Mortgages, Ed Pinto, And A Vast Conspiracy Of Silence

By: David Fiderer – February 13, 2013

There are plenty of crackpots like Ed Pinto, though few have attained his platform and level of respect. Like many of his cohorts, Pinto scavenges the public record from some kind of factoid, which is then presented out of context as "proof" of an otherwise indefensible theory.
This type of cherry picking pervades his "study" about, "50 years of failure at the FHA." Over the past few months, his findings have been touted CNBC, on Fox Business News and Bloomberg Radio. The American Enterprise Institute scholar has been afforded platforms in The Los Angeles Times, American Banker, The Atlantic, and The New York Times.

How did Pinto unearth this half century of "failure," given that the Federal Housing Administration belongs to a very elite group of mortgage lenders, those that received zero bailout funds during the financial crisis and remain standing today? Though FHA has been self-supporting since its founding 78 years ago, Pinto simply refuses to discuss that part FHA's financial track record.

He found a singular metric illustrated by his truly extraordinary hockey stick chart, one that transports us through 39 years of time travel in the blink of an eye. The two unbroken lines show dramatic inflection points, when "leverage" and "foreclosures" shoot up in straight lines, and when the date suddenly shifts from 1967 to 2006.

Pinto's key factoid is that FHA's foreclosure rate in 2006 is 13 times higher than it was in 1954. He attributes this spike in foreclosures to one singular cause, the spike in FHA borrower "leverage," which involves other calculations unique to Pinto. He writes, "From 1954 to 2006 FHA's compound leverage (the combined effect of lower down payment, a longer loan tern and higher debt-to-income ratios) increased 16-fold while its incidence of foreclosure also exploded, increasing 13-fold."

Nothing else penetrates into Pinto's little artificial world. Why should he consider any other changes that happened between 1967 and 2006? Why consider the dismantling of the Bretton Woods regime, the deregulation of interest rates, the legalization of adjustable-rate mortgages, the invention of securitization, the elimination of the consumer interest deduction, the demographic wave of baby boomers establishing new households, deregulation of savings & loans, the savings & loan crisis, the invention of financial derivatives, the lowering of tax rates, or the 21st century real estate bubble? Why ask if leverage increased anywhere else in the American economy? What do those things have to do with FHA's foreclosure rate, which is 13 times higher in 2006 than in it was in 1954?

When other commentators suggested ever so gently that Pinto's numbers may have been taken out of context, Pinto defiantly asserted that the current foreclosure rate, a 20-fold spike from 1954, proved his point about "putting working class families at risk."

Contrary to his professed interest in American enterprise, Pinto shows shows little curiosity about how the rest of the mortgage market performs. But   in the real world , that type of information is used by executive who make decisions involving millions of dollars every day. Check out any industry, you find that players are ranked by their relative performance. You see it in the major league tables and in the Neilson ratings. Oil companies are ranked to the per-barrel finding costs, retailers by sales per square foot, and hotels by RevPar . In the mortgage industry, a common metric for comparison is the serious delinquency rate (90+ days delinquent or in foreclosure).

And if you look at FHA in the context of the real world, Pinto's dramatic spike suddenly disappears. In fact, FHA's relative rise in delinquencies is much less pronounced than that of any other sector.

This chart is substantially similar to those presented by the Mortgage Bankers Association as part of its quarterly National Delinquency Survey.

But charts like this one have been banished from the American Enterprise Institute, the Cato Institute, the Heritage Foundation, the Mercatus Center, and the Heartland Foundation, so that Pinto can remain protected inside the cone of silence. Go ahead, look through any and all of the research and publications put out by the mortgage experts from these think tanks. You won't find any type of analysis comparing loan performance of these sectors over time.

In the business world, executives engage in another practice disavowed by Pinto and his friends. Managers continually review before-and-after analyses, comparing annual budgets with yearo-end results. Professionals make estimates and projections, which are tested over time. Not so inside of Pinto's cone of silence, where no one would be so unkind as to compare his earlier estimates with actual results.

Pinto's Orgy of Junk Mortgage Development Creates $1.6 Trillion "Default-Prone Loans"

Pinto, a former Fannie Mae executive who left the firm in 1989, emerged out of obscurity and became famous when he testified before Congress on December 9, 2008, and declared:

There are now approximately 25 million subprime and Alt-A loans outstanding [44% of the US total of 55 million], with an unpaid principal of about $4.5 trillion.

While Fannie Mae and Freddie Mac may deny it, there can be no doubt that they now own or guarantee $1.6 trillion in subprime, Alt-A, and other default-prone loans and securities.

Say what you will about Pinto, he gives good soundbites, which is why The New York Times led with, "Fannie Mae and Freddie Mac engaged in 'an orgy of junk mortgage development' that turned the two mortgage-finance giants into vast repositories of subprime and similarly risky loans."

This news seemed shocking and alarming, since industry professionals had been relying on data from the Mortgage Bankers Association and LPS , which both showed the the problems were concentrated in a small niche segment of the total mortgage market. The MBA calculated that 12% of all mortgages were subprime, whereas LPS calculated that subprime, Alt-A land Option-ARM loans together represented something close to 15% of the national total. The revelation that 44% of all loans were of comparable risk, and that a third of all GSE loans were "default-prone," seemed truly ominous. Look at the chart above, and imagine that 44% of all mortgages performed comparably to the "self designated" subprime segment.

People who followed Fannie and Freddie were shocked by the disconnect between Pinto's claims and GSE loan performance to date. In 2007, Fannie and Freddie's credit losses on their mortgages book totaled 5 basis points and 3 basis points, respectively. Over the prior 35 years, from 1971 through 2006, Fannie's average annual rate of credit losses was about 4 basis points. [See chart below.] What were the GSEs hiding?

Time passed. Since "there can be no doubt" that Fannie and Freddie held $1.6 trillion "default-prone loans," during the worst housing crash in 75 years, you would think that most of that $1.6 trillion had defaulted by now. After all , subsequent to Pinto's 6/30/08 reference date, home prices fell by another 20% in key markets such as Phoenix, Seattle, Miami, Portland, Atlanta, and Las Vegas (per Case Shiller),

But things didn't turn out that way. Pinto's "default-prone" designation was off by a factor of six. He was like Dick Morris on steroids. The vast disparity between the GSEs' superior loan performance and the rest of the market simply increased over time, as shown in the charts above. The chasm between Pinto's predictions and actual results, spoke for itself. So no one else would speak of it.

A Vast Right Wing Conspiracy Of Silence

It looks like Pinto's friends and allies entered into a secret pact, a vast conspiracy of silence, an agreement to never ever to compare GSE loan performance with that of the rest of the market, and to never ever compare Pinto's estimates with actual results, and hope that everyone else would ignore the elephant in the room.

Peter Wallison, also of the American Enterprise Institute, demonstrated a heroic level of loyalty to his colleague. As a member of the Financial Crisis inquiry Commission, Wallison eagerly touted Pinto's research and personally disseminated his reports to other FCIC commissioners . But when staffers tried to compare actual loan performance to Pinto's predictions, Wallison became furious and indignant . Staffers diligently kept reviewing Pinto's work and met with him repeatedly. But they could never square the circle, as explained in an FCIC memo , which was discussed in the final FCIC Report .

But Wallison disavowed any intrusion by the FCIC into Pinto's cone of silence. In his scathing dissent, Wallison proclaimed that the FCIC review never happened, and slammed the other commissioners and staffers for being so cavalier as to ignore Pinto's work. He wrote:

Any objective investigation of the causes of the financial crisis would have looked carefully at this research, exposed it to the members of the Commission, taken Pinto's testimony, and tested the accuracy of Pinto's research. But the Commission took none of these steps. Pinto's research was never made available to the other members of the FCIC, or even to the commissioners who were members of the subcommittee charged with considering the role of housing policy in the financial crisis.

Accordingly, the Commission majority's report ignores hypotheses about the causes of the financial crisis that any objective investigation would have considered, while focusing solely on theories that have political currency but far less plausibility.

Given that Wallison had himself disseminated Pinto's research to the other commissioners, he was exposed to ridicule and possible indictment. But he stood by his friend.

And then another think tank, the Center for American Progress, published another, similar take-down of Pinto's subprime designations.

Which meant that the cone of silence kept expanding and expanding. The number of verboten topics had increased, from:
(1) Any comparison of loan performance among the GSEs, FHA and the rest of the mortgage market, and
(2) Any comparison between Pinto's categorizations and actual loan performance,
to also include,
(3) Any mention of the FCIC critique of Pinto's work,
(4) Any mention of the CAP study,
(5) Any mention of Pinto's refusal to give a public response to the FCIC and CAP critiques, and
(5) Any mention of any article that might suggest that Wallison's dissent was dishonest.

Wallison tried to put an end to all that nasty talk once and for all. In "The Big Lie Defense," he explained that, "just before the financial crisis, the GSEs and other government agencies held or had guaranteed more than 20 million subprime and other low-quality loans-74 percent of the 28 million such loans then outstanding. It was the delinquencies and defaults among these loans, I argued, that caused the mortgage meltdown and the financial crisis." (Between 2008 and 2012, Pinto found another 3 million "high risk" loans.)

So there you have it. Pinto's friends and allies at conservative think tanks, academia and the media will continue to protect this "mortgage expert's" credibility by sidestepping any awkward questions about loan performance.

You can bet that they would never ask about the MBA chart below, which shows that the foreclosure rate for Prime ARMs is significantly worse than that for FHA loans, which, like GSE loans, are almost all fixed-rate.

Because if there's one thing Ed Pinto dislikes as much as FHA loans, it's fixed rate loans, because a, "New Bubble May Be Building in 30-Year Mortgages." "The 30-year fixed-rate mortgage," he says, "was responsible for two taxpayer bailouts in the last 20 years." That's certainly news to people who rely on data from the MBA. But neither Pinto, nor any of the other conservative think tanks, ever deem MBA data as worthy of recognition.

Dick Morris must feel jealous. His reputation would have remained in tact if no one ever compared final election results to his prediction of a Romney landslide. Pinto is lucky that way.

Below is Fannie and Freddie's loss data going back more than 40 years. Nationwide HPI numbers were also lifted from FHFA reports.