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MILLIONS TO THE MIDDLE *SERIES*

A HOME OWNERS' LOAN CORPORATION FOR THE 21ST CENTURY

HELPING AMERICANS BUILD ASSETS

Widely shared middle-class prosperity has made the United States the most hopeful and dynamic country on earth and is a foundation of strong democracy. Yet today, America's middle class is in trouble: the traditional routes into the middle class have become more difficult to travel and security has eroded for those already in the middle class. Major economic and policy changes over the past three decades have widened economic inequality and reduced mobility in ways that go far beyond the impact of the recent recession. Too many people who play by the rules and do everything right find that they cannot climb into the middle class—or stay there. To meet this challenge, Millions to the Middle offers dramatic public policy initiatives to rebuild and grow the nation's middle class.

POLICY IN FOCUS

A HOME OWNERS' LOAN CORPORATION FOR THE 21ST CENTURY

Establish a 21st Century Home Owner's Loan Corporation to directly acquire distressed mortgages from private lenders in exchange for government-issued bonds, address underwater mortgages by offering the difference between the amount outstanding on the mortgage and the value of the property as a credit to the homeowner, and be empowered to grant extensions and other types of forbearance to borrowers.

We aim to accomplish two broad interrelated goals: to ensure that all Americans have a chance to move into the middle class and, second, to ensure greater security for those in the middle class. The 14 policies we offer are rooted in mainstream American values and able to command strong public support over the long term. Together, they go beyond the confines of the current policy debates and are of sufficient scale to firmly establish a middle-class America.

Our policy agenda is based on the three broad pillars of middle-class opportunity and security: investments in human capital and education; support for growth, job creation, and career development; and helping Americans build assets. This policy is part of the **Helping Americans Build Assets.**

POLICY: A HOME OWNERS' LOAN CORPORATION FOR THE 21ST CENTURY

Establish a new public agency to acquire distressed mortgages from private lenders and directly refinance them under more affordable terms.

POLICY RATIONALE

Home ownership is commonly understood as the quintessential marker of having arrived in the middle class: a family's home is often the single largest asset that they own and has traditionally served as an important vehicle for wealth accumulation and economic security.

> **OPINION SNAPSHOT**
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> - Despite the housing crash, more than half of Americans still affirm that owning a home is a very important part of the American Dream. 89 percent say that it is at least a somewhat important part.[12]

Today, however, middle class neighborhoods are under assault from foreclosure. Approximately 29 percent of all families owe more on their home than the property itself it worth. If this trend continues, an estimated 14 million homes – 1 out of every 4 in the United States – will face foreclosure before the housing crisis is resolved.[1]

This large-scale upheaval will continue to devastate not only the families displaced from their homes but also the communities left behind in their wake – spikes in home vacancy lead not only to an increase in crime and social disorder[2] but also a decrease in nearby property values, eroding the tax base for local municipalities and threatening the solvency of the essential public services necessary for a middle class life.[3] In addition, the loss of housing wealth reduces consumer's ability to spend and retards the economic recovery.

Today more than ever, American households need the leg up they never received: the middle class cannot continue to survive, much less grow, so long as local communities continue to decay and household assets are allowed to deteriorate. An effective reform of U.S. housing policy must achieve two goals: allow families to refinance their mortgages under more affordable terms, and expand credit availability for those looking to purchase a home who cannot access a mortgage in today's excessively tight market.[4]

Unfortunately, the current political debate over housing policy has remained confined to a false choice between two unacceptable options: we must either let the market adjust itself, or offer voluntary incentives to encourage private lenders to modify distressed mortgages.[5] The first of these options is unacceptable for the sheer devastation to American families and communities that it entails; the second has already proven far too timid of a response to address the depth of the problem before us. What is missing from this debate is the case for a strong public entity to directly defend the middle class's access to homeownership by restructuring mortgage debt.

Such a public entity would have historic precedent. Consider the example of the last serious housing crisis in the United States: at the beginning of the Great Depression, a widespread economic contraction led to falling home prices, increasing numbers of underwater mortgages, and a rapid evaporation of household wealth.[6] The Hoover administration responded to this with a level of timidity that resembles our current predicament: rather than supporting homeowners with direct public intervention, the Federal Home Loan Bank Act was established in 1932 to provide extra capital to banks to stimulate the private lending industry.[7] With the limitations of a voluntary program, however, private lenders hesitated to act on their own initiative, and the program had an almost insignificant impact on the ailing housing market.

Once Franklin Roosevelt took office, more aggressive action was taken to assist struggling home owners through the creation of the Home Owners' Loan Corporation – a public entity empowered to directly re-finance distressed mortgages and offer low-interest, affordable mortgages to families that had already lost their homes. From 1933 to 1936, the HOLC refinanced or directly originated over 1 million mortgages in the United States, approximately 1 out of every 5 outstanding mortgages in the country at the time.[8]

The impact of this effort was enormous: the HOLC ensured that an entire generation of American homeowners did not slide into poverty while restoring their base of asset accumulation for the future. Moreover, by directly acquiring distressed mortgages from private lenders in exchange for government bonds, the HOLC provided a much stronger incentive for lenders to begin offering credit again to prospective homeowners, relative to the indirect incentives provided by the Hoover administration's Loan Bank.[9]

By restoring the direct relationship between debtor and lender that has been lost through the use of collateralized debt obligations and other complex financial instruments, a 21st-century HOLC would be able to interact closely with borrowers and provide for the refinancing of their mortgages on a cooperative, case-by-case basis.

It is important, however, to note that the original HOLC focused exclusively on borrowers with comparatively strong credit backgrounds – while it refinanced around 1 million mortgages in total, it denied almost a million more. The beneficiaries of the original HOLC were homeowners who were only facing foreclosure because of the widespread economic contraction of the Depression, and a 21st-century HOLC would target the same kind of homeowners. Those with weaker credit backgrounds who are homeowners primarily by virtue of the subprime lending spree will require not only refinancing but also a significant principal reduction, which is why we have also called for bankruptcy judges to be allowed to reduce the mortgage principal on a primary residence (see our "Fairness in Bankruptcy Act").

POLICY DESIGN

Our proposal for a modern-day Home Owners' Loan Corporation would closely resemble the "Home Owners' Loan Corporation for the 21st Century Act," introduced as H.R. 5649 in the 110th Congress. It is important to note that, while it is more common to hear progressive voices calling for the creation of a modern-day HOLC, it was Republican Congressman Mark Kirk of Illinois that sponsored H.R. 5649 back in 2008.[10]

- A 21st Century HOLC would directly acquire distressed mortgages from private lenders in exchange for government-issued bonds. H.R. 5649 mandates that the face value of the bonds issued in exchange for mortgages should be limited to 90 percent of the fair market value of the real estate involved.

- Similar to H.R. 5649, our version of a 21st Century HOLC would address underwater mortgages by offering the difference between the amount outstanding on the mortgage and the value of the real estate itself as a credit to the homeowner, reducing the amount the homeowner owes to the Corporation by that extent. It is important to note that the original HOLC did not offer this form of principal reduction, and instead restricted itself exclusively to refinancing; this limited scope is what allowed it to turn a small profit after several years. By offering principal reduction to underwater homeowners, our proposal for a 21st century HOLC would extend significant levels of subsidy (by some estimates, well over $350 billion)[11] in order to improve equity for American homeowners. While this would make our HOLC proposal no longer a profit-generating institution, widespread principal reduction is nevertheless essential to bringing a swift end to the steady deterioration of home values that are eroding the assets of middle class households.

- A modern-day HOLC would be empowered to grant extensions and other types of forbearance to borrowers, as needed to maintain residency in the home – this is particularly so for borrowers with subprime loans who were the victims of deception by their original lenders.

ENDNOTES

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