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TO: Interested Parties

FROM: Anne Kim, Director, Middle Class Program, and Rob Keast, Senior Policy Advisor*

RE: A More Effective Policy and Message Framework to Stem the Housing Crisis

For most Americans, the housing crisis has nothing to do with foreclosure, defaults, or late payments. In fact, only about 1 of every 100 homeowners in America is currently in foreclosure. But for nearly all Americans, the housing crisis has meant a shocking, confidence-killing loss of accumulated wealth.

In this memo, we argue that while foreclosure prevention should remain a critical goal, the hemorrhaging of middle-class wealth should be an equally important policy and message priority for policymakers tackling the housing crisis. We believe this broader focus will appeal more widely to the American people, have a greater effect on the middle class, and have the added benefit of paving the way for policies that help those in, or close to, foreclosure.

Loss of wealth will be far more catastrophic to the middle class than foreclosures.

Since the fall of 2005, home prices have been dropping steadily, and the latest numbers show that in October 2007, home prices saw their steepest decline since 1991.[1] In just the last nine months of 2007, homeowners lost $240 billion in home equity,[2] and the National Association of Realtors projects up to $350 billion in additional losses this year. This crash in home prices has sapped consumer confidence; equity from rising home values helped finance as much as $310 billion per year in personal spending from 2004 to 2006.[3] Moreover, this loss of wealth could seriously cripple the long-term ability of middle-class families to reach such financial aspirations as sending a child to college or living more securely in retirement.

A focus on wealth preservation can more effectively generate public support for government intervention.

Many policymakers may believe that the fear of foreclosure may be enough to persuade Americans that the current crisis requires strong medicine. But it's not. More than 98% of borrowers are not in foreclosure, and more than 95% are not in default.[4] One in three homeowners has no mortgage at all.[5]

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* Policy Advisor Tess Stovall provided research assistance for this memo.

As a consequence, opinion polls reveal significant ambivalence among Americans about government involvement in the current crisis, as the following two polls conducted by NBC News/Wall Street Journal near the end of 2007 illustrate. While one of these polls found that 52% of Americans believe that President Bush should be doing more to help troubled borrowers[6], the other found that 59% of Americans think it's not the job of the federal government to protect homeowners from foreclosure.[7]

Moreover, polls show deep resistance to the notion that all troubled borrowers are victims. Large majorities of Americans (as high as 80%) consistently oppose a "bail out" for borrowers,[8] while other surveys find that a significant portion of Americans blame borrowers, not lenders, for the current crisis. A December 2007 CNN poll, for example, found that 51% of Americans think troubled borrowers have "no one to blame but themselves."[9] Anecdotally, some state and local foreclosure prevention efforts, such as those in Seattle and Massachusetts, have run into stiff resistance from citizens.[10]

But by focusing on loss of wealth, policymakers can make the crisis more widely relevant while also sidestepping the issue of blame. Preventing foreclosures becomes important not because individual borrowers are victims in need of rescue but because foreclosures lead to lower property values for every other homeowner in the neighborhood.

Policies to Preserve Homeownership Wealth

Many of the solutions now championed by policymakers will readily fit into a broader agenda focused on wealth preservation. We offer the following set of ideas for a package aimed at preserving wealth by stabilizing and renewing confidence in the housing market as well as by preventing foreclosures:

Create a first-time homebuyer credit to stimulate housing demand.

A key step toward stabilizing the housing market is to rid it of excess inventory. Potential homeowners waiting in the wings should be encouraged to buy, and in fact, the current market is a favorable one for those who had felt priced out of the market before. Creating a $3,000 first-time homebuyer credit, applicable toward closing costs or a down payment, can stimulate housing demand and help restart the market. *Estimated cost: $7.2 billion per year.*[11]

Provide current homeowners with property tax relief.

Although home values are plummeting, tax assessments remain high and are a source of anxiety for taxpayers who are beginning to feel squeezed. We propose giving all homeowners, including non-itemizers, a one-time $500 federal tax rebate to provide temporary partial relief from state property taxes. *Estimated cost: $24 billion per year if made available to itemizers only; $38 billion if made available to all homeowners.*[12]

Expand federal loan guarantees to make refinancing opportunities more available.

The smooth functioning of the secondary mortgage market—in which mortgages are purchased, repackaged and sold to investors as securities—is critical for providing mortgage lenders with the capital they need to extend new loans to homebuyers or refinance old ones. But in the aftermath of the subprime meltdown, the loss of market confidence in mortgage-backed securities, particularly those backed by subprime loans, has made it tougher for lenders to raise capital for new loans. This in turn has left homeowners who want to refinance increasingly stuck.

The recently-enacted stimulus package took important first steps toward bringing more liquidity to the mortgage market and restoring investor confidence. The next step should be to alleviate some of the risks associated with troubled loans, for example, by allowing more mortgages to be refinanced into loans guaranteed by the Federal Housing Administration (FHA). One such option, among others, is a proposal by Credit Suisse to allow about 600,000 delinquent subprime borrowers—nearly half the subprime borrowers now in default—to refinance into FHA guaranteed loans.[13]

Help homeowners transition to lower-cost mortgages with a two-year refinancing credit.

A two-year, one-time $2,000 credit toward closing costs for homeowners who refinance into a fixed-rate mortgage can both encourage homeowners in riskier mortgages to refinance and defray transaction costs. *Estimated cost: $2.5 billion over two years.*[14]

Stem the tide of foreclosures through an emergency mortgage assistance program and more funding for non-profit housing counseling agencies.

Foreclosures are not just catastrophic for individual borrowers. One study estimates that each foreclosure negatively affects the value of 22 neighboring homes.[15] We propose a federal loan program to provide up to $5,000 in interest-free, one-time emergency loans to families in danger of foreclosure, with priority to families in states with high foreclosure rates or high unemployment rates. *Estimated cost: Minimum of $2 billion, which can partly be financed through earmarking civil penalties levied on mortgage brokers, lenders and other parties convicted of mortgage fraud or related crimes.*

In addition, we propose additional funding for efforts, such as HUD's Housing Counseling Assistance Program and HOPE NOW, which help families proactively avoid default and foreclosure. Many troubled borrowers are unaware that their lenders are frequently willing to work with them before problems arise. Greater counseling and outreach efforts, including efforts to improve financial literacy, can help stem trouble before it starts. *Estimated cost: $150 million.*[16]

Help future borrowers avoid trouble through better standards for disclosure and cracking down on bad actors.

Loan documents that were complex to begin with became exponentially more so with the rise of exotic mortgage products such as interest-only ARMs. And because of this complexity, many borrowers now in trouble with their mortgages may have failed to fully understand the terms of their loans. These complex products also provided opportunities for some dishonest or unscrupulous mortgage brokers to steer borrowers toward products they either did not understand or could not afford.

Among other things, better standards for disclosure and broker licensing will lead to better decisions by borrowers. Some industry leaders are paving the way with their own proposed standards for improving disclosure so that borrowers understand the key terms of a loan.[17] Industry-wide efforts should be encouraged, if not mandated. In addition, there should be strict and uniform licensing standards for mortgage brokers to ensure that brokers are properly regulated and bad actors swiftly punished. *Estimated cost: None*.

Endnotes

[1] Standard & Poor's, Press Release, "Broadbased, Record Declines in Home Prices in October According to the S&P/Case-Shiller® Home Price Indices," December 26, 2007, available at http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_Release_122622.pdf

[2] Board of Governors of the Federal Reserve System, "Flow of Funds Accounts of the United States, Flows and Outstandings, Third Quarter 2007," Table B.100. Figures for Q4 of 2007 were projected from the Q1-Q3 change.

[3] Peter S. Goodman, "Homeowners Feel the Pinch of Lost Equity, *New York Times,* November 8, 2007, available at http://www.nytimes.com/2007/11/08/business/08borrow.html

[4] Press Release, "Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey," Mortgage Bankers Association, December 6, 2007.

[5] Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances,* Federal Reserve Bulletin, vol. 92 (February 2006), pp. A1-A38.

[6] NBC News/Wall Street Journal Poll, national survey of 1,008 adults, December 14-17, 2007.

[7] NBC News/Wall Street Journal Poll, national survey of 1,002 adults, September 7-10, 2007.

[8] Fox News/Opinion Dynamics Poll, national survey of 900 registered voters, August 21-22, 2007.

[9] CNN/Opinion Research Corp Poll, national survey of 1,002 adults, December 6-9, 2007.

[10] William Yardley, "Foreclosure Aid Rising Locally, as Is Dissent," *The New York Times*, February 26, 2008.

[11] The National Association of Realtors estimates that about 40% of all homebuyers—or 3.2 million homebuyers annually—are buying their first home. This cost estimate assumes that all first-time homebuyers take full advantage of the credit. We also assume that the credit begins to phase out at $75,000 in household income.

[12] Third Way estimate. In 2006, 45 million taxpayers filed tax returns with itemized deductions. Our estimate assumes that *all* of these households will claim this credit. Likewise, our cost estimate for all homeowners assumes that each of the 76 million households living in owner-occupied housing will claim this credit.

[13] Damian Paletta, "Worried Bankers Seek to Shift Risk to Uncle Sam," *Wall Street Journal,* February 14, 2008.

[14] Third Way estimate.

[15] Broderick Perkins, "Foreclosure Fallout Landing On Neighboring Homes," *Realty Times*, February 13, 2008, available at http://realtytimes.com/rtpages/20071115_foreclosurefall.htm

[16] This proposal would double funding for this program, which was appropriated $150 million for fiscal 2008.

[17] See, for example, the one-page disclosure form created by mortgage lending giant Washington Mutual. Press Release, "WaMu Implements Industry Leading Standard for Mortgage Brokers, Launches Direct Call Program," October 1, 2007.