Center for American Progress Action Fund

An Agenda for Federal Action on the Housing Crisis

Congress must act quickly to adopt policies that will break the vicious downward spiral of home prices and restore confidence and liquidity to America's financial markets.

Legislation pending in both the Senate and House would accomplish many of the key steps necessary to help stabilize housing and credit markets.

The goal of policy now must be to protect homeowners and communities by preventing the continued acceleration of home foreclosures and by restoring confidence in the credit markets. Policies should aim to (a) keep more existing owners in their homes where possible as a way to preclude the significant costs to families, increased housing inventories and depressed values that come from foreclosure; and (b) support the acquisition and constructive reuse of foreclosed properties for affordable housing through homeownership with viable mortgages on responsible terms, and through quality rental units, as well as the creation of other community assets. Interventions that reduce foreclosures and support homeownership and affordable rental housing will benefit homeowners, neighborhoods, communities, and financial markets. *These strategies are mutually reinforcing and must be pursued in tandem.*

Bills Developed by Senators Harry Reid (D-NV) and Chris Dodd (D-CT) and Representatives Barney Frank (D-MA) and Maxine Waters (D-CA) Go A Long Way Toward This Goal and Must Be Adopted This Year

Taken together, these bills incorporate essential plans to keep people in their homes through bulk refinancing or restructuring and plans for reuse of foreclosed properties to stabilize neighborhoods. Each includes important elements of the Center for American Progress' own plans for these ends: the Saving America's Family Equity (SAFE) Loan Plan and the Great American Dream Neighborhood Stabilization (GARDNS) Fund.

The SAFE Loan Program would promptly facilitate the bulk transfer of mortgages into the hands of new private owners with the incentive and ability to modify or refinance the loans. Time and servicer capacity limitations do not allow the continued loan-by-loan evaluation of options by servicers who must serve the often conflicting interests of investors in complex securitization structures. Government must create a mechanism for the transfer of mortgages from securitization trusts with limited flexibility to new owners who will be responsible for helping homeowners stay in their homes with viable loans on responsible terms. When homeownership is not sustainable for current borrowers, as it will be in some instances, these new note holders will have the responsibility to terminate the mortgage using strategies that minimize adverse consequences for the borrowers and their communities.

Key components of the SAFE Loan Program include:

- ***Bulk Transfer or Bulk Refinancing.*** Enabling the bulk transfer of existing loans from the current holder of the mortgages—who is faced with a variety of uncertainties and conflicting interests—to new owners who will refinance them on affordable terms. Servicers willing to refinance existing loans in bulk by offering new loans on the same responsible terms need not transfer their loans to a new party.
- ***No Bailouts.*** The sale price paid would reflect the current value of those mortgages, significantly less than the face value. This "haircut" will ensure there is no bailout of the financial institutions and existing investors, many of whom uncritically and irresponsibly created the bubble by lending in the hope that continued house price appreciation would make up for the absence of meaningful credit evaluation. The resulting transfer will help to unfreeze financial markets.
- ***Restored Liquidity.*** Current investors will exchange the mortgage-backed securities they hold whose value is uncertain for the liquidity and reduced market risk of Treasury securities or cash.
- ***New Federally Backed and Responsible Loan Products.*** Given market uncertainty, investors will only fund new SAFE loans if the government insures against catastrophic losses. Credit enhancements for new SAFE loans

to owner-occupants would include more flexible Federal Housing Administration-insured loans as well as special programs for Fannie Mae and Freddie Mac.

- ***A Mechanism to Prevent Borrowers from Getting a Windfall.*** Any loan that is written down to below current fair market value of the home could be accompanied by a "soft" second mortgage that permits the lender to recover an amount up to the difference between loan amount and current value, if the home is subsequently sold for more than the new loan amount. A shared-equity instrument would enable the owner, funder, and insurer of the loans to share in home price appreciation up to the original loan balance.

- ***Housing Counseling Resources.*** Counselors are essential partners in helping homeowners into restructuring programs, but the system must grow to meet the current and future needs.

The Great American Dream Neighborhood Stabilization (GARDNS) Fund would provide resources to states, localities, and housing intermediaries to buy up bank-owned properties in bulk, rehabilitate them, and offer them for sale as affordable housing. The sale of these properties will reduce overhanging inventory and stabilize community property values by shrinking the number of vacant and abandoned properties that negatively impact home equity.

Key components of the GARDNS program include:

- ***Bulk Purchase of Foreclosed Properties.*** Providing state and local governments with grants of up to $20 billion in new Community Development Block Grants or HOME funds for programs to return foreclosed properties to productive use.

- ***Sustainable Communities and Affordable Housing.*** Putting families into homes with payments they can sustain will not only provide a new source of affordable housing and prevent crime and blight; the GARDNS program will reduce housing inventories and keep surrounding house prices from falling further.

- ***Targeted at Most Affected Areas.*** Funds would be targeted at communities most heavily impacted by foreclosures, and the funds would be used to purchase bank-owned properties at a discount which would be rehabilitated and then sold or rented affordably.

- ***Flexible Use of Funds.*** Each community's situation will dictate a different mix of strategies.

The Reid/Durbin proposal for judicial loan modifications would strengthen this agenda. An effective plan should also include legislation to conform the treatment of currently outstanding non-traditional and sub-prime mortgages on a primary residence to the treatment of other secured debt, including cars, second homes, and investment properties in Chapter 13 bankruptcy cases, in certain narrow circumstances. In addition to assisting borrowers in bankruptcy, the bill provides an incentive to servicers to speed up the process of voluntarily restructuring mortgages, where possible.

The Problem

Federal action is urgently needed. The U.S. economy teeters on the edge of recession because of a vicious downward spiral in housing prices, escalating foreclosures, rising losses on mortgage-backed securities, contagion in other credit markets, and dwindling liquidity. Consider that:

- 8.8 million Americans are underwater—they owe more on their mortgages than their homes are worth. If prices fall another 15 percent, one-third of all mortgages would face negative equity.

- The number of properties entering foreclosure in the fourth quarter of 2007 set a record, with 7.9 percent of ***all*** loans now delinquent or in foreclosure.

- Servicers are foreclosing in greater numbers than they are modifying mortgages and taking possession of properties faster than they can sell them.

- Foreclosure action was taken on almost one million properties in the second half of 2007, with more in the fourth quarter of last year than in the previous quarter notwithstanding efforts by the voluntary HOPE NOW Alliance to curtail foreclosures.

- A housing market correction after unprecedented price appreciation is appropriate, and people should not be protected from unwise speculation, yet a panicked freefall not supported by economic fundamentals is bad for the economy.

- We are facing the prospects of a long, severe credit crisis and economic stagnation.

- Monetary and fiscal policy alone will not resolve the crisis.
- As the housing bubble bursts, we see widespread recognition that the economy has offered little real progress for most in recent years Americans.

The market cannot resolve this crisis on its own. For almost a year the complex legal entities that hold these mortgages have failed to slow the pace of foreclosures—despite exhortations by the Bush administration for mortgage servicers, lenders, and investors to provide voluntary relief. The result:

- An inability to value underlying mortgage and other assets has been a major contributor to a worldwide credit market freeze.
- If policymakers do not facilitate the restructuring of millions of at-risk mortgages in private hands quickly, on responsible and sustainable terms, then U.S. policymakers may soon face widespread international pleas for more dramatic steps, including direct government control of distressed mortgage assets.

The American economy is suffering. Concentrations of foreclosures lead rapidly to neighborhood decline and lost equity for surrounding homeowners—even those who are making timely payments on prime mortgage loans. A looming recession will mean economic pain throughout the U.S. economy. Specifically:

- Lost equity spurs more defaults as borrowers under stress conclude that they cannot continue making mortgage payments with no prospect of retaining equity in their homes. And since housing equity and home mortgage debt have spurred economic growth, tightened credit and evaporating equity will continue to chill consumer demand, slowing the economy and resulting in job losses—just as inflationary pressures are appearing.
- The unprecedented decline in house prices threatens the financial stability of states and localities. Foreclosed, vacant, and abandoned properties attract crime and vandalism, requiring municipalities to shift resources away from other local priorities. Heightened demand for government services comes as revenues, tied to property taxes, decline.

The CAP Housing and Financial Markets Team of Experts

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To learn more

For more on the SAFE loan program, our GARDNS proposal, and other CAP initiatives to stabilize housing markets and put America on the road to economic recovery, see:

"Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation," Testimony of Michael Barr Before the United States Senate Committee on Banking, and Urban Affairs. http://www.americanprogress.org/issues/2008/01/barr_testimony.html

"Addressing Foreclosures: A Great American Dream Neighborhood Stabilization Plan," by David Abromowitz. http://www.americanprogress.org/issues/2008/01/pdf/abromowitz_gardns.pdf

"A Practical and Progressive Economic Stimulus and Recovery Plan," by John Podesta, Dr. Laura Tyson, and Sarah Rosen Wartell. http://www.americanprogressaction.org/issues/2008/stimulus.html

About the Center for American Progress Action Fund

The Center for American Progress Action Fund transforms progressive ideas into policy through rapid response communications, legislative action, grassroots organizing and advocacy, and partnerships with other progressive leaders throughout the country and the world. The Action Fund is also the home of the Progress Report and ThinkProgress.