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How the Trump administration can continue progress in U.S. housing

By Mark Zandi

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While housing has come a long way since the financial crisis, it has yet to fully recover.

First-time home buyers are still having difficulty getting mortgages, a housing shortage is quickly developing in many parts of the country, and taxpayers remain on the hook for the risk being taken by the two mortgage behemoths, Fannie Mae and Freddie Mac.

The incoming Trump administration has much work to do if it is to succeed in solving these problems.

Since growth in home values resumed five years ago, prices have risen by about one-third and are finally higher than at their peak in the housing bubble a decade ago.

Unlike during the bubble, when housing-market speculation and fraud were rampant, home prices today are built on a solid foundation. The typical U.S. household can readily afford the typically priced home at current mortgage rates.

Of course, there are wide disparities in housing conditions across communities, with some places fully recovered from the crisis and some not at all. Take the broader Washington area. The District has enjoyed a soaring house market since the crisis, with median sale prices at record highs. Meanwhile, median sale

prices in Fairfax County, Va., are close to their peak in 2005. But in Montgomery County, Md., median sale prices remain below the 2006 peak. There are also wide disparities across higher-income, trade-up home buyers and lower-income, potential first-time home buyers.

[\[What to expect in the housing market in 2017\]](#)

Getting a mortgage remains especially tough for first-timers. Since the bust, an estimated 6 million or so fewer loans have been made because of lenders' extraordinary reticence to extend credit. This has not been a matter of restoring sound underwriting. Instead, it is a response to the rise in the regulatory and legal risks associated with originating and servicing loans that fail.

Creditworthy families of color are being particularly poorly served, with the homeownership rate among Hispanics at 45 percent and among African Americans at 43 percent, compared with 72 percent for whites. Those numbers are particularly disconcerting given that families of color are gradually becoming the majority of new households formed in this country.

Fixing this problem should be at the top of the new Trump administration's housing policy agenda. The Federal Housing Administration, a government agency that is part of the Department of Housing and Urban Development and is the nation's largest lender to first-time buyers, needs to make it easier for banks to make FHA loans. Many banks are unwilling to make FHA loans because of the risk of being sued by the Department of Justice if they make a mistake, even a small one, under the False Claims Act. FCA violations force lenders to pay fines that are three times the size of the loan.

Small non-bank lenders are working hard to fill the void left by the banks, but they aren't up to the task. They don't have the needed capital. This is constraining FHA lending and increasing risks to taxpayers because the less-well-capitalized non-bank lenders surely will struggle more in the next housing downturn.



Banks need an incentive to get back to making FHA loans to first-time and underserved home buyers. (Matt Rourke/AP)

SOLUTION 1: Ease up on penalties against banks for making small lending mistakes. The penalties disincentivize them to make loans.

The solution is to align the FHA's recently developed taxonomy of lender errors — a ranking of the mistakes lenders may make when originating loans — with the penalties of making those errors. Small mistakes should receive small penalties, and the FCA cudgel should be used only for the significant mistakes that actually deserve it. Banks would have an incentive to get back to making FHA loans to first-time and underserved home buyers, while also improving their lending so as not to make the particularly bad mistakes that result in heavy penalties.

FHA lending would also be more attractive if the agency revamped its antiquated rules for servicing defaulted loans. Servicers must maintain foreclosed properties for long, uncertain periods before they transfer title to the FHA. This became uneconomical for lenders during the crisis as foreclosures mounted; it pushed them away from doing FHA business, which hurt underserved borrowers.

[\[2017 housing market forecasts — suburbs are in, low mortgage rates are out\]](#)

The Trump administration will also have to deal with a shortage of affordable rental and lower-priced single-family homes. Builders have increased housing construction since the crisis, particularly for high-end apartment units in larger urban areas such as Washington, and pricey single-family homes. But they've been reticent to build housing that caters to lower-income renters and first-time buyers.

The shortage is evident in steadily falling vacancy rates, which are at 30-year lows in all corners of the country from Massachusetts to Texas to California and sure to fall further given the dearth of new construction. Consider that no more than 1.25 million new housing units will be put up this year. That is double the amount of construction at the low point of the crisis, but nowhere near the 1.7 million units needed in a typical year to house the nation's growing population. It is no surprise that rent increases are becoming a serious financial burden, especially for lower-income households in urban centers.



Home building needs to be easier and less costly. (© Robert Galbraith / Reuters/REUTERS)

SOLUTION 2: President-elect Trump's economic advisers have suggested tax credits to help finance new infrastructure development. That should include the development of affordable housing.

The solution is to make building easier and less costly. Trump's economic advisers have suggested tax credits to help finance new infrastructure

development. That should include the development of affordable housing. The low-income-housing tax credit and the new market tax credit are popular and successful at incentivizing more affordable rental housing in underserved communities, and should be expanded.

Excessive land-use or zoning regulations and a significant increase in impact fees since the crisis also fetter home building. Municipalities, hit by the loss of property tax revenue when house prices declined, significantly increased fees on builders to help make up the difference and to pay for everything from schools and roads to utilities and environmental mitigation. These fees now amount to about 10 percent of the price of a typical American home, almost double the percentage a decade ago.

While setting land use regulations and impact fees is in the hands of state and local governments, the Trump administration should work to provide the information, incentives and expanded access to credit that can increase pressure to reform the most pernicious of these costs.

The fate of Fannie Mae and Freddie Mac should also be at the center of Trump's housing policy agenda. Together, Fannie and Freddie back about half of all the nation's mortgages, making them among the largest too-big-to-fail institutions in the world. They failed during the financial crisis, and have been in conservatorship under taxpayer control ever since.

This arrangement is not sustainable. In many ways, it has served the nation admirably by providing access to credit for a broad range of borrowers and a level playing field for lenders of all sizes. But it makes no sense for taxpayers to take on much of the risk of keeping housing running when private financial institutions and investors are willing to shoulder the burden.

To be sure, taxpayers need to continue to backstop the mortgage finance system against calamities like the financial collapse. With this backstop, mortgage rates will be far lower, allowing for more homeownership. The popular 30-year fixed-rate mortgage can also remain widely available. However, taxpayers should be compensated by mortgage borrowers for providing this service.

Getting Fannie and Freddie out of conservatorship is critical, but it must be done judiciously. Some have suggested that we go back to the pre-crisis system, but with a new and improved Fannie and Freddie that hold more capital and are subject to tighter regulatory control. Proponents argue that this would ensure that the mortgage giants avoid the mistakes that led to their downfall and taxpayer bailout.

Not so. Going back to the future by setting up another duopoly will mean unnecessarily higher mortgage rates for home buyers and less access to the housing finance system for lenders and underserved communities. And there is no guarantee it won't lead to similar perverse incentives, destructive risk-taking, and ultimately, another financial calamity.



Something needs to be done with Fannie Mae and Freddie Mac. (Kevin Lamarque/Reuters)

SOLUTION 3: Set a strict timetable for transferring the risk on mortgages backed by Fannie and Freddie to private institutions and investors.

Instead, the Trump administration should move toward a future system in which private markets take the risks in mortgage lending, not taxpayers, and the basic infrastructure of the system is in a government utility, and not a too-big-to-fail duopoly.

This can be done by empowering the current effort by Fannie and Freddie's regulator, the Federal Housing Finance Agency (FHFA), to transfer the risk on mortgages backed by Fannie and Freddie to private institutions and investors. To their credit, the two firms are increasingly innovative in how and with whom they risk-transfer. Still, they need to commit fully. They need a firm timeline to offload most of their risk, eventually providing private players only a backstop against calamity.

[\[Fannie Mae, Freddie Mac should be privatized, treasury secretary nominee says\]](#)

The FHFA is also pushing Fannie and Freddie to combine their systems for turning mortgages into securities. Each firm has its own way of doing this, which adds to the costs and also makes it difficult for others to compete with them. They are constructing a common securitization platform that they and other financial institutions can use. A common platform eventually will also allow Fannie and Freddie to issue the same mortgage security.

By ensuring that these steps get taken in a timely way, the Trump administration would accomplish a graceful change of the housing finance system. Taxpayers would be protected, home buyers would still be able to get affordable long-term fixed-rate mortgages, lenders of all types and sizes would be able to compete on an equal footing, and underserved communities would have appropriate access to credit.

It is a testimonial to the Obama administration's hard work that housing, which just a few years ago was at the center of one of the most serious financial crises in our history, has become an engine of economic growth.

But the job isn't done.

It remains overly difficult for many to get a mortgage or find an affordable home, and Fannie and Freddie operate in an uncomfortable limbo.

Let's hope the Trump administration will be able to complete the task.

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