

## THE BUZZ



### Re-engineering the Housing Finance System: Part One

By Buzz Roberts, Local Initiatives Support Corporation

Even as Congress and the Obama Administration continue to wrestle over major financial reform legislation, they have already begun to consider another set of issues: what the future of the U.S housing finance system should look like. The debate is critically important to families and communities, to the economy, and to housing and community development. The topic is too complex for policy makers to address this year or for one column to cover. So this column is only a first installment.

The federal conservatorship of Fannie Mae and Freddie Mac and the collapse of the private label securities (PLS) and commercial mortgage backed securities (CMBS) markets have left housing finance predominately to government channels. The federally backed Fannie and Freddie, along with the Federal Housing Administration, the Rural Housing Service and Ginnie Mae are driving the great majority of mortgage financing. The Treasury and Federal Reserve together have bought about \$1.2 trillion in government backed mortgage securities.

Though it may sound strange, this extraordinary federal intervention has actually been good news. It has kept mortgages available to home buyers and owners, as well as multifamily owners, and at relatively low interest rates. Underwriting has tightened, some would say too much, and many borrowers cannot get financing on any terms; however many observers consider federal support for the mortgage system to be one the Obama Administration's most successful financial system interventions and, more broadly, economic recovery policies. It is clear that housing and the economy

would be in much worse shape otherwise.

But it is also clear that the status quo should not and can not continue forever. The question of what to do next is complex and delicate. It will be important to have designed a new system before dismantling the current one, as well as to plan for a transition to the former from the latter. A hasty move, or even sending the wrong signals, could be disruptive and counter-productive. And designing a new system will be tricky at a time when the markets are still disrupted – what may be possible in the long run might not be possible today or next year.

So it is with due caution that the House Financial Services Committee (HFSC) has held two hearings to begin the discussion and the Obama Administration has solicited public input. It is interesting and appropriate that both HFSC Chairman Barney Frank and the Administration are framing the issues not in terms of Fannie and Freddie, but in a broader context of the housing finance system. Rep. Frank has gone so far as to declare that Fannie and Freddie should be abolished, suggesting that the policy debate should start with a clean slate. While the federal government could still have a significant role going forward, there is little support for any explicit or implicit federal backing for secondary market entities like Fannie and Freddie as such. The Senate has been too busy with broad financial reform legislation to consider housing finance, and the impending retirement of Sen. Christopher Dodd, the Banking Committee Chairman, means the issue awaits a new chairman next year.

*continued from page 1*

In thinking about how to move forward, it is important to understand what led to the collapse. The issues are subtle and somewhat clouded by ideology, politics, and perhaps a desire by some participants to avoid blame. For these reasons, it may be impossible ever to achieve a complete consensus, but it is possible to sort out some facts and myths.

One popular but misguided narrative is that Fannie and Freddie drove the collapse of the housing finance system by buying unsustainable loans. A closer look shows that funding for unsustainable mortgages – including subprime loans, loans without documentation of borrower incomes or assets, and mortgages allowing for negative amortization – developed and grew first in the PLS market. Fannie and Freddie did participate, but they followed the markets, not led them.

Another concern is that it was federal goals for financing affordable housing that drew Fannie and Freddie to support unsustainable mortgages. This is a variation on last year's campaign to blame the crash on the Community Reinvestment Act, an attack that has been largely discredited. In the case of Fannie and Freddie, most experts conclude that other objectives – preserving market share, keeping big lenders as customers, and high profit margins – were the primary motivations for buying unsustainable mortgages. By definition, it was impossible for Fannie and Freddie to count mortgages with no documentation of borrower income as serving low- and moderate-income families. And the CMBS market encountered more severe problems than Fannie and Freddie although no federal goals applied there.

That is not to say that Fannie and Freddie were merely victims of a bursting housing bubble. Even if they came to the unsustainable mortgage party late, Fannie and Freddie should not have come at all and should have left earlier. Unsustainable mortgages helped to cause their failure, Fannie and Freddie were undercapitalized and over-leveraged, and, like almost everyone else, they seriously misread the market and mispriced risk.

Indeed, there is plenty of blame go around. Throughout the mortgage finance chain, from lenders to borrowers, from appraisers to rating agencies, from investment bankers to investors, many incentives were out of alignment, mistakes and malfeasance were widespread, and transparency and safeguards failed. Everything appeared fine until it went bad, and then it spiraled out of control. Many innocent families and communities, as well as the broader financial system and the economy suffered serious and lasting damage. Because so much went wrong, there is much to fix, including consumer and investor confidence. It won't be easy.

In a future column, we will consider some of the characteristics and objectives of a new housing system. ♦

*continued on page 3*

## Novogradac Journal of Tax Credits Editorial Board

### PUBLISHER

Michael J. Novogradac, CPA

### EDITOR

Jane Bowar Zastrow

### MANAGING EDITOR

Alex Ruiz

### STAFF WRITERS

Jennifer Dockery

Jennifer Hill

### TECHNICAL EDITORS

Robert S. Thesman, CPA

James R. Kroger, CPA

Owen P. Gray, CPA

Thomas Boccia, CPA

Daniel J. Smith, CPA

### CONTRIBUTING WRITERS

Tom Boccia, CPA

Frank R. Buss II, CPA

Jieyi Cui, CPA

Brandi Day

Brad Elphick, CPA

Mattie Gonzalez

Darryl P. Jacobs

John Leith-Tetrault

Jeff Nishita, CPA

Forrest David Milder

Buzz Roberts

Kimberly Smith

Thomas Stagg, CPA

Carolina Torre, CPA

Stephen B. Tracy, CPA

### PRODUCTION

Jesse Barredo

James Matuszak

## Novogradac Journal of Tax Credits Information

Address all correspondence and  
editorial submissions to:  
Jane Bowar Zastrow / 415.356.8034

Address inquiries regarding  
advertising opportunities to:  
Emil Bagalso / 415.356.8037

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.



**NOVOGRADAC  
& COMPANY** LLP

CERTIFIED PUBLIC ACCOUNTANTS

© Novogradac & Company LLP

2010 All rights reserved.

ISSN 2152-646X

Reproduction of this publication in whole or in part in any form without written permission from the publisher is prohibited by law.

## Novogradac Journal of Tax Credits Advisory Board

### LOW-INCOME HOUSING TAX CREDITS

Bud Clarke	BOSTON FINANCIAL INVESTMENT MANAGEMENT
Jana Cohen Barbe	SONNENSCHN NATH & ROSENTHAL LLP
Tom Dixon	BOSTON CAPITAL
Valerie White	STANDARD & POOR'S CORPORATION
Rick Edson	HOUSING CAPITAL ADVISORS INC.
Richard Gerwitz	CITI COMMUNITY CAPITAL
Rochelle Lento	DYKEMA GOSSETT PLLC
John Lisella	U.S. BANCORP COMMUNITY DEV. CORP.
Phillip Melton	GRANDBRIDGE REAL ESTATE CAPITAL
Thomas Morton	PILLSBURY WINTHROP SHAW PITTMAN LLP
Stephen Ryan	COX, CASTLE & NICHOLSON LLP
Arnold Schuster	SONNENSCHN NATH & ROSENTHAL LLP
Rob Wasserman	U.S. BANCORP COMMUNITY DEV. CORP.

### PROPERTY COMPLIANCE

Rose Guerrero	CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE
Sharon Jackman	SIG SERVICES LLC
Michael Kotin	KAY KAY REALTY
Patricia Murphy	TEXAS DEPT. OF HOUSING & COMM. AFFAIRS
Mardi Roberts	WASHINGTON STATE HOUSING FINANCE COMMISSION
Michael Snowdon	MCA HOUSING PARTNERS
Gianna Solari	SOLARI ENTERPRISES
Ruth Theobald Probst	THEOPRO COMPLIANCE & CONSULT. INC.
Kimberly Taylor	HOMESTEAD CAPITAL

### HOUSING AND URBAN DEVELOPMENT

Sheldon Schreiber	PEPPER HAMILTON LLP
Monica Sussman	NIXON PEABODY LLP

### NEW MARKETS TAX CREDITS

Frank Altman	COMMUNITY REINVESTMENT FUND
Bruce Bonjour	PERKINS COIE LLC
Neil Kimmelfield	LANE POWELL
Scott Lindquist	SONNENSCHN NATH & ROSENTHAL LLP
Ruth Sparrow	FUTURES UNLIMITED LAW PC
Herb Stevens	NIXON PEABODY LLP
Mary Tingerthal	HOUSING PARTNERSHIP NETWORK
Tom Tracy	HUNTER CHASE & COMPANY
Joseph Wesolowski	ENTERPRISE COMMUNITY INVESTMENT INC.

### HISTORIC TAX CREDITS

Don Holm	FARRIS BOBANGO BRANAN PLC
John Leith-Tetrault	NATIONAL TRUST COMM. INVESTMENT CORP.
Bill MacRostie	MACROSTIE HISTORIC ADVISORS LLC
Donna Rodney	BRYAN CAVE LLP
John Tess	HERITAGE CONSULTING GROUP

### RENEWABLE ENERGY TAX CREDITS

Ed Feo	MILBANK, TWEED, HADLEY & MCCLOY LLP
Michael Hall	BORREGO SOLAR SYSTEMS
Jim Howard	DUDLEY VENTURES

continued from page 2



Benson F. "Buzz" Roberts is senior vice president for policy and program development at the Local Initiatives Support Corporation (LISC), a national not-for-profit organization. Mr. Roberts directs LISC's public policy and government relations activities. He has been involved in the creation of such policies as the low-income housing tax credit, the new markets tax credit, and the HOME housing development program. He can be reached at broberts@lisc.org.

This article first appeared in the May 2010 issue of the *Novogradac Journal of Tax Credits*.

© Novogradac & Company LLP 2010 - All Rights Reserved

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit [www.novoco.com](http://www.novoco.com).