Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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Questions for the Administration on Housing*

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October, 2013

1. <u>Will the frame of reference for the Administration activities in the mortgage field continue to be the housing crisis of the early part of the previous decade,</u> or will there be a different reference based on where we are now and where we want to go? If it is the latter, what are the goals of the Administration for housing in the U.S. during the next five years, and what is the implementation time line?

For nearly a decade, government officials have based their housing related activity and policy thinking on the crisis of the early 2000s and its carryover. In most markets, housing has now recovered and while one can debate whether it is a robust recovery or something more fragile, it has recovered. Even the last of the lawsuits seem to be winding down. Yet, in many speeches and regulations, the subject of such speech or regulation continues to be preceded by comments about the housing crisis of the 2000s. Usually the focus is on "bad" lending and not on the other causes, although at times some weight is given to "bad" regulation, credit ratings, securitizers, investors, and occasionally even borrowers. But, however described, the reference point against which activity should be measured has been that.

Is it time to move past that and to think more neutrally about the market?

2. <u>What is the responsibility of the borrower in a mortgage loan?</u> Should the borrower expect that if he or she is unable to make payments on their mortgage, the lender will modify the loan so that they can, including reducing the principal amount owed if necessary? Should bankruptcy or foreclosure cause the borrower to be treated less favorably when next he or she applies for a mortgage loan, or should lenders be forced to ignore them?

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Traditionally, mortgagors have been treated as a true party to a contract, and expected to meet the terms of the contract. In part, that is why mortgage lending has been relatively inexpensive in the United States — namely, the borrower has made every effort to make payments and understands that foreclosure is the result if he fails. Accommodations have often been made, but on an individual basis.

Now there appears to have been a shift in that thinking among policy makers, and certainly among consumers. Making the mortgage payment has lost its priority to making cell phone payments, cable TV payments, etc., and loan modifications and principal forgiveness have become the accepted expectations.

What then is the responsibility of the borrower, and what should his expectations be with respect to retaining his house if he defaults? Is the loan becoming an unsecured loan?

3. How would the Administration allocate priority among the various goals of housing — (1) providing mortgage credit to all Americans; (2) lenders making a reasonable profit on mortgage lending; (3) providing jobs to the housing industry; (4) providing a secure investment for global investors; (5) strict regulatory adherence to the multitude of regulations; or (6) assisting the government in implementing its housing policies.

Housing in its many aspects represents something like 15% of the nation's economy, and as such has many advocates that sell lots, build houses and other dwellings, sell them, sell furniture and fixtures that are placed in those dwellings, paint them, repair them, use them as security to get loans to buy other products, etc. Since shelter is a basic need for humans, housing also has a number of interested parties concerned about the ability of citizens to have adequate shelter. Elected governments have to care about this sector.

Yet, the goals may conflict — some citizens who want a house simply cannot afford to buy one if lenders are to make any profits and continue to be lenders. Governments like more loans to be made to create more jobs, but there may be a paucity of funds available for lending or of qualified buyers.

Is there a clear vision of priorities among these conflicting interests?

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4. How would the Administration define, with some clarity, the role of the FHA, and how its role can best be played in light of the financial constraints currently imposed upon all government activity?

The role of the FHA could be defined as assisting first time home buyers in buying their first residence, or it could be defined as assisting low- and moderate-income borrowers to buy houses they otherwise could not afford, or it could be defined as a housing lender of last resort, or in some other way.

How it is defined will determine its mission and can generate transparency in how its mission can be met. In a business cycle, if its role is to keep the level of housing lending at a reasonable level as some kind of lender of last resort, then it will be very hard to ensure that it will not become a liability to the federal budget. If it is to assist first time home buyers, fiscal restraint will be more easily obtained.

There is a lack of clarity about its role, purpose, and mission, and it would be helpful to define it more precisely.

5. With the growing concentration of our population in cities, should more focus be directed to multi-family housing and to rental housing? The American Dream has been a single family house. Generally in the GSE advertising, the house had a white picket fence around its green yard. It was in the open suburbs and had room for one or two family cars and a place for the kids and pets to play outside. Now, many of our citizens are living a quite different life style than that portrayed in those ads. They live in units of high rise buildings, rent cars when they are needed, rent bikes to tool around for their errands or even for their working commutes, may or may not think kids and pets are good ideas, and are more interested in the urban community of theaters, restaurants and services in walking distances of their homes.

This different life style may cause some to rethink about the best way to view housing during the next couple of decades. It would be useful to know how the Administration believes this will develop, and if, as part of the change in style, renting becomes trendy, how will that part of the housing needs best be met.

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6. What does the Administration see as the best way to take advantage of the advancements in communication?

A growing number of citizens trust their social media outlets more than the traditional ones of print and TV. The power and ability of computers has multiplied in geometric fashion over the past decades. The experience and education of systems and metrics personnel among the work force, while still lagging demand, has grown rapidly with the result that there is now a large crop of employees able to translate the efficiencies of the computer and its spin-off in a variety of productive ways.

The question then becomes how best to use these new tools to assist in meeting the goals selected for housing policy. For example, the more certainty there is in underwriting rules, the easier it is to translate that into an automated system and the greater efficiency the firm will have in deciding to whom to make loans. At the same time, the more certainty there is, the less opportunity that lenders have to adjust their go, no-go decision based on extenuating circumstances, and the less opportunity a borrower will have in the future to claim a violation of the rules.

It would be useful to know the Administration's thoughts on taking advantage of the new and faster modes of communication.

Unrelated Addendum — small banks

In 1994, all U.S. banks and savings and loan associations of $500 million or less in assets numbered about 12,000, or about 92% of all U.S, financial institutions. They held about 29% of the country's deposits.

In 2004, the number of such institutions was about 8,000, or about 88% of all such institutions. They held about 12% of the country's deposits.

In June of 2013, the number had dropped to about 5,600, or about 81% of all such institutions. They held about 8% of the country's deposits.

It appears that the importance to the general U.S. economy of banks under $500 million in assets has diminished considerably over the past two decades, probably to the point of irrelevance except for some local economies throughout the country.

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Of the failures of banks from 2004 to 2013, on the other hand, 376 (or 76%) were of banks under $500 million.

The major losses to the Deposit Insurance Fund during that period were caused by failures of banks with assets between $10 billion and $30 billion. Assistance was provided under TARP and other programs to many institutions, including some of the largest, but none of that assistance has cost the DIF anything.

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