VALLEY NEWS

Housing regulators feel pressure to ease lending rules as recovery lags

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WASHINGTON — Three years ago, in the dark days of the housing crisis, regulators pressed for a controversial rule that aimed to crack down on shoddy and dishonest lending practices. Now they're rolling back their plans.

The original proposal called on lenders to hold a stake in the mortgages they sold to investors — specifically loans with less than a 20 percent down payment. The government insisted that such "risk retention" would encourage more prudent lending. No longer would banks be off the hook if they offloaded loans that later went bad.

But then came fierce pushback from an unusual alliance. Not only did the industry oppose the plan, but so did housing advocates. Both sides, which rarely agreed on anything up to that point, said the change would force lenders to boost interest rates and fees on many low-down-payment loans — and shut too many people out of the housing market.

This week, six agencies adopted a milder version of the proposal. The move highlights a dramatic shift in focus for the government now that a full housing recovery is taking longer than expected. The immediate source of angst for regulators is no longer what the industry did to gin up business back then, but rather what they're not doing now: lending to the broader population.

Regulators have acknowledged that a tough regulatory environment unintentionally steered lenders to serve only those borrowers with the best credit, and now they're trying to encourage lenders to ease up.

The agency that oversees Fannie Mae and Freddie Mac said this week that it may soon lower down-payment requirements from 5 percent to 3 percent for loans backed by the two firms. The Federal Housing Administration, a popular source of low-down-payment loans, might soon consider lowering the fees it charges borrowers on the loans it insures. The nation's top housing official, Housing and Urban Development Secretary Julian Castro, recently said that it's time to "remove the stigma" tied to promoting homeownership.

And now, banks that package loans into securities and sell them to investors will not have to retain a 5 percent stake in mortgages with less than 20 percent down, according to the plan unveiled this week. They need only hold a stake in loans belonging to borrowers with too much debt relative to their income.

Jim Parrott, a former housing adviser in the Obama White House, said the original plan was so onerous that it unleashed a backlash that continues to play out in housing policy decisions today. "It was that really aggressive early move that woke people up," Parrott said.

The practical and political realities caught up with regulators, said Mark Calabria, a former Republican staffer on the Senate Banking Committee who is now at the Cato Institute. With the financial crisis receding, nobody wants to be accused of sabotaging the American dream of homeownership — even after taxpayers sunk billions of dollars to keep Fannie and Freddie solvent at the height of the crisis.

"The American public has mixed feelings on housing," Calabria said. "They don't like bailouts, but they like cheap credit."

Before the Great Depression, home buyers were often required to put down 50 percent or more. But after the Depression and World War II, the government sought to stimulate the housing market by dramatically lowering down-payment requirements, allowing buyers to put down 5 percent or less on loans backed by some federal agencies.

The nation's home ownership rate jumped, from 43.6 percent in 1940 to 64 percent in 1980, where it stayed for many years. The norm for down payments settled at about 20 percent, but the low-down-payment loans continued to be available for borrowers who met relatively strict criteria.

That went by the wayside as home prices soared at the start of the past decade. Banks began offering a new breed of low-down-payment, or no-down-payment, loans to a far wider range of borrowers, including many who were credit risks. Those mortgages were often linked to other risky lending practices, which contributed to the foreclosure crisis.

It was in that environment that Congress directed regulators to craft rules that would require banks to retain some risk in the loans they sell. The Treasury Department oversaw the process. Some of the agencies involved include the Federal Reserve and the Securities and Exchange Commission, both of which voted in favor of the proposal Wednesday.

The mortgage-risk retention plan should take effect in a year. The plan does not apply to loans backed by Fannie Mae, Freddie Mac or the FHA, which make up a big portion of the market. It affects mortgages that are pooled together and sold to investors by the private sector without any government backing.