded through the LIHTC, the project-based Section 8 program, the Section 202 and 811 supportive housing programs for the elderly and persons with disabilities, public housing, and the rental housing programs at the U.S. Department of Agriculture.¹²² In the coming years, these properties will play an even more vital role in housing the growing population of low-income adults over age 65, many of whom are aging in place in affordable rental units that were not initially designed to meet their current needs. Many of these properties are aging and not only need repair, but are operating inefficiently, resulting in crippling energy costs. With adequate funding for maintenance and modernization, this stock can provide decades of additional service, helping millions of households obtain and remain in stable, affordable housing.

To increase the supply of suitable, decent, and affordable homes, the commission recommends:

Protect and expand the Low Income Housing Tax Credit as the bedrock of the nation's efforts to preserve and increase the supply of affordable rental housing.

The LIHTC¹²³ is a capped federal tax incentive that is allocated to developers through state housing finance agencies. Developers compete for credit awards through applications that are scored based on how closely the proposed development would meet the affordable housing

d. Abt Associates has prepared a memorandum on this topic that provides the details of their analysis. See *Projections for 10-year Costs of Deep-Subsidy, Voucher-Type Program Offered to Unassisted Renter Households Below 30 Percent of AMI* found on the BPC Housing Commission website at www.bipartisanpolicy.org/housing.

priorities of the state as laid out in an annual qualified allocation plan, or QAP. The properties must be rented to tenants with incomes at or below 60 percent of AMI at rents that are capped for a period of at least 30 years. Federal law requires that states give preference to properties that target lower incomes; as a result, about 41 percent of LIHTC residents have incomes at or below 30 percent of AMI, and 80 percent have incomes below 50 percent of AMI, according to a recent study conducted by the Furman Center at New York University that found that many of these residents were benefitting from other subsidies like Section 8, as well.¹²⁴

It is not economically feasible to develop affordable housing at restricted rents, so a subsidy is needed to make up the difference between what a property costs to develop and the income that can be generated to support such development costs. The LIHTC plays that role. Because rental income is limited, affordable housing properties are not able to support sufficient levels of debt to finance development of the property. This contrasts with other real estate—both residential and nonresidential—which typically is substantially financed by debt. Developers use the tax credits to raise equity capital from investors in the property that serves as a substitute for higher levels of debt. Equity investors receive a stream of tax credits for ten years that reduces their tax liability on a dollar for dollar basis.

The program has a number of features that have made it a successful tool in affordable housing development. Most importantly, the program is administered at the state level by housing finance agencies that go through an annual process to develop allocation plans based on the housing needs of the state. These QAPs ensure that affordable housing investment is aligned with the housing needs within the state. This structure also builds flexibility into the system that enables states to continually tailor their plans to address evolving housing needs.

Another key feature of the program is the means by which it engages market forces to build affordable housing. This engagement occurs at a number of levels. First, developers compete against each other to obtain an award of credits. In most states, the number of applications far exceeds the available credits, causing developers to structure their applications to earn the most points possible under the state allocation plan. Second, investors compete against each other to invest in properties, a process that maximizes the prices they are willing to pay for the credits, resulting in greater taxpayer efficiencies. Third, profit margins for the companies that provide syndication services to raise equity capital and purchase LIHTC properties are driven down as they compete against each other, also benefiting the taxpayers.

A final feature that has made the LIHTC so successful is the minimization of risk to the federal government. The LIHTC is a pay-for-performance program in which the private sector, not the government, bears the full real estate risk of the investment. If for any reason the property falls out of compliance within the first 15 years, stringent IRS recapture rules require the investor to pay back a portion of the tax credits claimed in previous years.

The positive results are evident in the program's track record. Over the first 24 years of the LIHTC program's existence, it financed more than 16,000 properties, or 1.2 million units, across the country. During that period only 98 properties experienced foreclosure, an aggregate foreclosure rate of just 0.62 percent.¹²⁵ This record is unmatched by any other real estate class, including residential and nonresidential real estate.

In recent years, the LIHTC has been called upon to carry a larger load in serving the affordable housing priorities of federal and state governments. The use of the program to create new affordable housing has declined as a greater share of credits has been used to preserve the stock of

existing affordable housing, including both the federally assisted inventory of housing and older LIHTC properties that are in need of recapitalization. As HUD expands its efforts to revitalize an aging public housing stock by tapping the private capital markets, Housing Finance Agencies will undoubtedly be asked to allocate an increasing share of housing credits for the conversion of public housing units.

The commission strongly believes the LIHTC must be preserved. Furthermore, to help address the growing demand for rental housing, we recommend that the annual LIHTC allocation be increased by 50 percent, as the resources are identified, to support a higher level of affordable housing development. We estimate a 50 percent increase in the allocated credit would support the preservation and construction of 350,000 to 400,000 additional affordable rental housing units over a ten-year period at an average annual cost of \$1.2 billion over the first ten years.

An increase in the credits available would provide an opportunity to refine the targeting of credits to ensure the program is meeting the most critical rental housing needs. One approach might be to allocate additional credits based on a formula that measures a state's share of cost-burdened renters; another approach might be to base allocation on the relative size of a state's renter population. Either would be an improvement over the existing allocation formula, which is based on a per capita calculation and does not reflect differences from state to state in the share of the overall population who rents or has a rent burden.¹²⁶

We strongly endorse the use of LIHTC resources to preserve existing affordable rental properties at risk of loss, particularly in the high-opportunity and gentrifying neighborhoods where owners of these units are most likely to exit the program when affordability requirements expire. However, we recommend leaving the decision on how to best prioritize any new LIHTC resources up to the states.

Provide gap funding sufficient to support an expansion of the LIHTC.

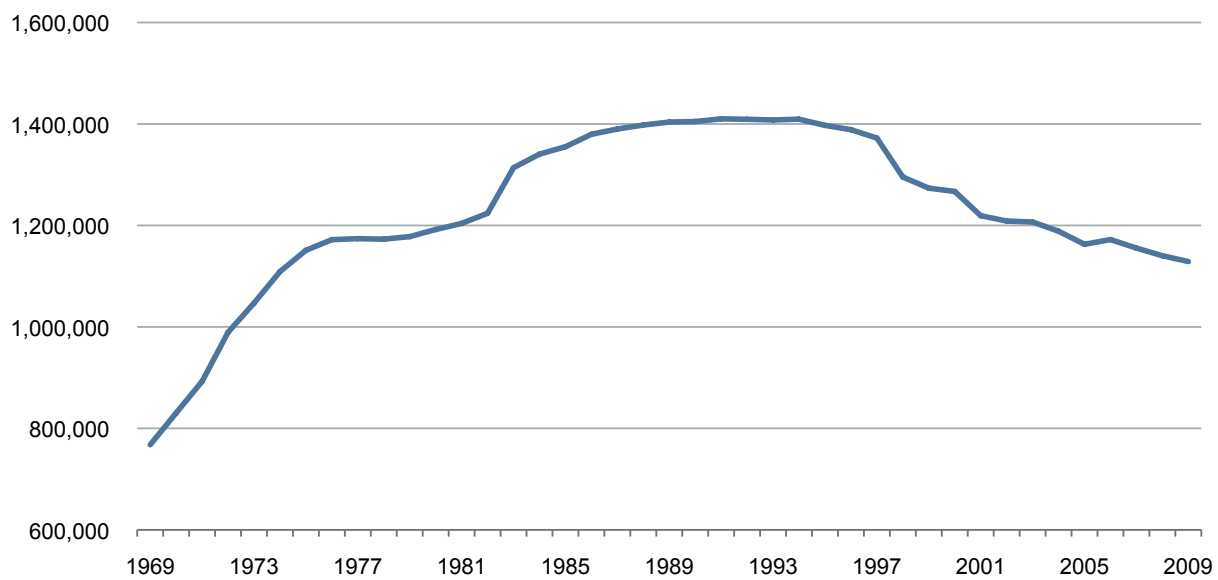
To help ensure effective utilization of the expanded LIHTC, the commission recommends the provision of gap funding at a level sufficient to support this expansion. In most markets, the costs to produce or preserve an affordable rental housing development exceed the funds available through the equity raised by the LIHTC and the debt that can be supported by projected rents. For both current allocations and an expansion of the LIHTC to be most effective, some level of additional funds is needed to cover this gap.

We estimate that \$1.0 billion in gap funding would help to support the new development financed through the suggested incremental increase to the LIHTC program. Beyond this funding, an additional \$1.0 billion (for a total of \$2.0 billion annually) would help support existing LIHTC allocations that have been impacted by the substantial reduction in federal appropriations for the HOME program in FY 2012. The new gap funding should be authorized through the HOME program and restricted for use in conjunction with the LIHTC.

Address the capital backlog and ongoing accrual needs in public housing to preserve the value of prior investments and improve housing quality for residents.

The nation's stock of public housing is deteriorating and shrinking and is in need of basic maintenance and modernization. This slow death-by-attrition wastes valuable federal housing assets and risks the loss of both high-quality and deteriorating units alike. In addition, it penalizes residents.

Accordingly, we recommend an overhaul of the public housing system to (1) introduce market discipline; (2) improve access to private capital; (3) incentivize public/private partnerships; (4) preserve the public investment in properties that have been well-maintained and are located

Chart 4-3: Number of Public Housing Units, 1969 to 2009

Source: Ingrid Gould Ellen, "Rental Housing Policy in the United States: Key Facts and Critical Trade-Offs" (presentation, *The Next Generation Housing Policy Convening on Rental Policy*, Washington, D.C., October 13, 2010), using estimates prepared by the Joint Center for Housing Studies of Harvard University.

in areas of opportunity; and (5) facilitate the transfer of subsidies from properties that are in very poor condition or are located in areas of highly concentrated poverty to newer properties with longer lifecycles and better locations.

While the commission stops short of endorsing HUD's Rental Assistance Demonstration program, we endorse its overall objectives of incentivizing public/private partnerships and facilitating access to private sources of capital by public housing authorities to support the revitalization and modernization of public housing.

The preservation of existing public housing is estimated to cost an additional \$4.0 billion annually.¹²⁷ Though this additional investment is not likely to increase the overall

number of units in the public housing stock, we estimate it would help revitalize and prevent the loss of the existing stock of 1.2 million public housing units over the next ten years. Moreover, where possible, as part of a capital improvements program, steps to improve the energy efficiency of existing public housing structures should be undertaken. By reducing the utility costs associated with the operation of these units, improved energy performance would result in cost savings over time that could be used to support the ongoing maintenance and preservation of the stock.¹²⁸

Encourage the removal of local and state barriers to the development of rental housing.

The nation's housing affordability challenges can be

exacerbated by barriers imposed by local and state zoning, permitting and other policies that raise the costs of producing new units or restrict the effective and efficient use of existing ones. While it is not the federal government's role to require local or state governments to adopt specific land-use policies, there are measures that can be taken to encourage better policies. Federal efforts should (1) ensure that communities employing highly restrictive zoning and building code policies that substantially drive up the cost of housing are not rewarded with larger allocations of federal housing funds; and (2) educate local and state leaders about the negative effects of regulatory barriers on affordable rental housing and highlight promising approaches for removing these barriers.

Provide short-term emergency rental assistance

While the incomes of extremely low-income renters are generally insufficient to afford private-market rents without ongoing rental assistance, households with somewhat higher incomes can afford private-market housing on their own in many communities. However, the loss of a job, the death or departure of a working household member, or a major medical crisis can lead to short-term affordability crises that can jeopardize the residential stability of these households, leaving some homeless and others consigned to making multiple unwanted moves. This instability can undermine educational achievement and create or exacerbate health problems. Short-term, targeted funding for security deposits, back rent, temporary rental assistance, and other limited forms of assistance, such as utility payments, could improve residential stability and help prevent homelessness for these renters.

The commission recommends dedicating supplemental funding to the HOME program to deliver one-time, emergency assistance to households with incomes between 30 and 80 percent of AMI. The HOME program currently allows tenant-based rental assistance to be provided to

special needs groups—the homeless or those at risk of homelessness. This authority should be broadened to include any low-income household with income between 30 and 80 percent of AMI who demonstrates a need for temporary assistance. Many of the eligible uses described above—security deposits and utility payments—are already allowable expenses through the HOME program and should be continued. Data currently collected through the HOME program does not sufficiently capture the level of detail necessary to demonstrate the effectiveness of this short-term assistance. Grantees receiving this incremental funding should therefore be subject to additional data collection requirements.

According to the analysis prepared for the commission by Abt Associates, the estimated annual cost of providing flexible, one-time emergency assistance to eligible renter households expected to participate is around \$3.0 billion, assuming assistance levels up to \$1,200 per household.¹²⁹ These households would be ineligible to receive assistance under the expanded housing voucher subsidy program for extremely low-income households outlined above, but nonetheless have modest incomes, may live in overcrowded conditions, and experience housing emergencies for which a temporary rental supplement could be beneficial.

This type of program would help to reduce pressure on homeless shelters, lowering the number of temporarily displaced households seeking assistance and generating offsetting savings in programs serving those populations. HUD has experience operating larger-scale programs of homelessness prevention, particularly the three-year Homelessness Prevention and Rapid Re-Housing Program (HPRP) that was part of the 2009 economic recovery legislation. HPRP is widely regarded as having been instrumental in preventing the large increase in homelessness that was expected to result from the Great Recession.¹³⁰

Further study of other mechanisms for delivering temporary emergency assistance could be helpful. For example, a rental insurance program may be a promising way to help households with temporary emergency needs. A rental insurance program would require tenants to make an initial payment upon occupancy of a unit toward an insurance policy that would cover payment of rent and utilities in the event of an emergency. The insurance program would be set up to provide a fixed payment amount to the landlord for a fixed number of months. Though rental insurance programs are promising, they still require rigorous testing to assess their overall effectiveness in preventing homelessness for low-income, unassisted renters; discouraging discrimination against lower-income households; and decreasing the average length of stay in longer-term assistance programs.

Reform existing rental assistance programs

The changes we have proposed above will enable more households to access affordable rental housing. However, we recognize that additional benefits could be achieved if we also improved how housing assistance is delivered. This section describes improvements to the process of delivering rental assistance, providing an important complement to our recommendations for expanding availability.

While HUD's rental assistance programs generally do a good job reducing to affordable levels the rents that households pay, there are a number of significant challenges that must be overcome in order for the programs to more fully realize their potential to improve the life outcomes of assisted households. To address these challenges, the commission proposes a major overhaul of the incentives' structure for all HUD rental assistance programs, creating stronger incentives for housing providers^e to improve efficiency and housing quality among other desired outcomes. This

e. We use the term "housing providers" to refer to any entity that administers a housing assistance program, including both housing authorities and private owners of multifamily assisted housing.

A Renters' Tax Credit

While the commission recommends that rental assistance be delivered through an improved voucher program, a renters' tax credit is another vehicle that illustrates how tax credits could be used to deliver rental assistance and may warrant additional consideration.

A renters' tax credit, developed by the Center on Budget and Policy Priorities, could be administered by states working in public-private partnerships with lenders and/or property owners. This approach is similar to that taken by the LIHTC program and the Section 8 voucher program. States would receive an annual allocation of credits determined by either population or a need-based formula. Credits allocated to each state could be used by low-income renters to reduce rents at a property of their choosing, by property owners offering affordable rental units for low-income households, or by lenders underwriting affordable rental properties. Property owners could either claim the tax credit based on the rent deduction provided, or pass the benefit along to the property's lender in return for reduced mortgage payments.

States would have the flexibility to set their own preferences for how to allocate and use the credits, including in combination with the LIHTC, consistent with federal income eligibility and targeting requirements. The program could also be used to advance identified state policy goals that benefit low-income households. States would be responsible for the program's administrative costs.

Such a program could help increase the ability of low-income households to pay prevailing rents in high-opportunity neighborhoods, as well as help stimulate production and preservation of affordable rental housing for low-income households and reduce homelessness. Renters benefitting from the tax credit would be required to pay no more than 30 percent of their income toward rent with the tax credit making up the gap between what a tenant could pay and the actual rent charge.

proposed system would reward high-performing housing providers with substantial deregulation, providing greater freedom to innovate and depart from standard HUD practices. At the same time, providers who fail to achieve acceptable results should lose the right to administer the programs, with new administrators chosen through competitions held among providers. The end result of these proposed changes would be more efficiency, better outcomes for residents, and more freedom for providers to innovate.

There are important differences among the various HUD rental assistance programs. The outcome-based system we articulate will therefore need to be tailored to the specific characteristics of each program. Nevertheless, the fundamental transformation in the delivery system—a shift in emphasis toward outcomes rather than process, combined with increased accountability for results and greater flexibility for high performers—would benefit all of HUD’s rental assistance programs. We propose to apply this new system initially to the three main HUD rental assistance programs: housing vouchers, public housing, and project-based Section 8, followed by adaptations for other more specialized programs, such as Section 202 and 811 supportive housing for the elderly and persons with disabilities, as well as eventually to rental assistance funded through USDA. States could also be encouraged to align the housing priorities articulated in their QAPs with the outcomes we outline below, allowing residents of LIHTC properties to benefit from this outcome-based approach.

A transition period will be necessary during which time various approaches to applying an outcome-based measurement system are considered and evaluated. This transitional period will provide a valuable opportunity to engage stakeholders in conversation—informed by the close analysis of program data—on how to improve the outcomes of our nation’s rental assistance programs.

Problems with the Current Delivery System

Overall, the nation’s rental assistance programs do a good job of ensuring that participating families have access to affordable rental units. At the same time, however, it is clear that the system can be improved in ways that benefit participants while improving efficiency and reducing administrative burden. High-capacity housing providers and other stakeholders administering HUD’s rental assistance programs regularly express a number of concerns with the current delivery system, including:

Overly prescriptive and burdensome rules. The laws and regulations governing HUD’s rental assistance programs have, over time, evolved into a set of highly prescriptive rules, which some housing providers believe make it difficult to effectively adapt the programs to meet local needs and generate substantial compliance costs that reduce the ability of agencies to focus resources on improving outcomes for residents. These rules generally were shaped by experience, often a scandal in program administration, and were designed to prevent its repetition and provide essential protection for taxpayers and program participants. Others are the result of congressional mandates or court rulings issued in response to lawsuits over management problems. Whatever their provenance, however, there is widespread agreement among housing providers that many of these prescriptive rules are hindering rather than fostering efficiency.

One specific concern raised by some housing providers is that the rules governing HUD’s rental assistance programs do not pay adequate attention to differences among local real estate markets. Providers argue that solutions must be crafted in the context of local real estate markets and the local economy. In this vein, providers argue for more flexibility, for example, to adjust voucher payment standards to account for local variations in rents and more flexibility to adjust inspection standards to account for neighborhood

quality (such as safety and/or concentration of vacant homes).

Insufficient accountability for results. A historical focus on process, rather than outcomes, has allowed housing providers in HUD's performance management systems to receive high scores even if their outcomes are mediocre. For example, in HUD's housing voucher program, the performance measurement system examines the extent to which agencies re-inspect properties found to have had a deficiency in an initial inspection, but does not directly assess the quality of the units that residents occupy.¹³¹ Perhaps as a result, HUD data raise serious concerns about the quality of housing occupied by assisted households.¹³²

Failing to realize the potential of housing as a platform. Today, many housing practitioners recognize that rental assistance can serve as a platform for attaining broader social outcomes related to resident health, educational achievement, economic opportunity, independent living for older adults and persons with disabilities, and the de-concentration of poverty. HUD has not set up a performance management structure that strongly incentivizes these outcomes, in part because of concerns by housing providers that they have neither full control over their achievement nor the ability to collect data measuring results in these areas. Nevertheless, some stakeholders argue that HUD should place more emphasis on these broader social outcomes through its performance management system and through enhanced partnerships with other relevant federal agencies.

Insufficient support for measuring outcomes and cross-site learning. Even as HUD invests resources in regular audits of local programs to make sure all the procedures are being followed, providers receive little assistance in measuring program outcomes or identifying promising approaches for achieving them. To its credit, HUD has stepped up its research program in recent years to help identify successful approaches for achieving a range of objectives,

but providers need even more assistance tracking real-world outcomes and impacts on assisted households, as well as opportunities to learn from the experiences of other providers facing similar challenges.

Remediating these concerns will require a shift in HUD's general approach to managing federal housing programs—from a rigid focus on compliance with program rules to a focus on achieving key outcomes, while providing support for innovation, entrepreneurship, and flexible administration. In this regard, it is important to acknowledge that additional staff, training, or other resources may be needed at HUD to ensure they can effectively manage these reformed programs. Staffing levels at HUD today are about one-half what they were in the 1980s.¹³³ It is not reasonable to layer more requirements for the programs HUD administers, or demand higher outputs and outcomes, without providing adequate tools and staff, or enabling flexibility in staffing and administration to support the agency's ability to carry out such mandates.

An Improved Approach

To address these challenges and strengthen HUD's rental assistance programs, we propose a fundamental shift in the incentives' structure for HUD-funded housing providers to a system marked by the following characteristics:

A focus on outcomes, rather than process. We propose establishment of a performance management system that measures resident outcomes across all rental assistance programs, focused on creating incentives for greater efficiency and improved housing quality, as well as ensuring that rental assistance meets its full potential to serve as a platform for the achievement of other social outcomes.

Expanded deregulation for high performers. As an incentive for providers to achieve strong outcomes, we propose to reward high-performing providers with substantial devolution, giving them broad latitude to depart from HUD

program rules akin to the flexibility currently provided to housing authorities enrolled in the Moving to Work demonstration.¹³⁴

Increased accountability through competition. At the same time, providers that consistently fail to deliver an acceptable level of performance should be held accountable for inadequate results by having the right to administer their housing subsidies taken away and assumed by a higher-performing agency selected through a competitive process.

Real-time learning environment. To support the outcome-based performance measurement system and stronger performance by housing providers, HUD (either directly or through contractors) should expand its role providing data, evaluating promising approaches, and facilitating the exchange of information among providers.

Greater focus on interagency partnerships. To more fully realize the potential of rental assistance to advance goals related to healthy housing, economic opportunity, independent living for older adults and persons with disabilities, and the de-concentration of poverty, we recommend the development of more robust interagency partnerships between HUD and other agencies that can help align performance management systems and resources to achieve these goals.

In addition to instituting and supporting this new performance measurement system, we recommend that HUD consider other opportunities to reduce the burden of regulatory compliance, particularly among small public housing agencies that lack staff capacity. A number of models have been advanced to address the concerns of small agencies.¹³⁵ Additional ideas for simplifying the administrative process, including ideas for streamlining the property inspection and income-verification processes have been developed and have bipartisan support. While the commission stops short of addressing any specific

legislation, we urge HUD to work collaboratively with the full range of stakeholders to consider these and other solutions for reducing the burden on housing providers, while ensuring the continuation of essential protections for residents.

Learning from Other Outcome-Based Measurement Systems

Stewards for Affordable Housing in the Future—an association of affordable housing developers with members who have properties throughout the country—has begun an initiative to track outcomes in areas which their members see as critical to helping low-income households help themselves. This system includes measures related to: work, income, and assets; youth and education; housing stability; community engagement; and health and wellness.

Likewise, NeighborWorks America has an outcome-based measurement system, known as the “Success Measures Data System,” that measures outcomes related to affordable housing, community building, and economic development.

In translating our recommendations into practice, it would be useful to consider the experiences of these and similar measurement systems developed by high-performing nonprofit organizations.

Key Desired Outcomes of HUD-Funded Rental Assistance

To more effectively achieve the full potential of rental assistance to improve participants’ life opportunities, the commission recommends that a new accountability system be established to achieve the following key outcomes:

1. Improve housing quality. All units funded through the housing voucher program must pass an inspection to ensure they meet basic housing quality standards. Public

housing authorities and owners of assisted rental housing are similarly responsible for maintaining acceptable levels of housing quality. These rules help to direct scarce federal resources to high-quality housing and should be strengthened in a reformed system that seeks the best outcomes for tenants. Federal resources should not be dedicated to supporting substandard housing.

- 2. Increase the efficiency with which housing assistance is delivered.** The rising cost of rental assistance requires significant budget increases each year to continue serving the same number of households and puts pressure on funding levels for other important HUD programs. There is a tension between the goal of lowering costs and achievement of other policy objectives, such as improving access to neighborhoods of opportunity. But all things being equal, lower costs would help HUD stretch scarce budget resources further. In particular, we recommend focusing on reducing administrative costs and on ensuring that rents are set at levels that are at or below market, and not inflated.
- 3. Enable the elderly and persons with disabilities to lead independent lives.** The population that receives federal housing subsidies is aging and growing increasingly frail. While many of these households can live independently without additional services, many cannot—particularly the frail elderly and persons with severe or multiple disabilities. Given the great expense and disruption of moving these households to nursing homes, the preferred alternative is to ensure that these households have access to the services that may be needed to enable them to live independent lives within HUD-assisted housing, such as coordination of health care, preparation of meals, and assistance with transportation. *See Chapter 6, Aging in Place: A New Frontier in Housing.*
- 4. Promote economic self-sufficiency for households capable of work.** Evidence indicates that housing assistance by itself is not enough to boost employment

and earnings.¹³⁶ Research on the Jobs Plus and Family Self-Sufficiency programs—two promising housing-based self-sufficiency initiatives—suggests that a combination of work-promoting services and financial incentives can help households with rental assistance increase adult employment and earnings.¹³⁷ Higher earnings, in turn, lead to higher rent payments by residents, reducing federal expenditures and enabling many households to transition off of assistance.

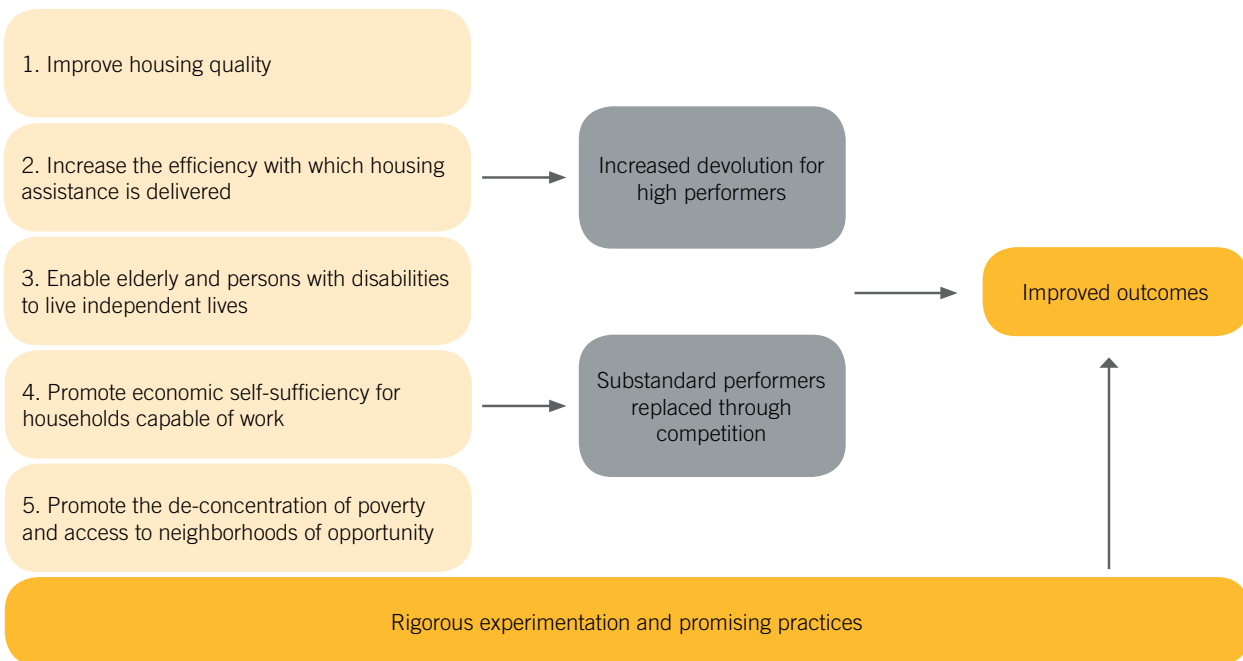
- 5. Promote the de-concentration of poverty and access to neighborhoods of opportunity.** Both research and practice confirm the harmful effects of concentrated poverty on the well-being of low-income households and the health and educational benefits of accessing neighborhoods with better schools and lower poverty rates.¹³⁸ While preserving individual choice, housing policy should strive to increase opportunities for households to find affordable housing in areas of opportunity and avoid concentrated poverty.¹³⁹

Among other strategies for achieving this goal are: (a) mobility counseling to help voucher-holders with children access available housing in high-opportunity neighborhoods with good schools, (b) the use of project-based vouchers to secure affordable housing opportunities for older adults in walkable neighborhoods near planned or existing transit stations, and (c) the redevelopment of public housing or project-based Section 8 housing in a manner that facilitates a greater mix of incomes.

Explanations of each system component follow:

Outcome-based performance standards.

By establishing an outcome-based measurement system, HUD could determine which providers are excelling in achieving key housing outcomes and which are not. Of course, providers also need to be competent in administering basic program functions and fulfilling basic requirements efficiently and effectively. But given the potential of affordable housing to lead to meaningful and

Figure 4-1: How the Proposed System Would Work**Outcome-Based Performance Standards**

measurable improvements in the lives of individuals, we recommend moving beyond a focus on rule compliance to a focus on outcome-based results.

For the most part, HUD's current rating systems fall short of this charge. HUD has established separate systems for rating the performance of local providers of Section 8 housing voucher programs, public housing programs, and multifamily assisted properties. The current rating system for Section 8 housing vouchers—the Section 8 Management Assessment Program, or SEMAP—focuses largely on compliance with basic program mechanics (such as full utilization of vouchers and prompt follow-up on quality deficiencies identified during housing quality inspections)

and stops well short of identifying truly excellent programs. HUD's assessment systems for public housing and multifamily assisted housing include a somewhat greater focus on outcomes—particularly housing quality¹⁴⁰—but stop short of identifying programs that excel in achieving the five programmatic outcomes the commission has identified.¹⁴¹ Providers also note that HUD's rating and reporting systems do not work effectively for agencies with Moving to Work authority, leading to complications and administrative burdens.

A new rating system will be challenging to implement, with providers likely to argue that they lack direct control over the outcomes that will be measured. The rating systems will

also need to account for differences in housing markets, as well as differences between rental assistance programs. For example, it will be much easier to promote the de-concentration of poverty in a tenant-based program like the housing voucher program than in a project-based program like public housing or project-based Section 8, where the physical location of a property is fixed. Despite these challenges, measures of program excellence need to be developed as the prerequisite for a system designed to promote better outcomes for participating households.

Some housing providers have expressed a preference for having a third party administer the rating system, rather than HUD. We do not express a specific opinion about who does the evaluation but rather emphasize the importance of ensuring that outcomes are measured effectively and objectively.

Increased devolution for high performers.

HUD should provide greater flexibility to agencies that have demonstrated their competence by excelling in achieving the outcomes measured by the new accountability system we propose. This flexibility should be broad—similar to that provided to public housing agencies participating in the Moving to Work demonstration. At the same time, this shift should be closely monitored to ensure that program beneficiaries are not inadvertently hurt. Special care should be taken to ensure that increased flexibility does not adversely impact the elderly and persons with disabilities.

Providers receiving this flexibility should continue to be monitored to ensure continued excellence, with penalties imposed if their performance declines sharply. The following are examples of the kind of flexibility that high-performing providers could use to better achieve key programmatic outcomes:

- **The ability to modify rent rules to promote economic self-sufficiency** - In Portland, Oregon the housing authority

has used its Moving to Work authority to offer participants in its Opportunity Housing Initiative a financial reward for higher earnings. Participants continue to pay income-based rents, but all amounts above \$300 per month go into an escrow account that the family can access once it has met the program requirements (which include employment and graduation from housing assistance). Among other benefits, the housing authority believes this variation on the traditional Family Self-Sufficiency program model is more likely to be cost-neutral or even revenue positive, allowing it to offer the incentive more broadly.

- **The ability to extend housing quality standards to incorporate neighborhood quality** - In Atlanta the housing authority decided that the use of a housing voucher to rent a unit in a dangerous neighborhood was not an acceptable outcome, even if the unit itself would meet traditional HUD housing quality standards. Accordingly, Atlanta has modified the standards that it uses to determine whether to approve a rental opportunity—offered to a family with a housing voucher—to include such issues as the extent of vacant and abandoned property nearby, as well as signs of suspicious illegal activity.¹⁴²
- **The ability of owners of multifamily assisted properties to achieve economies of scale by operating on a portfolio basis.**¹⁴³ - Current housing policies and programs drive affordable housing owners to manage each housing development as a separate stand-alone entity with its own financing, compliance, and reserves. For mission-oriented owner/operators who have large portfolios of properties, this approach needlessly raises operating and compliance costs, makes it difficult or impossible to raise capital at the enterprise level, and prevents deployment of capital and excess cash proceeds to achieve better outcomes for the people they serve. The commission supports consideration of policy changes that allow and

encourage the strongest, performance-oriented providers to manage their properties at a portfolio level to increase the impact of these resources. See *Text Box, Entity-level Finance and Operations*.

Entity-level Finance and Operations

Equity, excess reserves, and residual receipts associated with a property that is operating well are now locked in that property. If portfolio owners could move resources to a weaker property in the portfolio to improve its operating performance or preserve it as affordable housing over a longer period of time, the overall quality of the housing would be maintained and costly deferred maintenance avoided. Entity-level finance would enable owners or property managers to provide HUD and state housing officials with a single audit for a portfolio of properties rather than pay for an audit of each property as required under current practice. Flexible management of portfolios would also allow organizations to more efficiently raise larger amounts of capital at the enterprise level and then deploy this capital to those places in their portfolios with the greatest needs and the greatest return on the investment dollar. Finally, the management of rental assistance contracts at a portfolio level would make the system more efficient and effective by allowing owners to reposition the rental assistance on other properties in their portfolios or to new properties.

Substandard performers replaced through competition.¹⁴⁴

The prospect of competition should promote stronger performance among providers, while the competition process itself would strengthen administration by bringing in proven providers to run struggling programs. To protect residents, the competition should be limited to providers with a track record running the program in other locations. To gain experience, prospective providers who are not already operating a program could start out acting as sub-contractors to existing program providers.

In many cases, neighboring housing authorities or other local providers will be strong candidates for winning these competitions. Given the benefits of consolidating administration of smaller voucher programs, HUD may elect to make consolidation an explicit goal of the competition process.

In developing new accountability policies, it will be essential to recognize the impact of inadequate and uncertain funding on providers' ability to meet their responsibilities and run excellent programs. Public housing authorities, for example, report receiving funding at levels well below those necessary to operate their programs effectively, leading to reductions in housing quality and numbers of households served. Owners of project-based Section 8 developments raise similar concerns. The sweeping of provider reserve funds could likewise jeopardize provider flexibility to meet changed circumstances and adversely affect the ability of providers to attract talent and implement innovation.

Rigorous experimentation and promising practices.

Flexibility in program rules can create incentives for high performance. But flexibility also may lead to new approaches that yield better outcomes for households. When new approaches are tried and proven to be successful, without causing hardship or undermining other programmatic goals, they should be made available as options for all providers, including standard performers that may not have Moving to Work-type authority.

Rigorous evaluation of new approaches can help provide the data necessary to determine if a particular approach is effective, and HUD and Congress should invest in the data collection and evaluation tools needed to track and confirm the costs and benefits. The new approaches taken by high-performing providers through devolution provide a natural testing ground for evaluating new ideas. By tracking outcomes and constructing and executing research frameworks built around these ideas,¹⁴⁵ HUD can

ensure that new ideas are thoroughly studied before being incorporated into the program rules applicable to standard agencies.

A number of current studies by HUD's Office of Policy Development and Research (PD&R) illustrate the potential of rigorous evaluation to generate the evidence base needed to determine whether new program options should be made broadly available to all administering agencies. For example, PD&R is studying the effect of applying Small Area Fair Market Rents (FMRs) in six metropolitan regions across the country. In these trial areas, public housing authorities are able to use FMRs calculated at the zip-code level rather than the metropolitan or Core Based Statistical Area level, as is currently the case. One purpose of this effort is to provide assisted households accessibility to a broader range of neighborhoods, including high-opportunity areas that might otherwise be prohibitively expensive for low-income families. Early evidence from a Dallas case study suggests that significant shares of voucher-holders are moving to safer neighborhoods after a year of the Small Area FMRs being in effect. Additional research is needed to determine the fiscal impact of these changes and their impact in other study sites.

More robust efforts are needed to facilitate the documentation of innovative approaches and sharing of promising practices among program providers. With multiple providers trying new approaches for achieving similar objectives, strong lines of communication will be needed to ensure they have opportunities to learn from each other both about approaches that appear to lead to better outcomes and approaches that do not generate the expected benefits or lead to unexpected costs or other problems. Rather than asking each local agency to investigate and evaluate the practices of other providers on its own, it would be much more efficient and effective to assign this function to a single entity or consortium of entities with complementary expertise funded centrally by HUD.

This would not be a regulatory function—no local housing agency will be forced to adopt any of the policies highlighted in these reviews—but rather a support function designed to provide timely and relevant information to local providers to help them develop more effective rental assistance programs. The practices covered by this documentation and information-sharing process will include both the details of program administration (e.g., how to increase utilization of housing vouchers or improve the accuracy of income verification) as well as practices to better achieve key programmatic outcomes.

Many details will need to be worked out in order to fully implement an accountability system that improves the delivery of rental assistance. A transition period will help to appropriately identify and phase in the relevant metrics for measuring the identified outcomes. During the transition process, well-accepted measures of outcomes or outputs could be adopted and implemented on a phased-in basis, even as new measures are developed and existing ones are strengthened. In developing the new measures, it will be important to identify those that apply both to agencies operating under standard rules and the high-performing agencies that have received opportunities to depart from these rules.

The commission hopes to encourage a data-driven debate about what the nation ultimately wishes to achieve through its rental assistance programs, beyond the core value of affordability. As a transition period proceeds, it will be important to ensure that the debate itself does not undermine progress in developing and implementing the new system. The new performance measures should be thoroughly vetted and tested, but we cannot let the perfect be the enemy of the good. The perfect accountability system may be unattainable, but a much improved, reformed system is definitely achievable and will lead to stronger

outcomes for the millions of households participating in federal rental assistance programs.

Advance innovative programs that connect housing to other sectors

There is much that local housing providers can do on their own initiative to make progress in achieving goals such as increased economic self-sufficiency for residents and an increased ability of older adults and persons with disabilities to lead independent lives. However, the likelihood of achieving these goals will be increased substantially if housing providers can count on the active collaboration of partner agencies working at the local level on issues like education, workforce development, human services, health, aging and disability, and transportation.

Accordingly, HUD should continue to build strong relationships with other federal agencies to develop coordinated guidance at the federal level to promote the more efficient use of existing resources at the local level. Federal interagency efforts should be designed to generate guidance on specific actions that local agencies can take to advance shared goals.

In the area of economic self-sufficiency, for example, interagency partnerships among HUD, the Department of Labor (DOL), and the Department of Health and Human Services (HHS) could focus on coordinating the services offered by DOL and HHS grantees with family self-sufficiency programs administered by local housing providers to expand the number of families benefitting from a comprehensive array of services that can together help boost earnings and employment: stable affordable housing, economic incentives to increase earnings and build assets, work-promoting case management or coaching, and access to work-promoting services.

Similarly, an already-established partnership between HUD and HHS is focused (among other things) on maximizing

the access of older adults and persons with disabilities with rental assistance to the services needed for them to live independently. If implemented robustly, this partnership could, for example, facilitate the use of Medicaid for services that help older adults remain in HUD-assisted housing, rather than transitioning to nursing homes. Research is now underway to test the extent to which service-enriched housing can help reduce Medicaid and Medicare expenses; to the extent this research demonstrates savings, there will be additional benefits to this type of interagency collaboration. *See Chapter 6, Aging in Place: A New Frontier in Housing.*

Other promising areas of interagency collaboration include: combating homelessness, meeting the housing needs of veterans, promoting healthy homes, improving energy efficiency, and ensuring that families of all incomes have access to emerging areas of opportunity near public-transit stations, job centers, and other areas with low transportation costs. The commission applauds the federal government for its efforts to date in building partnerships between federal agencies and recommends that these efforts be continued and strengthened to more effectively meet the cross-sectoral challenges of housing, poverty, health, aging, and economic growth.

Summary of Recommendations

Table 4-1 summarizes the commission's recommendations for affordable rental assistance and provides estimated annual costs for each recommendation.

The commission is aware of the difficult issues that will need to be addressed in the coming years to balance federal budget priorities. The federal government currently provides substantial resources in support of housing, the majority of which is in the form of tax subsidies for homeownership, as set forth in Figure 4-2 below. The commission supports the continuation of tax incentives for homeownership—

recognizing the importance of this tax policy to homeowners in the United States today. The commission notes that various tax benefits provided to homeowners, including the mortgage interest deduction, have been modified over the years. In the ongoing debate over tax reform and budget priorities, all revenue options must be evaluated. In that context, the commission recommends consideration of further modifications to federal tax incentives for homeownership to allow for an increase in the level of support provided to affordable rental housing. Any changes should be made with careful attention to their effect on home prices and should be phased in to minimize any potential disruption to the housing market. A portion of any revenue generated from changes in tax subsidies for homeownership should be devoted to expanding support for rental housing programs for low-income populations in need of affordable housing.

In addition, the commission recommends retaining in a reformed housing finance system the fee adopted by Congress in the Housing and Economic Recovery Act of 2008 (HERA) and intended to be collected by the GSEs, to apply only to mortgages guaranteed by the Public Guarantor. Revenue generated should be used to fund the National Housing Trust Fund and the Capital Magnet Fund, with eligible activities to include housing counseling for first-time homebuyers and support for affordable rental housing.

The commission strongly opposes using fees imposed on mortgages to finance governmental expenditures outside of the housing sector. In 2011, Congress enacted a supplemental 10 basis point fee on single-family mortgages guaranteed by Fannie Mae and Freddie Mac to cover a portion of the cost of extending Social Security payroll tax relief. Proceeds from this fee are included in the cost of new mortgages guaranteed by the companies and the proceeds deposited in the general Treasury. In November 2012 the

Table 4-1: Estimated Annual Costs and Potential Impact

	Estimated Annual Costs (in billions)	Estimated Number of Units Produced/ Preserved or Households Served
Rental assistance to households with incomes at or below 30% AMI	\$22.5	2.5 million
Short-term assistance to households experiencing residential instability	\$3.0	2.4 million
Protect and expand the LIHTC program	\$1.2	35,000 – 40,000
Gap financing to support an expansion of the LIHTC program	\$1.0 – \$2.0	N/A
Capital backlog and ongoing accrual needs in public housing	\$4.0	110,000

Notes: In all cases, the dollar amount listed and units produced are incremental, on top of what is currently being spent and produced. Estimated annual cost for rental assistance to households with incomes at or below 30 percent AMI is based on participation rates in the Supplemental Nutrition Assistance Program (SNAP) among households with incomes below 30 percent of AMI. Average annual cost of Protect and expand the LIHTC program is over ten years—annual costs would range from \$0.26 billion in year three to \$2.9 billion by year 10 after enactment. (Because of lag time between allocation and production, no increases in tax expenditures would be experienced in the first two years.) The difference between the estimated accrual need and the actual accrual need in public housing will continue to grow if the capital backlog is not addressed. Addressing the capital backlog in the near future will decrease accrual needs in the long term. The estimates do not include administrative costs.

House of Representatives approved legislation to extend this fee for a year beyond its October 21, 2021, expiration to finance immigration reform legislation. There is no policy justification for requiring that the single-family mortgage finance system bear the burdens of programs that have no relationship to housing.

However, the adoption of fees to support targeted expenditures is well-established in Social Security, Medicare, transportation, and airport funding. HERA established a 4.2 basis point mortgage fee on new single-family mortgages guaranteed by Fannie Mae and Freddie Mac. The funds were allocated specifically to the National Housing Trust Fund to finance affordable housing for very low-income households, and the Capital Magnet Fund in the U.S. Treasury for CDFIs carrying out affordable housing and community and economic development lending. No fees were ever collected because shortly thereafter Fannie Mae and Freddie Mac were put into conservatorship and collection of the fees was suspended by the Federal Housing Finance Agency.

Affordable Housing Program: Making the Connection

The Federal Home Loan Banks' Affordable Housing Program (AHP) is a working example of a federal housing policy that promotes access to private capital. Created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the AHP requires each Federal Home Loan Bank to set aside 10 percent of its net income each year for assistance to low- and moderate-income families and individuals. Awards made through the program may be provided as grants or loans and can serve a variety of purposes related to affordable housing, including acquisition, construction, or rehabilitation of rental and owner-occupied housing. Set-asides may also be provided for homeownership assistance and housing counseling. Eligibility for AHP is limited to the member institutions of each Home Loan Bank, which partner with local housing developers and community organizations to submit applications and benefit from the opportunity to earn credit toward their community investment goals.

Notes: Summing tax expenditures can lead to an overestimate of the total tax benefit. Each estimate, in isolation, treats itemization separately. This can result in an over count of the total estimate. See: Altschuler, Rosanne and Robert Dietz, "Reconsidering Tax Expenditure Estimation," *National Tax Journal* 64, no. 2, part 2 (2011), 459-489.

Other tax expenditures - owner includes exclusion of interest on government qualified private activity bonds for owner-occupied housing (\$1.1 billion) and exclusion of income attributable to the discharge of principal residence acquisition indebtedness (\$1.3 billion); *Other appropriations - owner* includes block grant programs (HOME and CDBG) owner activities (\$1.5 billion) and USDA programs (\$1.0 billion); *Other tax expenditures -*

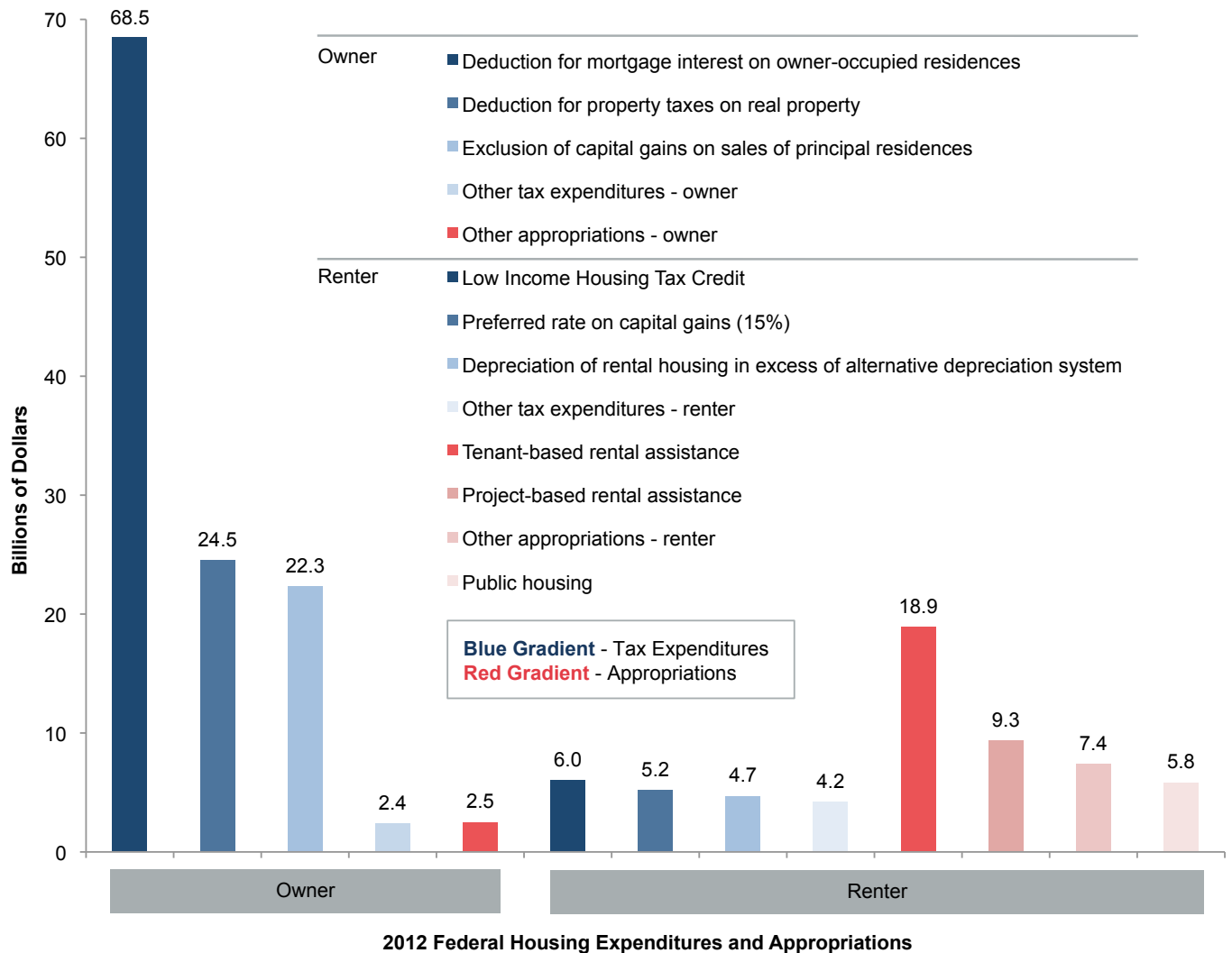
renter includes deferral of gain on like-kind exchanges (\$2.5 billion - includes all real estate transactions that utilize the section 1031 like-kind exchange rules and assumes that the exchange of apartment buildings is approximately 40 percent of the total of both corporate and individual deferrals), exclusion of interest on government qualified private activity bonds for rental housing (\$0.8 billion), and credit for rehabilitation of structures (\$0.9 billion); *Other appropriations - renter* includes homeless assistance and other HUD programs (\$3.6 billion), block grant programs (HOME and CDBG) rental activities (\$2.7 billion), and USDA Section 521 rental assistance and other USDA programs (\$1.1 billion).

Preferred rate on capital gains estimate based on Joint Committee on Taxation estimate of the tax expenditure for the preferred tax rate on gains and dividends, assuming 4 percent of the value is due to residential rental property, consistent with the share of gains income found in the 2007 IRS Sales of Capital Assets (SOCA) data.

Sources: Tax expenditure numbers from the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017* (Washington, D.C.: U.S. Government Printing Office, 2013). Appropriations numbers from McCarty, Maggie and David Randall Peterman, *Transportation, Housing and Urban Development, and Related Agencies (THUD): FY2013 Appropriations* (Washington, D.C.: Congressional Research Services, 2012).

Figure 4-2: Estimates of Federal Tax and Spending Supports for Housing

OWNER	FY 2012 Dollars <i>in billions</i>	RENTER	FY 2012 Dollars <i>in billions</i>
Tax Expenditures		Tax Expenditures	
Deduction for mortgage interest on owner-occupied residences	68.5	Low Income Housing Tax Credit	6.0
Deduction for property taxes on real property	24.5	Preferred rate on capital gains (15%)	5.2
Exclusion of capital gains on sales of principal residences	22.3	Depreciation of rental housing in excess of alternative depreciation system	4.7
Other tax expenditures - owner	2.4	Other tax expenditures - renter	4.2
TOTAL	117.7	TOTAL	20.1
Appropriations		Appropriations	
Other appropriations - owner	2.5	Tenant-based rental assistance	18.9
TOTAL	2.5	Project-based rental assistance	9.3
		Other appropriations - renter	7.4
		Public housing	5.8
		TOTAL	41.5





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Chapter 5. The Importance of Rural Housing

Although housing costs are generally lower in rural communities, lower incomes and higher poverty rates make housing unaffordable for many rural residents. Overall, the median income for rural households (\$40,038) is 20 percent lower than the national median income (\$50,046) and more than 20 percent lower than the median income for urban households (\$51,998).¹⁴⁶ In 2010, the U.S. poverty rate was at its highest since 1993 at 15.1 percent,¹⁴⁷ yet, the rural poverty rate was even higher at 16.5 percent.¹⁴⁸ Many rural households live in counties classified as high poverty areas with a poverty rate of 20 percent or more.¹⁴⁹

More than seven million families—or nearly 30 percent of all rural households—spend more than 30 percent of their monthly income on housing costs and are considered cost-burdened.¹⁵⁰ The lack of affordable housing prevents households from meeting other basic needs, such as nutrition and health care, or saving for their future.

Although rural homeownership rates are higher than the national average¹⁵¹ and mortgage-free homeownership is more common in rural America than in urban and suburban areas,¹⁵² the home values in rural parts of the country are generally lower, with more than 40 percent of rural homes valued at less than \$100,000.¹⁵³ In addition, rural homes are more likely to be in a substandard condition. Nearly 6 percent of rural homes are either moderately or severely substandard, without hot water, or with leaking roofs, rodent problems, or inadequate heating systems.¹⁵⁴ These poor housing conditions put additional financial constraints on low-income families.

Rental housing is an important housing option in rural America. While renters from rural areas occupy 17 percent of all U.S. rental-housing units, rural renters are more likely to live in single-family homes or smaller multifamily structures (with fewer than five units) than their urban and suburban counterparts. In addition, a far larger percentage of rural renters occupy manufactured homes. Rural rental housing is also generally older than rural owner-occupied homes, with approximately 35 percent of rural rentals built more than 50 years ago.¹⁵⁵

The same demographic trends that are transforming the country are also at work in rural America. While the population of rural America is generally older than that of the nation at large, rural parts of the country are graying with the aging of their Baby Boomer populations and the outmigration of younger households, many of whom are seeking employment opportunities elsewhere. In addition, Hispanics now rank as the largest minority group in rural America, with much of the population growth in rural communities attributable to the growth in the number of Hispanics who live there.¹⁵⁶

Federal Role in Rural Housing

The federal role in supporting rural housing can be traced back to the Housing Act of 1949, which authorized the Farmers Home Administration to issue mortgages for the purchase and repair of rural single-family houses, as well as to provide financial support for rural rental housing. Subsequent federal legislation shifted these responsibilities to the Rural Housing Service (RHS), the agency within the U.S. Department of Agriculture that today administers the USDA's rural housing programs.

Key USDA Housing Programs

The following are brief summaries of the major rural housing programs provided by USDA.^f These programs are often used in combination, and provide loans, grants, loan guarantees, and other support to help meet housing needs in rural America.

Homeownership programs

- Section 502 Guaranteed Loan – Guarantee of up to 90 percent of principal on mortgage loans issued by private lenders to low- and moderate-income families, in amounts up to 102 percent (including a 2 percent guarantee fee) of the home's market value or acquisition cost (*Funding in FY 2012: \$24 billion*)
- Section 502 Direct Loan - Direct, fixed-interest financing in amounts up to 100 percent of the home's market value or acquisition cost to low-income individuals to purchase, build, repair, or renovate homes (*Funding in FY 2012: \$900 million*)
- Section 504 Very Low-Income Rural Housing Repair Loan and Housing Assistance Grants - Direct loans up to \$20,000 and, for very low-income elderly homeowners only, grants up to \$7,500, for housing repairs and improvements (*Funding in FY 2012: \$39.5 million*)
- Section 523 Mutual and Self-Help Grant - Grant funding for local providers to deliver technical assistance to groups of low- and very-low income families who work cooperatively to build their houses (*Funding in FY 2012: \$30 million*)

Rental programs

- Section 521 Rental Assistance - Project-based rent assistance to owners of Rural Housing Service-financed projects (*Funding in FY 2012: \$905 million*)
- Section 538 Multi-Family Housing Guaranteed Loans – Guarantee of up to 90 percent of principal (97 percent for nonprofit developers) on loans issued by private lenders to support construction, acquisition, and rehabilitation of multifamily housing for low- and moderate-income households (*Funding in FY 2012: \$130 million*)
- Section 515 Rural Rental Housing Direct Loans - Long-term, low-interest loans to limited-profit and nonprofit developers to support the construction, acquisition, and rehabilitation of multifamily housing for low- and moderate-income renters (*Funding in FY 2012: \$64.5 million*)

Other programs

- Section 514 and 516 Farm Labor Housing Loans and Grants - Loans and grants to farm owners, nonprofit organizations, and others to buy, build, improve, or repair housing for farm laborers (*Funding in FY 2012: \$27.9 million*)

To be eligible for a USDA housing program, the beneficiary of the program must live in a rural area, which includes for purposes of these programs:

Any open country, or any place, town, village, or city which is not part of or associated with an urban area and which

- (1) Has a population not in excess of 2,500 inhabitants, or
- (2) Has a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or
- (3) Has a population in excess of 10,000 but not in excess of 20,000, and (A) is not contained within a standard metropolitan statistical area, and (B) has a serious lack of

mortgage credit for lower and moderate income families, as determined by the Secretaries of Agriculture and HUD.¹⁵⁷

This definition of “rural area” encompasses approximately 109 million individuals, or 34 percent of the U.S. population.¹⁵⁸

USDA programs have proven cost-effective and efficient at serving some of the nation's most vulnerable rural households, and support for and preservation of these programs must be given priority attention. For example, in FY 2012 the total cost to the federal government of enabling a low-income rural family to become a homeowner through the Section 502 Direct Loan program was \$7,200 over the life of the loan.¹⁵⁹ Likewise, the annual Section 521 Rental

f. Summaries of USDA rural housing programs rely on information contained in Tadlock Cowan, *An Overview of USDA Rural Housing Programs* (Washington, D.C.: Congressional Research Service, 2010).

Assistance for households living in Section 515 Rural Rental Housing was \$4,400 in 2011,¹⁶⁰ compared with \$7,640 in the Housing Choice Voucher program.¹⁶¹ In 2011, USDA housing programs helped nearly 140,000 rural families become homeowners and assisted in meeting the rental housing needs of an additional 470,000 individuals.¹⁶² The following recommendations aim to strengthen successful programs in a way that can serve a greater number of the most vulnerable rural households.

Policy Recommendations

1. Support and strengthen USDA's role in rural housing.

USDA has a presence in rural communities that is critical for administering support to vulnerable households. While increased collaboration and efficiency across agencies is important, Congress should not pursue proposals to shift USDA programs to other government agencies where they will be absorbed by other federal programs.¹⁶³ USDA is well-positioned to leverage the existing resources and infrastructure of rural service providers that understand the unique conditions of local markets.

2. Extend the current definition of rural areas through the year 2020. Any area currently classified as rural for the purposes of USDA housing programs should remain so at least until after the receipt of data from the decennial census in 2020, provided the area's population does not exceed 25,000.

Without congressional action, hundreds of rural communities are at risk of losing eligibility for funding designated for rural areas. A change in the definition would sweep up many small towns and farming communities into larger metro areas, reducing the population eligible for rural housing assistance by roughly 8 percent.¹⁶⁴ Extending the definition would help to ensure low-income rural families, elderly, and persons with disabilities living in these

communities continue to access low-cost loans, grants, and other needed assistance, as well as provide certainty to housing developers on where they can build utilizing the resources of USDA rural housing programs.

3. Increase budget allocations to serve more households.

Today, USDA holds or guarantees 944,000 loans totaling \$84.4 billion, or less than 1 percent of the \$9.4 trillion in U.S. mortgage debt outstanding. Since 2007, however, USDA's loan volumes have tripled. In FY 2011, the department guaranteed \$16.9 billion in loans and issued \$1.1 billion in direct loans.¹⁶⁵ Many of these loans are securitized, and Ginnie Mae guarantees the timely payment of principal and interest on these securities. Additional funding for the Section 502 Direct Loan program would enable more rural households to become homeowners at relatively low cost to the federal government. However, any additional federal appropriations for the Section 502 Direct Loan program should be contingent on an evaluation of underwriting risks associated with the program, which for the past four years has carried delinquency rates hovering around 14 percent.¹⁶⁶ Specifically, the program's current no-down-payment requirement should be reconsidered with a minimum down payment required on all future loans.

4. Dedicate resources for capacity-building and technology to strengthen USDA providers. A portion of the resources available for rural communities should be dedicated to providing technical assistance to nonprofit providers operating in rural communities, as well as to modernizing the technology that USDA providers use for loan processing, some of which is still done by hand. Specifically, local agencies receiving USDA funds should be incentivized to operate on compatible software to ease data and information sharing. These improvements could help USDA monitor and improve the performance of its rural housing programs.



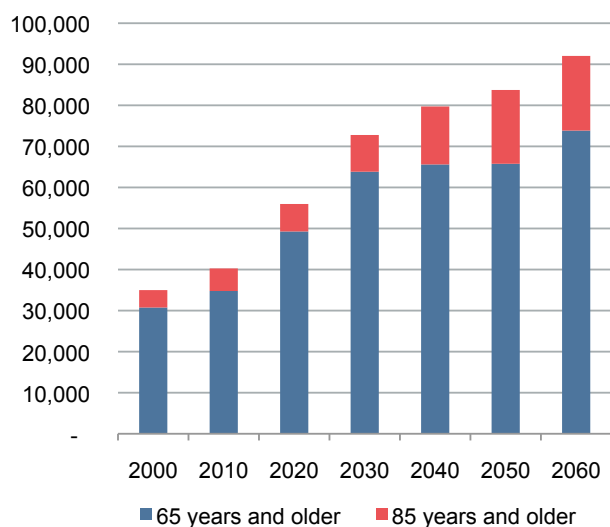
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Chapter 6. Aging in Place: A New Frontier in Housing

In 2011, the first members of the Baby Boom generation turned age 65. In the coming decades, millions more Baby Boomers will enter their retirement years. As indicated in Chart 6-1, the number of Americans aged 65 or older will rise from 35 million in 2000 to nearly 73 million in 2030 and more than 90 million in 2060. The very oldest Americans, those aged 85 and older, will increase in number from 4.2 million in 2000 to nearly nine million in 2030 and then to 18.2 million in 2060. At the same time, the ratio of working-age people to those who have reached retirement age will fall significantly.¹⁶⁷

Chart 6-1: U.S. Population Aged 65 and Older
Numbers in thousands



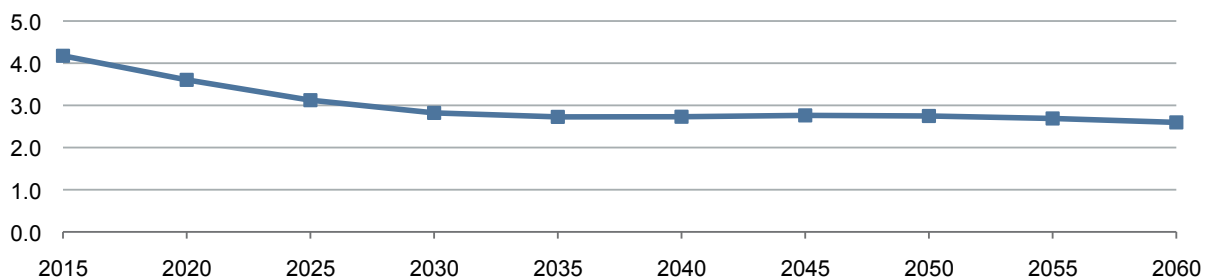
Source: 2000 and 2010 counts from U.S. Census Bureau, "Summary File 1, Matrices DP-1: Profile of General Demographic Characteristics: 2000 and 2010." *Decennial Census* (Washington, D.C.: 2001 and 2012); projections from U.S. Census Bureau, "Table 2. Projections of the Population by Selected Age Groups and Sex for the United States: 2015 to 2060," *2012 National Population Projections: Summary Tables*.

These unprecedented demographic changes will have a profound impact on American society. Cultural attitudes about aging and the role of seniors in our communities are likely to change. The graying of America, with fewer

workers supporting more retirees, will strain the budgets of already overburdened state and local governments. And, as America's senior population grows, we will need to reexamine our housing priorities to determine how best to meet the needs of the overwhelming majority of seniors who wish to age in place.

"Aging in place" is defined as "the ability to live in one's own home and community safely, independently, and comfortably, regardless of age, income, or ability level."¹⁶⁸ Studies show that some 70 percent of Americans aged 65 and older live in single-family detached homes, and nearly 90 percent intend to age in place and remain in their homes permanently.¹⁶⁹ For most seniors, the desire to age at home is the most cost-effective and financially sensible housing option, so long as their physical abilities allow. Understandably, seniors wish to remain linked to their family, friends, and communities, supported by the very connections that have given meaning to their lives and provide a sense of belonging, independence, and peace of mind. For the 30 percent of seniors who are renters and typically have lower incomes than homeowners, aging in place means the ability to achieve similar goals in their apartments.

Yet, this strong desire to age in place runs into a harsh reality: Many of today's homes and neighborhoods were designed at an earlier time before the demographic changes now transforming the country were even recognized. For many seniors, their homes lack the necessary structural features and support systems that can make independent living into old age a viable, safe option. Similarly, many of our nation's communities fail to provide for adequate street lighting, accessible sidewalks and transportation options, and other services and amenities that would make aging in place in those communities a realistic choice.¹⁷⁰

Chart 6-2: Projected Ratio of Working-age Americans (aged 18 to 64) to People Aged 65 and Older

Source: Bipartisan Policy Center tabulations of U.S. Census Bureau, "Table 2. Projections of the Population by Selected Age Groups and Sex for the United States: 2015 to 2060," *2012 National Population Projections: Summary Tables*.

Rising to the Challenge

This new demographic reality demands that we think creatively about how the houses in which we live affect our health, longevity, and the cost of caring for an aging population. At every stage of life, our houses and apartments are both the shelter we seek for ourselves and our families, and the platform from which we engage with nearly every other aspect of our lives. This is true to perhaps the greatest extent in promoting healthy independent lives for seniors. When we broaden our focus on housing's role in our lives—including as a vehicle for the delivery of lower-cost and more effective health care for seniors—we can begin to think more strategically about how we make housing-related investments, taking into account the full life-cycle costs of both housing infrastructure and health care expenses.

A key focus of this effort must be strengthening our nation's capacity to deliver health care and other critical services in residential and community-based settings. If implemented properly, these new approaches have the potential to empower our nation's seniors to make even greater

contributions to society. And, as more seniors forego long-term care in costly institutionalized settings, they also have the potential to produce real long-term savings for cash-strapped governments at all levels. Studies of programs in Japan and the United Kingdom, for example, suggest that retrofitting existing properties to accommodate the needs of seniors could produce significant savings as the cost of medical care and other services is reduced.¹⁷¹ Savings in the health care system can be used to support further extensions of these services and take advantage of the virtuous circle created by helping seniors remain in their homes.

Modifying existing single-family houses, apartments, and communities—as well as designing new ones—to support aging in place for those millions of Baby Boomers now entering their retirement years must become a far greater national priority.

Any discussion of modifying our homes and communities to accommodate the desire of seniors to age in place must take cost into account. For some seniors and their families, personal savings and retirement earnings may be sufficient to finance home modifications. Reverse mortgages and

Leadership in Practice

Numerous private and public institutions have already begun to respond to the challenges posed by the graying of the population and the desire to age in place. Organizations such as the American Association of Retired Persons (AARP), the National Association of Home Builders, the American Institute of Architects, and the American Society of Interior Designers have all initiated programs to educate professionals in their respective fields about relatively simple steps that can be taken to transform an existing home into one that is livable and safe for an elderly person. Better home lighting, use of contrasting colors on the edges of furniture and steps, strategic placement of handrails and grab bars, modest structural alterations to bathrooms and kitchens, and the removal of tripping hazards such as throw rugs and electrical cords are just some of the suggestions that can make a big difference in the living conditions of seniors. These organizations also emphasize the importance of applying universal design principles to new home construction so that a home built today has structural features, such as a zero-step entrance and wider doors and hallways, that will allow the home's initial owners to age in place if they choose.¹⁷²

State and local governments are also beginning to respond to the challenge. All across the country, neighborhoods are naturally being transformed into concentrated pockets of older residents who are aging in place. There is even a name for these neighborhoods: Naturally Occurring Retirement Communities, or NORCs. A NORC can take a variety of forms. It can be a large

multifamily rental complex or a neighborhood populated with single-family homes whose residents are growing older. NORCs exist in central cities, in suburbs, and even in rural areas. The AARP estimates there are some 5,000 NORCs throughout the United States but cautions they are “the most dormant and overlooked form of senior housing.”¹⁷³

Some states, including Georgia, Maryland, Massachusetts, Missouri, New York and Pennsylvania, encourage the use of NORCs as efficient and cost-effective venues to deliver health care and other services to senior residents.¹⁷⁴ In New York alone, there are more than 50,000 seniors living in NORCs and benefiting from the supportive services delivered through these communities. The federal government is also playing a role: The U.S. Department of Health and Human Services (HHS), through its Administration on Aging, helps fund the development of NORCs in some twenty-five states.¹⁷⁵

Another state-level model that combines housing with supportive services is “Communities for a Lifetime.” A major goal of this model is to establish neighborhoods that support aging in place and more deliberately integrate seniors into community life. Key elements of this approach include ensuring senior-friendly transportation options and land-use planning. States such as Florida, Indiana, Michigan, and North Carolina are actively promoting “Communities for a Lifetime” programs and activities.¹⁷⁶

home equity lines of credit offer other financing options, particularly for seniors with little or no outstanding mortgage obligations. State and local tax benefits and grant programs may provide additional help. But for many seniors, whose earnings have fallen dramatically since leaving the workforce, financing options are more limited. In fact, 9.5 million households headed by someone over the age of 65

spend more than 30 percent of their income on mortgage or rental costs, leaving little left over to cover the cost of even basic maintenance that can greatly impact safety in the home. Even worse, some 5.1 million senior households spend more than half their income to cover housing costs.¹⁷⁷ These households may be forced to make difficult choices between covering housing costs and purchasing needed medication or nutritious food.

Affordable rental housing can also be a platform for delivering services that enable aging in place, often averting high-cost institutional care. For example, Stewards of Affordable Housing for the Future, LeadingAge, and Enterprise Community Partners, with their nonprofit members, have done pioneering work to develop strategies that link senior housing with health care and supportive services. Innovative providers are not only working with traditional fee-for-services approaches and waiver-enabled programs, but also sorting out how they could work effectively with the accountable care organizations and managed care entities that are increasingly serving the low-income elderly. Multi-state providers such as National Church Residences and Mercy Housing, and smaller scale organizations such as the Cathedral Square Corporation in Vermont and Sanborn Place in Massachusetts, are using residential solutions to achieve the triple aim of improving health, improving the experience of those who are served, and reducing the per capita cost of health care. These strategies have the potential to enable low-income seniors to remain in their apartments and communities and to enhance care and coordination for the high-cost population eligible for both Medicare and Medicaid.

Finally, there is a group of older Americans for whom there are much more basic problems of affordability. While Social Security has made dire poverty among older Americans a less common phenomenon than it would otherwise be, it has not eliminated it entirely. The commission's proposal for long-term rental assistance for the most vulnerable Americans with incomes at or below 30 percent of AMI would provide a solid floor, ensuring that those older households with the lowest incomes would at least have their basic housing needs met, and providing a foundation for some of the other improvements discussed above. See *Chapter 4, Affordable Rental Housing*.

The Federal Response

The federal response to meeting the housing needs of low-income seniors historically has focused on construction and rehabilitation programs to produce or preserve housing either designated for seniors or that increasingly over time has come to serve seniors who have aged in place. The Section 202 Supportive Housing for the Elderly Program is designed exclusively to meet the needs of low-income seniors, and has taken several forms since 1959. However, funding for new Section 202 housing has been very limited since the early 1980s. In recent years, there were ten applicants on the waiting list for every unit that becomes available annually.¹⁷⁸ Most seniors in HUD-subsidized housing live in public or privately owned assisted housing that, in general, was not designed to house this increasingly frail population.

Other HUD programs that provide assisted housing to low-income seniors are the Section 221(d)(3) Below Market Interest Rate and Section 236 programs that offer mortgage subsidies and support properties specifically dedicated to the elderly and date back to the 1960s and 1970s. The project-based Section 8 housing programs, begun in 1974 and ended as a new construction or rehabilitation program in 1983, as well as rural housing programs administered by USDA, also support projects that serve senior households.¹⁷⁹ Finally, some states allocate a share of their Low Income Housing Tax Credit financing for senior housing. According to some estimates, 14 percent of LIHTC properties limit residency to tenants aged 55 or older.¹⁸⁰

Table 6-1: Federal Rental Housing Programs for Low-Income Elderly Households

	Share of Units Occupied by Elderly Households	Number of Units Occupied by Elderly Households
Section 8 Project-Based Rental Assistance	47%	593,772
Housing Choice Vouchers	19%	408,047
Public Housing	31%	346,566
USDA Section 521 Rental Assistance	59%	160,243
Supportive Housing for Elderly and People with Disabilities (202/811)	81%	121,009
Other HUD Programs	25%	9,329
Total	31%	1,546,039

Source: Center on Budget and Policy Priorities, *Federal Rental Assistance Facts* (December 19, 2012).

In addition, HUD operates four supportive services programs for those seniors living in HUD-assisted properties. The Congregate Housing program, the Service Coordinator program, and the Resident Opportunity and Self-Sufficiency Service Coordinator program each offer meals and other forms of assistance to help seniors with the activities of daily life. The Assisted Living Conversion program makes grants to HUD-assisted properties for purposes of converting some or all units into assisted living facilities.¹⁸¹ Other programs, such

as the Community Development Block Grant and HOME Investment Partnerships programs, support multiple, and sometimes competing, housing priorities but could be used to help finance local aging-in-place initiatives.

These efforts are all worthwhile, but except for the LIHTC program, none is producing new units. In addition, many of the remaining federally assisted units, especially in public housing, need modernization and rehabilitation. Moreover, aging senior properties typically house the oldest and frailest residents, yet they often lack the necessary features to meet these residents' needs, such as hand rails, barrier-free entrances, or roll-in showers.

Many of the recommendations presented in Chapter 4, Affordable Rental Housing, will help to address these challenges. The following are some additional policy recommendations that can help provide a more dedicated focus on responding to the housing challenges of a growing senior population.

Policy Recommendations

1. Better coordination of housing and health care. HUD and HHS should jointly identify and remove barriers to the creative use of residential platforms for meeting the health and long-term care needs of low- and moderate-income senior residents and seniors who live in the surrounding community. HUD and HHS should encourage accountable care organizations, medical homes, federally qualified health centers, and other managed care entities to partner with housing providers to create more integrated systems of services to meet the needs of residents, enable them to age in place, and achieve cost savings for the Medicare and Medicaid programs. In evaluating the costs of housing programs that serve frail seniors, Congress and the Office of Management and Budget should identify and take into account savings to the health care system made possible by the use of housing platforms with supportive services.

Many public housing and multifamily assisted properties already provide services designed to help older adults and persons with disabilities live independent lives. Working in partnership with states and localities, nonprofit providers such as Mercy Housing and National Church Residences, have already made great strides in improving coordination of housing, health care, and supportive services for low-income seniors, including through co-location of housing with health care and fitness centers, social programming, and assisted living for residents who need a higher level of care. At the state level, the Vermont Support and Services at Home (SASH) demonstration is another promising approach that bears close attention. The initiative uses multifamily assisted housing as a platform for providing integrated health services, with funding from Medicaid and Medicare.¹⁸² As evaluation results come out in the coming years, the SASH program may serve as a model for similar programs in other states.

In states and localities that do not yet have an aging-in-place strategy, the proposed reforms to existing federal housing programs described in Chapter 4—particularly those related to the goal of enabling the elderly and persons with disabilities to live independent lives—will help providers measure the effectiveness of these services and encourage adoption of best practices to improve quality of life for assisted residents.

2. Support initiatives to retrofit homes and apartments for energy conservation and aging in place. The Energy Department's Weatherization Assistance Program helps low-income families permanently reduce their energy bills by taking simple steps to make their homes more energy efficient, such as sealing leaks around windows and doors and installing insulation. Under the program, the federal government provides funding to states and Indian tribal governments, which in turn support local community action agencies, nonprofit organizations, and local governments that provide weatherization services. The Energy Department estimates that the program has

provided weatherization services to more than 6.4 million low-income households since inception, reducing annual energy bills for these households by an average of \$437.¹⁸³ Weatherizing homes to reduce energy costs and improve living conditions and health outcomes is an important element of any aging-in-place strategy.¹⁸⁴ Funding for the program should continue and its scope expanded to include home assessments and modifications for aging in place.

Energy conservation retrofits are equally important for senior apartments, although unique challenges in multifamily properties call for a different strategy.¹⁸⁵ Modest retrofits can produce material energy and cost savings, especially in older buildings, and can be funded in large part with borrowed money that is repaid from savings on utility costs. In subsidized properties, most of the eventual savings will flow to the federal government. Working with affordable housing providers, technology firms, and others, HUD has already started to explore approaches to jump-starting these approaches¹⁸⁶ and should continue work to take them to scale.

3. Better integration of aging-in-place priorities into existing federal programs. Existing housing programs such as the Community Development Block Grant (CDBG) and the HOME Investment Partnerships programs should place greater emphasis on supporting local aging-in-place strategies. Many states and communities already use a portion of these flexible funds on senior households—for example, by allocating CDBG funds to local Area Agencies on Aging and other community groups to offer home rehab services for low-income homeowners aged 62 and older or to provide in-home services—but there is room for even further support for aging-in-place priorities. In addition, the federal Partnership for Sustainable Communities—a collaborative project of HUD, the U.S. Department of Transportation (DOT), and the U.S. Environmental Protection Agency—should reinforce the importance of affordable senior housing and senior-friendly transportation planning in its outreach, education, and

grant-making activities. Policy makers should also consider integrating aging-in-place priorities into a broader range of federal programs, such as programs under the Older Americans Act and the federal transportation reauthorization.

4. Reverse mortgages and other home equity access products. For seniors who have spent a lifetime making mortgage payments, their home is typically their most valuable asset. In 2009, for example, half of homeowners aged 62 and older had at least 55 percent of their net worth tied up in home equity.¹⁸⁷ Currently, reverse mortgages are the main option for homeowners to tap into this equity to fund retirement needs and to support their desire to age in place. However, in a recent report to Congress, the Consumer Financial Protection Bureau concluded that few consumers fully understood the financial mechanics of these loans and that the increasingly complex product choices in the reverse mortgage market were making it much more difficult for housing counselors to provide effective guidance to their clients.¹⁸⁸

With limited retirement savings among some aging Baby Boomers, and a shrinking social safety net, consumer interest in this type of mortgage product is likely to increase significantly, and it will be imperative that older homeowners have access to low-cost and effective reverse mortgage counseling so they can learn about the risks and potential benefits of these mortgage products before they face a financial crisis. Congress should also promote the development of alternative, low-cost home equity access products, particularly for seniors and family caregivers who face substantial out-of-pocket long-term care expenses.

In December 2012, FHA, which currently insures virtually all reverse mortgages through its Home Equity Conversion Mortgage (HECM) program, announced a moratorium on a popular lump-sum reverse mortgage option, due to disproportionately large losses to the FHA's insurance fund stemming from the program. Looking ahead, other FHA-insured reverse mortgage products will continue to be

available, although they may be more difficult to obtain as the FHA makes further changes to its loan programs. Efforts to develop safe new home equity products would help to ensure the effective use and orderly draw-down of this valuable asset to manage financial risk in retirement.

5. Convene a White House conference on aging in place. The White House Conference on Aging is a once-in-a-decade conference sponsored by the Executive Office of the President. The first such conference was held in 1961 and the last in 2005. To draw national attention to the issue of senior housing and provide a high-level forum for the sharing of ideas and best practices, the President should convene a White House Conference on Aging with a focus on aging in place. Participants in this conference should include representatives of all levels of government—mayors, county executives, governors, as well as top federal officials such as the secretaries of HUD, HHS, DOT, USDA, and the VA. Other participants should include housing practitioners, community planners, and health care providers from across the country with substantial experience serving the needs of the elderly, and representatives of the homebuilding, architecture, remodeling, and interior design industries.

In advance of the conference, HUD should convene a series of meetings with members of the housing community to share best practices and identify innovative private-sector solutions that could be brought to scale. These innovations include prototype homes, new appliances and accessories, and creative market options such as co-housing and live/work flex housing that allows seniors to continue to pursue careers while working at home. Moreover, these meetings should highlight innovative efforts to weave together community services in support of the elderly, such as the Virtual Village-to-Village Network. To ensure broad dissemination of this information, HUD should develop a publicly available catalogue of best practices related to accessible home modification and new construction and home assessment tools.



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Chapter 7. Concluding Thoughts: A Call to Action

Our nation's housing system is broken. Homeownership remains out of reach for far too many families who stand prepared to assume its financial and other obligations, while limited access to affordable mortgage credit impedes our nation's economic recovery and future growth. The country's lowest-income households continue to suffer under the crushing burden of high rental housing costs that are rising even more as rental demand increases. And we are not equipped to respond to the desires of millions of Americans who wish to stay in their own homes and age in place during their senior years.

The commission hopes that this report provides some valuable guidance on how best to respond to these challenges and will serve as a catalyst for action. This report has proposed:

- A responsible, sustainable approach to homeownership that will help ensure that all creditworthy households have access to homeownership and its considerable benefits.
- A reformed system of housing finance in which the private sector plays a far more prominent role in bearing credit risk while promoting a greater diversity of funding sources available for mortgage financing.

- A more targeted approach to providing rental assistance that would direct scarce resources to the lowest-income renters while insisting on a high level of performance by housing providers.
- A more comprehensive focus on meeting the housing needs of our nation's seniors that responds to their desire to age in place and recognizes the importance of integrating housing with health care and other services.

The problems we face in housing are so significant and so urgent today that inaction is no longer a viable option. In responding to these problems, we have an opportunity to improve the lives of millions and make America a stronger and more economically vibrant country, today and well into the future. It is therefore the commission's hope that 2013 will be the year that Congress and the administration finally elevate housing to the top of the national policy agenda and give housing the dedicated attention it deserves. The commission's 21 members, Democrats and Republicans, stand ready to help in this effort.



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Aerial view of BPC Housing Commission Regional Housing forum in Bar Harbor, Maine at College of the Atlantic, July 25, 2012.

Appendix: Commission Structure and Process

Regional Housing Forums

The Bipartisan Policy Center (BPC) Housing Commission in partnership with the Jack Kemp Foundation hosted four regional forums to solicit input on key housing issues and best practices from stakeholders across the country. Public input was an integral part of the commission's process to craft a package of realistic and actionable recommendations for improving the nation's housing policy. All forums were open to the public and available by live webcast.

- San Antonio, Texas — March 6, 2012
- Orlando, Florida — April 17, 2012
- St. Louis, Missouri — June 5, 2012
- Bar Harbor, Maine — July 25, 2012

Research Undertaken by the Commission

Four research papers were prepared by consultants to the BPC as background for the deliberations of the commission. These papers were presented and discussed during the regional forums, and made available to the public on the BPC website, www.bipartisanpolicy.org/housing.

- *Demographic Challenges and Opportunities for U.S. Housing Markets*
By Rolf Pendall, Lesley Freiman, Dowell Myers, and Selma Hepp
- *A Comparative Context for U.S. Housing Policy: Housing Markets and the Financial Crisis in Europe, Asia, and Beyond*
By Ashok Bardhan, Robert Edelstein, and Cynthia Kroll
- *Housing Programs in the United States: Responding to Current and Future Challenges*
By Diane Levy, Rolf Pendall, Marty Abravanel, and Jennifer Biess
- *The State of the Residential Construction Industry*
By Carlos Martín and Stephen Whitlow

Additional research and analysis was conducted to inform the commission's deliberations, including contributions by Norman K. Carleton, former Director, Office of Federal Finance Policy Analysis, U.S. Department of Treasury; Robert D. Dietz, Assistant Vice President, Tax and Policy Issues, Economics and Housing Policy, National Association of Home Builders; Richard K. Green, Professor, Director and Chair of the USC Lusk Center for Real Estate; Ann B. Schnare, Principal, AB Schnare Associates, LLC; Kristin Siglin, Vice President-Policy, Housing Partnership Network; Eric Toder, Institute Fellow, Urban Institute and Co-director, Urban-Brookings Tax Policy Center; and Paul Weech, Executive Vice President-Policy and Member Engagement, Housing Partnership Network.

Key partners who assisted the commission with roundtable discussions include Vicki Been, Boxer Family Professor of Law at New York University School of Law, Associate Professor of Public Policy at NYU's Robert F. Wagner Graduate School of Public Service, and Director of the Furman Center at NYU; Mark Willis, Resident Research Fellow, the Furman Center at NYU; Janis Bowdler, Director, Wealth-Building Policy Project, National Council of La Raza; Marcie Chavez, Vice President, Community Development Commission/Housing Authority of the County of Los Angeles; Terry Gonzalez, Director, Community Development Block Grant Division and Intergovernmental Relations, CDC/HACLA; Sean Rogan, Executive Director, CDC/HACLA; Elisa Vasquez, Intergovernmental Relations/Public Information, CDC/HACLA; Eve O'Toole, Senior Policy Advisor, Holland & Knight; Daniel D. Clute, Senior Vice President, Federal Home Loan Bank of Des Moines; Curt Heidt, Vice President, External Relations, Federal Home Loan Bank of Des Moines; Gary Kain, President and Chief Investment Officer, American Capital AGNC Management, LLC and American Capital Mortgage MTGE Management, LLC; Sarah Mickelson, Policy Associate, Rapoza Associates; Robert A. Rapoza, President and Principal, Rapoza Associates; Mary White Vasys, President, Vasys Consulting Ltd.; and Susan M. Wachter, Richard B. Worley Professor of Financial Management, Professor of Real Estate and Finance, Co-Director - Institute for Urban Research, The Wharton School, University of Pennsylvania.

Housing Expert Forum

On a monthly basis, the commission collected responses to questions on pressing housing policy issues from experts across the industry. The expert responses were shared on the commission's website in an effort to help educate the public and policy makers, as well as to add to the commission's own research.

Contributors included:

- Angela Antonelli, Former Chief Financial Officer (CFO), U.S. Department of Housing and Urban Development
- Joseph N. Belden, Deputy Executive Director, Housing Assistance Council
- Michael Bodaken, President, National Housing Trust
- Mark A. Calabria, Director of Financial Regulation Studies, Cato Institute
- Robert J. Cristiano, President, L88 Investments LLC
- Conrad Egan, Senior Advisor, Affordable Housing Institute
- Eileen Fitzgerald, CEO, NeighborWorks America
- Kevin Igoe, Owner, IGOE/Associates
- Bill Kelly, President & Co-Founder, Stewards of Affordable Housing for the Future
- James Kemp, President, Jack Kemp Foundation
- Jeffrey Lubell, Executive Director, Center for Housing Policy
- Lora McCray, Manager, Housing Opportunity, National Association of Realtors
- Brian Montgomery, Chairman, The Collingwood Group
- Jeremy Nowak, former President and CEO, William Penn Foundation
- Jonathan T.M. Reckford, Chief Executive Officer, Habitat for Humanity International
- Barry Rutenberg, Immediate Past Chairman, National Association of Home Builders
- Barbara Sard, Vice President for Housing Policy, Center on Budget and Policy Priorities
- Dennis Shea, Founder and Principal, Shea Public Strategies, LLC
- David A. Smith, Founder and Chairman, Recap Real Estate Advisors
- Ali Solis, Senior Vice President, Public Policy and Corporate Affairs, Enterprise Community Partners
- Frank J. Vaccarella, President, Vaccarella & Associates, Consulting, LLP
- Joseph M. Ventrone, Vice President, Regulatory and Industry Relations, National Association of Realtors
- Kent Watkins, Chairman, National Academy of Housing and Sustainable Development
- Paul S. Willen, Senior Economist and Policy Advisor, Federal Reserve Bank of Boston

Website

The commission's website provided a platform for the commission to discuss its work, as well as for housing leaders to gain insight into the issues the commission considered throughout its year of deliberation. Some of the features of the website, www.bipartisanpolicy.org/housing, include:

- Housing by the Numbers: an interactive dashboard of key housing market indicators.
- Infographics: visual representations and explanations of trends that affect housing policy.
 - o *Household Formation and Demographic Trends*
 - o *Housing's Impact on the Economy*
 - o *Rental Housing Market Trends*

- **What We're Reading:** a review of top news stories that address critical developments in housing policy.
- **Housing Visualized:** a compilation of useful graphic and multimedia resources that explain economic indicators and statistical trends.
- **Commission in the News:** an aggregator of news articles and multimedia featuring commission members.

Commission Meetings

The full commission met regularly throughout the past year. In addition to these meetings, smaller groups of commissioners met frequently to focus on specific topics, such as single-family finance, multifamily finance, affordable rental housing, and homeownership. Full commission meeting dates were as follows:

- December 14/15, 2011
- February 13/14, 2012
- May 14/15, 2012
- July 25/26, 2012
- October 16, 2012
- November 27/28, 2012
- January 10, 2013

Roundtable Discussions with Invited Housing Practitioners

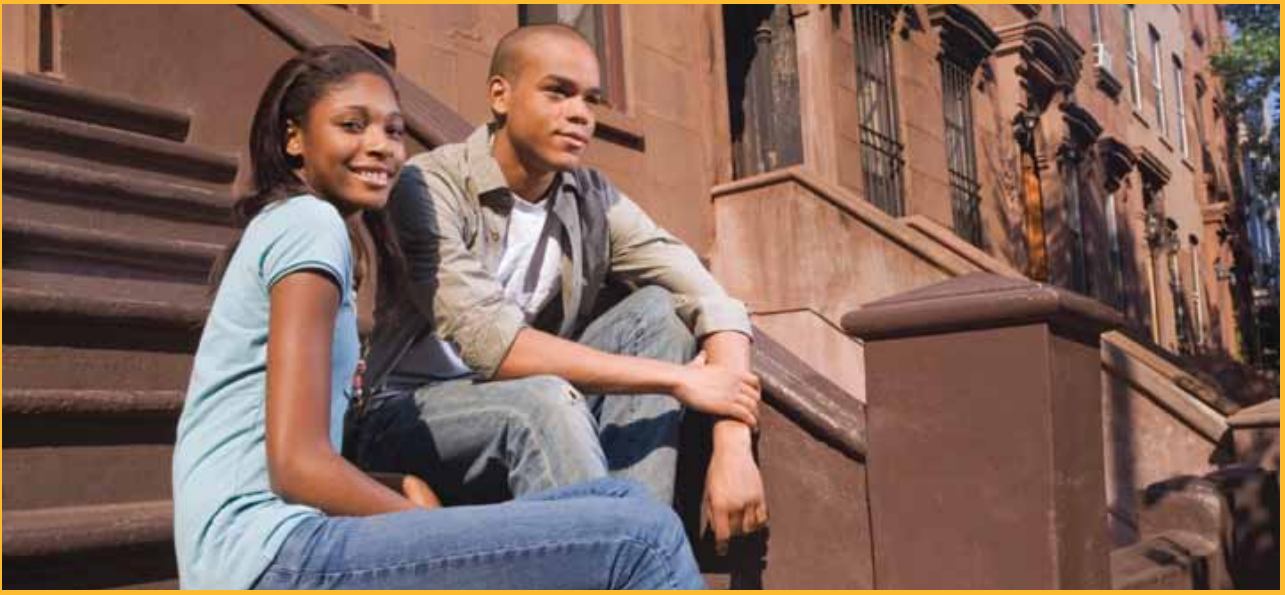
The commission held a number of roundtable discussions with practitioners in various areas of the housing field to solicit ideas about the appropriate role of the federal government in the housing sector, the need for reforming specific housing-related programs and funding mechanisms, as well as to get preliminary reactions to the

commission's proposals. These gatherings throughout the past year were as follows:

- Roundtable on Affordable Rental Housing — February 3, 2012
- Roundtable on Affordable Rental Housing — February 10, 2012
- Roundtable on Affordable Rental Housing — April 2, 2012
- Capital Markets — April 4, 2012
- Community Lending Roundtable — June 4, 2012
- Multifamily Housing Finance Industry Roundtable — June 11, 2012
- Addressing Challenges in the Small Rental Stock, in partnership with the John D. and Catherine T. MacArthur Foundation — August 14, 2012
- Roundtable Discussion on Section 8 — August 17, 2012
- Obstacles, Costs, and Opportunities for Bringing More Private, Credit Risk-taking Capital into the Housing Market, in partnership with the Furman Center at NYU — September 19, 2012
- Accessibility and Affordability in the Mortgage Market, in partnership with the National Council of La Raza — September 25, 2012
- Positioning the Federal Role in the Future U.S. Multifamily Housing Finance System, in partnership with the Wharton School, University of Pennsylvania — September 27, 2012
- Housing Commission Discussion with Rural Housing Providers — October 18, 2012
- Housing Commission Discussion with Community Development Commission/Housing Authority of the County of Los Angeles — December 3, 2012



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Endnotes

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6. Ibid.
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75. An independent audit released in November 2012 found that for the first time in its history, the FHA's expected losses over the next 30 years are projected to exceed revenues. If projections prepared by the White House find similar results, FHA will need a draw from the Treasury to bring its capital reserve ratio (which measures reserves in excess of the levels needed to cover projected losses over a 30-year period) back to the statutorily required level.
76. "First loss risk" is a term that is often used to reflect the idea that the private sector will take the majority or the primary portion of the credit loss risk, leaving the "catastrophic risk" to the government. However, the term "first loss" can be misunderstood. Since it actually refers to the predominant portion of the loss (not just the first loss), this paper will use the term "predominant loss" when referring to the primary credit risk borne by the private sector.
77. If the private credit enhancer becomes insolvent and is unable to reimburse servicer losses due to default, the Public Guarantor will make those reimbursements.
78. Private credit enhancements themselves are no guarantee against failure. Rigorous capital standards, continuing oversight, and flexible regulation will be required to ensure the long-term stability of a system that relies on such private credit enhancements in order to protect taxpayer interests. Moreover, the reliance on private credit enhancers could potentially limit smaller lenders' ability to obtain insurance at reasonable prices. It will be critical for the Public Guarantor to monitor how the reliance on private credit enhancers affects smaller lenders' market access and, if necessary, to propose steps to remedy any disadvantageous outcomes that may result.
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84. Shear, William B., et al., *Fannie Mae and Freddie Mac's Multifamily Housing Activities Have Increased*. GAO-12-849 (Washington, DC: U.S. Government Accountability Office, 2012).
85. JCHS, *The State of the Nation's Housing: 2012* (Cambridge, MA: 2012), 23-24.
86. *Ibid.*
87. Kim Betancourt, *Multifamily Market Commentary – January 2012* (Washington, DC: Fannie Mae, Multifamily Economics and Market Research, 2012).
88. In 2011, bank funding for apartment buildings increased by 60 percent, or \$40 billion, from 2010. See Brian Browdie, "Apartment Lending Jumped 60% in 2011," *American Banker*, October 9, 2012.
89. Between 2008 and the third quarter of 2011 Fannie Mae and Freddie Mac's multifamily operations brought in \$7 billion in revenue with default rates consistently under one percent. See Federal Housing Finance Agency, Office of the Inspector General, *Semiannual Report to the Congress: October 1, 2011, through March 31, 2012*. (Washington, DC: FHFA-OIG, 2012). Fannie Mae and Freddie Mac have taken very different approaches to managing their risks in multifamily mortgages. Fannie Mae has relied mostly on risk-sharing on a loan-by-loan basis with approved Delegated Underwriting and Servicing (DUS) lenders. DUS lenders share in all losses on multifamily rental mortgages, typically on a *pari passu* basis, with the DUS lender covering up to one-third of losses and Fannie Mae two-thirds. DUS lenders are required to maintain specified levels of net worth, liquidity and reserves with respect to their risk-sharing obligations. Freddie Mac has relied on underwriting multifamily mortgage loans directly without risk-sharing, although it recently began to share risk by issuing subordinated debt to support its guaranteed senior tranches under its K-series CMBS program.

90. The purpose of the affordability requirement is to provide liquidity for projects that will continue to serve low- and moderate-income households over time. As such, safeguards should be adopted to prevent those transactions where the underwriting indicates intent to increase rents to levels above the affordability threshold from having access to the guarantee in cases where this adjustment would shift the balance of the loan pool above the affordability threshold. This means that the pro-forma financing of the property could not count on rent increases phased in over time to satisfy underwriting criteria. That is, owners of properties financed with a government guarantee enjoy the flexibility to raise rents but not to finance a property with low initial rents just to qualify for the guarantee.
91. The exception is limited availability under the FHA multifamily program of 15 percent down payments.
92. In this new system, the issuer would be in the position to decide how it shares the predominant risk of credit losses, provided it retained some of this risk as required of it by the Public Guarantor. The Public Guarantor would provide a list of acceptable and approved vehicles for issuers to share the predominant risk with other private investors.
93. A brief and unsuccessful experience sharing risk with private counterparties under the FHA co-insurance program in the late 1980s underscores the importance of assuring that counterparties have the capital and liquidity needed to make good on their commitments.
94. Shear, William B., et al., *Fannie Mae and Freddie Mac's Multifamily Housing Activities Have Increased*.
95. For calendar year 2012, per-unit mortgage limits for Section 207/223(f) Mortgage Insurance for Purchase or Refinance of Existing Multifamily Rental Housing ranged from \$47,553 for studio apartments in non-elevator buildings to \$106,719 for 4+ bedroom units in elevator buildings, and from \$47,325 for non-elevator studios to \$101,195 for 4+ bedroom elevator units for Section 221(d)(4) Mortgage Insurance for Rental and Cooperative Housing. See Federal Register notice docket number FR-5592-N-01 for more details. In addition to these core programs, FHA also provides mortgage insurance for a host of other housing types, including multifamily manufactured home parks, rental housing for the elderly, and hospitals and residential care facilities.
96. The 2001 Residential Finance Survey is the most recent dataset of housing on a property basis (generally defined as a building or buildings under a single mortgage or contiguous properties owned debt free by the same owner and construed as a property). By contrast, there are more recent datasets that report on the number of housing units by structure type. By this measure, in 2009, 37 percent of rentals were in single-family buildings or manufactured homes, 20 percent in two- to four-unit buildings, 25 percent in buildings with five-19 units, and 9 percent in buildings with 20-49 units. Many 50-plus-unit properties are composed of multiple buildings with fewer than 50 units. Hence, for example, while in 2001 there were only 3.1 million buildings with 50 or more units, there were 10.6 million properties with 50 or more units.
97. Owners of just a single-unit property intended for rent should probably still be underwritten like homeowners in the sense that the decisions should be based on the borrowers' credit score and ability to carry the mortgage debt without relying on rental income. If the owner holds more than one such property, then policy makers should give consideration as to whether incremental additions should be handled under the multifamily system and take a portfolio view of the two or more separate properties owned.
98. The Board of Governors of the Federal Reserve System, among many others, have underscored the importance of helping support land banks – quasi-governmental entities set up to help own and manage low-value properties that markets might otherwise leave unrehabilitated and abandoned, dragging down property values in neighborhoods. See the Federal Reserve's 2012 White Paper entitled "The U.S. Housing Market: Current Conditions and Policy Considerations."
99. CDFI membership in the FHLB system was authorized in the Housing and Economic Recovery Act of 2008, with final regulations issued by the Federal Housing Finance Agency in 2009. But the Act did not designate CDFIs as Community Financial Institutions (CFIs), limiting the ability of certain CDFIs to pledge nontraditional collateral allowed CDFIs to secure advances from the FHLBs.
100. American Community Survey, 1-Year Estimates. *Median Household Income the Past 12 Months by Tenure* (U.S. Census Bureau, 2011).
101. Steffen, Barry, et al., *Worst Case Housing Needs 2009: Report to Congress*. (Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011), 28.
102. See Rebecca Cohen, *The Impacts of Affordable Housing on Health: A Research Summary* (Washington, DC: Center for Housing Policy, 2011); Maya Brennan, *The Impacts of Affordable Housing on Education: A Research Summary* (Washington, DC: Center for Housing Policy, 2011).
103. Acs, Gregory, Pamela J. Loprest, and Austin Nichols, *Risk and Recovery: Documenting the Changing Risks to Family Incomes* (Washington, DC: The Urban Institute, 2009).
104. Been, Vicki and Ingrid Gould Ellen, *Challenges Facing Housing Markets in the Next Decade: Developing a Policy-Relevant Research Agenda* (New York, NY: NYU Furman Center for Real Estate and Urban Policy, 2012).
105. J. Ronald Terwilliger, *America's Housing Policy-the Missing Piece: Affordable Workforce Rentals* (Washington, DC: Urban Land Institute, 2011).
106. For the first comprehensive examination of local regulatory barriers to affordable housing, see Advisory Commission on Regulatory Barriers to Affordable Housing, "Not in My Backyard": *Removing Barriers to Affordable Housing* HUD-5806 (Washington, DC: U.S. Department of Housing and Urban Development, 1991); see also U.S. Department of Housing and Urban Development Office of Policy Development and Research, "Why Not in Our Community?" *Removing Barriers to Affordable Housing* (Washington, DC: 2004).
107. A wealth of research confirms that regions with restrictive regulatory regimes tend to have higher housing costs than regions with fewer regulatory restrictions. See Pendall, Rolf, Robert Puentes, and Jonathan Martin, *From Traditional to Reformed: A Review of the Land Use Regulations in the Nation's 50 Largest Metropolitan Areas* (Washington, DC: The Brookings Institution, 2006); Glaeser, Edward L. and Joseph Gyourko, "The Impact Of Building Restrictions On Housing Affordability," *FRBNY Economic Policy Review* (June 2003), 21-39; Michael H. Schill, "Regulations and Housing Development: What We Know," *Cityscape: A Journal of Policy Development and Research* 8, no. 1 (2005), 5-19.
108. Based on American Housing Survey data as tabulated by Abt Associates. July 16, 2012, memo to BPC staff.
109. There are different ways of calculating this statistic. One approach compares the number of renters with incomes below 80 percent of area median income (AMI) reporting receipt of rental assistance (4.6 million) with the total number of renters with incomes below 80 percent of AMI who either: spend 30 or more of their income for housing (14.3 million) or report receipt of rental assistance (4.6 million). This generates an assistance percentage of 24.3 percent, based on numbers reported in the 2009 American Housing Survey, as tabulated in Steffen, Barry, et al., *Worst Case Housing Needs 2009: Report to Congress*.

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110. Historically, from the late 1970s to the early 1990s, multifamily housing starts made up 34 percent of all housing starts. From the early 1990s to late 2000s, however, the overall share of new housing starts that were multifamily was less than 18 percent. Production of both affordable and market rate rental housing fell precipitously with the recent economic downturn, with production of multifamily rental units dropping by nearly 41 percent between 2009 and 2011 alone. Though the number of multifamily housing starts has begun to rise again, recently close to 29 percent of all new starts on average, overall multifamily production is still nearly 150,000 units short of where the average production levels were from 1994 to 2008.
111. Terwilliger, *America's Housing Policy-the Missing Piece: Affordable Workforce Rentals*.
112. Lawrence L. Thompson, *A History of HUD* (Washington, DC: 2006), 4.
113. Thompson, *A History of HUD*, 4-5.
114. Heinz, John, et al., *Omnibus Budget Reconciliation Act of 1981: An Information Paper prepared by the Special Committee on Aging, United States Senate* (Washington, DC: U.S. Government Printing Office, 1981), 19.
115. *The 2011 Annual Homeless Assessment Report to Congress* (Washington, DC: U.S. Department of Housing and Urban Development, 2012), 71.
116. *The 2012 Point-in-Time Estimates of Homelessness* (Washington, DC: U.S. Department of Housing and Urban Development, 2012), 18.
117. U.S. Department of Housing and Urban Development, *FY2012 State Income Limits* (Washington, DC: 2012).
118. Today, public housing agencies may issue up to 25 percent of vouchers to households earning up to 80 percent of AMI.
119. This shift in eligibility is expected to make available for the lowest-income households, on average, about \$3.3 billion per year over a ten-year period - ranging from \$0.7 billion in the first year to upwards of \$5.6 billion by the tenth year of the program.
120. Burt, Martha, et al., *Homelessness: Programs and the People They Serve: Findings of the National Survey of Homeless Assistance Providers and Clients* (Washington, DC: The Urban Institute, 1999).
121. Kuhn, Randall and Dennis P. Culhane, "Applying Cluster Analysis to Test a Typology of Homelessness by Pattern of Shelter Utilization: Results from the Analysis of Administrative Data," *American Journal of Community Psychology* 26, no. 2 (1998), 207-232.
122. Ingrid Gould Ellen, "Rental Housing Policy in the United States: Key Facts and Critical Trade-Offs" (presentation, *The Next Generation Housing Policy Convening on Rental Policy*, Washington, DC, October 13, 2010), using estimates prepared by the Joint Center for Housing Studies of Harvard University.
123. In addition to the allocated tax credit program, the LIHTC includes a multifamily tax-exempt bond program which is awarded under a state's private activity bond cap and which includes lower valued tax credits.
124. O'Regan, Katherine M. and Keren M. Horn, "What Can We Learn about the Low Income Housing Tax Credit Program by Looking at the Tenants?" Forthcoming, *Housing Policy Debate* (New York, NY: NYU Furman Center for Real Estate and Urban Policy, Moelis Institute for Affordable Housing Policy, 2012).
125. CohnReznick LLC (formerly "Reznick Group"), *The Low-Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance* (New York, NY: CohnReznick LLC, 2011).
126. By contrast, the LIHTC is currently allocated based on overall population. Allocating the 50 percent increase in LIHTC by renter population will help to increase the credit allocation to states with a greater use for them.
127. The Council of Large Public Housing Authorities and the Public Housing Authorities Directors Association, *FFY 2013 PHADA/CLPHA Public Housing and Section 8 Funding Needs*, February 1, 2012. Calculation based upon the *Abt Associates, Inc. 2010 Capital Needs Assessment* average accrual number (adjusted for inflation).
128. U.S. Department of Housing and Urban Development Office of Policy Development and Research, "Quantifying Energy Efficiency in Multifamily Rental Housing." *Evidence Matters*, Summer 2011.
129. This number is based on a tabulation of the average emergency assistance made available per household by grantees of the Homelessness Prevention and Rapid Re-Housing Program as tabulated by Abt Associates. For reference, 18 percent of HPRP grantees provided average grants at this level or lower. September 28, 2012, memo to BPC staff.
130. National Alliance to End Homelessness, *Ending Family Homelessness, National Trends and Local System Responses* (Washington, DC: 2011), 6.
131. HUD measures housing quality directly in the public housing and project-based Section 8 programs. See below for further discussion.
132. Internal HUD data from the 2000 to 2003 period indicate that about 22 percent of units assisted through the housing voucher program had 8 or more defects of the type measured by HUD's Housing Quality Standards (which include minor defects as well as major ones) while roughly 13 percent had one or more critical problems sufficient to warrant an identification as severely inadequate under the standards used in the American Housing Survey. See Gray, Robert W. et al., *Tell Us About Your Home: Three Years of Surveying Housing Quality and Satisfaction in the Housing Choice Voucher Program*, U.S. Department of Housing and Urban Development, Draft, 2009. NOTE: More recent housing quality data are expected to be available early in 2013 once HUD releases an enhanced version of the 2011 American Housing Survey, which includes identifiers for participation in HUD programs.
133. When founded in 1965, HUD employed 13,700 people and grew to 17,100 employees by 1980. In the late 1980s, abusive management practices triggered the 1989 HUD Reform Act, which ushered in a review of HUD's mission and goals. Secretaries Henry Cisneros (1993-1997) and Andrew Cuomo (1997-2001) proposed and implemented reductions in HUD staff levels. By 2012, HUD employed roughly 9,200 people. See data from the Office of Management and Budget as cited in Thompson, *A History of HUD*, 40; U.S. Department of Housing and Urban Development, "Cuomo Announces Historic Management Reforms for HUD to Stamp Out Waste, Fraud and Abuse and Improve Performance," press release, June 26, 1997; HUD, "Fiscal Year 2013 Budget, Full-Time Equivalent (FTE) Employment," A-1 (2012).
134. The Moving to Work Demonstration provides participating providers with broad flexibility to depart from statutory and regulatory requirements related to HUD-funded rental assistance. Originally authorized in 1996, the Demonstration currently applies to 35 housing authorities administering public housing and/or Section 8 housing vouchers. Participating agencies enter into a Moving to Work agreement with HUD that specifies the terms under which they will be funded by HUD as well as the nature of any waivers of legal requirements and a set of protections for residents.
135. See the Small Housing Authority Reform Proposal, jointly sponsored by the National Association of Housing and Redevelopment Officials and the Public Housing Authorities Directors Association.
136. See, for example, Mills, Gregory, et al., *Effects of Housing Vouchers on Welfare Families* (Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2006).

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137. See Bloom, Howard S., et al., *Promoting Work in Public Housing: The Effectiveness of Jobs-Plus* (New York, NY: MDRC, 2005); De Silva, Lalith, et al., *Evaluation of the Family Self-Sufficiency Program: Prospective Study* (Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011).
138. See, generally, Wilson, William Julius, *The Truly Disadvantaged: The Inner-City, the Underclass and Public Policy* (Chicago, IL: University of Chicago Press, 1987).
139. HUD's voucher program rating system already includes a "bonus" de-concentration measure that examines the extent to which voucher-holders have gained access to low-poverty neighborhoods. This measure could be evaluated and improved if necessary to ensure it effectively measures the success of the voucher program in helping families access neighborhoods of opportunity. Because public housing and project-based rental assistance units are not portable like vouchers, other approaches will be needed to measure access to opportunity in these programs.
140. While HUD already measures housing quality in the public housing and multifamily assisted housing programs, it will be important during the standards-setting process to consider whether the current quality standards could be strengthened to better reflect the latest research on how housing promotes health – for example, with respect to ventilation, moisture and pests. See, generally, Jacobs, David E. and Andrea Baeder, *Housing Interventions and Health: A Review of the Evidence* (Columbia, MD: National Center for Healthy Housing, 2009).
141. A number of proposals have been made to reduce the frequency of HUD's inspections of public housing and assisted units and/or of housing authority inspections of voucher-funded units. We would support such streamlining so long as the change in frequency of inspections does not lead to a measurable deterioration in housing quality.
142. See "Housing Choice: Is your property ready?" Atlanta Housing Authority, accessed January 7, 2013, <http://www.atlantahousing.org/housingchoice/landlords/index.cfm?Fuseaction=checklist>.
143. According to one representative of large multifamily property owners, "owners could achieve improved operating efficiencies and reduce subsidy costs if they had greater flexibility to (i) merge entities and use pooled financing, (ii) access accumulated equity and reserves, and (iii) make partial or full transfers to other properties of section 8 rental assistance and operating support for section 202 properties now tied down by regulatory agreement. The ability to build capital at the parent or portfolio level would enable an owner to cross-subsidize its weaker properties and to have working capital to innovate." July 3, 2012 statement submitted to the BPC Housing Commission by Stewards of Affordable Housing for the Future.
144. The middle group of providers that have an acceptable level of performance but do not rank as excellent will be exempt from competition but also will not have access to the regulatory flexibility provided to high performers.
145. To ensure the results can be interpreted effectively, it will also be necessary to utilize a control group and/or to compare a proposed new approach with other similar interventions. For example, if a high-performing agency wants to try a new intervention that combines financial incentives for increased work with case management to promote work, it may make sense to also examine the impacts of each of these components in isolation, and to compare the results to a control group that is not offered the opportunity to participate in the program.
146. DeNavas-Walt, Carmen, et al., *Income, Poverty, and Health Insurance Coverage in the United States: 2010*. U.S. Census Bureau, Current Population Reports, P60-239 (Washington, DC: U.S. Government Printing Office, 2011).
147. Housing Assistance Council ("HAC"), *Poverty in Rural America* (Washington, DC: HAC, 2011).
148. DeNavas-Walt, Carmen, et al., *Income, Poverty, and Health Insurance Coverage in the United States: 2010*, 18.
149. Tracey Farrigan, *Rural Income, Poverty, and Welfare: Poverty Geography* (Washington, DC: U.S. Department of Agriculture, Economic Research Service, 2010).
150. 2011 American Housing Survey, *Housing Costs – All Occupied Units (National)* (U.S. Census Bureau, 2011).
151. Housing Assistance Council ("HAC"), *Homeownership in Rural America* Rural Research Note (Washington, DC: 2012), 1.
152. HAC, *Taking Stock: Rural People, Poverty, and Housing in the 21st Century* (Washington, DC: 2012), 35.
153. *Ibid.*
154. HAC, *Housing in Rural America* (Washington, DC: 2010).
155. HAC, *Taking Stock*, 36-37.
156. HAC, *Taking Stock*, 3.
157. See U.S. Code 42USC 1490. For purposes of this subchapter, any area classified as "rural" or a "rural area" prior to October 1, 1990, and determined not to be "rural" or a "rural area" as a result of data received from or after the 1990 or 2000 decennial census shall continue to be so classified until the receipt of data from the decennial census in the year 2010, if such area has a population in excess of 10,000 but not in excess of 25,000, is rural in character, and has a serious lack of mortgage credit for lower and moderate-income families.
158. See Housing Assistance Council ("HAC"), *Estimating Potential Changes to USDA-RD's Eligible Area Designations* (Washington, DC: HAC, 2011), 3. By comparison, about 16 percent of the population resides outside OMB-designated Metropolitan Areas, and 23 percent of the population is located in Census Bureau-defined Rural Areas.
159. October 23, 2012 letter submitted to the BPC Housing Commission by Robert Rapoza, National Rural Housing Coalition.
160. January 29, 2013 email communication with Donn Appleman, U.S. Department of Agricultural Development - Rural Development.
161. January 24, 2013 email communication with Barbara Sard, Center on Budget and Policy Priorities.
162. House Appropriations Committee, *Rural Development before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies*, 112th Congress (2012) (statement by Tammy Treviño, Administrator, Rural Housing Service).
163. Scirè, Mathew and James White, *Housing Assistance: Opportunities Exist to Increase Collaboration and Consider Consolidation*. GAO-12-554, (Washington, DC: U.S. Government Accountability Office, 2012).
164. Housing Assistance Council, *Estimating Potential Changes to USDA-RD's Eligible Area Designations*. Rural Housing Research Note (Washington, DC: 2011), 1.
165. In Fiscal Year 2011, the U.S. Department of Agriculture guaranteed \$16.9 billion in loans and issued \$1.1 billion in direct loans. See Ruth Simon, "USDA is a Tough Collector When Mortgages Go Bad," *Wall Street Journal*, May 24, 2012.
166. Bipartisan Policy Center and Housing Assistance Council tabulations of U.S. Department of Agriculture data.

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167. Henry Cisneros, "New Visions for Aging in Place," in *Independent for Life: Homes and Neighborhoods for an Aging America*, ed. Henry Cisneros, Margaret Dyer-Chamberlain, and Jane Hickie (Stanford, CA: Stanford Center on Longevity, 2012), 8.
 168. Centers for Disease Control and Prevention, *Healthy Places Terminology* (Washington, DC: Centers for Disease Control and Prevention, 2010).
 169. Farber, Nicholas, et al., *Aging in Place: A State Survey of Livability Policies and Practices* (National Conference of State Legislatures and AARP Public Policy Institute, 2011), 1.
 170. Henry Cisneros, "New Visions for Aging in Place," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 8.
 171. Green, Richard K. and Gary D. Painter, "Housing Finance," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 238-239.
 172. Esther Greenhouse, "The Home Environment and Aging," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 88-97; and Greg Miedema, "A Contractor's Perspective," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 113-122.
 173. Elinor Ginzler, "From Home to Hospice: The Range of Housing Alternatives," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 57.
 174. Farber, Nicholas, et al., *Aging in Place: A State Survey of Livability Policies and Practices*, 48-50.
 175. Elinor Ginzler, "From Home to Hospice: The Range of Housing Alternatives," *Independent for Life: Homes and Neighborhoods for an Aging America*, 57.
 176. Farber, Nicholas, et al., *Aging in Place: A State Survey of Livability Policies and Practices*, 50.
 177. Center for Housing Policy tabulations of the 2009 American Housing Survey. For an analysis of these data by age and income cohorts, see Lipman, Barbara, Jeffrey Lubell, and Emily Salomon, *Housing an Aging Population: Are We Prepared?* (Washington, DC: Center for Housing Policy, 2012).
 178. Andrew Kochera, *Developing Appropriate Rental Housing for Low-Income Older Persons: A Survey of Section 202 and LIHTC Property Managers* (Washington, DC: AARP Public Policy Institute, 2006), 4.
 179. Shirley Franklin and Jane Hickie, "A Political Strategy," in *Independent for Life: Homes and Neighborhoods for an Aging America*, 248-249; see also: Libby Perl, *Section 202 and Other HUD Rental Housing Programs for Low-Income Elderly Residents* (Washington, DC: Congressional Research Service, 2010), 1.
 180. Andrew Kochera, *Developing Appropriate Rental Housing for Low-Income Older Persons: A Survey of Section 202 and LIHTC Property Managers*.
 181. Ibid.
 182. For more information, see Center for Housing Policy, "Meeting the Health Care Needs of Aging Residents of Affordable Multifamily Housing." Case study prepared for the How Housing Matters Conference, Washington, DC, November 2011.
 183. U.S. Department of Energy, *Fiscal Year 2011 Summary of Performance and Financial Information* (Washington, DC: 2012), 16.
 184. Keith Wardrip, *Strategies to Meeting the Housing Needs of Older Adults*, 3-4.
 185. Government Accountability Office, *States' and Localities' Uses of Funds and Actions Needed to Address Implementation Challenges and Bolster Accountability* GAO-10-604 (Washington, DC: 2010), 121.
 186. U.S. Department of Housing and Urban Development, "HUD Awards \$23 Million to Test New Energy-Saving Approaches in Older Multi-Family Housing Developments," press release, March 8, 2012.
 187. Consumer Financial Protection Bureau. *Reverse Mortgages: Report to Congress* (Washington, DC: 2012), 5.
 188. Consumer Financial Protection Bureau. *Reverse Mortgages: Report to Congress* (Washington, DC: 2012), 111.

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