A National Homeownership Strategy for the New Millenium

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The Mortgage Bankers Association, HopeNow, and the Conference of State Bank Supervisors recently released progress reports on modification programs. Many policy conclusions are being drawn, some saying the modification is proceeding apace and others concluding that nowhere near enough is being done. In seeking to forestall all foreclosures, however, all the modification programs treat a mortgage as *per se* evidence that an individual sought to buy a home when, in fact, that is not necessarily the case. In fact, in pushing home ownership over the past decade, social policies pushed the misuse of mortgage credit. The story goes like this.

It used to be that individuals bought homes to live in the rest of their lives. They would put down roots, work in the community, send their children to school, look after the neighborhood, and be vigilant with crime and decay. Perhaps most importantly to politicians, they voted. And if legislators *helped* them *get* that dream home the homeowners would vote for *them*!

THE NATIONAL HOMEOWNERSHIP STRATEGY

Out of this logic arose the National Homeownership Strategy, prepared by the U.S. Department of Housing and Urban Development (HUD), under the direction of Secretary Henry G. Cisneros, in response to a request from President Clinton.

According to the website devoted to the Strategy initiative at HUD[1], "In the spring and summer of 1994, Secretary Henry Cisneros met with leaders of major national organizations from the housing industry to solicit their views about establishing a national homeownership partnership. In August 1994 these planning sessions culminated in a historic meeting at which industry representatives agreed to the formation of working groups to help develop the National Homeownership Strategy," (The National Homeownership Strategy:

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[1] The National Homeownership Strategy material was removed from the HUD web site in 2007. I acknowledge a substantial debt of gratitude to Joshua Rosner for archiving those pages before they were removed.

Partners in the American Dream, Chapter 1: The National Homeownership Strategy).

The Strategy brought together a diverse set of public and private housing market participants in coordinating an approach to, "…achieve an all-time high level of homeownership in America within the next 6 years." The Strategy included input from, "…private and public sector resources and commitments to implement three broad approaches designed to make homeownership more affordable, accessible, and available." Specifically, strategies advocated under the initiative include:

> *…streamlining transaction costs, expanding creative financing and public gap financing, and making technological improvements in loan underwriting [that] will reduce the costs of homeownership…. Regulatory reforms will allow developers and builders to reduce the costs of land assembly, housing construction, and home rehabilitation, making homeownership more affordable for willing homebuyers who are now priced out of the housing market (The National Homeownership Strategy: Partners in the American Dream, Chapter 1: The National Homeownership Strategy).*

Chapter 4 of the Strategy deals with innovative approaches to mortgage financing that can help borrowers live in homes (I say "live in" homes because non- or negative-amortizing instruments do not help individuals *buy* homes). In what now appears to be rather startling language, the Strategy advocates, "…financing strategies, fueled by the creativity and resources of the private and public sectors," to help homebuyers that lack cash to buy a home or income to make the payments," (The National Homeownership Strategy: Partners in the American Dream, Chapter 4: Financing). It strikes me as reckless to promote home sales to individuals in such constrained financial predicaments.

With respect to down payments, the Strategy lauded the, "…great strides [which] have been made by the lending community in recent years to reduce down payment requirements, particularly for low- and moderate income homebuyers." The Strategy even went so far as to advocate using, "…existing household assets that may be converted to down payment assistance, subject to income tax and other considerations. For example, many households now participate in tax-advantaged savings vehicles (such as 401(k) plans), which historically have not been available for down payment on a home." (Let's be glad *that* piece never became reality.) (The National Homeownership Strategy: Partners in the American Dream, Chapter 4: Financing)

With respect to mortgage payments, the Strategy sought to, "…reform the basic contract between borrowers and lenders to reduce interest costs." The Strategy notes further that:

> *The most significant monthly housing cost for most new homeowners is the monthly mortgage cost…. When mortgage rates are high, many households are precluded, at least for a while, from the opportunity to own a home. Low mortgage interest rates sustained over an extended period of time can have a compelling, beneficial impact on mortgage affordability and the rate of homeownership in America. (The National Homeownership Strategy: Partners in the American Dream, Chapter 4: Financing)*

The Present Situation

The strategy worked. It worked really well. Some might say too well. The strategy indeed had both the intended "…beneficial impact on mortgage affordability and the rate of homeownership in America," as homeownership rose to record highs by 2007. But in doing so the partnership of public and private institutions that originate, service, and sell mortgages ignored many important prerequisite warnings included in the one-hundred action items in the Homeownership Strategy.

For instance, the Strategy acknowledged that, "In many instances,… prospective first-time homebuyers find that developing the proper savings patterns to accumulate sufficient cash for the down payment is difficult." The Strategy also admitted that, "…although the variety in loan products available to the borrower is commendable, it can prove confusing to a first-time homebuyer," (The National Homeownership Strategy: Partners in the American Dream, Chapter 4: Financing). A great many of the present ills could have been avoided had some of those warnings been heeded before politicians were lured by the siren song of homeownership and the votes it brings.

Three Types of Borrowers

Instead, we now have a mortgage market in which the products and approaches encouraged by the National Homeownership Strategy have been misused to increase leverage throughout the market and encourage speculation by builders, buyers, and financial institutions, alike.

The Strategy certainly helped some renters achieve the dream of homeownership. But the Strategy was also fundamentally misused to extend more credit to prime borrowers, fueling home price inflation. That home price inflation led builders to build ever more developments, using creative financing to sell the homes. In the process, speculators also used the creative financing to leverage their bets on home price appreciation in the bubble environment, ultimately resulting in record foreclosures in the present marketplace.

Modification policy now needs to struggle with the three types of borrowers that have borrowed under the same encouragement originally extended in the National Homeownership Strategy:

1. Borrowers who attempted to abide by the original purpose of the Strategy should, indeed, be helped wherever possible.
2. Borrowers, usually already homeowners, who sought to increase leverage with the creative financing tools developed to meet the Strategy goals, whether to augment income from cash-out refinancing or to trade up to larger houses before they can afford them in any stable fashion, need to learn that those tools are not for them.
3. Borrowers who were mere speculators and perpetrators of fraud need to face market discipline.

Along the entire way, neighborhoods (and not all agglomerations of houses are neighborhoods, especially in developments that are often less than a year or two old with houses being finished only to offset builder losses on land expenses) need to be preserved. One way to preserve neighborhoods, however, is to sell the foreclosed homes *and have them reoccupied as soon as possible after sale*. Sometimes, that can be achieved by leasing the home back to the existing occupant. We may need creative financing and auction tools to promptly and economically undertake the task, but I am certain that the minds that created the problem can solve it, too.

The homeownership problem is multidimensional and complex. But it is not insurmountable. The majority of homeowners support distinguishing between the three types of borrowers. Why don't government initiatives? Perhaps because it is an election year. Sorting out the problem, however, is the key to moving on from this crisis and not repeating the same mistakes over again.

We stand at a crossroads in National Homeownership Strategy. Do we just plow ahead and encourage the present misapplication of the original Strategy? Or do we try to revise the approach, which in its original form included limiting the creativity to helping those in need, providing financial education and disclosure appropriate to the new types of mortgages, and the limitation of risk at other levels of the market?

We already have the highest home ownership levels in the world and seem to have therefore reached (and perhaps exceeded) a "natural rate" of maximum ownership. It's time to decide where to direct policy next.