

Affordable Rent and Access to Homeownership Refreshing the Debate in the Context of Housing Finance Reform

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Introduction

The continuing policy debate over restructuring the plumbing of the secondary mortgage market may ultimately prove to be the easy part—at least politically—of housing finance reform. The past eight years of proposals and counterproposals have focused the range of outcomes increasingly within a fairly narrow band—more private capital, a mortgage-backed security (MBS) explicitly guaranteed by the government, the elimination of the government-sponsored enterprise (GSE) duopoly, and flawed ownership model all being consistent themes. The proposal we put forward last year favored leveraging a single government MBS—the Ginnie Mae security—coupled with a well-regulated and competitive market for credit enhancement.¹

Arguably, though, the more important part of reform—the part still in need of fresh thinking—is whether and how to produce broader and more sustainable access to credit for first-time home buyers and low- and moderate-income Americans as well as how to increase the supply of affordable rental housing. All of this is a vital part of ensuring that reform creates a system that can meet the needs of an evolving 21st century American economy. And after all, if Washington is going to engage in a financial restructuring exercise, the focus should be on improving the lives of current and future generations of Americans.

¹ Michael Bright and Ed DeMarco, “Toward a New Secondary Mortgage Market,” September 2016.
<http://www.milkeninstitute.org/publications/view/823>

While this is a separate paper, we want our readers to be aware that we did not put the cart before the horse; the plumbing reforms we proposed were designed in large part to help address issues of access and affordability. How so? By embracing a competitive marketplace, we believe that innovation and disruption can usher in an era in which more mortgages are made and on more successful terms. And by using a single government-backed MBS, we can create a transparent and accountable revenue stream to properly—and transparently—help subsidize access to housing opportunities for all communities.

In this paper, we analyze more deeply the discussion around access and affordability. We believe that the housing finance challenges faced by American families today, whether they be millennials entering the market for the first time or baby boomers heading into retirement, need fresh thinking and solutions. We believe that our housing market is not working as well as it could. Importantly, we believe that housing finance reform offers us the opportunity to tackle these challenges.

Our key conclusions and recommendations may be briefly summarized as follows:

- (1) The rental market in America today is frequently inhibited by local land use, zoning, and building restrictions that, while well-intentioned, can impede the creation of affordable rentals. The federal government can't solve every problem. Tackling the supply constraints in developing more-affordable rental units starts with local governments. Still, we believe policymakers in Washington need a fuller appreciation of the magnitude of the challenges facing many low-income Americans. Near-term additional federal assistance could bring immediate relief, but in the longer term, local changes that unlock supply constraints will make the most meaningful impact.
- (2) In multifamily finance, we recommend keeping in place much of the loss-sharing arrangements used by Fannie Mae and Freddie Mac in their K-Series and DUS programs² but we suggest separating Fannie and Freddie's multifamily units into independently owned and operated private companies separate from their single-family business units. Any government guarantee of MBSs backed by affordable multifamily loans would be done through Ginnie Mae and accessed by any eligible entity.
- (3) Turning to single-family housing, for those who believe that there are good loans that are not being made—a proposition for which there is some evidence—our view is that more competition and innovation in underwriting is critical to solving this challenge. This can best be achieved by opening the market for credit enhancement to new participants. If policymakers want to facilitate new entrants and innovation in mortgage credit, the data that sit at Fannie Mae and Freddie Mac that help inform their “black box” underwriting engines (Desktop Underwriter and Loan Advisor) should be made available to all entities eligible to issue or credit-enhance Ginnie Mae MBSs. These new entrants, subject to Federal Housing Finance Agency

² <https://www.fanniemae.com/multifamily/multifamily-delegated-underwriting-servicing-dus>
<http://www.freddie.mac.com/multifamily/investors/kcerts.html>

(FHFA) oversight, should be permitted to evolve the credit box by building their own underwriting systems, subject to FHFA approval, to improve upon that of the GSEs. This “disruption” is a critical part of meeting the evolving needs of renters and home buyers and their changing demographics. No market functions well when managed entirely through a privileged duopoly; housing—and the market for mortgage credit risk—is not inherently any different.

- (4) A reformed secondary mortgage market should encourage lending to all income levels and communities. If policymakers are deciding to help subsidize and facilitate this market, it is about reaching the marginal borrower. As such, the government-supported market should be built on the concept that participating firms have a duty to serve the entire marketplace, not just high-end or the most creditworthy borrowers. A requirement on approved credit enhancers to produce “geographically and economically diverse, representative sample pools” of mortgages for securitization, combined with detailed loan reporting, would establish a public baseline for all secondary market entities that credit-enhance loans put into government-backed MBS.
- (5) To augment this “duty to serve,” we propose a simple, transparent, and accountable fee on all borrowers benefiting from access to a government-backed securitization process. The proceeds, generated by a charge of 10 basis points or so added to borrower interest rates, would be used to provide affordable-rent subsidies for low-income families, to provide financial assistance to eligible first-time home buyers, and to subsidize the servicing of loans made to targeted low-income home buyers who become delinquent on their mortgages.
- (6) The Federal Housing Administration (FHA) should be modernized, starting with a restatement of its mission and purpose. It then must be given the resources needed to update its systems, processes, and technology to fulfill its new mission. That mission must include serving as a countercyclical force if or when private credit markets pull back from time to time, as they did in the years immediately following the financial crisis. When assessing whether the housing finance system as a whole is serving all markets, loans insured by the FHA should be included in the analysis.
- (7) As long as we are going to have subsidies and public policy designed to help low-income families or communities on the margin to buy homes, we must recognize that what counts is not simply how many loans are made, but whether the loans are successful. It is the final, long-term outcome that matters, not simply the making of a loan. We propose that any regulations around “duty to serve” measure success in a way that does not count loans that go into default within 24 months of being made. Put another way, any loan that goes into default within 24 months of being made should not be viewed as having fulfilled the obligation to serve a homeowner, a family, or a community.
- (8) The single-family market needs to focus more on preparing renters to be successful homeowners. The process should include programs designed to help prospective homeowners

save for a down payment, supplemented by public and private down-payment assistance and by borrower education and credit counseling. Innovative ways of helping new borrowers become homeowners should be considered and encouraged, subject to robust consumer protections.

Part I: The Rental Market

While the rental market often takes a backseat in housing finance reform discussions, it has the greater potential to improve affordable-housing opportunities, and it is the market where most people start their housing journey. We understand that much of housing reform is geared toward the cost of ownership, and we appreciate that focus. Still, for a host of reasons, we would be remiss if we did not include a broad and substantive look at the challenges facing American renters. After all, many of today's renters are tomorrow's first-time home buyers. Therefore, to us, the issues are inextricably linked. Therefore, we begin with an analysis of the rental and multifamily markets.

All is not well here. In fact, it is quite the opposite for many families. The J. Ronald Terwilliger Foundation for Housing America's Families, among other research, reports that more than 11 million families—more than 1 in 4 renter households—pay more than 50 percent of their monthly income on rent.³ This unacceptable imbalance between income and rent hinders both economic growth and family well-being and raises moral issues.

Of course, the issue is highly complex. For example, while rental housing may conjure visions of downtown high-rise apartment buildings or perhaps suburban garden apartments, the fact is that the majority of rentals are in one- to four-family houses. According to the Census Bureau's American Community Survey, in 2015 just over one-third of families in rental housing were in dwellings of five or more units. Accordingly, we consider multifamily rental separate from single-family. Both areas need solutions, but both have unique challenges.

Multifamily Rental Market

Financing of multifamily rental properties is not like that of single-family homes. The property owner does not obtain a 30-year, fixed-rate mortgage and pay off the principal of the building over 30 years. Instead, the commercial loan is often 10 years, with only a portion of the principal being paid. As the loan term expires, the owner refinances the property. Individual properties may be separately incorporated, and thus the lender's recourse is to the property itself, not to the broader assets of the building owner.

Basic economics suggest that the supply of multifamily rental housing should respond to current and projected increases or decreases in demand in a given area. Thus, if demand for rentals increases and

³ J. Ronald Terwilliger et al., Foundation for Housing America's Families, "The Silent Crisis: A Snapshot of Current and Future Conditions," June 18, 2015. <https://www.joomag.com/magazine/the-silent-housing-crisis/0290011001434491644?short> The Terwilliger report cites Daniel McCue, "The Burden of High Housing Costs," Cascade, n. 26, Winter 2015, Federal Reserve Bank of Philadelphia. See also "Projecting Trends in Severely Cost-Burdened Renters: 2015-2025," Enterprise Community Partners and Joint Center for Housing Studies of Harvard University, 2015. <http://www.enterprisecommunity.org/download?fid=10007&nid=13350>

rents increase in response, one would expect an increase in supply to follow. But the reality is more complicated than that.

Not only does it take time to increase the supply of multifamily rental property—obviously one does not build an apartment complex overnight—it is a highly regulated commercial activity, with most regulations originating at the state and local levels. Indeed, the biggest barriers to a market-driven response to the demand for more rental housing are land use restrictions, building code requirements, and local opposition. Land use restrictions dictate whether and where vacant land or land being used for other purposes may be converted into rental housing. In many metro areas, those restrictions can be substantial. Building code requirements, whether for health and safety, environmental impact, aesthetics, local infrastructure, or other reasons increase the cost of building and maintaining rental properties.⁴ Whatever the merits of such requirements, they ultimately add to cost and thus add to rent. While this may not affect matters much for a high-income, luxury apartment building, it can be the difference between the rent being affordable or unaffordable for a lower-income family.

Another regulatory issue is the costs of federal, state, and local programs and subsidies designed to direct investment toward the construction and maintenance of affordable rental housing. These programs are meant to lower costs and increase supply, each leading to lower rents and greater access. Understandably, the governments that create such programs want accountability to ensure that funds are used as intended. Fair enough. But as the prescriptions regarding renter eligibility, building characteristics, and a host of other matters increase in detail and complexity, compliance costs rise accordingly.

This leads to at least three responses that increase costs when the intent of the government program was to drive them down. First, there are the required record-keeping and compliance mechanisms. Second, some developers or landlords may not participate in these markets, making the bidding less competitive, because they either cannot afford the compliance costs or are unwilling to risk the penalties for compliance failures. And third, affordable-housing projects frequently have multiple sources of subsidy and each source has its own requirements for independent reviews and audits. That also drives up costs. So, while taxpayers rightly expect government officials to ensure that taxpayer funds are used appropriately, the reality is that one hand is lowering costs while the other is raising them.

In communities suffering from shortages of affordable multifamily rental housing, citizens and their representatives need to evaluate local land use ordinances, building codes, labor rules, legal requirements, taxes, and any other requirement that limits supply or drives up the cost of adding new supply. Often, there are understandable and legitimate differences of view and different value judgments about open space, traffic, sight lines, infrastructure requirements, and so on. But the sad truth is that these myriad requirements combined with local political battles and never-ending litigation

⁴ For a deeper explanation of the sources and impact of costs on affordable rental supply, see Andrew Jakobovics, Lynn M. Ross, Molly Simpson, and Michael Spotts, “Bending the Cost Curve: Solutions to Expand the Supply of Affordable Rentals,” Washington, DC: Urban Land Institute, 2014. http://uli.org/wp-content/uploads/ULI-Documents/BendingCostCurve-Solutions_2014_web.pdf

can halt development of new housing supply for many years. The end result is that creating more of this basic human need—affordable housing—is stifled.

Increasing the multifamily rental supply is not just about building where there is open space. It is about preserving and rehabilitating an aging stock of rental housing where this is economically feasible, and not just for luxury rental units. It is also about repurposing existing structures for housing. Yet too many barriers seem to be standing in the way.

The Obama administration urged local officials to reduce the government-imposed impediments to markets' working for all income levels. Last year, the White House published a "Housing Development Toolkit" outlining methods to reduce obstacles that discouraged the private market from supplying more-affordable housing.⁵ As the R Street Institute's Jonathan Coppage noted, this sensible set of guidelines for local governments does not exempt the federal government from rethinking the challenges it unwittingly imposes. In particular, he cites the FHA's stringent limits on mixing commercial and residential development.⁶

The federal role in supporting the local supply of multifamily rental housing comes largely from the Low-Income Housing Tax Credit (LIHTC) and through various HUD programs (such as the HOME Program) to support the building, rehabilitation, and financing of multifamily dwellings. Significant support also comes from tenant-based and project-based housing vouchers (what used to be known as Section 8 vouchers, now referred to as the Housing Choice Voucher Program). The efficacy of these programs is beyond the scope of this paper.⁷ Suffice it to say there are advocates who believe these programs are vastly underfunded while others argue that they make matters worse by concentrating poverty and actually limiting supply by preventing markets from functioning.⁸ Regardless, we are of the view that lawmakers and the Trump administration should move past old debates in pursuit of results-oriented ideas such as linking federal programs to affordable-housing development in walkable communities or in conjunction with liberalized land use to address supply constraints. This, in all likelihood, will require additional funds.

⁵ "Housing Development Tool Kit," White House website https://www.whitehouse.gov/sites/whitehouse.gov/files/images/Housing_Development_Toolkit%20f.2.pdf

⁶ Jonathan Coppage, "To End the Affordable Housing Crisis, Washington Needs to Legalize Main Street," *Washington Post*, October 4, 2016. https://www.washingtonpost.com/posteverything/wp/2016/10/04/to-end-the-affordable-housing-crisis-washington-needs-to-legalize-main-street/?utm_term=.195c36222557

⁷ Harvard's Joint Center for Housing Studies published a comprehensive analysis of multifamily market conditions and the role of various federal programs in this market. See "America's Rental Housing: Expanding Options for Diverse and Growing Demand," Joint Center for Housing Studies of Harvard University, December 2015. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/americas_rental_housing_2015_web.pdf

⁸ For three perspectives on whether and how the federal government should increase, decrease, or alter how it supports affordable rental housing, see National Low Income Housing Coalition, "2017-2018 Public Policy Priorities," http://nlihc.org/sites/default/files/2017-2018_Policy-Priorities.pdf; Bipartisan Policy Center Housing Commission, "Housing America's Future: New Directions for National Policy," February 2013, http://cdn.bipartisanpolicy.org/wp-content/uploads/sites/default/files/BPC_Housing%20Report_web_0.pdf; and Howard Husock, "Public Housing and Rental Subsidies," on the Downsizing the Federal Government website. Accessed March 31, 2017. <https://www.downsizinggovernment.org/hud/public-housing-rental-subsidies>

Housing vouchers, arguably the most direct way to subsidize low-income renters, have a degree of support across most of the political spectrum, making this program a possible avenue to consensus. It is also the most efficient way to subsidize rents until local rules are changed to help clear the path for more-affordable units. Over the long run, then, our view is that local governments need to be more forward-leaning in ensuring that they modernize zoning rules so that regulations such as those governing parking spots per unit do not unwittingly incentivize luxury rental at the expense of affordable rental. In the meantime, we believe that housing finance reform could create an explicit and transparent mechanism for helping augment rental vouchers (more on that below).

In the end, it is fair to ask whether decades of federal efforts to generate more rental housing and in particular more-affordable rentals for low- and moderate-income families, have achieved more than if the market had simply been allowed to work with less government involvement. The evidence suggests that collectively we are falling short with the approaches used today and that making current programs more complicated is not likely to help. Streamlining requirements, reducing duplication, and loosening some local restrictions on land use and unnecessary building requirements appear to be more promising approaches. Markets should be free to respond to demand, and there appears to be plenty of unmet demand in many cities.

Single-Family Rental Market

The last decade's financial crisis and the resulting foreclosures on several million homeowners led to the development of a new market—the institutional market for single-family rental housing. Buying up distressed properties in metropolitan areas hit hard by the crisis, institutional investors built large inventories of single-family homes with the intent to manage the properties as rental units. At one level, there is nothing novel about this. One- to four-family properties constitute the majority of rental units. What is different is the institutional ownership and management of these types of properties, which traditionally were small, local operations.

The financing challenges for these two competing approaches to single-family rental are different. Institutional investors have hundreds, or thousands, of properties to finance. There is no reason such entities cannot and should not obtain financing through normal commercial financing structures. In our view, the recent decision leading Fannie Mae to guarantee a \$1-billion loan to one of these entities is nothing more than using Fannie's government backstop to subsidize the cost of credit to that entity. There is no market failure here, only the opportunity for a private firm to lower its funding cost slightly by availing itself of a government-backed guarantor. If we are going to have a government role in the rental market, it should target areas where market failures actually exist.

In the meantime, mom-and-pop operators get no such assistance. Limited by Fannie Mae and Freddie Mac rules to a handful of mortgages per landlord, small operators pay a higher price, reflecting the higher risks relative to those associated with owner-occupied housing. In the future, a competitive secondary mortgage market post-conservatorship needs to focus on expanding credit to these smaller rental operations by relaxing the restrictions on volume in exchange for rigorous underwriting of the property, neighborhood, and owner.

This is an example of what we believe are the detrimental effects of the protected Fannie Mae – Freddie Mac duopoly. In this case, they lack incentive to compete for loans to small single-family rental groups. A more competitive market where lenders have more paths to attract private capital needed to support these loans should increase supply and lower costs to local single-family landlords.

Post-Conservatorship Multifamily Finance: Greater Competition

Unlike in the single-family market, Fannie Mae and Freddie Mac are important but not dominant players in multifamily finance. More important, their business model has many design features that we actually aim to replicate in the single-family market. Most notably, risk-sharing that takes place at the onset of a deal has long been part of each GSE's multifamily line of business. All multifamily deals come with substantial amounts of first-loss capital borne by private investors, not the GSEs.

Still, a more competitive marketplace can bring advantages. We can start by separating the GSE multifamily business lines and allow them to operate in a market with other actors. The multifamily business lines at the enterprises today operate independently from the single-family line of business; there are few or no synergies beyond sharing common administrative functions. Separating the multifamily lines from the single-family businesses would lose no significant economies of scale. Indeed, freeing the multifamily business operations to compete in the marketplace without the benefits and limitations of GSE status or the encumbrance of being second fiddle to the much larger single-family operations could actually stimulate innovation and growth in the multifamily business segment. It is also worth considering single-family rental as part of the multifamily business line.

The expertise and management oversight at each firm surely has value that could be realized in operating as a stand-alone business operation. Thus, we recommend that when Fannie Mae and Freddie Mac are wound down and placed in receivership, as we proposed in our previous paper, the multifamily lines of business be spun off to purely private, commercial ownership. The new market would, by statute and regulation, operate similarly to that of the past, namely with enterprises required to obtain significant capital in a structured transaction ahead of any government role.

Either as a transition mechanism or as a remaining federal support for multifamily finance, the privatized multifamily businesses should be given access to Ginnie Mae multifamily securitization for multifamily mortgages that meet a clear standard for affordable housing. Even there, we would require that the first-loss risk-sharing requirements be retained. This is not entirely new for Ginnie Mae. Ginnie today securitizes multifamily loans guaranteed by the FHA and by the Department of Agriculture's Rural Development program. As with our proposal for the single-family secondary market, Ginnie's charter could be amended to allow for Ginnie securitization of eligible mortgages backing affordable multifamily properties that meet a sufficient standard of private credit enhancement.

Again, we are comfortable with this approach because GSE multifamily securitization already requires a substantial amount of private first-loss capital. Of course, if greater multifamily access to a Ginnie wrap is allowed, it should not be restricted to just the multifamily spin-offs from Fannie and Freddie but to any private enterprise that meets the eligibility and credit enhancement requirements for properties that meet the specified affordability requirements.

Part II: The Ownership Market

We turn now to the ownership market. Senate efforts to advance housing finance reform in 2014 stalled in large part due to unresolved debates over how the new system would ensure credit for low- and moderate-income households and communities. Yet few believe the old regime actually made a meaningful difference and many believe it contributed to the financial crisis. Rather than seek new approaches, policy debates have fallen back on the old system as, in our view, “the devil we know.”

We want to help advance the evolving discussion about affordable-housing policy. In this section, we will consider new ways of thinking about government programs and the role of the secondary mortgage market, both as it was and as it could be. We also offer some thoughts on changes we believe are needed in how government programs and the private market support affordable housing.

Government Affordable-Housing Programs

Federal Housing Administration

The FHA is the federal government’s flagship program for encouraging homeownership. Established in 1932, the FHA loan guarantee contributed greatly to the growth of homeownership and the establishment of sound underwriting. Yet the homeownership rate has remained largely unchanged since the late 1950s, with the brief exception of the last decade’s housing bubble. Which is to say that if the percentage of Americans who own a home is our metric for success, we have not moved the needle much in the past 60 years.

Of course, that is not the only metric. Success can also be measured in the quality of the homes we buy, the amount of disposable income a borrower has to pay for a home, the sustainability of homeownership, the housing wealth accumulated over time, and the durability of housing credit through the economic cycle. On these points the data are a bit more generous.

Continued underinvestment in the FHA, however, threatens the agency’s financial stability. More than that, though, underinvestment has left the agency less responsive to the evolving needs of potential homeowners. We believe the FHA has the opportunity to restore its leadership role as a key source of mortgage credit for first-time and for low- and moderate-income home buyers, if it were given a renewed focus and made part of structural reform. In our view, housing finance reform should give the FHA a clear mandate appropriate to today’s challenges and the resources to achieve that mandate.

A modernized FHA, for example, could help develop and implement thoughtful transition processes that would establish best practices for preparing potential homeowners by teaching them principles of finance, equity building, and self-sufficiency. This would not only reduce the likelihood of foreclosure but would also better equip families for retirement and for life’s exigencies. In this way, the FHA could guide people into homeownership and greater financial independence and self-sufficiency.

By improving the transition process to ownership and strengthening its underwriting, the FHA should experience lower default rates. By making loans more sustainable, the FHA would foster

homeownership while reducing the enormous costs from mortgage defaults and improve its financial strength. That would provide a sound basis for lowering FHA guarantee premiums.

To help make these ideals a reality, we suggest the following changes to the FHA:

- Build the FHA reserve to the same capital level required of banks: at least 4 percent of outstanding loans. That would make it a true countercyclical buffer strong enough to provide added support to the market in times of stress.
- Fund the needed technology upgrades. Ideally, this would be done via appropriations. If that is politically unachievable, to us there is a reasonable policy argument for allowing the FHA to fund the upgrades using assessments it controls. Outsourcing should also be considered.
- Account for the FHA on a fair-value basis. While this is part of a larger debate about federal accounting for credit subsidies, the current approach is out of step with normal accounting conventions, including the methodology used by the Congressional Budget Office to account for Fannie Mae and Freddie Mac in conservatorship.
- Give the FHA a mandate to experiment with down-payment assistance options, transition-to-homeownership programs, risk-sharing, enhanced borrower counseling, residual income underwriting, borrower reserves, and other approaches to creating a pathway to sustainable homeownership, and then give it the authority to develop those tools.
- Eliminate the misalignment across the FHA, its inspector general, and the Department of Justice that is producing lender uncertainty and unmanageable lender liability risk. Intra-governmental arguments about what is permitted leaves private the FHA lenders at risk, constraining lending. More generally, by treating bad lending outcomes, or even poor lending practices, as criminal defrauding of the government arguably harms borrowers as much as or more than it helps them. Punishing lenders for violating program rules is one thing; imposing penalties that are outsized relative to the infraction and to the harm done only makes matters worse. A healthier lending environment would have clear program rules and proportionate penalties for violating those rules. These concerns extend to servicing practices as well as loan origination.
- Finally, we believe that housing finance reform should give the FHA a mandate to serve as a countercyclical buffer. Before the crisis, when financial markets went through one of their periodic disruptions, investors would flee to safety. Seeing Fannie Mae and Freddie Mac as closely aligned with the government, markets treated the GSEs as a safe harbor during such events, which greatly benefited Fannie and Freddie shareholders. In their absence, the FHA is the logical source of such countercyclical stability (as was recognized in the House Financial Services Committee's PATH Act). The Financial Stability Oversight Council (FSOC) could be authorized to declare a temporary market dislocation, thereby broadening the FHA loan eligibility parameters.

Importantly, policymakers should recognize that the "government" market and the "conventional" market are not operating in different universes. Instead, they can and should play complementary roles. We should expect the private markets to see a slight drop in market share in the event of a credit downturn. And when this happens, we should expect that the FHA's market share might grow a bit. Vice

versa during economic expansions, especially as the private market tests out an evolving set of underwriting standards and works to reach lower-income

Americans in new, innovative—but safe—ways. This is all fine and should be expected. And so, when regulators ask the private markets to help ensure access for all communities, they should caution against setting up an endless price war between the FHA and the private markets and instead recognize that it is sustainable and continuous access that counts, not where the loan comes from.

State Housing Finance Agencies (HFAs)

State housing finance agencies collectively manage important government programs supporting affordable housing and first-time home buyers. Were the FHA to take the approach we have just outlined, it would immediately have 50 laboratories to examine. Each state’s housing finance agency offers programs to support citizens wanting to become homeowners. Most of these programs and services target first-time home buyers and low- to moderate-income families. Borrower education, counseling, and down payment assistance are integral to most of the programs offered. Typically, HFAs must fund themselves so that the programs they offer are fiscally sound. Many HFAs work closely with private lenders and nonprofits in their states, forming partnerships that leverage the expertise of each partner.

HFAs have their own concerns with housing finance reform. They want to be sure that reforms maintain a deep and liquid secondary mortgage market that continues to support affordable housing generally and, in particular, gives HFAs a “preferred partnership” with the new secondary mortgage market.⁹ That is, HFAs want to ensure that mortgages they make or guarantee in support of affordable housing continue to have easy acceptance into secondary market securitizations. They also seek to continue their special relationship with the FHA and Ginnie Mae. Since Ginnie Mae is at the center of our proposal for secondary market reform, we believe that the outcome envisioned by the state HFAs can be realized in our reform framework.

Advocates for federalism and for affordable housing should both be strong supporters of state HFAs. Housing needs can vary dramatically from state to state. In some, there is a robust demand for mortgages for first-time home buyers. In others, the demand is more focused on senior housing. In some states, there is a surplus of housing units as population has declined; in other states, demand far exceeds supply. Allowing for scarce dollars to be distributed at the state level, where the needs are greatest, makes more sense than a single, national solution. Since there are already strong partnerships between the federal government and state HFAs, housing finance reform should reinforce those bonds while ensuring HFAs may credit enhance and sell their mortgages through the new, national secondary market system.

⁹ “Creating Affordable Housing Opportunity through a Preferred Partnership between the New Secondary Mortgage Market and State Housing Finance Agencies,” National Council of State Housing Agencies, 2014. <https://www.ncsha.org/resource/ncsha-white-paper-housing-finance-reform-2014>

Rethinking \$190 Billion in Housing Expenditures

Before searching for new federal dollars for affordable housing, legislators should take a hard look at the \$190 billion in direct expenditures and tax expenditures devoted to helping people purchase homes or pay rent in 2015¹⁰ and ask: Is this the best use of these funds in the housing sector? While the entire federal housing budget should be scrutinized, a remarkable share of housing expenditures goes to upper-income families, largely through the mortgage interest deduction. We acknowledge that these tax subsidies could likely be directed more efficiently, although we recognize that jurisdictional issues in the House and Senate relegate this to a discussion of tax reform as opposed to housing finance reform.

The Secondary Mortgage Market

The Way It Has Been

Some see the secondary mortgage market, operated through the two GSEs, as an important federal policy tool for two reasons. The first consists of the explicit affordable-housing goals each GSE must meet. The second is the average cost pricing approach, in which borrowers with stronger credit subsidize mortgage costs for those with weaker credit. We will briefly summarize each of these approaches and their shortcomings before turning to alternatives.

Affordable-Housing Goals

In 1992, Congress imposed a set of explicit affordable-housing goals on Fannie Mae and Freddie Mac and assigned the Department of Housing and Urban Development to periodically update numerical targets for each. In 2008, Congress updated the goals categories and assigned the setting of numerical targets to the FHFA. Whether those goals contributed to the financial crisis is controversial, and we do not intend to resolve it here.¹¹ Regardless, we believe that in order to modernize our paradigm for access to homeownership, we need to analyze objectively the following question: How do we best ensure that the secondary mortgage market is helping the primary mortgage market to serve all communities responsibly?

Since Fannie and Freddie do not make loans but rather buy loans from lenders, the affordable-housing goals regime sets up an odd competition between each GSE and lenders. For example, in the pre-crisis regime, multifamily loans, which were often “goals rich,” would be held from the GSEs until late in the year, setting up a bidding war between the two enterprises. This did not benefit renters; rather, the gains accrued to the lenders who were simply gaming the housing goals regime.

In the single-family space, many of the same types of gaming took place as well. Loans to low-income families often were used to achieve premium pricing that benefited the lenders not to help the

¹⁰ Will Fischer and Barbara Sard, “Federal Housing Spending Is Poorly Matched to Need: Tilt Toward Well-Off Homeowners Leaves Struggling Low-Income Renters Without Help,” Center on Budget and Policy Priorities, March 8, 2017. <http://www.cbpp.org/sites/default/files/atoms/files/12-18-13hous.pdf>

¹¹ The Financial Crisis Inquiry Commission concluded that the goals “contribute[d] marginally to these practices” that led to the GSEs’ failure. Peter Wallison, an FCIC member, vigorously dissented in this conclusion, arguing that U.S. government housing policy, including the housing goals, caused the crisis. See *The Financial Crisis Inquiry Report*, 2011 (p. 323) and Peter Wallison, *Hidden in Plain Sight*, Encounter Books, 2015. All of the major legislative reform proposals in 2013-14 would have eliminated the housing goals regime.

homeowner. Worse, the desire to give the appearance of effectiveness at times in the past led the GSEs to respond to ever-increasing goals with ever-weakening underwriting standards. Few were looking out for the long-term health of the homeowner or whether the homeowner really was a marginal borrower, since all that mattered was making a loan. Whatever one thinks of the degree to which the housing goals regime contributed to the financial crisis, we now know that a race to the bottom occurred on some level and that it failed our most vulnerable families.

We believe a reliable, affordable flow of credit for mortgages to creditworthy borrowers is a nonpartisan goal. We also believe that it is a nonpartisan objective that such borrowers succeed. We also believe that, with some new thinking, these need not be mutually exclusive objectives. In light of the many problems associated with the pre-crisis housing goals regime, we believe that our country ought to be searching for a better means to this end.

Cross-Subsidization

Pre-conservatorship, Fannie Mae and Freddie Mac charged the same guarantee fee—effectively the credit insurance premium—for almost all the loans they securitized. (The notable exception to this was that they would charge lower guarantee fees to lenders who sold them more loans than they charged to smaller lenders, regardless of the credit quality of the underlying mortgages.) By charging one insurance premium regardless of risk, the GSEs’ pricing system produced a cross-subsidy whereby lower-risk borrowers paid more for credit than their risks required while higher-risk borrowers paid less. Not surprisingly, we ended up with more-risky borrowers, and higher leverage, than a more risk-based regime would have produced.

The Way It Should Be

By distorting the price of credit, the current system fails to produce the normal price signals associated with financial risk that would inform borrowers, align incentives, and compensate lenders for risk-taking. In a world of rising nominal house prices and stable employment and income, people tended not to think much about these risks. The past crisis showed us the consequences. We propose replacing the old regime and its many flaws with a more targeted yet flexible system that places Congress in control of directing subsidies and that encourages the market to serve and innovate. The following three approaches stand out for us: establishing a duty-to-serve mechanism for all communities beyond rural and manufactured housing, establishing an explicit affordable-housing revenue stream, and opening the door to disruption and innovation.

Duty to Serve

The debate over affordable housing, in the context of housing finance reform, is underpinned by this question: How can policymakers be sure that private operators do not simply “cream” the market by making loans only to those individuals, families, and communities that have very low risks of default? Other key questions: How can we be sure that in replacing the GSEs we create a secondary mortgage market that will *responsibly* build a new generation of homeowners as demographics rapidly evolve? Should we have risk-based pricing, and if so, how much?

Whatever entity or entities come to replace the secondary market functions carried out today by Fannie Mae and Freddie Mac should have a responsibility to ensure that the secondary market serves all eligible borrowers. But given that secondary market entities do not originate mortgages, the idea of setting secondary market purchase goals without knowing or controlling for the actual lending taking place in the primary market both skews incentives and invites game-playing between primary and secondary market players that has little to do with serving borrowers.

We believe a better system could come in the form of an expanded and interactive duty to serve applied to the system as a whole, including successors to Fannie and Freddie, new entrants, and the FHA. Such a paradigm is promising in our view because the recent duty-to-serve regulations—which currently apply largely to rural and manufactured housing—rely more upon a forward-looking, market leadership role for credit enhancers. Building off of this would allow for a much more dynamic interaction among secondary market, primary market, and regulator.

So that we are clear, to us a duty to serve means that all eligible mortgages and all communities should find direct access to the secondary market on a nondiscriminatory basis through the business cycle and that approved credit enhancers should be required to show how they are working to make this a reality.

A duty to serve in a new secondary mortgage market means that access to government-backed securitization carries with it a responsibility to serve all borrowers and communities within an entity's market area or charter. We do not envision this to necessarily mean blunt numerical targets but rather a standing obligation to have, and carry out, a prudent business plan that demonstrates commitment. The recent duty-to-serve regulation from FHFA, while limited by law to three targets—manufactured housing, affordable-housing preservation, and rural housing—in our view illustrates such an approach and can be leveraged to help ensure that private credit markets are effectively serving all communities. It can be expanded upon as a mechanism for better reaching and serving all communities nationally.

In the context of our housing finance reform proposal, each Ginnie Mae issuer above a specified size would have a duty to serve all communities within its footprint, as described in the preceding paragraph, and a reporting requirement to document how well the commitment is being fulfilled and how loans are performing. FHFA would be required to work with HUD to ensure that the entire market was being served, including loans being insured by the FHA.

We envision here reporting that would allow each Ginnie issuer to be benchmarked against the overall market as well as narrative reporting on targeted efforts to enhance credit availability more broadly. This could include pilot programs to expand access in minority or rural communities or to issue smaller loans, or to enhance credit access for manufactured and micro housing units, or other ideas that secondary market participants develop. FHFA and HUD would report on the same metrics nationally.

FHFA would have the responsibility for ensuring that any approved credit enhancement process was helping to fulfill this duty. A credit enhancer found to have an inadequate plan for responsibly facilitating broad access to low-income communities or to have failed to carry out a duty-to-serve plan

would need to take corrective action or face penalties, including perhaps the loss of the ability to enhance loans for Ginnie Mae securitization.

Having a duty-to-serve mandate would make clear to lenders and Ginnie Mae issuers that they could not limit their lending and securitization activities to the high end of the market if they wanted access to Ginnie Mae securitization. Being in this market, with access to Ginnie MBSs, requires prudently serving all markets at all times. This is achievable by requiring MBS pools to be “scalable, repeatable, and geographically and economically diverse.” They would also have a requirement that they “not detract from the system’s ability to serve all markets.” By adding these rules to statute, the FHFA would have to keep those factors in mind when approving any new risk syndication structures or new entrants. This combination could help keep the right balance of market innovation, incentive alignment, and broad access to the secondary market for all communities.

Our objective here is to migrate from static goals that are somewhat clunky, that are reliant on having the secondary market following the primary market, and that show a history of being gamed toward a more interactive and dynamic system that allows for innovative thinking (subject to consumer protection), a holistic dialogue between primary and secondary markets and their regulator, and a set of credit enhancers who can provide leadership and ideas to the primary market. We believe replacing goals with an expansion of the recent duty-to-serve regulations is a promising approach to such an end.

Pay It Forward

An innovation in the Corker-Warner proposal, also utilized by Johnson-Crapo and other housing finance reform bills, was the replacement of the quota-based housing goals assigned to Fannie Mae and Freddie Mac with a user fee. As part of Corker-Warner’s full faith and credit guarantee on securitization, qualifying mortgages were to be assessed 10 basis points, with the proceeds going to trust funds established in 2008 to support the production and preservation of affordable housing (the National Housing Trust Fund administered by HUD). The proceeds also were to be used to finance community development financial institutions (CDFIs) and nonprofit housing organizations (the Capital Magnet Fund administered by the Treasury Department’s CDFI Fund). The idea was to replace the poorly targeted subsidies associated with the housing goals with direct funding for specific affordable-housing programs.

Like others, we support taking this approach, but with certain refinements. We view the basic principle behind such a user fee as this: Notwithstanding all efforts to reform the secondary mortgage market to bring private capital and risk-bearing to the mortgage market and to minimize the likelihood the government’s catastrophic guarantee will be needed, there is a residual benefit accruing to all borrowers from the full faith and credit guarantee of MBS. Imposing a small user fee equally on all mortgages going through this system is a simple way to acknowledge that fact and to establish a mechanism to share that benefit with the less fortunate in our housing markets.

A user fee of 10 basis points could raise as much as \$5 billion per year, assuming a Ginnie market of \$5 trillion (roughly the size of the Fannie-Freddie market today). What to do with the proceeds is a congressional responsibility. Congress could choose to fund the trust funds or to apply some or all of the funds elsewhere. Under the assumption that the funds should support critical affordable-housing needs,

they could be applied to the funding shortfall for rental vouchers used by very low-income families, thereby relieving some of the burden of extraordinarily high rental payments relative to income. Some portion might also be used to fund down payments, closing costs or home buying counseling for lower-income first-time home buyers. An attractive feature of this approach is that as struggling families succeed and move on to homeownership they would pay back into the system. Successful families would, in effect, pay it forward to the next set of folks trying to achieve the same measure of success.

We also suggest that some of the proceeds be used to encourage lending to more-marginal borrowers, but in a manner designed to encourage a prudent approach. A key factor limiting mortgage credit availability to riskier borrowers is the extraordinary cost of default servicing, especially in the wake of the financial crisis. This challenge is often overlooked in questions about today’s credit box, but it is certainly a contributing factor to the increase in average credit scores of GSE production. The Mortgage Bankers Association reports that the cost of servicing a delinquent mortgage has increased nearly fivefold since the financial crisis. Significant cost burdens from servicing delinquent loans discourage lenders from making somewhat riskier loans in the first place. If lawmakers wanted to preserve some subsidy to encourage credit availability, one option could be to subsidize the cost of default servicing on targeted affordable-housing loans.

Specifically, as was often done during the financial crisis to promote loan modifications, servicing costs could be subsidized for delinquent loans that meet a predefined affordability standard. Lenders would have a greater incentive to make more loans, while the subsidy payment would be required only in the event of delinquency. The payment should be for only a portion of the cost to keep servicers properly motivated.

As we developed our housing finance reform proposal, we tried to be mindful of aligning incentives and building in buffers. We believe the user fee becomes another area in which incentive alignment and countercyclical buffers can be established. Specifically, we would tie some or all of the funds raised by the fee to the financial condition of the Mortgage Insurance Fund (MIF) described in our previous paper. While there are numerous ways of doing this, and numerous levels at which fees may be set, the following example illustrates our approach and may serve as a starting point for more discussion.

MIF Reserves	MIF Fee	AH User Fee	Total Fee
0-1 percent	10 bp	0 bp	10bp
1-2 percent	5 bp	5 bp	10bp
Above 2 percent	0	10 bp	10bp

Notes: The MIF is measured as a percent of outstanding MBS. BP is basis points, and the amount reflects the added monthly interest cost, in basis points, that would flow from the mortgage payment to fund the MIF reserve and to the funding of affordable housing (AH).

Since our proposal, and most other current reform proposals, envisions a Mortgage Insurance Fund backstopping the mortgage credit market, and because such a fund would be starting from a zero balance, we believe it should build a reserve that would rapidly amount to at least 1 percent of

outstanding MBS and more slowly increase to 2 percent. Since both the MIF and the affordable housing fee effectively tax mortgages, the idea is to avoid the tax from becoming a double burden on home buyers. Thus, we would prioritize funding the MIF for safety and soundness reasons, alter the mix once the MIF had some measure of reserves, and then completely shift the revenue stream to affordable housing once the MIF was fully capitalized.

This approach creates a natural countercyclical buffer by avoiding an added tax on mortgages in the event of catastrophic losses like those experienced in the last crisis. It also aligns incentives in that advocates for the affordable-housing revenue stream would share an interest in ensuring that the system continued to operate in a prudent manner, avoiding excessive risk. And it means that whenever a mortgage is issued, the recipients are subject to the same fee, creating equity across borrowers over time. Depending on the implementation timing, this fee might have no long-term impact on mortgage rates given that Congress imposed a 10-basis-point fee on Fannie and Freddie MBS back in 2011 to finance a temporary payroll tax holiday; that fee expires October 1, 2021.

Disruption as a Powerful, Positive Force

While Fannie Mae and Freddie Mac have been accused of many things, being dynamic and innovative are not typically high on any such list. Secondary-market reform should not just allow but encourage disruptions and innovations that benefit home buyers and expand access to credit.

The secondary mortgage market should promote more options than just the 30-year fixed-rate mortgage. Product diversity should lead to borrowers having, and making, choices that can build equity faster. But any new products should meet consumer protection standards, including Dodd-Frank ability-to-repay rules, and should be accompanied by appropriate borrower education.

To further encourage competition and disruption, lenders should be given access to the enormous cache of loan data accumulated by Fannie Mae and Freddie Mac during their years as a government-sponsored duopoly. Broad distribution of the data, some of which has already taken place during the conservatorships, would deepen the knowledge base from which lenders and the mortgage credit risk market could evaluate affordable-housing markets and borrowers. With knowledge comes the ability to assess and price risk, and the willingness to do so.

Disruption and innovation also open the door to market-based responses to emerging needs. The coming wave of baby boomer retirements suggests the need to build more senior housing and to retrofit or remodel the homes of seniors who decide to age in place. A flexible, dynamic mortgage market should be ready to respond to such needs with an array of financing tools, including responsible reverse mortgage products and commercial financing of senior housing developments, continuing care retirement communities, and so on. Our proposal begins with a fundamental premise that there are quite likely good loans that could be made but that are not because of barriers. Opening the door to disruption will help.

The critical reason for this, in our view, is that Fannie Mae's underwriting system, Desktop Underwriter (DU), has a near monopoly on determining lending decisions. DU is used even by Freddie lenders, which

often employ it to cross-check loans accepted by Freddie’s system. This means, in effect, that no lender can originate any loan for secondary market sale that is outside of DU’s complex (and largely black box) guidelines. A world in which a credit enhancer can look for innovative ways to qualify a borrower—using cell phone payments or leveraging certain types of counseling, for example—is a world in which more loans can be made. This is especially important as our country’s demographics evolve rapidly. Only a credit-risk-taking enterprise that has the capacity to try out new products—subject to Consumer Financial Protection Bureau (CFPB) oversight and FHFA approval—can help really move the needle on enhancing access and affordability. In addition, the way our Qualified Mortgage “patch” works today, loans with greater than a 43 percent debt-to-income ratio qualify for the safe harbor only if they are approved by DU or by Freddie Mac’s automated underwriting system (Loan Advisor).¹² This is not a recipe for allowing the mortgage market to grow and evolve.

The more rigid and rules-driven our housing finance system, the slower it will be to respond to these changes and the less capable it will be of responding to emerging needs and opportunities. Competition, flexibility, and innovation need to be characteristics of the new secondary mortgage market.

Affordable Housing: Universal Changes Needed

Enhancing the availability and sustainability of mortgage lending to lower-income borrowers, whether through government programs such as the FHA or through private markets, would be enhanced by paying greater attention to three things: shock absorbers, accountability, and wealth building.

Shock Absorbers

While most underwriting is focused on income level, income volatility is an important factor to consider in underwriting a mortgage. Qualifying for a mortgage, which means the borrower has the ability to repay the loan, is necessary. But it is not sufficient to ensure a *sustainable* mortgage. The unexpected can occur, and so having reserves is critical. Emerging research on financial challenges facing lower-income families highlights the need for such reserves and offers ideas for creating such buffers.¹³ Housing policy that is truly concerned with sustainable mortgage outcomes should carefully consider ways to ensure such buffers are available. One simple approach would be a savings account tied to a mortgage payment, as outlined by Stephanie Moulton, Anya Samek, and Căzilia Loibl.¹⁴

Second, and following from the first point, the FHA originally was structured as mutual insurance. The agency could consider methods to mutualize this risk across its borrowers to add some payment shock buffer. Moreover, HUD could examine its rental programs, including rental vouchers, for ways to

¹² [https://www.fanniemae.com/singlefamily/desktop-underwriter#
http://www.freddie.com/loanadvisorsuite/](https://www.fanniemae.com/singlefamily/desktop-underwriter#http://www.freddie.com/loanadvisorsuite/)

¹³ See, for example, Michael Barr, *No Slack: The Financial Lives of Low-Income Americans*, Brookings Institution Press, 2012; and J.M. Collins, ed., *A Fragile Balance: Emergency Savings and Liquid Resources for Low-Income Consumers*. New York: Palgrave Macmillan, 2015.

¹⁴ Stephanie Moulton, Anya Samek, and Căzilia Loibl, “Save at Home: Building Emergency Savings One Mortgage Payment at a Time,” in *A Fragile Balance*. J.M. Collins, ed. New York: Palgrave Macmillan, 2015.

leverage limited dollars to serve as a financial shock absorber for lower-income renters rather than as a regular, monthly payment subsidy.¹⁵

Accountability for Long-Term Outcomes

Across the array of ideas offered in this paper, we emphasize the need to measure long-term success. It is not good enough to have a housing finance system that provides ample credit if the result is a high level of delinquency and default. We must concern ourselves with outcomes.

For example, does our housing finance system enable people to accumulate wealth by building and retaining equity in their homes during their working lives? If a duty-to-serve mechanism is established for secondary market entities, are people simply “getting loans,” or are they making timely mortgage payments and building wealth? We should not stop at measuring the number of loans made. We should be even more concerned about whether those loans succeed.

To make this a tangible set of policy recommendations, in our view, a lender or credit enhancer should not get points in any duty-to-serve reports for “serving” a community simply by making a loan. We should also measure whether the loan was a success or failure over a reasonable period. Yes, loans will go bad simply because of a changing economy or unforeseen circumstances, and we do not advocate a credit box where no one goes delinquent. But no loan that goes into default within just a couple of years of being made should count toward fulfillment of a goal, duty, or any other name we want to give to the responsibility of serving all communities equitably. Such thinking should also apply to the FHA program.

And so, we would propose that whatever policymakers settle on as it relates to managing and measuring the success of duty to serve, the metrics be based on a rolling 24-month look back, not counting loans as they are made. FHFA should examine the success of each approved credit-enhancers business plan based not simply on how well it will reach borrowers, but whether those borrowers perform. We call this “elbow grease lending.” There are good loans that can be made successfully, but they may also require a higher touch strategy from the servicer. The credit enhancer—the entity ultimately on the hook for the success of these loans—should have a strong incentive to find servicers who can help borrowers pay down their debt and stay on top of their mortgage.

Building Paths to Homeownership and Wealth Building

Almost all discussion of policies encouraging homeownership opportunities for low- and moderate-income families cites the long-term wealth-building opportunity as the primary motivation. It begs the question then as to whether our affordable-housing programs and housing policies actually lead to wealth building or not. That is an involved set of questions that one of us has tackled in other papers.¹⁶ We will summarize the key points here.

¹⁵ The downward spiral facing at-risk low-income renters is documented by Matthew Desmond in *Evicted: Poverty and Profit in the American City*. New York: Crown Publishing, 2016.

¹⁶ Ed DeMarco, “Homeownership, Wealth Creation, and Financial Stability,” *Milken Institute Review*, Fourth Quarter 2016. Edward DeMarco, “Creating Pathways to Sustainable Home Ownership That Builds and Retains Wealth,” *Milken Institute Viewpoint*, May 2017. <http://www.milkenreview.org/articles/homeownership-wealth-creation-and-financial-stability?IssueID=17>; <http://www.milkeninstitute.org/publications/view/863>.

Although the policy motivation for promoting ownership opportunities is wealth building, the key federal supports for homeownership are all delivered through subsidizing credit. These programs, the mortgage interest deduction, the FHA program, and the secondary market operated through Fannie Mae and Freddie Mac, each offers buyers subsidies that are maximized by taking on as much debt as possible, not by building equity. If the goal is wealth building, one might think that federal policies would be more concerned with building equity. Yet we promote borrowing to buy a home that creates a degree of leverage (housing debt relative to equity) that we outlawed long ago for banks.

Our federal housing policies also do not much concern themselves with establishing a *process* for becoming a homeowner. Instead, their focus is on bending underwriting standards to qualify more borrowers even as doing so creates substantial risk for those families and for the financial system. In a time of rising house prices and strong employment, most people can win at that game. But the Great Recession taught us (again) how brutally families can be crushed when conditions turn less favorable.

This leads us to believe both government lending programs and private lending programs, as well as nonprofits and other housing advocates, should spend more time developing families to become homeowners. Processes that took a longer-term view of preparing families to become successful homeowners would focus more seriously on saving for a down payment as well as searching for down payment assistance rather than subsidized credit. Such processes would also recognize the desire to become a homeowner as a good time to assist families with financial education and credit counseling, not just to make them better informed about the responsibilities of owning a home and having a mortgage, but to improve their overall financial literacy and capacity to manage financial risk.

Finally, pathways to homeownership may not always involve going directly to purchasing a house and getting a 30-year, fixed-rate mortgage. New, more consumer-friendly approaches to rent-to-own and other financial strategies—subject of course to CFPB oversight—may be more appropriate for certain households, and they at least warrant greater attention and study. And new mortgage products designed to build equity faster or create savings buffers may also be routes to both affordable and sustainable mortgage lending.

Conclusion

This survey of housing finance issues for rental housing and homeownership is meant to stimulate more thinking in the debate over access and affordability. A competitive market promoting economic growth and opportunity can produce access to credit at an affordable price. We will never modernize our housing market nor allow it to reach its full potential when a Washington-based duopoly dominates all decisions in mortgage lending.

For new private-credit risk-takers, a focus on sustainable lending practices can reduce default rates, improve family financial stability, and enhance the opportunity for homeownership to yield long-term wealth-building opportunities. The path to such outcomes lies in a robust process for transitioning to homeownership—teaching potential home buyers about credit, counseling them on financial management, explaining how a mortgage works and how equity is built, describing the responsibilities

and preparedness needed to handle the bumps in the road—and properly aligning incentives so that servicers and credit enhancers are held to long-term outcomes as measures of success. And any new entrant should have to show how its business plans are helping to create a mortgage ecosystem providing responsible access for all communities.

Housing finance should be produced in a competitive market that efficiently allocates credit while creating opportunity. A new secondary mortgage market that produces an environment for the sort of practices and innovations described here should also enhance the availability of affordable rental housing and the ability of families to access the credit needed to finance home purchases that create economic opportunity rather than economic risk.

Nine years after the financial crisis, it is long past time to take a holistic look at the mechanics of America's secondary mortgage market and make some needed changes. But for Americans outside the Beltway and beyond Wall Street, this is not a mechanical exercise. The work we do will affect how and on what terms Americans can rent or buy a home. Thus, it is no wonder that reform has taken so long to enact.

Yet it is also vital that we think boldly and beyond the narrow scope of rigid policy parameters that have trapped our debate in years past. The pre-2008 system failed. Meanwhile, today's system is not working as well as it could, and so the impact on the lives of Americans from this lingering policy challenge is real.

It is time that Washington focus on housing finance reform not only to modernize our system of mortgage plumbing, but also to responsibly open up economic opportunity for the 21st century American renter and homeowner.

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