Testimony of

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The Future of the Mortgage Market and the Housing Enterprises

Any discussion of the housing finance system's future should start from a clear sense of what we want the system as a whole to accomplish. The recent GAO report considers the range of roles historically played by the housing enterprises, specifically Fannie Mae and Freddie Mac. But if the Committee restricts its analysis of the past and prescriptions for the future to simply the GSEs, it will miss the most significant origins of the current crisis and produce a system that is inadequate to support the essential role of housing finance in our economy. The real question for the Committee's consideration is what are the goals of the system and what combination of public, private, and hybrid arrangements, if any, will deliver those objectives.

My goal for today's testimony is to therefore lay out a series of principles that describes the essential functions that the housing finance system must serve. In short, the specific principles are: access to credit and liquidity, countercyclicality, risk management and oversight, standardization, transparency and accountability, systemic stability, and consumer protection. I hope that these principles are useful as a starting point for reform of the housing finance system, particularly with respect to the secondary market and its participants—both public and private. I will also touch upon important lessons to be learned from the past so that we do not learn the wrong lessons from the subprime crisis, as some may be inclined to do. In short, the systemic failures stemmed from the proliferation of poorly underwritten mortgages channeled through the so-called shadow banking system of unregulated private label securities.

The principles that I present today are the result of the collaborative efforts and discussions of a group of experts and stakeholders in mortgage finance convened by the Center for American Progress that have been meeting for more than a year. The group is known as the Mortgage Finance Working Group, or MFWG. These principles, which are available on the Center for American Progress's website,[1] were publicly released at an event in March. While we at CAP have tremendously benefited from MFWG members' insights and expertise over the past year, my remarks this morning should not be construed as their personal or institutional endorsement of my testimony. Needless to say, any errors herein are my own.

Looking at any proposal that is made going forward, based on these principles, the Committee should ask the following questions:

- Will institutions of any size in any market have access to capital and liquidity in all markets at all times?
- How well will it do in ensuring a steady supply of 30-year fixed rate mortgages?
- How well will it do in ensuring a steady supply of finance for affordable multifamily house?
- Will it support and speed innovation?
- Will it support and encourage transparency?
- Will all our communities, especially those devastated by this crisis, have access to credit on fair and nondiscriminatory terms?
- How can we transition to a new system without disruption?

With these questions in mind, policymakers can design a regime that not only sets the policy framework for the primary and secondary market actions of purely private entities and public credit enhancement agencies and provides carefully designed government backing only for those select activities of private actors that are determined to be necessary to ensure that there is credit available to support *all* the nation's housing needs.

Liquidity across products and time

The first concern of policy makers in contemplating any redesign the US mortgage finance system must be ensuring sufficient credit liquidity at all times to meet the needs of US homeowners. American borrowers have shown a strong preference for long-term, fixed-rate, self-amortizing loans that have allowed them to build assets and plan loan repayment. Most investors, on the other hand, seek short-term, liquid investments. Mortgage markets in the United States in recent decades have done a remarkable job of intermediation between those different needs. (As Susan Wachter has mentioned, no other housing finance system provides long-term, fixed-rate mortgage lending as well as the American system.)

What do we mean by liquidity? An investor needs to know that there will be a market for their assets—in the context of mortgage-backed securities, their particular share of loans made to individual homeowners—at all times. If an investment is not liquid, investors will charge more, if they make the capital available at all. If they don't, a new homebuyer cannot get a loan and an existing owner may be unable to sell.

In thinking about liquidity, two important aspects must be considered: first, the need to have consistent credit liquidity through booms and busts; and second, the need to have broad availability of credit across places and housing types, Each is of paramount importance in thinking about the future of U.S. housing finance.

Broad demands for liquidity must be consistently met over time. In the most recent housing cycle, we saw too much credit flow into the U.S. housing markets during the boom, creating a housing price bubble that misallocated trillions of dollars of capital. Private mortgage securitization played an unquestionably pro-cyclical role during these bubble years. Conversely, during the aftermath of the housing bust, there has been a notable drying up of credit liquidity, one which has only been filled by the housing enterprises, Fannie Mae and Freddie Mac, both before and particularly after being placed in conservatorship, and FHA/Ginnie Mae. If not for these governmental and government-backed sources of housing finance, the downturn would have been much more severe, and no one would be talking about the possibility that we've seen a bottom, either for the housing market or the broader economy.

Any housing finance reform efforts must consider the importance of ensuring sufficient credit liquidity during down times, and who might provide that liquidity. Institutions with the capacity and responsibility for countercyclical activity are a requirement for a well-functioning system. This countercyclical role is one that will require some measure of government backing, as the private sector has proven itself unable or unwilling to independently provide sufficient and necessary capital during periods of retrenchment.

Credit liquidity must also be deep in addition to being broad. Policymakers must consider how a revised system will succeed in maintaining the confidence of domestic and international investors to continue directing their capital into U.S. housing markets. This confidence has been shaken, most particularly with respect to the primary lenders and secondary market institutions that are at the heart of mortgage finance today. Perhaps the biggest question policy makers face is whether U.S. housing finance can attract sufficient capital to meet its needs without a significant government role, particularly in the wake of massive failures in the private securitization market which have caused the global investment community massive losses on U.S. mortgage securities. I believe the answer to the question is that there remain critical roles for government to play in the provision of mortgage finance liquidity.

Beyond the issue of constant and deep liquidity, U.S. housing finance must provide liquidity across geographies to support the acquisition and refinancing of a wide range of housing types, from the single-family suburban home to the high-rise apartment building, from double-wide manufactured housing to triple-decker row homes. An emphasis on ensuring the availability of mortgage finance to support homeownership remains appropriate, even in the aftermath of the housing crisis, as homeownership is still the key route to economic mobility and wealth accumulation for large segments of the American populace.

But homeownership is not appropriate for everyone at every point in their lives. If the reformed housing system fails to provide sufficient financing for the production and maintenance of affordable rental housing, the system will fail to serve the needs not only of a large and sometimes vulnerable segment of the population, but also of the rest of us. Not only have almost all of us rented at some time in our lives, but the lack of quality affordable rental housing affects the fabric of our entire economy and society.

The idea of ensuring sufficient credit liquidity translates for most Americans into ensuring a supply of capital flowing to originators of single-family mortgages. But policymakers should also be careful to consider the needs of multifamily housing as well. In the context of the secondary mortgage market, providing liquidity for multifamily housing in particular will be a challenge to policymakers going forward. Because multifamily housing is not as easily securitized or underwritten as single-family mortgages are, ensuring constant liquidity is more difficult. In periods of significant to stress to the banking system during the past two decades, permanent financing for multifamily housing was predominantly financed by the GSEs, both through their direct efforts as well as through their role as an active purchaser of the tax credits that helped finance the equity portions of multifamily housing deals. Research by the National Multi Housing Council highlights the critical role the housing enterprises played during the S&L crisis, providing $9 billion for multifamily housing at a time when savings and loans were responsible for $43 billion of disinvestment in the sector. Similarly, between October 2007 and September 2008, the GSEs provided a combined 82 percent of the $83 billion in net new multifamily financing.[2]

Demographic changes coupled with the fallout from the housing crisis make it a certainty that demand for rental units will soar in the near future, and much of that demand will be for affordable rental housing in places with access to decent job opportunities. During the height of the boom, much of the multifamily construction took the form of condominiums and higher-end developments.[3] Any reformed housing finance system will need to meet the demand for financing multifamily housing across the range of price points; this will likely require a range of delivery channels for deeply subsidized, narrowly subsidized, and unsubsidized units.

Fair and affordable access to credit

We should expect private capital to provide consumers with access to credit on profitable but fair terms. In particular, underserved communities should receive access to credit on terms that reflect their actual, not perceived, credit risk and not on predatory terms. These are the communities that have been hardest hit by the housing and economic crisis and will need the most capital to rebuild. While an emphasis on better risk management is likely to lead to tighter underwriting standards, policymakers should be careful in ensuring that those changes are based on criteria empirically tied to credit risk—while remaining sensitive to the true costs of providing that credit—rather than on ideological or discriminatory assumptions about the credit profiles of certain communities. Stronger underwriting should ultimately lead to a more careful allocation of credit within all communities, not a deprivation of credit to underserved communities.

It is worth noting that the modern long-term fixed rate mortgage, where the homeowner does not bear interest rate risk, such as the 30-year fixed-rate mortgage that we all take for granted, is actually an affordable housing financial product created by government policy. In the 1920s and early 1930s, private-sector mortgages were short-term, non-amortizing bullet loans—many of same features found in the most toxic of the toxic mortgages originated at the height of the bubble. The Home Owners' Loan Corporation was created in 1933 at the height of the depression to refinance distressed borrowers into stable, long-term—then 15-year—mortgages at up to 80 percent loan-to-value. FHA followed the HOLC offering these innovative long-term products. The adoption of the self-amortizing, fixed-rate mortgage by the private sector was a reflection of a need to compete on the best terms with public entities—in contrast to the race to the bottom among lenders we have witnessed over the past several years.

Long-term, fixed rate loans are a unique feature of the American system. As a policy matter we should want to ensure their continued availability, because they remain essential to creating wealth/asset building opportunities for consumers. Moreover, unlike adjustable-rate mortgages, these loans shift interest rate risk away from homeowners, the party with the least ability to manage that risk, onto institutions and individuals with greater risk-management capacity.

Absent a policy intervention to ensure the availability of these long-term mortgages, they probably will not exist, a point implicitly acknowledged by Wells Fargo CEO John Stumpf in a recent call for the GSEs to be given permission to purchase jumbo mortgages as a way to "help revive the moribund market for big mortgages."[4]

Another important goal is the provision of affordable housing finance products to all communities, not just the middle and upper class, but also to those underserved traditionally by decent and fair financial products and sources. Unfortunately, many have taken the wrong lessons from this crisis about the ability of low and moderate income people to be homeowners.

And while society has sometimes over-emphasized homeownership over the last two decades at the expense of rental housing, we should not learn the wrong lesson. The current high rate of default on subprime mortgages does not mean that homeownership is inappropriate for low- and moderate-income households. Indeed, from 1998 to 2006, only 9 percent of subprime mortgages went to first-time homebuyers, with 62 percent being used to refinance existing homes.[5] As I will discuss shortly, the lesson policy makers should be taking away from the crisis is that level playing fields are necessary, particularly when it comes to affordable access to credit. When safe, affordable, and well underwritten loans must compete against unregulated exotic mortgage products priced without regard to underlying asset value or risk and marketed by brokers with misaligned incentives, the results are disastrous, both for homeowners and for the larger economy. We must ensure that parallel systems cannot again emerge that put the soundly underwritten loans in competition with unregulated and non-transparent products.

Many nonprofit, CDFI, and other innovators such as the Self-Help Credit Union were finding compelling and sound ways to lend to lower income families that proved to be far more successful than the track record of subprime product.[6] The originations and servicing of these successful Self-Help mortgages were by banks motivated by CRA, with the liquidity provided by Fannie Mae. The Ford Foundation provided a guarantee and Self-Help provided management. In other words, this model presents a partnership that relied on government incentives and provided safe loan products to consumers at no risk to the originating lender. The real lesson of these loans is that standard, well underwritten, low downpayment mortgages to low-wealth, low-income borrowers just like those offered through myriad CRA lending programs offered a safe and durable alternative to subprime products.

It is important to understand that affordable housing finance for lower income and minority families was at a marked disadvantage in competing with predatory subprime product that was irrationally priced, poorly underwritten, and/or marketed with predatory practices. In 2005, 55 percent of borrowers given subprime loans that were sold into private label securities qualified for prime loans at the time of origination.[7] Good affordable lending was driven out—a perfect example of Gresham's law, "Bad money drives out good."

We need to ensure that all the money in the game is available under the same rules. This doesn't mean that lenders should not differentiate between legitimate credit risks and price their offerings appropriately, but recent CAP research found that even among borrowers earning at least twice area median incomes, African-American and Hispanic borrowers were about three times as likely as whites to be given higher-priced mortgages. This is hardly a characteristic found in a system that ensures equal access to fairly priced credit.

We must reestablish such efforts to allocate capital on fair but economically viable terms, particularly through innovation, not shy from doing affordable homeownership right.

Consumer protection

There has been a lot of discussion about the merits of consumer protection in the context of the administration's proposal for a Consumer Financial Protection Agency, so I won't go into great detail here to explain CAP's support for that proposal. Rather, I will make a few brief points about the importance of consumer protection to an effective system of housing finance and vice versa—points that have been absent from the broader conversation to date.

First, it is worth noting that to a large extent, consumer protection—i.e., efforts to prevent predatory lending and encourage the origination of safe and sustainable loans—is really also a means to protect investors as well. If loans are originated with aligned incentives, consumers should tend to receive sustainable, well-underwritten loans, which benefits investors by making their investments safer. What we saw in the last market cycle was mortgage brokers and originators with misaligned incentives to sell unsustainable, high-fee mortgages because compensation was immediate and risks were divested.

At the origination level, brokers and originating lenders had no incentives to make sustainable loans, and typically had perverse compensation incentives to sell high-risk, high-fee mortgages over safer products. Subprime and Alt-A mortgages, mainstays of private label securitization, were a particular problem, as we all know. Originating lenders like Countrywide paid originators more if they sold higher risk mortgages such as option ARMs and interest only loans. (They also got paid more for higher interest rate loans, which has led to our suggesting the need for greater scrutiny of whether there had been fair lending violations at the height of the housing bubble.)[8]

With such misaligned incentives, it is not surprising that there have been rampant reports of origination fraud, and more importantly, that the mortgages composing private-label MBS were across the board poorly underwritten with historically astronomical default risks. For example, 44 percent of subprime mortgages, and 9 out of 10 Alt-A option ARMs, originated in 2005 were made without full income documentation.[9]

At all levels of the shadow banking system, the incentives for market actors, including credit rating agencies, were to generate as much volume as possible, with no regard for credit risk and often perverse incentives to generate higher cost, higher risk loans. Because the costs generated by their poorly underwritten mortgages were not ultimately borne by the key market actors in the private securitization process, but were instead borne by others (including the taxpayer)—an externality—their incentives were all aligned towards generating high short-term fees and payments, and away from the long-term viability of the underlying mortgages.

In thinking about these problems, one potential solution stems from greater transparency and standardization. It's a lot easier to shop for a product where you can do comparison shopping, so to the extent that the current system encourages the mass availability of certain standard mortgage products (15/30yr FRM in particular), it empowers the consumer. This is not to say that certain innovative mortgage products should be excluded entirely from the marketplace; borrowers with unique circumstances should not be forced to accept a standard product that is unsuitable for them. Nevertheless, even in these instances, terms should be easily understood and presented in a fashion that allows for consistent comparisons across offerings.

The benefits of standardization accrue to the consumers of securitized mortgages—investors—as well. As we have seen, securities with the same AAA rating have performed very differently over time. Transparency in MBS down to the loan level is often available only to market participants with very deep pockets, leaving other investors to guess how much future impairment is already priced into the security. MBS and collateralized debt obligations trade without TRACE requirements, which also impede market participants' ability to accurately price securities that may have been sliced and diced multiple times over.

The secondary market ultimately drives the standardization that benefits consumers. Investors who innovate with exotic products should have a higher, not lower, obligation for transparency and consumer protection. Products with transparency that allows for ease of comparison across offerings in both the primary and secondary mortgage markets provide much greater efficiency and stability for individual participants and for the system as a whole.

These consumer protection considerations are essential not only for primary market regulation. The secondary market plays a key role as well.

Risk management and oversight creates transparency

Finally, there is the principle of risk management. In contemplating the reform of the housing finance system, most policy makers have understandably focused on the need to restore stability and sufficient risk oversight to the housing finance system. But those who would focus primarily on GSE reform are missing the bigger picture. After all, it is clear that the unregulated private securitization markets caused this crisis through poor underwriting and misaligned incentives that ultimately became the toxic MBS whose losses infected seemingly invincible institutions. And so we believe that any efforts to reform the housing finance system that ignore the private securitization markets are destined for failure. We must ensure a level playing field.

In discussing the crisis that hit the housing finance system, it is critical that the difference between GSE-conforming MBS and private-label MBS is understood. This is something that is clearly not well understood by many.

GSE-conforming MBS have been around since at least the 1970s and involve a guarantee from one of the government sponsored entities Fannie Mae or Freddie Mac on the timely payment of principal. This guarantee was thought to carry the implied backing of the federal government, something which was confirmed in the recent crisis, when the federal government took over the GSEs in a conservatorship and near-explicitly guaranteed their obligations. GSE-guaranteed MBS are securities based upon "conforming mortgages," which typically are safe and standard mortgages—such as the 30 yr FRM—with strong underwriting requirements. The GSEs also purchased ARMs, Alt-A, and even subprime mortgages, but even in those cases, the quality of those loans were mostly better than what was securitized through PLS, in part because the terms of the loans contained fewer predatory features.[10]

GSE-conforming mortgages, in large part due to the standards set by the GSEs themselves and the requirement of private mortgage insurance on loans in excess of 80 percent of the property's value, have historically performed very well. Even in this historically unprecedented housing downturn, GSE-conforming mortgages have seen default rates that are small relative to PLS. In fact, serious delinquency rates for PLS are considerably higher than Fannie Mae or Freddie Mac's portfolios (including their held Alt-A and subprime mortgages) as of the end of the second quarter of 2009. PLS make up 13 percent of the outstanding single-family first mortgages but account for 35 percent of the serious delinquencies. The housing enterprises, in contrast, collectively hold 57 percent of those mortgages but only 26 percent of the serious delinquent mortgages.[11] In other words, there are more than one-third more delinquent mortgages in PLS than owned by the GSEs, despite the GSEs' market share being more than three times the size.

The housing and financial crisis originated in "toxic" private-label MBS

Having laid out the principles that describe the essential functions of the housing finance system, I would like to also touch upon the key points of failure of the existing system.

Specifically, the rapid expansion of a “shadow banking system” consisting of private label securities and their complex derivatives distorted the secondary mortgage market and chased safer loan products out. The proliferation of PLS comprised of loosely underwritten mortgages was made possible by a lack of prudential oversight and misaligned incentives throughout the origination and securitization processes.

The unregulated private MBS market, free from any direct safety and soundness supervisory oversight, was hailed as a paradigm for efficient markets, with sophisticated private actors and cutting-edge quantitative analysis efficiently managing and allocating risk, whose complexities were boiled down into a series of letter grades issued by credit rating agencies who were paid handsomely by those packaging mortgages into securities. Despite the inherent conflicts of interest in ratings agencies’ business model, belief that the “shadow banking system” could manage its own risk while providing strong returns was nearly universal. Thus, the regulatory playing field was tilted to the advantage of private securitization, as regulators and legislators alike were reluctant to regulate a market that seemed to be functioning efficiently without regulation. The lack of regulation allowed the shadow banking system to enjoy cost advantages over other sources of housing finance, which allowed it to dominate the marketplace.

Because private securitization had relatively little regulation but the near-universal belief that its products were safe—AAA ratings coupled with expectations of perpetual house price appreciation--global capital flooded into the shadow banking system, and thus the U.S. housing markets, during the Bush administration. Private-label MBS have been created and sold for more than two decades, but their expansion was dramatic in the earlier part of this decade, expanding almost nine-fold from $135 billion 2000 to almost $1.2 trillion in 2005.[12]

The U.S. PLS share of MBS went from 12 percent in 2002 to nearly 50 percent in 2006, which had the effect of distorting the overall economics of the U.S. housing market. Coupled with low interest rates, this flood of capital caused massive appreciation in housing prices that was unsupported by the underlying economic trends. By the end of 2007, U.S. housing prices had seen an inflation-adjusted 86 percent increase since 1996, even as household income stagnated.[13] The PLS-induced housing bubble burst and has today left approximately one in three mortgages underwater,[14] and that number could rise to nearly 50 percent by 2011, according to a recent study from Deutsche Bank.[15]

The growth in mortgages originated for private securitization displaced the so-called “plain vanilla” mortgage products offered by the GSEs, FHA, and portfolio lenders. GSE conforming mortgages shrank to less than 30 percent in 2006, down from 50+ percent in the 1990s. 2005 was the first year in which PLS originations outstripped mortgages originated for agency MBS—including GNMA. Unsurprisingly, 2005 also marked the year in which mortgage lending standards deteriorated markedly, based on the proportion of loans where the intersection of credit score and LTV ratios had historical lending precedents.[16] “By June 2006,” notes Whitney Tilson based on loan performance data presented by Amherst Securities Group, “mortgage lending standards had collapsed, even for the best loans.”[17]

This unprecedented market share of the “shadow banking system,” which performed the basic functions of bank lending but without the risk oversight imposed on banks, was tied to the belief that these market players could self-regulate their own risk, and therefore this process of private securitization didn’t need regulation for safety and soundness. As Alan Greenspan noted:

"Deregulation and the newer information technologies have joined … to advance flexibility in the financial sector. Financial stability may turn out to have been the most important contributor to the evident significant gains in economic stability over the past two decades … Recent regulatory reform, coupled with innovative technologies, has stimulated the development of financial products, such as asset-backed securities, collateral loan obligations, and credit default swaps, that facilitate the dispersion of risk."[18]

In hindsight, this was clearly a tremendously flawed assumption, but one which enjoyed huge support at the time.

Private-label MBS imploded because of a lack of prudential oversight and misaligned incentives

All modern banking systems have a prudential oversight regime, but when regulators fail to use their authorities, or loopholes are created that allow certain products and market participants to avoid oversight, the stability of the entire system is threatened.

At the origination level, the Federal Reserve, which had specifically been tasked by Congress to develop guidance on subprime mortgages, ignored this obligation for more than a decade. And when state-level regulators sought to provide much-needed guidelines for products and institutions operating within their borders, the Bush administration's Office of the Comptroller of the Currency sued them arguing that national banks were already subject to federal regulation, despite the OCC's determined unwillingness to protect consumers from dangerous loan products. The former attorney general of North Carolina, Roy Cooper, was led to remark, the OCC "took 50 sheriffs off the job during the time the mortgage lending industry was becoming the Wild West."[19]

The problem of regulators being philosophically opposed to regulation was an even more critical failing in light of the problem of misaligned incentives throughout the system. Put simply, virtually none of the participants in the mortgage securitization process had the incentive to originate and sell loans that were viable over the long term.

At the securitization level, loan underwriters had no incentives to verify the underwriting of the loans they were pooling, or to take measures to ensure that defaults were limited. Instead, they merely needed to attain a AAA rating for as high a volume of securities as possible.

Credit rating agencies were tasked with assessing the risk associated with these private label MBS. As Chairman Dodd, Vice Chairman Shelby, and Sen. Schumer, among others, have described, these rating agencies faced inherent conflicts of interest, as they were paid by the MBS issuers, and paid more for higher volumes of new issues.

Indeed, we have begun to see renewed activity among re-REMICs, wherein previously downgraded MBS are reorganized into new securities with better ratings, even as the underlying impaired mortgages are left untouched. This alone should put pause to anyone claiming that the market has learned its lesson (once burned, twice shy) and the worst excesses of originators and the PLS market are unlikely to return. Similarly, some who have put forth proposals that ignored the possibility of a reinvigorated PLS market and therefore saw no need to develop a regulatory structure for it are inviting a return of these distortions on the conventional market .

One possibility we at CAP are considering to ensure that whatever PLS market emerges competes on fair and transparent terms with future conventional mortgage lending would be to require all those who securitize residential mortgages to obtain a license that brings with it certain duties to transparency, risk management, and a countercyclical market presence. There are advantages and disadvantages to this model, but it is worth exploring further.

The costs of excessive risk taking by private MBS market participants were borne by others

In 2007, Fed Chairman Ben Bernanke famously stated that the damage from the subprime mortgage crisis had been contained. In fact, as we now know, this was terribly incorrect, as the excessive defaults from subprime and Alt-A securities, as well as those caused by the depreciation of housing markets artificially inflated by the surge of global capital into U.S. housing, became so great that they paralyzed our entire global financial system, necessitating massive injections of public funds into private Wall Street financial institutions and the housing enterprises.

By 2007, all of the world's largest financial institutions had assumed enormous exposure to the U.S. private-label MBS market. As a result, when these securities began to see higher defaults as a result of their poor mortgage origination practices and the overall inflation of US housing prices, the resulting losses impacted areas of the financial markets far beyond private mortgage origination. Financial institutions as disparate as Citigroup (primarily a bank holding company regulated by federal banking regulators), AIG (primarily an insurance company regulated by state insurance regulators), and Bear Stearns (primarily an investment bank and broker-dealer regulated by the SEC) experienced losses related to their private label MBS exposure that were so severe that it impacted their other financial activities.

Ironically, the housing enterprises also experienced enormous losses as a result of the private-label MBS market. This occurred through losses on their guarantee book of business as well as through more profound losses on the private-label securities they themselves had bought in an effort to boost profits in response to lost market share from the vary same PLS.

Conclusion

In summation, the housing finance system as a whole must offer access to credit and liquidity, countercyclicality, risk management and oversight, standardization, transparency and accountability, systemic stability, and consumer protection. A robust system will likely require a combination of public, private, and hybrid entities to deliver all of these objectives. It is instructive to look back at the rapid expansion of the PLS market at the expense of conventional lending to identify the failures of the past as we begin to consider how to reform the housing finance system to achieve the principles we have laid out.

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[1] See http://www.americanprogress.org/issues/2009/03/pdf/mortgage_finance_principles.pdf.
[2] Mark Obrinsky. "NMHC Research Notes: The GSEs' Role in Multifamily Finance." National Multi Housing Council. February 3, 2009; Available at

http://www.nmhc.org/Content/ServeContent.cfm?ContentItemID=5039. See also Paul Weech, More than Homeownership: The Role of the Housing GSEs in Multifamily Housing Finance (Forthcoming from the Center for American Progress.)

[3] Joint Center for Housing Sudies. "America's Rental Housing: The Key to a Balanced National Policy." Harvard University, 2008. http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/rh08_americas_rental_housing.pdf

[4] http://www.ft.com/cms/s/0/85c9c1c8-a258-11de-9caa-00144feabdc0.html?nclick_check=1

[5] http://www.responsiblelending.org/mortgage-lending/research-analysis/Net-Drain-in-Home-Ownership.pdf

[6] http://www.self-help.org/secondary-market

[7] Rick Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy." Wall Street Journal, December 3, 2007. http://online.wsj.com/article/SB119662974358911035.html

[8] See http://www.americanprogress.org/issues/2009/08/tarp_lending.html.

[9] Wei Li and Keith Ernst, "Do State Predatory Lending Laws Work?", Housing Policy Debate, Vol. 18, Issue 2 at page 361 (2007), *available at* http://www.mi.vt.edu/data/files/hpd%2018.2/6.hpd_wei-ernst_web.pdf.

[10] See https://www.efanniemae.com/sf/mortgageproducts/pdf/armmatrix.pdf for the types of adjustable rate mortgages that Fannie Mae would purchase. Note that the factors that determine the interest rates (index plus margin) are generally favorable to the borrower and prohibit negative amortization and no lifetime floors.

[11] http://www.freddiemac.com/corporate/company_profile/pdf/fm_housing_crisis.pdf.

[12] http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fall01_chart02.html.

[13] http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf

[14] First American CoreLogic

[15] http://www.bloomberg.com/apps/news?pid=20603037&sid=ac9y1xr7yNhQ.

[16] http://www.moremortgagemeltdown.com/download/pdf/T2_Partners_presentation_on_the_mortgage_crisis.pdf

[17] *Ibid.*

[18] http://www.federalreserve.gov/boarddocs/speeches/2005/20051012/default.htm

[19] Robert Berner and Brian Grow, "States warned about impending mortgage crisis," BusinessWeek, October 12, 2008. http://www.msnbc.msn.com/id/27121535