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Democratic Principles for Housing Finance Reform

After exploring the issues related to housing finance reform with interested advocates, academics, and industry representatives at a series of working roundtables this year, we Democrats on the House Financial Services Committee, have agreed to a set of critical core principles for housing finance reform. We will oppose any legislation that is inconsistent with these principles.
-- Democratic Members, Committee on Financial Services

A robust mortgage market is required for a healthy, growing middle-class and broad economic growth. The secondary market plays a significant role in ensuring the health of the market, and that can best be pursued by incorporating the principles described below into the design of the housing finance system.

- **Maintain Access to the 30-Year Fixed Rate Mortgage.**

    - **Protect a stable, well-understood financial product.**

        - Before the 1930s, mortgages required high down-payments (typically more than 50 percent) and were offered at interest rates much higher than today. Moreover, most products had similar features as the unregulated subprime loans of the 2000s (typically short-term, often interest-only, often carrying variable interest rates, and usually featuring "balloon" payments of principal at term). Because of the creation of FHA, Fannie Mae and Freddie Mac, the 30-year, fixed-rate mortgage became the bedrock of American homeownership until the introduction of exotic products during the subprime bubble.

    - The traditional, 30-year, fixed rate mortgage was not the cause of the recent crisis. In fact, there is reason to believe that a primary cause of the recent housing bubble was the introduction and rapid growth of short-duration, resetting mortgages during the subprime boom. The record clearly demonstrates that traditional 30-year, fixed rate mortgages default and go to foreclosure at much lower rates than adjustable rate products.

    - The full faith and credit of the United States government is necessary to assure the continuation of the traditional 30-year fixed rate mortgage. Mortgage originators are unlikely to offer long term fixed rate mortgages because they do not want to bear the risk of fluctuating interest rates. A federal backstop is necessary to ensure that traditional 30-year fixed-rate mortgages are available at reasonable interest rates and terms.

- The traditional 30-year, fixed rate mortgage provides certainty to American homebuyers, and concentrates interest rate risk with institutions (who can manage this risk through hedges), rather than borrowers.

- **Protect Taxpayers.**
  - Ensure that a government guarantee must be paid for by the private sector with an explicit, ex ante fee that is priced fairly, but provides adequate revenue to cover the risks.
  - Ensure that sufficient private capital is in place to take a first-loss position to protect taxpayers.
  - Ensure competition and prevent any one or more entities from presenting a threat to the financial system.
  - Ensure a strong regulatory framework to promote proper oversight and accountability.
  - Fully recoup the taxpayer's loan to Fannie Mae and Freddie Mac.

- **Provide Stability and Liquidity.**
  - Rein in excessive risk-taking and provide for adequate capital levels.
  - Promote products that produce sustainable homeownership.
  - Ensure the availability of capital at times when the credit markets are constricting.
  - Rein in loose credit periods that can lead to bubbles.
  - Ensure the continued, smooth operation of the "To-Be-Announced" (TBA) market through any transition and after, so that market participants do not lose the ability to lock in a price for securities before loans are sold.

- **Prevent Disruptions to the U.S. Housing Market During a Transition to a New Finance System.**
  - Maintain the full faith and credit guarantee of the US for outstanding agency securities.

- Provide for sufficient time for all market participants to adjust to the new system.

- **Require Transparency and Standardization.**

  - Provide for transparency in underwriting and securitization standards so that borrowers, investors and regulators can accurately evaluate products and price risk. The pricing mechanism must be insulated from political pressure to the greatest extent practical.

  - Promote a standardized system, which can ensure that community banks, credit unions and community development financial institutions, including women- and minority-owned institutions, are able to equally access the secondary market.

  - Provide clear mortgage servicing standards that protect borrowers, and make the rights of investors clear.

- **Maintain Access for All Qualified Borrowers that Can Sustain Homeownership and Serve Homeowners of the Future.**

  - Ensure that downpayment requirements and credit score criteria do not unfairly cut-out underserved borrowers that could sustainably own homes, including low- and middle-income families and minority households.

  - Provide that the secondary mortgage market has the tools and incentives to ensure that all creditworthy borrowers are served regardless of geography, housing type, and racial/ethnic background.

  - Provide that any new entity with a government-backstop follows all laws regarding fair housing and fair lending.

- **Ensure Access to Affordable Rental Housing.**

  - Ensure a stable and liquid secondary mortgage market for loans secured by multi-family residential properties.

  - Support affordable housing by funding the National Housing Trust Fund and the Capital Magnet Fund, and ensure that funding is appropriately targeted to very-low and extremely-low income families.