

Ben S Bernanke: Challenges in housing and mortgage markets

Speech by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, at the Operation HOPE Global Financial Dignity Summit, Atlanta, Georgia, 15 November 2012.

* * *

Good afternoon. I'd like to thank John Bryant and Operation HOPE for inviting me to speak today. I'd also like to congratulate Operation HOPE and the Ebenezer Baptist Church on the grand opening of the HOPE Financial Dignity Center, which holds the promise of becoming a tremendous resource for the people of Atlanta and sits next to Martin Luther King's home church. Dr King's legacy to our society is strong and enduring, and the new center is very much in the spirit of his work.

The past few years have been difficult for many Americans and their communities. At the Federal Reserve, we understand the depth of the problem and the need for action, and we will continue to use the policy tools that we have to help support economic recovery. We also know that the burdens of a weak economy and the benefits of economic growth often are not equally shared, and that, to be truly effective, policymakers must take into account how their decisions affect the least advantaged, not just the economy as a whole.

My remarks today will focus on an important part of our economy, the housing sector. Housing and housing finance played a central role in touching off the financial crisis and the associated recession, and the ensuing wave of foreclosures wreaked great damage on communities across the country. As I will discuss, for the first time in a number of years, the housing sector is improving, adding to growth and jobs. But the housing revival still faces significant obstacles, and the benefits of that revival remain quite uneven. Strengthening and broadening the housing recovery remain a critical challenge for policymakers, lenders, and community leaders. The degree to which that challenge is met will help determine the strength and sustainability of the economic recovery and the extent to which its benefits are broadly felt.

Developments in housing and housing finance

The multiyear boom and bust in housing prices of the past decade, together with the sharp increase in mortgage delinquencies and defaults that followed, were among the principal causes of the financial crisis and the ensuing deep recession – a recession that cost some 8 million jobs. And continued weakness in housing – reflected in falling prices, low rates of new construction, and historic levels of foreclosure – has proved a powerful headwind to recovery. It is encouraging, therefore, that we are seeing signs of improvement in the housing market in most parts of the country. House prices nationally have increased for nine consecutive months, residential investment has risen about 15 percent from its low point, and sales of both new and existing homes have edged up.¹ Homebuilder sentiment has improved considerably over the past year, and real estate agents report a substantial rise in homebuyer traffic. The growing demand for homes has been underpinned by record levels of affordability, the result of historically low mortgage rates and house prices that are 30 percent or more below their peaks in many areas.

¹ House prices are a staff calculation based on seasonally adjusted data from CoreLogic. Residential investment includes construction of single-family and multifamily houses as well as improvements to existing structures and brokers' commissions. The staff calculation of residential investment is based on data from the national income and product accounts. Home sales data are from the Census Bureau and the National Association of Realtors.

To be sure, the housing sector is far from being out of the woods. Construction activity, sales, and prices remain much lower than they were before the crisis. About 20 percent of mortgage borrowers remain underwater – that is, they owe more than their homes are worth. Despite marked improvements in overall credit quality, 7 percent of mortgages are either more than 90 days overdue or in the process of foreclosure.² And, although the number of homes in foreclosure has edged down since cresting in 2010, that number remains in excess of 2 million, three times the historical norm. Meanwhile, the national homeownership rate has slipped nearly 4 percentage points from its 2004 high of 69 percent, and it now stands at a 15-year low.³ So, although there are good reasons to be encouraged by the recent direction of the housing market, we should not be satisfied with the progress we have seen so far.

Lower-income and minority communities are often disproportionately affected by problems in the national economy, and the effects of the housing bust have followed that unfortunate pattern. Indeed, as a result of the crisis, most or all of the hard-won gains in homeownership made by low-income and minority communities in the past 15 years or so have been reversed. For example, among all income groups, between 2007 and 2010, homeownership rates fell the most for households with income of \$20,000 or less, according to the Federal Reserve's Survey of Consumer Finances.⁴ Data from the Census Bureau show that, over the period from 2004 to 2012, the homeownership rate fell about 5 percentage points for African Americans, compared with about 2 percentage points for other groups.⁵

Homeownership rates fall when existing homeowners lose or leave their properties, when barriers to homeownership increase, or both. In recent years, both factors have been important. As I mentioned, home loss through foreclosure, though down from its peaks, remains an important problem, with lower-income and minority homeowners often being the hardest hit. Importantly, foreclosures can inflict economic damage beyond the personal suffering and dislocation that accompany them. Foreclosed properties that sit vacant for months (or years) often deteriorate from neglect, adversely affecting not only the value of the individual property but the values of nearby homes as well. Concentrations of foreclosures have been shown to do serious damage to neighborhoods and communities, reducing tax bases and leading to increased vandalism and crime. Thus, the overall effect of the foreclosure wave, especially when concentrated in lower-income and minority areas, is broader than its effects on individual homeowners. A strengthening housing market will help to gradually undo that damage, but the process has only begun.

Homeownership rates have also declined because fewer households have chosen, or have been able, to become new homeowners in recent years. Buying a home usually means obtaining a mortgage, and the data show that the pace of mortgage lending has fallen considerably on a national basis; the extension of first-lien mortgages to purchase homes fell by more than half from 2006 to 2011 and now stands at the lowest level since 1995.⁶ Again,

² This is a staff calculation for 2012:Q2 based on data from the Mortgage Bankers Association's National Delinquency Survey.

³ See U.S. Census Bureau (2012), "Housing Vacancies and Homeownership", webpage, third quarter, historical tables, table 16, available at www.census.gov/housing/hvs/data/histtabs.html.

⁴ Derived from the Board's Survey of Consumer Finances. See Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus (2012), "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 98 (February), pp. 1–80, www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf.

⁵ The homeownership rate for each year is calculated as the average of the quarters displayed in table 16 of "Housing Vacancies and Homeownership". See U.S. Census Bureau, "Housing Vacancies", table 16, in note 3.

⁶ Data on home-purchase lending are from annual filings pursuant to the Home Mortgage Disclosure Act. Data are available at Federal Financial Institutions Examination Council, "Home Mortgage Disclosure Act" webpage, www.ffiec.gov/hmda/default.htm.

the contraction in mortgage originations has been particularly severe for minority groups and those with lower incomes: Since the peak in mortgage lending in 2006, the number of home-purchase loans extended to African Americans and Hispanics has fallen more than 65 percent, whereas lending to non-Hispanic whites has fallen less than 50 percent. Home-purchase originations in lower-income neighborhoods have fallen about 75 percent, compared with around 50 percent for middle- and upper-income neighborhoods.

To be clear, the reduction in mortgage originations and home purchases for all groups relative to the pre-crisis period partly reflects weakness in the effective demand for housing rather than the unavailability of mortgage credit. Unemployment, income loss, and income insecurity prevent many households from purchasing homes, and concerns about the future direction of the labor market, housing prices, and the economy more generally keep other potential buyers on the sidelines. In addition, the fall in home prices means that many current homeowners cannot rely as much as they could in the past on tapping their existing home equity to trade up to larger or better homes, while underwater homeowners may be financially unable to move from their current homes.

Although the decline in the number of willing and qualified potential homebuyers explains some of the contraction in mortgage lending of the past few years, I believe that tight credit nevertheless remains an important factor as well. The Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices indicates that lenders began tightening mortgage credit standards in 2007 and have not significantly eased standards since.⁷ Terms and standards have tightened most for borrowers with lower credit scores and with less money available for a down payment. For example, in April nearly 60 percent of lenders reported that they would be much less likely, relative to 2006, to originate a conforming home-purchase mortgage to a borrower with a 10 percent down payment and a credit score of 620 – a traditional marker for those with weaker credit histories.⁸ As a result, the share of home-purchase borrowers with credit scores below 620 has fallen from about 17 percent of borrowers at the end of 2006 to about 5 percent more recently.⁹ Lenders also appear to have pulled back on offering these borrowers loans insured by the Federal Housing Administration (FHA).

When lenders were asked why they have originated fewer mortgages, they cited a variety of concerns, starting with worries about the economy, the outlook for house prices, and their existing real estate loan exposures. They also mention increases in servicing costs and the risk of being required by government-sponsored enterprises (GSEs) to repurchase delinquent loans (so-called putback risk). Other concerns include the reduced availability of private mortgage insurance for conventional loans and some program-specific issues for FHA loans as reasons for tighter standards. Also, some evidence suggests that mortgage originations for new purchases may be constrained because of processing capacity, as high levels of refinancing have drawn on the same personnel who would otherwise be available for handling loans for purchase. Importantly, however, restrictive mortgage lending conditions do not seem to be linked to any insufficiency of bank capital or to a general unwillingness to lend.

Certainly, some tightening of credit standards was an appropriate response to the lax lending conditions that prevailed in the years leading up to the peak in house prices. Mortgage loans that were poorly underwritten or inappropriate for the borrower's circumstances ultimately had devastating consequences for many families and communities,

⁷ The Senior Loan Officer Opinion Survey on Bank Lending Practices is available on the Board's website at www.federalreserve.gov/boarddocs/SnLoanSurvey/default.htm.

⁸ A conforming mortgage is one that is eligible for purchase or credit guarantee by Fannie Mae or Freddie Mac.

⁹ These data are staff calculations based on the Federal Reserve Bank of New York Consumer Credit Panel. The 10th percentile of credit scores on mortgage originations rose from 585 in 2006 to 635 at the end of 2011.

as well as for the financial institutions themselves and the broader economy. However, it seems likely at this point that the pendulum has swung too far the other way, and that overly tight lending standards may now be preventing creditworthy borrowers from buying homes, thereby slowing the revival in housing and impeding the economic recovery.

Policy responses

The factors contributing to reduced mortgage lending and lower rates of homeownership are varied and complex; no simple solutions exist that can, on their own, restore the housing market to health. Since the extent of the crisis became apparent, a range of initiatives has been undertaken. For example, a number of public and private efforts have been made to help avoid unnecessary foreclosures and to enable underwater and other borrowers to refinance at lower interest rates. Alternatives to foreclosure, including short sales and deed-in-lieu arrangements, have become more common. The recent settlement with a group of large servicers includes provisions to improve the process for working with delinquent borrowers and to compensate foreclosed-upon homeowners who were unfairly treated in the past.

As I have noted, vacant foreclosed homes lose value and create problems for neighborhoods. The overhang of empty homes also slows the recovery of the housing market by keeping prices low and limiting the need for new construction. To explore ways to address the number of foreclosed homes standing empty, the Federal Housing Finance Agency, which supervises the GSEs, undertook a pilot initiative that made it easier for qualified investors to purchase pools of foreclosed properties from Fannie Mae; the acquired properties would then be rented for a specified number of years. For our part, the Federal Reserve is encouraging the institutions we supervise to manage their inventories of foreclosed homes in ways that do not exacerbate problems in local neighborhoods, including renting them out, where appropriate, rather than leaving the properties vacant.¹⁰

Policymakers have also taken steps to remove barriers to the flow of mortgage credit. The Federal Housing Finance Agency recently announced new rules that will provide mortgage lenders greater clarity about the conditions under which they will be required to buy back defaulted mortgages from Fannie Mae and Freddie Mac or otherwise address origination problems. This greater clarity may result in reduced concern about putback risk, which in turn should increase the willingness of lenders to make new loans. In its rulemakings and supervision, the Federal Reserve, along with other bank supervisors, has worked with lenders to try to achieve an appropriate balance between reasonable prudence and ensuring that qualified borrowers are not denied access to credit.

Although regulatory policy will be important for restoring a fully functioning housing and mortgage market, the strength of the overall economic recovery is crucial as well. Obviously, loss of employment or income makes it more difficult for families to pay their mortgages, maintain good credit histories, refinance their mortgages at lower rates, and avoid foreclosure. People who are worried about their jobs are understandably more reluctant to purchase homes, and households who have suffered hits to their incomes face difficulty qualifying for a mortgage and saving for a down payment. Concerns about the financial strength of households and about the economic recovery also make lenders more cautious.

At the Federal Reserve, we have sought to support the economic recovery and maintain price stability – the two goals given to us by the Congress – by keeping both short-term and longer-term interest rates historically low. Low interest rates reduce the cost to households of buying homes, cars, and other consumer durables while increasing the

¹⁰ See Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation (2012), "Policy Statement on Rental of Residential Other Real Estate Owned (OREO) Properties", Supervision and Regulation Letter SR 12-5 (April 5), www.federalreserve.gov/bankinforeg/srletters/sr1205.htm.

attractiveness of new capital investments by firms. Increased demand in turn leads to faster economic growth and more jobs. My colleagues and I have been and remain quite concerned about the stubbornly high level of unemployment – particularly long-term unemployment. We have taken strong actions throughout the financial crisis and recovery to help stabilize the economy. In September, we took the added step of stating that we will continue actions to put downward pressure on longer-term interest rates until the outlook for the job market improves substantially in a context of price stability. Our hope is that our statement provides individuals, families, businesses, and financial markets greater confidence about the Federal Reserve's commitment to promoting a sustainable recovery with price stability and that, as a result, they will become more willing to invest, hire and spend. In addition, of course, the historically low mortgage rates that have resulted from the Federal Reserve's policies are directly supporting the housing market by putting homeownership within the reach of more people.

While the economic recovery and regulatory policy affect access to credit for all households, some potential borrowers may face the added burden of discrimination. In our role as a banking regulator, the Federal Reserve strives to ensure that the banks we supervise obey laws that prohibit illegal discrimination in lending. I am reminded here that fair treatment in housing was a significant focus of Dr King's, and the Fair Housing Act of 1968 – still one of the nation's cornerstone laws to prohibit discrimination – was passed only a week after his assassination and stands among his legacies.

Two types of discrimination continue to have particular significance to mortgage markets: One is redlining, in which mortgage lenders discriminate against minority neighborhoods, and the other is pricing discrimination, in which lenders charge minorities higher loan prices than they would to comparable nonminority borrowers. The Federal Reserve has been vigilant in identifying and stopping such abuses, and we remain committed to vigorous enforcement of the nation's fair lending laws. We currently co-chair, with the Department of Justice, an interagency task force to promote robust fair lending supervision and enforcement.

Government policies, both microeconomic and macroeconomic, have an important role to play in restoring the health of the housing sector. However, government can only be part of the solution; in the remainder of my remarks I will discuss what others can do, including potential homeowners themselves.

Financial preparedness and homeownership

One lesson of the past few years is that the desire to own a home is not enough. Although many foreclosures resulted from job loss or other economic hardships, others occurred because people bought more of a house than they could afford, took out a loan that was not appropriate to their circumstances, or did not manage their resources well. Future homeownership must be built on a more solid foundation. And while much of the responsibility for building that foundation must lie with lenders and with regulators, consumers must do their part as well by acquiring the information and financial knowledge they need to make sound decisions. Operation HOPE has made this point frequently and forcefully.

Effective financial education – aimed at both youths and adults – can provide people with the knowledge they need. Some of the skills that prospective homeowners need are relatively basic – for example, knowing how to shop for the lowest interest rate and fees, understanding the difference between a fixed-rate and an adjustable-rate mortgage, and, very importantly, knowing how to find trustworthy information and advice. More generally, the decision to buy a home must be consistent with a family's longer-term objectives, needs, and resources. Good financial planning – including effective budgeting, adequate saving, and sensible investing – can help families maintain homeownership while also pursuing other important objectives, such as preparing for retirement or financial emergencies. And

financially informed households will have a better chance to build wealth, reducing – in the case of minority households – the large wealth gap that exists between minorities and other groups.

At the Federal Reserve, we appreciate the benefits to families of acquiring basic information and skills about managing their money. But we see another important advantage of financial education, which is that an economy with financially knowledgeable households is likely to be stronger, more equal, and more stable. As such, we all gain from efforts to increase financial literacy.

Although basic knowledge about money management and decisionmaking is extremely useful, it is not practical, of course, for everyone to be a financial expert. Sometimes a professional can help, and people should not be afraid to seek advice at appropriate times. For example, an individual may be involved in buying a home – a complex and intimidating experience for many people – only once or twice in a lifetime. That's why advice from a housing counselor at the right point in the process can make all the difference. Nonprofit organizations can help prospective homeowners assess their readiness to purchase. And, by providing useful information about how to search for a home, apply for financing, handle home maintenance, and prevent delinquency, these nonprofits can help aspiring homebuyers find the right home and maintain their mortgage payments.¹¹ We have also seen that counseling can help consumers who are facing delinquency or default. Borrowers in trouble who receive foreclosure counseling are relatively more likely to subsequently become current on their mortgage, receive a loan modification, and, ultimately, keep their home.¹²

Financial preparedness is important not only for prospective homebuyers. It ought to be a lifelong undertaking, starting with children and teenagers. Organizations around the country – including Operation HOPE – help people across a range of ages develop their skills. Despite, or perhaps because of, the broader economic challenges we face, it now seems to be a time of creativity and innovation in this field. We are seeing experimentation, knowledge sharing, public-private collaborations, “bottom up” community-driven approaches, and state- and local-government efforts to promote family financial security and opportunity.

More generally, community organizations like Operation HOPE have played an important role in helping low-income and minority communities weather the storm of the past few years. Besides promoting financial literacy and providing counseling (and sometimes credit) for homebuyers, community organizations have helped build small businesses through investment and technical assistance. Organizations such as NeighborWorks America (and as an aside, Federal Reserve Governor Sarah Bloom Raskin currently chairs its board) have been leaders in fighting the blight in neighborhoods with high rates of foreclosure. Unfortunately, just as families have been hurt by the financial crisis and recession, so have many community-based organizations. These groups face the daunting task of finding new sources of capital and investment in a constrained financial environment. Some organizations have begun to retool their operations and develop new markets, products, and strategies to better serve the financial needs of consumers and communities. Among other goals, they are developing strategies to foster responsible homeownership, which they see as an important building block for stronger communities.

To return to where I began, after a long and difficult period, we are seeing welcome signs of improvement in the housing market. An improving housing market will in turn aid the economic recovery while strengthening neighborhoods and increasing the financial well-

¹¹ See U.S. Department of Housing and Urban Development (2012), *Pre-Purchase Counseling Outcome Study: Research Brief Housing Counseling Outcome Evaluation* (Washington: HUD), www.huduser.org/portal/publications/hsgfin/pre_purchase_counseling.html.

¹² See J. Michael Collins and Maximilian D. Schmeiser (forthcoming), “The Effects of Foreclosure Counseling for Distressed Homeowners”, *Journal of Policy Analysis and Management*.

being of families. Our recovery must be broadly felt to be complete, and families and communities that were already struggling before the crisis must be included in that recovery. As Dr King is widely quoted to have said, “We may have all come on different ships, but we’re in the same boat now.”

The Federal Reserve will continue to do what we can to support the housing recovery, both through our monetary policy and our regulatory and supervisory actions. But, as I have discussed, not all of the responsibility lies with the government; households, the financial services industry, and those in the nonprofit sector must play their part as well. In that spirit, I would like to close by expressing my appreciation and admiration for the work that so many of you are doing to restore our neighborhoods and to help individuals and families regain a solid financial footing.

Thank you.