IX. Our Weak Foundation: An Overview of the American Housing Crisis

A. Introduction

In the discussion of America's current financial troubles and future prospects, "the housing crisis" has loomed large, becoming a catchall reference to the spark that lit the tinder. The phrase's rise to ubiquity, however, was not accompanied by concomitant clarity. Using historical statistics, this article aims to contextualize the housing crisis and illustrate the severity of the housing bubble's deflation. Furthermore, this article aggregates and compares the various conclusions of the Financial Crisis Inquiry Commission regarding when the crisis began, how the crisis came about, and who was most responsible in an effort to provide a comprehensive picture of the role "the housing crisis" played in driving America into the worst recession since the Great Depression.

B. Sifting Through the Wreckage: Housing Crisis by the Numbers

Statistics related to home ownership, home prices and housing starts between 2001 and 2011 all trace a similar, illuminating trajectory, reinforcing the boom-bust narrative of the housing bubble that inflated and popped over the course of the past decade. The U.S. Census Bureau calculates the United States homeownership rate by dividing the number of owner-occupied housing units by the total number of occupied housing units and provides data from as far back as 1968.[1] In the third quarter of 2001, the United States homeownership rate reached 68% for the first time.[2] By the second quarter of 2004, the homeownership rate climbed to an all-time high of 69.2%.[3] Most recently, in the second quarter of 2011, the

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[1] Press Release, U.S. Census Bureau, Residential Vacancies and Homeownership in the Second Quarter 2011, at 12 (July 29, 2011), http://www.census.gov/hhes/www/housing/hvs/qtr211/files/q211press.pdf.
[2] U.S. CENSUS BUREAU, TABLE 5: HOMEOWNERSHIP RATES FOR THE U.S. (July 2011), http://www.census.gov/hhes/www/housing/hvs/qtr211/files/tab5.xls.
[3] *Id.*

homeownership rate was calculated to be 65.9%, a low that has not been seen since 1998.[4]

As homeownership rates rose and fell, so too did housing prices. The Federal Housing Finance Agency ("FHFA"), formerly the Office of Federal Housing Enterprise Oversight, has published the housing price index ("HPI") since 1996.[5] The HPI measures the movement of single-family housing prices using information from repeat mortgage transactions on single-family houses where the mortgages have been purchased or securitized by Fannie Mae or Freddie Mac since January 1975.[6] The FHFA housing price index reached its peak in the second quarter of 2007 at $225,950.[7] Since hitting that peak, the purchase-only HPI has declined about 19.5% over 16 quarters and was $182,010 in the second quarter of 2011.[8]

Housing starts also followed the general heating and cooling of the housing market. According to the Census Bureau, construction began on 2,068,300 new, privately owned housing units housing structures during 2005, the highest number of housing starts reported in a year since the early seventies.[9] Of that number, 1,715,800 were single unit projects, the most reported since 1959.[10] Four years later, in 2009, only 554,000 housing starts were recorded and only 445,100 were single unit projects.[11] The numbers improved only marginally in 2010 when construction began on 586,900 housing units, 471,200 of which were single unit structures.[12]

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[4] *Id.*

[5] Charles Calhoun, *OFHEO House Price Indexes: HPI Technical Description*, OFFICE OF FED. HOUS. ENTERPRISE OVERSIGHT, 1 (March 1996), http://www.fhfa.gov/webfiles/896/hpi_tech.pdf.

[6] *About HPI,* FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=81 (last visited Oct. 26, 2011).

[7] FED. HOUSING FINANCE AGENCY, FHFA USA INDEXES (PURCHASE-ONLY AND ALL-TRANSACTIONS): USA, (Aug. 24, 2011), http://www.fhfa.gov/webfiles/22524/2q11POSummary.xls.

[8] *Id.*

[9] U.S. CENSUS BUREAU, NEW PRIVATELY OWNED HOUSING UNITS STARTED: ANNUAL DATA (2011), http://www.census.gov/const/www/newresconst index.html (under heading "History Tables" select "Annual Data" from drop-down menu next to "Housing Starts").

[10] *Id.*

[11] *Id.*

[12] *Id.*

1. A Leaning Tower of Credit

The rises in home ownership and home prices and the expansion of the American housing stock were fueled by a wide availability of credit and an increased willingness to take on debt. In six years, the mortgage debt of American households rose almost as much as it had over the entire course of the nation's 200-year history, from $5.3 trillion in 2001 to $10.5 trillion in 2007.[13] On a per household basis this translated into rise of nearly 40% from $91,500 in 2001 to $149,500 in 2007.[14] The total volume of home refinancing loans also skyrocketed during this period, rising more than 80% from $460 billion in 2000 to $2.8 trillion in 2003.[15] In 2006 alone, Americans refinanced their homes for a total of $334 billion—more than seven times the amount of 1996.[16] As homeowners extracted more and more equity from their homes through refinancing, consumer spending rates rose and the personal savings rate dropped.[17] Between 1998 and 2005, the personal savings rate dropped from 5.3% to 1.4%.[18] The homeowner mortgage financial obligations ratio (FOR) has been calculated by the Federal Reserve Board since 1980 and measures the percentage of an average homeowner's income he or she owes in mortgage, insurance and tax payments.[19] In 2006, the mortgage FOR crossed 11% for the first time and, in the third quarter of 2007 it reached an all-time of high of 11.3%.[20]

The availability of credit during this period also contributed to the significant growth of the nonprime mortgage market. Between

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[13] FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 7 & 466 n.25 (2011).
[14] *Id.*
[15] *Id.* at 5 & 466 n.10.
[16] *Id.* at 5 & 466 n.14.
[17] *Id.* at 87.
[18] *Id.*
[19] *Household Debt Service and Financial Obligations Ratios: About the Release,* THE FED. RESERVE BOARD, (Oct. 6, 2009), http://www.federalreserve.gov/releases/housedebt/about.htm; THE FED. RESERVE BOARD, HOUSEHOLD DEBT SERVICE AND FINANCIAL OBLIGATIONS RATIOS, (Sep. 20, 2011), http://www.federalreserve.gov/releases/housedebt/default.htm [hereinafter *FOR Data*].
[20] *FOR Data, supra* note 19.

2000 and 2003 the top 25 nonprime lenders increased mortgage origination volume from $105 billion to $310 billion.[21] As the housing bubble inflated, once rare nonprime mortgage products, such as subprime, Alt-A, I-O (interest-only), low-doc, no-doc and ninja (no income, no job, no assets) loans gained in popularity.[22] Between 2003 and 2005, the percentage of mortgage originations characterized as subprime rose from 8% to 20%.[23] Many of these products enabled borrowers who would previously have been considered ineligible the opportunity to buy houses in unattainable markets.[24] However, these products carried significant risks with hidden hazards for both individual borrowers and the economy at large. In an interview with the Financial Crisis Inquiry Committee, Michael Mayo, a managing director at Calyon Securities, compared the financial creativity of the early decade to "cheap sangria," saying: "It might taste good for a while, but then you get headaches later and you have no idea what's really inside."[25]

2. A Long Way Down

According to the National Association of Realtors, 2007 saw the sharpest decline in existing home sales in 25 years.[26] Between 2007 and the first quarter of 2009, $17 trillion worth of household net wealth—the difference between what households own and what they owe—had been lost.[27] Declining home prices were responsible for about $5.6 trillion dollars of that total loss.[28] In the early part of the decade, the percentage of mortgages in serious delinquency, defined as those 90 or more days past due or in foreclosure, averaged about 1%.[29] At the end of 2009, 9.7% of all mortgage loans were seriously delinquent[30] and 1.88 million of the 14.5 million nonprime loans issued from 2000 to 2007 had completed the foreclosure

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[21] FIN. CRISIS INQUIRY COMM'N, *supra* note 13, at 11 & 467 n.45.
[22] *Id.* at 6.
[23] *Id.* at 104 & 483 n.13.
[24] *See id.* at 109-11.
[25] *Id.* at 6 & 466 n.19.
[26] *Id.* at 215 & 505 n.7.
[27] *Id.* at 391.
[28] *Id.*
[29] *Id.* at 215 & 505 n.11.
[30] *Id.*

process.[31] Of the 4.59 million nonprime loans that remained active in 2009, 41.5% were in some state of delinquency, with 30% in a state of serious delinquency.[32]Although the initial shock of the housing bubble deflation has subsided, many homeowners are still treading water. As housing prices have continued to decline from their 2007 peak, an increasing number of mortgage holders have found themselves in negative equity. In the second quarter of 2011, CoreLogic, an economic research firm, reported that of the some 48 million properties with mortgages, 27.5%were in negative or near negative equity (less than 5% equity).[33] The report also revealed that nearly 75% of these "underwater" homeowners are paying above market interest rates on their mortgages.[34] In 2010, a record 2,871,891 U.S. properties received foreclosure filings, a 23%increase from 2008 levels.[35] Some reports estimate that, by the time the economy stabilizes, foreclosures may total more than 13 million.[36]

C. The Bubble Begat the Crisis: The Findings of the Financial Crisis Inquiry Commission

Over the course of American history, the economy has endured multiple speculative bubbles, but not every speculative bubble has driven the country into a financial crisis. The question then becomes, what was it about this particular housing bubble that drove the country into a financial crisis? Congress created the Financial Crisis Inquiry Commission ("FCIC") to explore this question and provide an answer.

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[31] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-805, NONPRIME MORTGAGES: ANALYSIS OF LOAN PERFORMANCE, FACTORS ASSOCIATED WITH DEFAULT, AND DATA SOURCES 10 (Aug. 2010).

[32] *Id.* at 11.

[33] *Q2 2011 Negative Equity Report*, CORELOGIC, (Sep. 13, 2011), http://www.corelogic.com/about-us/researchtrends/asset_upload_file831_12143.pdf.

[34] *Id.*

[35] *Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30 Month Low in December*, REALTY TRAC (Jan. 12, 2011), http://www.realtytrac.com/content/press-releases/record-29-million-us-properties-receive-foreclosure-filings-in-2010-despite-30-month-low-in-december-6309.

[36] FIN. CRISIS INQUIRY COMM'N, *supra* note 13, at 402 & 543 n.3.

1. History of the FCIC

The FCIC was created pursuant to section five of the Fraud Enforcement and Recovery Act, a bill signed by President Obama in May 2009.[37] The group—comprised of ten private citizens with "significant depth of experience in such fields as banking, regulation of markets, taxation, finance, economics, consumer protection and housing" appointed by Congressional leaders—was charged with "examin[ing] the causes, domestic and global, of the current financial and economic crisis in the United States."[38] Over the course of their inquiry, the FCIC and staff interviewed more than 700 witnesses, held nineteen days of hearings across the country and reviewed millions of pages of documents.[39] The final report issued in January 2011 contained three separate sets of conclusions about what had happened during the financial crisis and what factors had been instrumental in creating the crisis. Six of the ten members voted to adopt the official conclusions contained in what came to be known as the majority report. Three dissenting members, Keith Hennessey, Douglas Holtz-Eakin and Bill Thomas, collaborated on one dissent, while one remaining member, Peter Wallison, published his own dissent to the majority report.

2. The Majority Report

Over the course of more than 400 pages, the majority explores how, between 2001 and 2007, the housing sector became a foundational and influential segment of an increasingly inter-connected American economy. Simply, the majority finds "[i]t was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008."[40] The majority describes a chain of events that began when the Federal Reserve lowered interest rates, which in turn jumpstarted mortgage originations. As mortgage originations steadily increased, commercial banks, thrifts and investment banks, following the lead of government sponsored entities Fannie Mae and

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[37] FIN. CRISIS INQUIRY COMM'N, *supra* note 13 at xi.
[38] Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21 § 5, 123 Stat. 1617, 1625-28 (codified in 31 USC § 3729 Note).
[39] FIN. CRISIS INQUIRY COMM'N, *supra* note 13 at xi.
[40] *Id.* at xvi.

Freddie Mac, sought to securitize those loans. The secondary market's increased appetite for home loans led originators to expand their business and increase their volume of originated mortgages. In order to originate more mortgages, originating institutions relaxed previously conservative lending standards to provide loans to a wider, if less qualified, borrowing audience. Simultaneously, financial institutions created new financial instruments to pool debts and sell securities to investors. Notably, financial institutions increased production of collateralized debt obligations ("CDOs") to sell securities rated less than triple-A, which, although providing high returns to investors, carried more risk because the underlying loans were given to less creditworthy borrowers. Despite the risks, investors were attracted to the high returns, and the secondary market for nonprime loans expanded. Mortgage originators, both to keep up with the secondary market's demand for more loans and to increase their market share, began marketing a variety of unconventionally structured nonprime mortgages to appeal to the widest range of borrowers and to stand out from competitors in a crowded field. And while securitizing institutions believed that they were sufficiently transferring risk down the line, when delinquencies began, the risks proved to be more concentrated than anyone had predicted. [41]

The majority report is largely a chronicle of how the economy became increasingly interconnected and of its descent into a recession. That being said, the majority does come to some conclusions about what caused the financial crisis and outlines them at the beginning of its report. Rather than blaming individual players, the majority's conclusions identify systemic shortcomings that when working in conjunction allowed the housing market and related secondary market to go largely unchecked and become unmanageable. In the majority's opinion, the financial crisis was avoidable.[42] A powerful financial industry worked to strip away key regulatory safeguards while individual financial institutions cherry-picked the weakest regulatory agency.[43] Regulators failed in both their exercise of the authority they did have and in seeking the authority they lacked.[44] Major financial firms cultivated cultures of self-preservation that "rewarded the quick deal . . . without proper consideration of long-term consequences" and produced investment

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[41] *See generally id.* at i-24.
[42] FIN. CRISIS INQUIRY COMM'N, *supra* note 13, at xvii.
[43] *Id.* at xviii.
[44] *Id.*

strategies that became nearly impossible to manage.[45] The financial system lacked transparency, and both financial firms and individuals leveraged themselves "to the hilt."[46] As the economy weakened, the government showed itself to be "ill prepared for the crisis and its inconsistent response added to uncertainty and panic in the financial markets."[47] The mortgage securitization machine, fueled by both domestic and international demand for securities, led to irresponsible, predatory and fraudulent lending practices.[48] The majority also notes that without the sycophantic relationship between financial firms and the unregulated ratings agencies, the soaring mortgage backed securities market might never have been possible.[49] These conclusions are undeniably sweeping but together they reinforce the majority's conclusion that "[c]ollectively, but certainly not unanimously, we acquiesced to or embraced a system, a set of policies and actions that gave rise to our present predicament."[50]

3. The Dissent of Hennessey, Holtz-Eakin and Thomas

In their dissent, Hennessey, Holtz-Eakin and Thomas take issue with the sweeping nature of the majority's conclusions. In their opinion, the majority delivered "an account of bad events" and failed to explain what had happened and why, noting that "[w]hen everything is important, nothing is."[51]As an alternative to the majority, they offer a list of the ten essential causes of the financial and economic crisis. They cite the global credit bubble; the US housing bubble; the origination of high-risk, nontraditional mortgages; failures in credit ratings and the securitization process; the concentrated, correlated risk carried by financial institutions; the failure of financial firms to maintain appropriate day-to-day liquidity; the risk of contagion inherent in the interconnected nature of financial institutions; the common shock shared by financial institutions due to failed bets on housing; the financial shock and panic in 2008; and the contraction on the real economy due to the

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[45] *Id.* at xix.
[46] *Id.*
[47] *Id.* at xxi.
[48] *Id.* at xxiii-iv.
[49] *Id.* at xxv.
[50] *Id.* at xxiii.
[51] *Id.* at 414.

financial shock and panic.[52] Hennessey, Holtz-Eakin and Thomas do not necessarily disagree with the majority's range of findings. Rather, they disagree with the idea that the causes of the crisis cannot be narrowed for the purposes of understanding what happened and developing a strategy to prevent another crisis going forward.

4. The Dissent of Peter Wallison

In his dissent, Peter Wallison goes even further than Hennessey, Holtz-Eakin and Thomas and argues that the housing policy of the United States government was the "*sine qua non*" of the financial crisis.[53] Wallison contends that had the United States not pursued a policy of increasing homeownership, the financial crisis would not have occurred.[54] According to Wallison, over the course of nearly fifteen years, the U.S. government sought to increase homeownership rates by eroding mortgage underwriting standards.[55] Banks and government-sponsored entities were effectively forced by government policy to compete for mortgage borrowers at or below their area's median income.[56] This race eroded underwriting standards and increased the number of high-risk loans beyond what the market would have otherwise produced.[57] According to Wallison, this meant that when the housing bubble began to deflate, the high number of delinquencies came as a surprise and led investors to flee the mortgage backed securities market en masse, dealing a blow to financial institutions now forced to write-down losses.[58] The situation was exacerbated by the government's disharmonious handling of Bear Stearns and Lehman Brothers which led to uncertainty in financial markets and resulted in a "virtually unprecedented period of market paralysis."[59] Rather than accepting the interplay of inter-connected forces and actors, Wallison believes that had the government not pursued such aggressive homeownership goals, the financial crisis would have never occurred.[60]

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[52] *Id.* at 417-19.
[53] *Id.* at 444.
[54] *Id.*
[55] *Id.*
[56] *Id.* at 445.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.* at 444.

D. Conclusion

Despite years of government efforts to aid ailing homeowners, troubles in the housing sector have endured. Most recently, the FHFA overhauled the Home Affordable Refinance Program ("HARP") and adopted new rules to allow severely underwater homeowners the opportunity to refinance their home at today's lower rates, freeing up cash for borrowers to spend elsewhere.[61] Opinions on the efficacy of governmental efforts such as this one vary. Critics contend that government intervention artificially delays the market's natural, albeit painful, recovery.[62] Proponents argue that governmental initiatives like HARP are the only means of curing the economic paralysis brought upon by oppressive housing costs.[63] Regardless of which perspective eventually prevails, it is clear our nation's financial health is inextricably linked to the health of the housing sector. As counterintuitive as it may seem, the housing sector that led us into our current slump must also be part of our ascendance from the mire.

Joe Piscina[64]

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[61] Jackie Calmes, *Jobs Plan Stalled, Obama to Try New Economic Drive*, N.Y. TIMES, Oct. 23, 2011http://www.nytimes.com/2011/10/24/us/politics/jobs-plan-stalled-obama-to-try-new-economic-drive.html?ref=politics; Zachary Goldfarb & Scott Wilson, *Government Announces New Program to Help 'Underwater' Homeowners*, WASH.POST, Oct. 24, 2011, http://www.washingtonpost.com/business/economy/fhfa-announces-new-program-to-help-underwater-homeowners/2011/10/24/gIQAG1oUCM_ story.html.

[62] Steven Greenhut, *Honesty, Not More Subsidies*, N.Y. TIMES, Oct. 25, 2011, http://www.nytimes.com/roomfordebate/2011/10/25/obama-the-homeowners-helper-or-enable/voters-crave-honesty-not-more-subsidies.

[63] David Abromowitz, *Good Policy and Politics*,N.Y. TIMES, Oct. 25, 2011, http://www.nytimes.com/roomfordebate/2011/10/25/obama-the-homeowners-helper-or-enable/good-policy-and-politics-for-homeowners.

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