The Federal Reserve Board

Remarks by Governor Edward M. Gramlich

At the Home Ownership Summit of the Local Initiatives Support Corporation (LISC), Washington, D.C.
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Promoting and Sustaining Home Ownership

Thank you for the opportunity to participate in LISC's second summit on the housing industry. The point of these summits is to define emerging issues regarding housing and to discuss their impact on community renewal activities and strategies. This year the issues focus on home ownership, and I am pleased to give my views.

Home ownership has significant social and economic implications for all of us and ranks high on our list of personal and national priorities. As you well know, many for-profit, nonprofit, and government entities have committed their energies to increasing homeownership opportunities. Great progress has been made, with the rate of home ownership reaching new highs each year since 1995. It is important to examine the factors that have contributed to this success in order to understand how to sustain these gains, respond to changes in market forces, and identify new strategies to promote home ownership.

The Economic and Social Benefits of Home Ownership

As the title of your conference underscores, home ownership is often characterized as the "American Dream." Its achievement by households yields economic and social advantages for both individuals and communities. For a family, a home is generally its most significant asset and serves as its primary wealth-building vehicle. Survey results consistently indicate that buying a home ranks among the top motivations for saving. For communities, studies have shown that higher levels of home ownership improve the stability of neighborhoods, resulting in higher levels of civic activities and tax revenues and lower crime rates.

Much public and private investment is devoted to increasing opportunities for families to buy a home. A long list of government agencies are involved, ranging from the Department of Housing and Urban Development (HUD) and the Department of Agriculture's Rural Housing Services, to locally driven organizations like LISC and the various Neighborhood Housing Services (NHS) affiliates of the Neighborhood Reinvestment Corporation (NRC). These groups have created innovative funding programs and intensive financial counseling curricula to support homeownership objectives. In addition, secondary market institutions such as Fannie Mae and Freddie Mac have provided liquidity to mortgage lenders to facilitate expanded home ownership. Much has been accomplished through this work and the partnerships with community organizations and mortgage lenders and securitizers.

The Upward Trend of Homeownership Rates

Statistics released by the U.S. Census Bureau show increased rates of home ownership. As of the second quarter of 2001, nearly 68 percent of the population owned their homes, up from 65 percent in 1995. It is particularly encouraging that this growth was across racial categories, possible evidence of the success of initiatives designed to meet the needs of traditionally underserved markets. In particular, homeownership rates among black households increased from 43 percent to 48 percent over this period; among Hispanics, from 42 percent to 46 percent; and among lower-income households, from 47 percent to 50 percent.

Various factors have contributed to these favorable trends. Among the most important were the expansion of the economy, low interest rates, market and product innovation within the mortgage industry, and regulatory changes. These events have provided the backdrop for both public and private sector organizations to fulfill their mission of promoting home ownership.

Before this year, the economy was expanding smartly. Generally, with more job security and higher incomes, families seemed to be in better financial positions to purchase a home. Concurrently, the affordability of mortgages increased as lenders employed automated underwriting tools that allowed them to reduce the costs of processing applications while more effectively measuring credit risk. Further, the climate of low interest rates increased the affordability of mortgage loans, offering borrowers more financial leeway through lower monthly payments. Also, competition among lenders increased significantly as the set of mortgage originators expanded and opened up more credit options for consumers. With increased competition and a continuing agenda of supporting home ownership, the mortgage industry redefined underwriting guidelines to accommodate more borrowers, lowering down-payment requirements and expanding criteria for assessing creditworthiness. In addition, changes in the regulations that implement the Community Reinvestment Act further encouraged financial institutions to increase mortgage lending to lower-income families and neighborhoods, while enforcement of fair-lending laws underscored the importance of ensuring that credit policies were nondiscriminatory. All of these forces fueled mortgage lending and ignited activity in the subprime sector of the industry, which significantly increased access to credit for traditionally underserved groups, in particular, borrowers with lower incomes and blemished credit histories.

Yesterday's Loans in Today's Economy

With all of these positive developments, we are now concerned with the ability of marginal borrowers to meet their mortgage obligations in today's less ebullient economy. The sharp decline in equity values reduced the net worth of many households. In addition, unemployment rates have increased by 1.5 percentage points from this time last year, and consumer debt service burdens have shown a steady rise over the past three years, from about 13 percent in the second quarter of 1998 to 14 percent at the same time in 2001. During the second quarter of this year, data reported by the Mortgage Bankers Association indicated an increase of 1/4 percentage point in the number of delinquent mortgage loans and a slight rise in credits on which foreclosure had begun. In addition, HUD data note an increase in the rate of delinquencies for FHA-insured housing loans from just under 6.5 percent in 1998 to nearly 11 percent in the second quarter of 2001. Meanwhile, the Mortgage Information Corporation reports that 6.6 percent of subprime mortgages were seriously delinquent in June, up a percentage point from the end of last year. While the full economic implications of the 2001 slowdown and tragic events of September 11 are not yet known, these debt statistics may increase further as households struggle to meet their obligations in the face of significant layoffs. With these data, we might focus more attention, at least temporarily, on sustaining gains rather than on developing incentives to create new homeowners.

But not all housing statistics are bleak. Underlying housing values have remained relatively strong even as other economic measurements have softened. Moreover, home equity levels for lower-income families and black homeowners are still rising according to the most recent data. Such indicators represent encouragement for organizations like yours to keep up the fight.

Understanding New Opportunities and Meeting New Challenges

One of my *ex officio* duties at the Federal Reserve is to serve on the board of the NRC. There I have personally observed that a prominent characteristic of affordable-housing developers is their creativity, a trait that has contributed greatly to the record levels of home ownership for lower-income and minority households. Through the creation of strategic partnerships with financial institutions, government agencies, and secondary market institutions, community-based organizations have created eligible borrowers through homeownership and credit counseling, generated innovative new financing structures to leverage funding, and devised programs to prevent delinquencies and foreclosures. With these fundamental elements in place, the affordable-housing field is well positioned to deal with the challenges presented by the new economic environment.

Education is a very important theme. Affordable-housing groups have recognized the value of training in assisting families in their quest for home ownership, and they have also seen its importance in helping families keep their homes. A recent study released by Freddie Mac confirms the effectiveness of counseling, finding a reduction in delinquency rates of as much as 34 percent among borrowers who participated in homeownership training. Post-purchase counseling is an integral component of loss-mitigation programs designed to help families work out budgets that will help them meet their mortgage obligations and other housing expenses. These programs also help borrowers understand options and resources available to them in the event that they fall behind in their payments because of financial emergencies. For example, borrowers can and do work with creditors to explore options to make the debt more manageable. Since it is generally desirable for both borrowers and lenders to prevent foreclosures, various strategies may be used to mitigate losses, including restructuring the terms of the loan. Borrowers who approach their lenders when they know they are unable to meet their payments have a better chance of averting foreclosure. In fact, a review of HUD data suggests that about 50 percent of loans classified as 90-days delinquent are worked out before foreclosure is initiated. Post-purchase counseling can also assist borrowers in understanding and exercising these and other loan workout options.

Often training is required before a borrower can take advantage of special loan programs or other financial assistance designed to prevent foreclosure. For example, participation in extensive counseling is mandatory to qualify for credit under the Home Equity Loss Prevention Initiative, a special lending program developed by Freddie Mac and NRC. This $20 million loan program was devised to make funding available to homeowners who have high levels of consumer debt, are in need of home improvement financing, or have other financial circumstances that may make them vulnerable to the pressures of unscrupulous lenders. Incorporating education into such programs helps to improve the functioning of credit markets by creating more-astute borrowers.

Just as homeownership counseling has value, so also do financial literacy efforts have broader benefits. Educating individuals about the fundamentals of budgeting and saving serves as the foundation for building wealth. To that end, compelling evidence that financial education matters was revealed in a recent article in the *Journal of Public Economics,* which found that high-school students who received instruction on financial decisionmaking--including budgeting, credit management, and saving and investing--had significantly higher levels of wealth in adulthood than others. With a working understanding of and a comfort with financial matters also comes the ability to consume banking services more knowledgeably--from checking and savings accounts to car loans and mortgages. A familiarity with basic terms enables individuals to shop for the right product at the best price and possibly to save money, results that are especially important for lower-income households. Further, knowledge of how to find financial information can help consumers to make their way through the wide variety of available financial instruments and the ever-increasing range of providers and to choose products that best suit their needs.

Increasing financial literacy can also foster an appreciation for the need to save, which serves as the basis for wealth accumulation and for preparedness for financial uncertainties and retirement. Saving provides some measure of financial security in case of a lost job or unexpected necessary expenditures, such as for uninsured medical treatment. Saving is important in sustaining home ownership among lower-income families. Although most financial advisers suggest that households should have accumulated savings equal to six to nine months of income to handle financial crises, the typical low-income household has financial assets equal to only about two months of income. Further, about one-third of low-income households report having no financial assets at all. These families are living from paycheck to paycheck with no financial cushion of their own for rough times, a situation that puts their continued home ownership in jeopardy.

The Federal Reserve System is among the many organizations working to promote saving as a part of financial literacy training. Through our Washington office and the twelve Reserve Banks, we sponsor and participate in various financial education initiatives, including launching interactive web sites to help users create their own budgets and participating in local public-private partnerships, such as the Consumer Federation of America's "Cleveland Saves" initiative, to promote savings.

Strategies for the Future

There is a valid debate as to whether continuing to increase overall homeownership rates much further is feasible or even desirable. But surely pockets of the housing market exist in which such efforts can still pay off. For example, affordable-housing proponents are looking to tap into the burgeoning immigrant markets by tailoring counseling and outreach programs that bridge language and cultural gaps. Because they are locally run, these programs respond to clients' educational needs with regard to household budgeting, credit management, and the mortgage process. The basics of these training curricula, which have helped thousands of first-time homebuyers understand and prepare for purchasing a house, can be applied to foreign-born consumers also seeking the benefits of owning a home. In addition, the relationships that these programs foster among participants and trainers generate valuable insight into lifestyle differences in relation to financial management. This information can assist underwriters in identifying new ways to measure creditworthiness. To illustrate, because immigrants often have no experience with our credit system, assessing a credit history may require using payment performance on other obligations.

Funding is always a scarce resource, and affordable-housing lenders are accustomed to identifying new sources for financing additional mortgage loans. For example, local housing groups, in partnership with local housing authorities, are designing programs that allow renters to apply HUD's Section 8 vouchers toward home ownership. Two chapters of NHS have designed pilot programs that can serve as a model for other organizations seeking to access this source of funding to offer renters the opportunity to purchase a home. In addition, LISC's Center for Home Ownership is sponsoring a workshop series to share strategies among affordable-housing providers for using this federal funding source.

As I previously mentioned, affordable-housing organizations have already implemented post-purchase counseling as a strategy for mitigating delinquencies and foreclosures. Recently, this type of assistance and other intervention programs have been developed to help counter the devastating effects of predatory lending, the most damaging of which is foreclosure. One example of such a service is NHS's Chicago's Neighborhood Ownership Recovery Mortgage Assistance Loan, or NORMAL. This funding vehicle was developed to provide alternative financing to borrowers who are in danger of losing their homes as a result of credit deals with unscrupulous lenders. In partnership with as many as fifteen financial institutions, the NHS of Chicago is helping to preserve home ownership in its lower-income communities by combining actual affordable credit along with its counseling services. This program illustrates the creativity and responsiveness of affordable-housing groups in their efforts to avert financial tragedy for lower-income families in their communities. This type of assistance can also serve as a model for educating borrowers and providing resources to families suffering from the financial stress caused by less-favorable economic times.

These examples demonstrate the strength of the infrastructure of the affordable-housing field. This infrastructure, coupled with the industry's commitment to supporting continued high rates of ownership, greatly improves the future prospects for underserved households in becoming homeowners, even in an economic downturn. The presence of leaders such as you, determined to anticipate challenges and seek responsive strategies, promises great benefits. I look forward to learning of the innovative ideas that result from your meetings and seeing new ways of promoting and preserving affordable housing.