agencies and individuals are constantly trying to find scapegoats for their own bad decisions, but HUD's effort to blame Fannie and Freddie for the decline in underwriting standards sets a new standard for running from responsibility. Contrast the 2010 statement quoted above with this statement by HUD in 2000, when it was significantly increasing Fannie and Freddie's affordable housing goals:

> Lower-income and minority families have made major gains in access to the mortgage market in the 1990s. A variety of reasons have accounted for these gains, including improved housing affordability, enhanced enforcement of the Community Reinvestment Act, *more flexible mortgage underwriting*, and stepped-up enforcement of the Fair Housing Act. *But most industry observers believe that one factor behind these gains has been the improved performance of Fannie Mae and Freddie Mac under HUD's affordable lending goals. HUD's recent increases in the goals for 2001-03 will encourage the GSEs to further step up their support for affordable lending.*[62] [emphasis supplied]

Or this statement in 2004, when HUD was again increasing the affordable housing goals for Fannie and Freddie:

> Millions of Americans with less than perfect credit or who cannot meet some of the tougher underwriting requirements of the prime market for reasons such as inadequate income documentation, limited downpayment or cash reserves, or the desire to take more cash out in a refinancing than conventional loans allow, rely on subprime lenders for access to mortgage financing. *If the GSEs reach deeper into the subprime market, more borrowers will benefit from the advantages that greater stability and standardization create.*[63][emphasis supplied]

Or, finally, this statement in a 2005 report commissioned by HUD:

> More liberal mortgage financing has contributed to the increase in demand for housing. During the 1990s, lenders have been *encouraged by HUD and banking regulators* to increase lending to low-income and minority households. The Community Reinvestment Act (CRA), Home Mortgage Disclosure Act (HMDA), government-sponsored enterprises (GSE) housing goals and fair lending laws have strongly encouraged mortgage brokers and lenders to market to low-income and minority borrowers. *Sometimes these borrowers are higher risk, with blemished credit histories and high debt or simply little savings for a down payment. Lenders have responded with low down payment loan products and automated underwriting, which has allowed them to more carefully determine the risk of the loan.*[64] [emphasis supplied]

Despite the recent effort by HUD to deny its own role in fostering the growth of subprime and other high risk mortgage lending, there is strong—indeed irrefutable—evidence that, beginning in the early 1990s, HUD led an ultimately successful effort to lower underwriting standards in every area of the mortgage market where HUD had or could obtain influence. With support in congressional legislation, the policy was launched in the Clinton administration and extended almost to the end of the Bush administration. It involved FHA, which was under the direct control of HUD; Fannie Mae and Freddie Mac, which were subject to HUD's affordable housing regulations; and the mortgage banking industry, which—while not subject to HUD's legal jurisdiction—apparently agreed to pursue HUD's

---

[62] Issue Brief: HUD's Affordable Housing Goals for Fannie Mae and Freddie Mac, p.5.

[63] Final Rule, http://fdsys.gpo.gov/fdsys/pkg/FR-2004-11-02/pdf/04-24101.pdf.

[64] HUD PDR, May 2005, HUD Contract C-OPC-21895, Task Order CHI-T0007, "Recent House Price Trends and Homeownership Affordability", p.85.

policies out of fear that they would be brought under the Community Reinvestment Act through legislation.[65] In addition, although not subject to HUD's jurisdiction, the new tighter CRA regulations that became effective in 1995 led to a process in which community groups could obtain commitments for substantial amounts of CRA-qualifying mortgages and other loans to subprime borrowers when banks were applying for merger approvals.[66]

By 2004, HUD believed it had achieved the "revolution" it was looking for:

> Over the past ten years, there has been a 'revolution in affordable lending' that has extended homeownership opportunities to historically underserved households. Fannie Mae and Freddie Mac have been a substantial part of this 'revolution in affordable lending'. *During the mid-to-late 1990s, they added flexibility to their underwriting guidelines, introduced new low-downpayment products*, and worked to expand the use of automated underwriting in evaluating the creditworthiness of loan applicants. HMDA data suggest that the industry and GSE initiatives are increasing the flow of credit to underserved borrowers. *Between 1993 and 2003, conventional loans to low income and minority families increased at much faster rates than loans to upper-income and nonminority families*.[67][emphasis supplied]

This turned out to be an immense error of policy. By 2010, even the strongest supporters of affordable housing as enforced by HUD had recognized their error. In an interview on Larry Kudlow's CNBC television program in late August, Representative Barney Frank (D-Mass.)—the chair of the House Financial Services Committee and previously the strongest congressional advocate for affordable housing—conceded that he had erred: "I hope by next year we'll have abolished Fannie and Freddie . . . it was a great mistake to push lower-income people into housing they couldn't afford and couldn't really handle once they had it." He then added, "I had been too sanguine about Fannie and Freddie."[68]

2. The Decline of Mortgage Underwriting Standards

Before the enactment of the GSE Act in 1992, and HUD's adoption of a policy thereafter to reduce underwriting standards, the GSEs followed conservative underwriting practices. For example, in a random review by Fannie Mae of 25,804 loans from October 1988 to January 1992, over 78 percent had LTV ratios of 80 percent or less, while only 5.75 percent had LTV ratios of 91 to 95 percent.[69] High risk lending was confined primarily to FHA (which was controlled by HUD) and specialized subprime lenders who often sold the mortgages they originated to FHA. What caused these conservative standards to decline? The Commission majority,

---

[65] Steve Cocheo, "Fair-lending pressure builds," *ABA Banking Journal*, vol. 86, 1994, http://www.questia.com/googleScholar.qst?docId=5001707340.

[66] See NCRC, *CRA Commitments*, 2007.

[67] *Federal Register*,vol. 69, No. 211, November 2, 2004, Rules and Regulations, p.63585, http://fdsys.gpo.gov/fdsys/pkg/FR-2004-11-02/pdf/04-24101.pdf .

[68] Larry Kudlow, "Barney Frank Comes Home to the Facts," GOPUSA, August 23, 2010, available at www.gopusa.com/commentary/2010/08/kudlow-barney-frank-comes-home-to-the-facts.php#ixzz0zdCrWpCY (accessed September 20, 2010).

[69] Document in author's files.

echoing Chairman Bernanke, seems to believe that the impetus was competition among the banks, irresponsibility among originators, and the desire for profit. The majority's report offers no other explanation.

However, there is no difficulty finding the source of the reductions in mortgage underwriting standards for Fannie and Freddie, or for the originators for whom they were the buyers. HUD made clear in numerous statements that its policy—in order to make credit available to low-income borrowers—was specifically *intended* to reduce underwriting standards. The GSE Act enabled HUD to put Fannie and Freddie into competition with FHA, and vice versa, creating what became a contest to lower mortgage standards. As the Fannie Mae Foundation noted in a 2000 report, "FHA loans constituted the largest share of Countrywide's [subprime lending] activity, until Fannie Mae and Freddie Mac began accepting loans with higher LTVs [loan-to-value ratios] and greater underwriting flexibilities."[70]

Under the GSE Act, the HUD Secretary was authorized to establish affordable housing goals for Fannie and Freddie. Congress required that these goals include a low and moderate income goal and a special affordable goal (discussed below), both of which could be adjusted in the future. Among the factors the secretary was to consider in establishing the goals were national housing needs and "the ability of the enterprises [Fannie and Freddie] to lead the industry in making mortgage credit available for low-and moderate-income families." The Act also established an interim affordable housing goal of 30 percent for the two-year period beginning January 1, 1993. Under this requirement, 30 percent of the GSEs' mortgage purchases had to be affordable housing loans, defined as loans to borrowers at or below the AMI.[71]

Further, the Act established a "special affordable" goal to meet the "unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income families." This category was defined as follows: "(i) 45 percent shall be mortgages of low-income families who live in census tracts in which the median income does not exceed 80 percent of the area median income; and (ii) 55 percent shall be mortgages of very low income families," which were later defined as 60 percent of AMI.[72] Although the GSE Act initially required that the GSEs spend on special affordable mortgages "not less than 1 percent of the dollar amount of the mortgage purchases by the [GSEs] for the previous year," HUD raised this requirement substantially in later years. Ultimately, it became the most difficult affordable housing AH burden for Fannie and Freddie to meet.

Finally, the GSEs were directed to: "(A) assist primary lenders to make housing credit available in areas with low-income and minority families; and (B) assist insured depository institutions to meet their obligations under the Community Reinvestment Act of 1977."[73] There will be more on the CRA and its effect on the quality of mortgages later in this section.

Congress also made clear in the act that its intention was to call into question the high quality underwriting guidelines of the time. It did so by directing Fannie and Freddie to "examine—

---

[70] Fannie Mae Foundation, "Making New Markets: Case Study of Countrywide Home Loans," 2000, http://content.knowledgeplex.org/kp2/programs/pdf/rep_newmortmkts_countrywide.pdf.

[71] GSE Act, Section 1332.

[72] Id., Section 1333.

[73] Id., Section 1335.