

NOTE

THE MORTGAGE CRISIS IN HISTORIC PERSPECTIVE: IS THERE HOPE?

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INTRODUCTION

The strength of the American economy has deep roots in our country's history of widespread property ownership. Economic and legal scholars have written convincingly that key legislative decisions about how to distribute property as the United States expanded westward provided the fertile soil in which the booming economy of the twentieth century came to bear fruit.¹ Our country now faces a massive crisis in which the property ownership of millions of Americans is under threat.

While the main focus of recent legislation and presidential programs has been to get the economy off its back and running again in the short term, there have also been a number of specific efforts aimed at protecting current homeownership and fostering future ownership. It is informative to consider

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1. See generally HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000).

the potential long-term impact of the housing programs on the economy.

This Note will first explain how universal property ownership has bolstered the economy and how key legislation, particularly the Homestead Act of 1862, helped to achieve that end. Second, this Note will briefly describe the housing crisis of 2008 as a necessary precursor to exploring the legislation designed to stop the wave of foreclosures. Third, this Note will examine the housing legislation of the past year for its potential to further similar positive ownership and economic results. In particular, the Housing and Economic Recovery Act of 2008 (HERA),² passed under President Bush, and the Making Home Affordable Program (MHA) under President Obama will be described and analyzed. The Note will suggest that some important provisions have been made; however, none of the legislation appears to be having an impact as large as intended or needed. During the analysis of each piece of legislation, this Note will suggest some amendments that could help ensure that our efforts now will translate into economic strength in the future.

DEMOCRATIZING LAND OWNERSHIP

Even before the United States gained its independence, the debate had begun over what to do with public land and how to handle the expansion from the thirteen colonies into the West. Thomas Jefferson was an ardent advocate of using broad land ownership as a tool for ensuring his vision of an agrarian republic.³ Regarding the proposed constitution, he wrote to Madison:

I think our governments will remain virtuous for many centuries; as long as they are chiefly agricultural; and this will be as long as there shall be vacant lands in any part of America. When they get piled upon one another in large cities, as in Europe, they will become corrupt as in Europe.⁴

On the opposite side of Jefferson's agrarian ideal was Alexander Hamilton's more industrial conception of what the economy and society should look like.⁵ He envisioned distribution of public lands as a way to solidify the financial condition of the country and encourage domestic manufacturing.⁶ This policy perspective had two implications. First, it stressed the need to sell larger blocks of open land to large investors or stock companies who could afford to build roads, mills and factories and thus industrialize the new land.⁷ Second, the

2. Pub. L. No. 110-89, 122 Stat. 2654 (to be codified in scattered sections of U.S.C.).

3. See THOMAS JEFFERSON, *A SUMMARY VIEW OF THE RIGHTS OF BRITISH AMERICA* (1774), reprinted in 1 *THE FOUNDERS' CONSTITUTION*, at 435 (Philip B. Kurland & Ralph Lerner eds., University of Chicago Press 1987), available at <http://press-pubs.uchicago.edu/founders/documents/v1ch14s10.html>; see also Mark E. Brandon, *Home on the Range: Family and Constitutionalism in American Continental Settlement*, 52 EMORY L.J. 645, 665-66 (2003) (discussing *A Summary View of the Rights of British America*).

4. Letter from Thomas Jefferson to James Madison (Dec. 20, 1787), in THOMAS JEFFERSON: *WRITINGS*, at 918 (Merrill D. Peterson ed., 1984).

5. See Brandon, *supra* note 3, at 668-70.

6. See *id.* at 699.

7. See SCOTT LEHMANN, *PRIVATIZING PUBLIC LANDS* 33 (1995).

policy was thought to be better suited to keeping a “sizeable laboring population back east to man the workhouses of the infant U.S. manufacturing industries,” which was in opposition to the agrarian ideal of small farms as the dominant economic activity.⁸

Federal legislation over what role the government should play in distributing land vacillated between these two poles for years.⁹ The question was most firmly put to rest in a Jeffersonian vein with the passage of the Homestead Act of 1862.¹⁰ The secession of the southern states removed opposition in Congress to the Homestead Act,¹¹ and President Lincoln signed it into law on May 20, 1862.¹² The Act promoted property ownership at the lowest economic levels of society in two ways: one part of the Act provided protections for the family homestead from the claims of creditors,¹³ and the remaining bulk of the Act launched a scheme of massive land distribution at extremely low costs to those who were willing to move west.¹⁴ This Act took public resources and put them into the hands of private individuals, giving them a valuable asset that they could develop and pass on to future generations.

The Homestead Act provided would-be homesteaders with the chance to claim 160 acres of public land if they farmed it for five years and built a home on the land.¹⁵ Over the next decades the Act proved a tremendous success.

Between 1862 and 1938, [three] million people applied and almost 1.5 million households were given title to 246 million acres of land. . . . The U.S. Department of Interior (1998) lists that 287.5 million acres of the public domain were granted or sold to homesteaders under the Homestead Act. This is approximately 20% of all existing public land in the [United States].¹⁶

Throughout the intervening years, various requirements and provisions of the Act were changed to deal with the realities of different land qualities and

8. Robert Hockett, *A Jeffersonian Republic by Hamiltonian Means: Values, Constraints, and Finance in the Design of a Comprehensive and Contemporary American “Ownership Society,”* 79 S. CAL. L. REV. 45, 100 (2005).

9. See Douglas W. Allen, *Homesteading and Property Rights; Or, “How the West Was Really Won,”* 34 J.L. & ECON. 1, 7–8 (1991) (describing in more detail the specific requirements of land grant laws from 1796 forward).

10. Homestead Act of 1862, ch. 75, 12 Stat. 392 (repealed 1976).

11. The southern states feared that the Homestead Act would lead to an increase in farming on the new lands and threaten the structure of plantations. See Hockett, *supra* note 8, at 102. The question of whether new land would be free or slaveholding was also a barrier to agreement. See Debora A. Person, *Wyoming Pre-Statehood Legal Materials: An Annotated Bibliography – Part II*, 7 WYO. L. REV. 333, 401 (2007).

12. 12 Stat. at 393.

13. 12 Stat. at 393.

14. See Harold J. Krent & Nicholas S. Zeppos, *Monitoring Governmental Disposition of Assets: Fashioning Regulatory Substitutes for Market Controls*, 52 VAND. L. REV. 1705, 1720 (1999).

15. 12 Stat. at 392.

16. Deborah Groban Olson, *Fair Exchange: Providing Citizens with Equity Managed by a Community Trust, in Return for Government Subsidies or Tax Breaks to Businesses*, 15 CORNELL J.L. & PUB. POL’Y 231, 250 (2006) (discussing the historical precedent for government investment in private businesses and individuals).

resource needs in the public land being distributed.¹⁷

While the various provisions of the Homestead Act are interesting for an analysis of how government distributes resources,¹⁸ the long-term impact of that distribution on the American economy is more relevant to this Note. The impact has been massive; the Homestead Act spread the potential for economic independence to millions, and it is the foundation for much of today's current homeownership. Trina Williams Shanks studied the link between homesteading claims under the Act and current property ownership. She used Census Bureau statistics on population growth and demographics tied to the historical number of Homestead Act claims in twenty-five year segments. Using several different sets of assumptions as to which descendants inherited the original properties, she estimated that there are between twenty million and ninety-two million current property owners whose ownership is directly linked to an ancestor having a Homestead Act claim.¹⁹ Taking the middle of this range—about forty-six million people—and using population statistics from when she wrote her paper in 1998, it can be estimated that somewhere around 25% of the U.S. adult population has links to Homestead Act ancestors.²⁰

Homeownership itself is an obvious benefit for the security and stability it can provide for a family; however it has huge economic benefits beyond the simple ownership of the land or house. While the most obvious centers of economic power and wealth in the United States are massive corporations, economic historians have written convincingly that widespread property ownership by the masses is as significant of a source of economic might.²¹ The economist Hernando de Soto studied the development of property rights in the American frontier in order to gain a comparative perspective on why America has succeeded economically where other former colonies, like those in South America, have failed.²² He argues that the economic success of American capitalism rests on a clear system of property rights, which was created during the expansion of the frontier.²³ The lack of such an integrated system of property rights in today's developing nations makes it impossible for the poor

17. For example, provisions were added to allow higher acreage grants in areas with low rainfall, and some states created specific requirements for homesteaders regarding their use of the land. See, e.g., Trina Williams Shanks, *The Homestead Act: A Major Asset-Building Policy in American History*, in *INCLUSION IN THE AMERICAN DREAM: ASSETS, POVERTY & PUBLIC POLICY* 20, 25 (Michael Sherraden ed., 2005).

18. Considering the various options that could have been employed for the distribution of this land is interesting, but the topic falls outside the scope of this Note. The choice to broadly distribute land to almost anyone who wanted it represented a substantially innovative step. Many other countries facing similar questions of distribution chose to employ sharecropping or other more feudal-type land use arrangements. See Sanford A. Mosk, *Latin America Versus the United States*, 41 *AM. ECON. REV.* 367, 367-376 (1951).

19. Shanks, *supra* note 17, at 31 tbl.2.2, 33 tbl.2.3, 34 tbl.2.4.

20. *Id.* at 32.

21. See DE SOTO, *supra* note 1. De Soto is one of the leading economic scholars studying the importance of widespread property rights as a precursor to economic development. For his discussion of the importance of property rights in the development of the U.S. See *id.* at 105-151.

22. *Id.*

23. *Id.* at 149-150 ("American property changed from being a means of preserving an old economic order to being, instead, a powerful tool for creating a new one. The result was the expanded markets and capital needed to fuel explosive economic growth.").

to leverage their non-titled ownership into capital or collateral for loans, which de Soto claims forms the basis for entrepreneurship and small business growth.²⁴ The Homestead Act, by providing such inexpensive access to property for millions of Americans, set the stage for those same millions to have a ready source of capital to invest in their future, whether they were starting a business, sending children off to school, or simply creating a reserve pool of capital to rely on when times got rough.

In addition to the broad land distribution spurred by the Homestead Act, the development of careful land title records for the newly distributed land further encouraged economic development.²⁵ Land title records made it extremely easy for property to change hands with very little risk to the prospective buyer. A prospective buyer could check the title and know that the individual he planned to buy from actually owned the property. This provided great flexibility. For example, with land titling in place, someone in New York could safely and confidently negotiate to buy property from someone in Texas without ever meeting the seller or looking at the property in person. If there was no land titling, the level of trust needed for this kind of transaction would be prohibitively high.²⁶

The greater security and flexibility that land titling brought to the property market allowed for the development of a thriving banking sector in which people were able to tap the assets of their real property for loans backed by their title.²⁷ This ready source of capital allowed people to start small businesses, access capital in family emergencies and, in the case of farms, invest in the development of the property, or purchase more land to expand onto.

The Homestead Act allowed millions of people who previously owned no property to gain title for simply claiming some land and making improvements to it. As mortgage markets developed, these millions were able to take advantage of their property values directly by turning them into working capital.

The same patterns of economic development that took place after the Homestead Act still apply today. Recent improvements in the collection of statistics on small business ownership and funding have made it possible to examine the link between property ownership and the development of new businesses. A study from 1998 found that the largest sources of finance for small businesses—the principal owner, commercial banks and trade creditors—

24. *Id.* at 40–67.

25. See Robert J. Samuelson, *The Spirit of Capitalism*, 80 FOREIGN AFF. 205, 207 (2001) (reviewing HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM SUCCEEDS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000)) (“According to de Soto, clearly defined property rights generate what economists call positive externalities, or benefits shared by everyone. Not only do property rights help people borrow more easily, because property can be pledged as formal collateral; they also create information needed by markets. If property rights are recorded, for example, utility companies can deliver power and bill customers more easily.”).

26. See *id.*

27. See DE SOTO, *supra* note 1, at 63–64 (“It is property documentation that fixes the economic characteristics of assets so that they can be used to secure commercial and financial transaction . . .”).

account for over 70% of total funding.²⁸ The study also found that the principal owner of a small business is usually the biggest provider of equity for the small business, contributing over 30% of total equity.²⁹ The source of this equity often comes from funds the owner is able to obtain through a home equity mortgage.³⁰ Unfortunately, exact statistics of how much capital is actually converted from personal housing equity into business equity is hard to obtain. Because the information on personal equity is private, it is not as easily captured by groups that track such statistics. However, another way of determining the importance of home ownership as a foundation for small business growth is to consider how such businesses gain credit from commercial sources. Often outside investors in the business will put very significant weight on the financial condition and reputation of the owner.³¹ For small businesses, where there is often a single owner, this creditworthiness is usually reflected in the state of their personal property ownership and credit history.³²

The United States has been so successful in reaping the benefits of widespread property ownership and land titling that other countries are beginning to experiment with similar plans. For example, there have been numerous suggestions of granting land title to slum dwellers outside cities as a way of entitling land ownership and jumpstarting economic growth. Indeed, a plan under consideration in Brazil suggests a similar structure to the Homestead Act.³³ The fact that economists still consider such property programs to be of high value to economic strength points to the importance of maintaining such standards in the United States.

Not everyone has considered the Homestead Act a positive development. Challenges have come from both economic perspective and environmental perspectives. The economic critique centers on the efficiency of the land use. The argument is that the Homestead Act "induced settlement of the west 'too soon.'"³⁴ Benjamin Hibbard, a U.S. historian, considered that "the homestead acts served to spread population too rapidly over a wide stretch of territory. . . .

28. Allen N. Berger & Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613, 619 (1998) (using the Small Business Association definition of a small business as a firm with less than 500 "full-time equivalent employees").

29. *Id.* at 618 (finding that principal owners provide "31.33% of total equity plus debt or about two-thirds of total equity").

30. *Id.* at 641 (reporting that about 40% of small business loans and close to 60% of loan dollars are guaranteed and/or secured by personal assets). The largest source of personal assets owned by most families is their home; thus, it may be assumed that the family home is the collateral for these loans.

31. Small businesses are not subject to disclosure rules like those of publicly traded companies. As such, there is less information available about the health of these businesses, making outside personal collateral and guarantees important for securing business loans. See *id.* ("[T]he use of personal collateral and guarantees occurred more often: (1) for firms that were younger, smaller and had fewer tangible assets (are arguably more informationally opaque)").

32. *Id.* at 641-42.

33. See John C. Martin, *Bringing Dead Capital to Life: International Mandates for Land Titling in Brazil*, 31 B.C. INT'L & COMP. L. REV. 121 (2008).

34. Andrew P. Morriss, Roger E. Meiners & Andrew Dorchak, *Homesteading Rock: A Defense of Free Access Under the General Mining Law of 1872*, 34 ENVTL. L. 745, 795 (2004).

Land was being used too soon and in too great quantities [sic] in relation to other occupations and developments."³⁵

The efficiency criticism can be challenged in two areas. First, proponents of the argument themselves admit that such evaluations of an optimal rate of land distribution are fraught with uncertainties.³⁶ Second, and more fundamentally, the efficiency critique may not be as relevant to such a distribution if the attained results years down the line significantly overshadow the original inefficiency. Indeed, why should the central criteria for land distribution be efficiency?

Several authors have argued that it should not. Harold J. Krent and Nicholas S. Zeppos studied methods and objectives of government distribution of land and wrote that "[t]he government may use resources in a way that maximizes return not on the asset itself but for the economy as a whole."³⁷ Their analysis of land grants for railroads and homesteads found that while "failing to maximize return for land, [the grants] represented a sound investment in the nation's economy."³⁸ This is essentially a temporal critique. While the land grants were inefficient at an individual level at the time they were granted, they have led to a broad distribution of capital that, as explained above, served as a dynamic engine for growth at a later date.

The Homestead Act has also been criticized from an environmental perspective. The dust bowl of the 1930s was likely exacerbated by land ownership and use conditions made possible by the Homestead Act.³⁹ The 160-acre parcels distributed by the Act created farm sizes where soil preservation practices were too expensive and inefficient and eventually led to denuded land.⁴⁰ The once fertile land became fragile through improper conservation, and when drought came in the 1930s, the dust bowl was almost inevitable.⁴¹ This is a valuable criticism to remember whenever resources are being distributed by the government to private actors who may consume them without consideration of the damage caused to others. However, the environmental damage was not caused by the mere fact of government land distribution but rather by how the land was used. For the purposes of this Note's analysis of HERA, the environmental critique is less applicable, since the property in question is residential housing that has already been built.

Though our Homestead Act is now long gone,⁴² legislation to promote or

35. *Id.* at 795 (quoting R. Taylor Dennen, *Some Efficiency Effects of Nineteenth-Century Federal Land Policy: A Dynamic Analysis*, 51 AGRIC. HIST. 718, 731 (1977)).

36. *See id.* at 791 n.245 ("Of course, we can evaluate whether a given policy was 'optimal' from both an ex ante and an ex post perspective. It is impossible to know with certainty what the optimal policy is ex ante since uncertainties abound.").

37. Krent & Zeppos, *supra* note 14, at 1720.

38. *Id.*

39. *See* Daniel K. Benjamin, *The Dustbowl Reconsidered*, 22 PROP. & ENVTL. RES. CENTER REPS., Dec. 2004, at 17-18, available at <http://www.perc.org/pdf/dec04.pdf>.

40. *See id.* at 17.

41. *Id.*

42. The Homestead Act was repealed in 1976. Federal Land Policy and Management Act of 1976, Pub. L. No. 94-579, § 702, 90 Stat. 2743, 2787-89 (repealing the Homestead Act but permitting a ten-year extension for lands in Alaska).

protect current ownership should be encouraged for the same reasons that the Homestead Act was a success. The current mortgage crisis that has crippled the economy makes the need for such a plan more important now than at any time since President Franklin Roosevelt removed most remaining public land from eligibility for Homestead Act settlement.⁴³

THE MORTGAGE CRISIS

In order to understand the need for government assistance for homeowners and to have a baseline for which to compare recent housing to the Homestead Act, it is necessary to examine the rapid rise in foreclosures that have resulted from the subprime mortgage crisis.⁴⁴

From the first quarter of 2007, the number of U.S. homes in foreclosure began to soar. By June 2007 more than one million mortgages were in default or foreclosure.⁴⁵ This represented a 50% increase from defaults and foreclosures in 2005.⁴⁶ Defaults and foreclosures have continued to grow since 2007. By January 2009 the total number of foreclosures may have been close to three million homes.⁴⁷ The most recent data available shows that for the month of July 2009 “[new] foreclosure filings—default notices, scheduled auctions and bank repossessions—were reported on 360,149 U.S. properties.”⁴⁸ Clearly, the housing crisis is far from over.

The recent foreclosures represent a significant threat to the gains in homeownership made in the last fifty years. Homeownership has been growing at a very slow pace since the 1960s. The United States Census Bureau has been tracking aggregate homeownership statistics since 1965. When it started collecting the data, U.S. homeownership was at about 62.9% of households.⁴⁹ Homeownership peaked in the third quarter of 2004 at 69.2%. It

43. See Shanks, *supra* note 17, at 25.

44. For a detailed explanation of the 2008 recession, see Ben Bernanke, Chairman, Fed. Reserve Bd., Keynote Address at The Brookings Institute: A Year of Turmoil: Fed. Chairman Ben Bernanke Reflects on the Stabilization of the Financial System Since the Events of Last September (Sept. 15, 2009) (transcript available at http://www.brookings.edu/~media/Files/events/2009/0915_financial_crisis/20090915_bernanke.pdf).

45. U.S. GOV'T ACCOUNTABILITY OFFICE, HOME MORTGAGE DEFAULTS AND FORECLOSURES: RECENT TRENDS AND ASSOCIATED ECONOMIC AND MARKET DEVELOPMENTS 1 (2007), available at <http://www.gao.gov/new.items/d0878r.pdf> (reporting to the House of Representatives Committee on Financial Services).

46. *Id.*

47. See Jim Wasserman, *Citigroup Shift on Senate Bankruptcy Bill May Aid Homeowners*, SACRAMENTO BEE, Jan. 10, 2009, at 7B.

48. Press Release, RealtyTrac, U.S. Foreclosure Activity Increases [7%] in July (Aug. 13, 2009), <http://www.realtytrac.com/ContentManagement/PressRelease.aspx?ItemID=7192>. RealtyTrac is a private company that provides foreclosure statistics across the country. They offer their services commercially for potential buyers. Their statistics are collected by compiling public default and foreclosure notices.

49. See U.S. Census Bureau, Housing Vacancies and Homeownership: Historical Tables tbl.14 (Sept. 2009), <http://www.census.gov/hhes/www/housing/hvs/historic/files/histtab14.xls> (last accessed Oct. 15, 2009) (compiling homeownership rates for the U.S. and regions from 1965 to the present).

receded to 67.9% by the third quarter of 2008.⁵⁰ This is a decline of 1.3%. While this is not a large number on its face, the fact that homeownership had only increased by 6.3% since 1965 means that a decline of 1.3% is in reality a significant loss of about 20%.

There is obvious political importance in helping the people hit by this crisis. However, beyond the politics of today, the analysis above suggests that finding a solution to reduce foreclosures is not only good for the people in foreclosure but for the long term economy as well. That is, it is good for all of us.

THE EFFORTS TO SAVE HOUSING

Both HERA and President Obama's MHA have important provisions to try to protect current homeownership and promote future homeownership. This Note will divide the provisions into three sections, corresponding to the three different avenues for addressing the housing problem. The first section will deal with provisions that use government money to directly purchase at risk mortgages and mortgage backed securities. The second section will deal with tax incentives to promote new homeownership. The third, and more substantial, section will deal with two programs—the HOPE for Homeowners Program and MHA that provide direct support to homeowners facing foreclosure.

HERA was Congress's first response to the mortgage crisis. Substantial legislation had been passed to address other elements of the overall economic crisis, but HERA was the first and central piece of legislation to deal specifically with the foreclosures and defaults that caused the crisis. HERA is a 260-page behemoth that does everything from tweaking the Truth-in-Lending mortgage disclosure requirements⁵¹ to establishing a new Federal Housing Finance Agency.⁵² Dealing with the entire Act is out of the scope of this Note, but there are several pieces of legislation within HERA that are extremely relevant to the protection and promotion of homeownership.

Though HERA was the first legislative response to the housing crisis, it was by no means the last word. MHA was launched early in President Obama's Administration. The Program draws on support from several pieces of legislation, the first being the American Recovery and Reinvestment Act of 2009, also known as the Stimulus Bill.⁵³ The more substantial part of MHA is found in the Helping Families Save Their Homes Act of 2009.⁵⁴

Both HERA and MHA have consonant goals, and parts of MHA draw directly on programs that were started under HERA. Therefore, rather than analyzing the programs separately, I will analyze them together.

50. *Id.*

51. See Lynette I. Hotchkiss, *Fighting the Failure to Communicate*, BANKING & FIN. SERVS. POL'Y REP., Aug. 2008, at 1 (describing the substantial changes made to the Truth-in-Lending Act disclosure requirements that lenders must fulfill when communicating with potential customers about their financial products).

52. HERA § 1101, 12 U.S.C. § 4511 (West Supp. 2008).

53. Pub. L. No. 111-5, 123 Stat. 115 (to be codified as amended in scattered sections of U.S.C.).

54. Pub. L. No. 111-22, 123 Stat. 1632 (to be codified in scattered sections of 12 U.S.C.).

Government Purchase of At-Risk Mortgage Securities

One of the most important sections of HERA provides for direct government action to purchase mortgages and related mortgage securities. Division A, Title I of the Act, deals mostly with reforms and new regulations for the federal housing enterprises, Fannie Mae and Freddie Mac, collectively known as the government-sponsored entities (GSEs).⁵⁵ It establishes the Federal Housing Finance Agency,⁵⁶ which replaces and consolidates several previous housing agencies, such as the former Federal Housing Finance Board.⁵⁷ The amended Title I also provides new regulatory guidelines for capitalization levels, mortgage interest rates, corporate structures, and executive compensation that are meant to improve the mission of the GSEs. Most importantly for the current crisis, it provides for the direct purchase of obligations and securities issued by the GSEs and other banks. Section 1117 is buried in the midst of other sections that speak more to new regulation than to schemes to rescue homeowners. This makes it easy to overlook, but it provides an important new authority to the Secretary of the Treasury:

to purchase any obligations and other securities issued by the corporation under any section of this Act, on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine. Nothing in this subsection requires the corporation to issue obligations or securities to the Secretary without mutual agreement between the Secretary and the corporation.⁵⁸

The corporation referred to in the section is Fannie Mae, and there is an identically worded section provided for Freddie Mac.⁵⁹

Fannie Mae and Freddie Mac are both tasked with the mission of providing liquidity and funding for the mortgage market.⁶⁰ The idea is to have both enterprises purchase mortgages issued by other mortgage companies, package the mortgages into securities, and then sell them on the open market. When this is done successfully, it provides capital to mortgage issuers and, thus, encourages them to issue more mortgages. By changing the conditions under which the GSEs purchase mortgages, Congress is able to encourage other private companies to lend to lower income borrowers who otherwise would

55. HERA §§ 1001-1163.

56. *Id.* at § 1101.

57. *See id.* at § 1311 (transferring the Federal Housing Finance Board responsibilities to the Federal Housing Finance Agency).

58. *Id.* at § 1117(a).

59. *Id.* at § 1117(b).

60. For a self-description of the mission of the GSEs, see About Fannie Mae, <http://www.fanniemae.com/about/index.html> (last visited Dec. 28, 2009) ("Rather than making home loans directly to consumers, we work with mortgage bankers, brokers and other primary mortgage market partners to help ensure they have funds to lend to home buyers at affordable rates. We fund our mortgage investments primarily by issuing debt securities in the domestic and international capital markets.").

have been priced out of the market.⁶¹

The Secretary's authority to purchase "obligations and other securities" from Fannie Mae and Freddie Mac is limited by a provision requiring the Secretary to certify that such action is for an emergency situation, to consider the long term cost to taxpayers, and to report to Congress any such action.⁶² However, the Secretary has a great deal of freedom under the section to structure and condition such funding as he sees fit. This authority has already been used. Both enterprises were placed in conservatorship in September 2008 as the financial crisis unraveled.⁶³ They had over \$5.2 trillion of mortgage-backed securities issued at that time and about \$1.7 trillion worth of debt.⁶⁴ Utilizing the section 1117 powers, Treasury Secretary Henry Paulson committed up to \$200 billion to keep the GSEs solvent through purchases of GSE preferred stock.⁶⁵

The alternative to this move would have been to allow the GSEs to go into default. Secretary Paulson claimed that the conservatorship and emergency funding was ultimately necessary for the economy, even if they were paid for by taxpayers. He argued:

Fannie Mae and Freddie Mac are so large and so interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the globe. This turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement. A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation.⁶⁶

The continued economic turmoil, including the multi-billion dollar collapse of Lehman Brothers within a week of the press release, underscored the importance of government intervention in the mortgage market in order to stabilize the economy.

This intervention will have a positive effect on long term homeownership. As described above, the GSEs play the role of purchasing mortgage products from other lenders, thereby providing extra capital and liquidity for the overall

61. For a general overview of how Fannie Mae and Freddie Mac can change the mortgage market, see Steven A. Holmes, *Fannie Mae Eases Credit to Aid Mortgage Lending*, N.Y. TIMES, Sept. 30, 1999, at C2.

62. HERA § 1117(a).

63. Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y. TIMES, Sept. 8, 2008, at A1.

64. See Dawn Kopecki, *U.S. Considers Bringing Fannie, Freddie on to Budget*, BLOOMBERG, Sept. 11, 2008, <http://www.bloomberg.com/apps/news?pid=20601109&sid=adr.czwVm3ws&refer=home>.

65. Press Release, U.S. Dep't of the Treasury, Fact Sheet: Treasury Senior Preferred Stock Purchase Agreement (Sept. 7, 2008), http://www.treasury.gov/press/releases/reports/pspa_factsheet_090708%20hp1128.pdf; see also Henry M. Paulson, Jr., U.S. Sec'y of the Treasury, Statement on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008) (transcript available at <http://www.treas.gov/press/releases/hp1129.htm>).

66. Paulson, *supra* note 65.

mortgage market. The capital infusion by the Treasury kept the GSEs from collapsing in the short term and also ensured that they could continue to play their role in expanding the mortgage market. This is an important step for long term homeownership; the GSEs hold over \$5.2 trillion worth of mortgages and mortgage guarantees,⁶⁷ which represents over half the value of the entire U.S. mortgage market of roughly \$10 trillion.⁶⁸

If mortgage lenders are unable to sell mortgages to the GSEs, many will have to be significantly more conservative in their lending standards.⁶⁹ This will reduce the ability of potential homeowners from lower economic levels to access mortgages. If the GSEs disappear, it will not necessarily change the homeownership of people who have already purchased homes and have current mortgages, but it will cause a contraction in the secondary mortgage market, where people are able to access the equity built up in their homes.⁷⁰ It will also mean that, in the future, many middle- and low-income households will no longer have access to the mortgage market.

The underlying reason for this potential contraction is that the GSEs essentially act as insurance agencies for mortgage lenders. By purchasing the mortgages from the issuers, the GSEs take away the risk of default from the original lenders, and because the GSEs are able to operate on such extremely high volumes, the normal rate of defaults on mortgages is easily absorbed within the profit margin of the GSEs.⁷¹ The system obviously went terribly awry over the course of the past year; however, it had operated successfully for many years before.⁷² The current failure of the GSEs is due to a lethal cocktail

67. Kopecki, *supra* note 64.

68. Statistical Release, Bd. of Governors of the Fed. Reserve Sys., Flow of Funds Accounts of the United States 96 (Sept. 17, 2009), <http://www.federalreserve.gov/releases/z1/20090917/z1.pdf>.

69. See MARK JICKLING, CONG. RESEARCH SERV., FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP 1 (2008), available at <http://fpc.state.gov/documents/organization/110097.pdf> ("[T]he GSEs have provided strong support to the housing market. When a bank (or other lender) sells a mortgage loan to the GSEs, it receives cash to make new loans, and avoids the risks of holding a long-term asset. Without this secondary (or resale) market, in which private firms participate as well as the GSEs, lenders would have to keep loans on their own books, and mortgage credit would become more expensive and difficult to obtain.").

70. See *id.*

71. For the purposes of this Note, it is not necessary to explain in full how securitization takes place within the mortgage market. For more information on securitization, see Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077, 1082-83 (2007) (summarizing what Freddie Mac and Fannie Mae do with the loans they buy). Forrester writes:

In 1983 Freddie Mac issued the first Collateralized Mortgage Obligation (CMO), which created multiple classes of bonds all backed by the same mortgage pool but with each class paid sequentially as principal payments were received from the underlying mortgages. Fannie Mae began securitizing mortgage loans in the 1980s. When the GSEs issue [mortgage-backed securities] they "guarantee that investors will receive timely principal and interest payments regardless of what happens to the underlying mortgages." Today Fannie Mae and Freddie Mac are almost identical in their charters and functions. They both purchase home loans to hold in their portfolios but securitize even more loans.

Id. at 1082 (citations omitted).

72. Fannie Mae was chartered in its current form in 1968, and Freddie Mac was chartered in its current form in 1970; since that time loan origination and home ownership have both grown

of overly risky loan standards and falling housing prices. According to a Congressional Research Service Report to Congress:

[T]he turmoil in housing and credit markets that began in 2007 has put extreme financial pressure on the GSEs. The value of their mortgage assets has fallen, but the debt they took on to purchase those assets remains. To maintain a positive net worth in the face of falling asset values, financial firms have several options to raise capital, but none of these were readily available to Fannie or Freddie. If they sold assets, they would depress the prices of mortgage loans and [mortgage-backed securities] still further, worsening both their own balance sheet problems and those of many other financial firms. They cannot use retained earnings to bolster capital because their operations have not turned a profit since 2006. Finally, rapidly falling share prices made it difficult to impossible to raise capital by selling new equity or common stock.⁷³

Despite this failure, the GSEs are still a good idea. It is important that the GSEs continue to provide the “insurance” mechanism, because, by doing so, they enable the private mortgage market to issue mortgages to more borrowers and increase overall homeownership. Section 1117’s authorization for the Treasury to protect the financial viability of the GSEs is sound; it will have a long term positive impact on homeownership precisely because it keeps the GSE system in place.

Tax Incentives to Promote Future Homeownership

Both HERA and the subsequent American Recovery and Reinvestment Act of 2009 provide tax incentives to promote homeownership. Section 3011 of HERA amended the first-time homebuyer tax credit. Individuals who were first-time homebuyers in 2008 were allowed a tax credit equal to 10% of the purchase price of the home.⁷⁴ The value of the credit is not to exceed \$7,500.⁷⁵ Unfortunately, this tax credit is structured as a loan rather than an outright credit. Taxpayers who took advantage of this housing credit are required to pay back the credit in fifteen equal installments in their fifteen subsequent tax filings.⁷⁶ The Internal Revenue Service’s website provides an example: “[A]n eligible taxpayer who buys a home today and properly claims the maximum available credit of \$7,500 on his or her 2008 federal income tax return must begin repaying the credit by including one-fifteenth of this amount, or \$500, as

steadily. See *supra* note 49. It would be hard to prove that these two GSEs are the sole reason for that growth, but it is clear that they have had a significant positive impact on overall ownership by changing the conditions of the mortgage market to include buyers who otherwise might have been priced out.

73. JICKLING, *supra* note 69, at 2.

74. HERA § 3011(a), 26 U.S.C. § 36 (West Supp. 2008).

75. *Id.* at § 3011(b).

76. *Id.* at § 3011(f).

an additional tax on his or her 2010 return.”⁷⁷ Essentially, the credit is a interest-free loan from the government to facilitate the purchase of a home.

The American Recovery and Reinvestment Act of 2009 provides an improvement over HERA’s tax credit. Section 1006 provides that a first-time homebuyer purchasing in 2009 is entitled to up to an \$8,000 tax credit, which, unlike the HERA tax credit, needs not be paid back.⁷⁸

While the 2009 tax credit is obviously more beneficial than the HERA tax credit, both are important incentives for encouraging homeownership in the short-term. Several changes could be made, though, to strengthen their impact for the long-term. Many families have already had to foreclose and have lost their homes; these tax credits will not apply to their home purchases in the future, as they are no longer first-time buyers. An exception should be made to extend this tax credit to buyers who had their principal residence foreclosed on during some reasonable period corresponding to the current crisis, likely 2007 to 2010. This extended credit would give people an additional chance to once again become homeowners. The cost to overall tax collections due to such an exception would be acceptable because of the future economic vitality that homeownership will provide to those helped by the tax credit. As with the Homestead Act, the one-time transfer of wealth from the state to the individual will provide a mechanism for growth, not just for the individual but for future generations as well.

Direct Support for Homeowners

The third important element of the effort to shore up homeownership is found in two programs aimed at directly supporting at-risk homeowners. The first program is the HOPE for Homeowners Program, initiated under HERA.⁷⁹ It provides support for homeowners currently in default and facing foreclosure. While the HOPE Program was certainly well intended, it has failed to be effective and has some significant long-term problems written into its structure. The second program is MHA, started by the Obama Administration and run by the Treasury using the general bailout funds apportioned to the Treasury.⁸⁰ This Program has had much more success. This section will describe each program, discuss each program’s potential long-term impact for homeownership and provide some suggestions for reform.

77. Internal Revenue Serv., Tax Credit to Aid First-Time Homebuyers; Must Be Repaid over 15 Years (Sept. 16, 2008), <http://www.irs.gov/newsroom/article/0,,id=186831,00.html>.

78. American Recovery and Reinvestment Act § 1006, 26 U.S.C. § 36 (West Supp. 2008).

79. HOPE for Homeowners Act of 2008, Pub. L. No. 110-289, §§ 1401-04, 122 Stat. 2654, 2800-10 (to be codified at scattered sections of 12 U.S.C.).

80. See *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues: Hearing on TARP Oversight Before the S. Comm. on Finance*, 111th Cong. 9 (statement of Gene L. Dodaro, Comptroller Gen. of the U.S.), available at <http://finance.senate.gov/hearings/testimony/2009test/033109gdtest.pdf> [hereinafter *TARP Oversight Hearing*].

1. HOPE for Homeowners

HOPE is a temporary program administered by the Federal Housing Authority (FHA).⁸¹ It was initially authorized to insure up to \$300 billion in mortgages and is expected to serve approximately 400,000 homeowners.⁸² The Program began October 1, 2008 and is set to sunset on September 30, 2011.⁸³

The Program offers “hope” to homeowners by seeking to induce mortgage lenders to refinance at-risk loans at lower rates by offering to insure the mortgage lender against further decreases in home values or default by the borrower.⁸⁴ The HOPE for Homeowners Act sets strict standards for insurance eligibility under the HOPE Program. The borrower must certify an inability to pay the mortgage at its current terms and the borrower must have a debt-to-income ratio greater than 31%.⁸⁵ The Program is only available for mortgages on a primary residence; the mortgagor must provide documentation to prove his residence and that the property is the only residence in which the mortgagor has a current ownership interest.⁸⁶ This provision ensures that people who bought real estate as an investment are not eligible for the Program. The new refinanced mortgage must have a principal amount that does not exceed 90% of the appraised value of the property,⁸⁷ and it must be within the reasonable ability of the mortgagor to make payments.⁸⁸ The new mortgage is required to be at a fixed rate of interest with a maturity date of “not less than [thirty] years”⁸⁹ and cannot exceed certain limits for total loan amounts,⁹⁰ currently set at \$550,440.⁹¹ In order to be eligible for insurance, the mortgagor must also agree not to take out a second mortgage on the property for the next five years after it is insured under the HOPE Program.⁹²

To date participation in the HOPE Program has been abysmal. Though there is a substantial list of mortgage companies willing to refinance on HOPE

81. The FHA insures private loans that are issued for new and existing homes. It was created by Congress in 1934 and became part of the Department of Housing and Urban Development’s (HUD) Office of Housing in 1965. See Federal Housing Administration, FHA Refinance and Mortgage Fact #1: About the FHA, <http://www.fha.com/hud-fha-01.cfm> (last visited Oct. 15, 2009).

82. U.S. Senate Comm. on Banking, Hous. & Urban Affairs 110th Cong., Summary of the “Housing and Economic Recovery Act of 2008” [hereinafter Summary of HERA].

83. HOPE for Homeowners Act sec. 1402(a), § 257(r).

84. *Id.* at sec. 1402(a), § 257(b).

85. *Id.* at sec. 1402(a), § 257(e)(1)(B).

86. *Id.* at sec. 1402(a), § 257(e)(11).

87. *Id.* at sec. 1402(a), § 257(e)(2)(B).

88. *Id.* at sec. 1402(a), § 257(e)(2)(A). The standard of what is within the reasonable ability of the mortgagor to pay is to be determined by the Secretary of HUD or the Federal Housing Finance Oversight Board. *Id.*

89. *Id.* at sec. 1402(a), § 257(e)(5)(A)–(B).

90. *Id.* at sec. 1402(a), § 257(e)(6) (setting the dollar limit for loans under the HOPE Program). The Act limits the loan amounts to 132% of the maximum loan size for the GSEs in 2007. See *id.*; see also 12 U.S.C. § 1454(a)(2) (setting general loan limits for the GSEs).

91. See U.S. Dep’t of Hous. & Urban Dev., Fact Sheet: FHA to Provide Additional Mortgage Assistance to Struggling Homeowners (July 31, 2008), <http://www.hud.gov/fha/home080730.cfm>.

92. HOPE for Homeowners Act sec. 1402(a), § 257(e)(7).

terms,⁹³ very few mortgage holders have even begun the process. In January 2009, the FHA reported:

While total activity under the Program continues to be low, it appears to be increasing. As of January 24, 2009, [twenty-two] Program loans have closed, an increase of [twenty-one] loans from the December 2008 Report to Congress; however, none of the loans have completed the insurance endorsement process. As of late-January, 442 case numbers have been assigned.⁹⁴

Despite the epidemic of foreclosures, only *twenty-two* loans has been closed in compliance with this Program, and for those loans, the HOPE Program had not even finished the internal fraud review required before the FHA will insure the new loan. While the fact that not even a single loan has been fully processed and insured is disappointing, the fact that there were so few total applications is even more worrying.

There are several fundamental problems with the HOPE Program that have led to these disappointing numbers, including its voluntary nature, the lack of education about the Program, problematic requirements regarding the terms of the new loans, unsound restrictions on the use of future equity, and the systematic problems due to the securitization of mortgages.

The first issue with HOPE is its voluntary nature.⁹⁵ Many lenders have not agreed to the Program's terms.⁹⁶ In order for the new loan to be eligible for HOPE insurance, the lender must deeply discount the value of the existing mortgage on the property; the statute requires that the loan not exceed 90% of the value of the property.⁹⁷ While it may be true that refinancing under HOPE will create a smaller net loss for the mortgagor than if the property were foreclosed and sold in a judicial sale, the low numbers of lenders who have registered indicates that the terms of HOPE are still stringent enough to discourage many lenders.

The low participation rate and severe criticism of the Program's terms have prompted the FHA to use the authority granted to it under a later amendment to HERA to change some of the original mortgage insurance terms.⁹⁸ Most

93. HUD maintains a list of mortgage companies that have registered with the FHA as willing to refinance on HOPE terms. See U.S. Dep't of Hous. & Urban Dev., HOPE for Homeowners Participating Lenders List (Apr. 24, 2009), http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/list_of_lenders_who_are_participating_in_the_hope_for_homeow/H4H%20Lender%20List%2020090424.pdf.

94. FED. HOUS. FIN. OVERSIGHT BD., HOPE FOR HOMEOWNERS PROGRAM MONTHLY REPORT TO CONGRESS FOR JANUARY 2009 4 (2009), available at http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/h4h_monthly_reports_to_congress/H4H%20Report%20to%20Congress%20January.pdf [hereinafter JANUARY 2009 REPORT TO CONGRESS].

95. HOPE for Homeowners Act sec. 1402(a), § 257(b)(1).

96. See JANUARY 2009 REPORT TO CONGRESS, *supra* note 94, at 3 (noting that "only a few sponsoring lenders, who would underwrite, close and fund Program loans, have registered for the list").

97. HOPE for Homeowners Act sec. 1402(a), § 257(e)(2)(B).

98. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (to be

importantly, the amendment gives authorization for the FHA to modify the maximum loan-to-value ratio for a Program mortgage above 90%.⁹⁹ In November 2008 the FHA increased the loan-to-value ratio to 96.5%.¹⁰⁰ At the same time, the FHA also made changes that allowed mortgage companies to refinance mortgages on a forty-year basis, rather than the thirty-year cap.¹⁰¹

It is hoped that these changes will reduce the overall loss to mortgage lenders enough to encourage their voluntary entry into the HOPE Program. The change in the loan-to-value ratio means the lenders do not lose as much up front, and the extension of the loan period of up to forty years enables the lender to collect more total interest, while also potentially lowering the monthly cost of the loan for the borrower. It remains to be seen if lenders and borrowers will take advantage of the changed Program. Although these changes were initiated a few months ago, the realities of filing for mortgage modification and dealing with the accompanying paperwork put a significant time lag between the modifications and the market's response. Ultimately, there is little the government can do to force lenders and borrowers to use the HOPE Program, other than make its terms attractive enough to induce participation.

Even if the terms of the Program are made attractive enough to induce participation, the problem of education and awareness is still a significant barrier to entry. The FHA has reported to Congress that they are collaborating with the Department of Housing and Urban Development's extensive housing advocacy network to raise awareness.¹⁰² It is too early to evaluate how many eligible homeowners are actually aware of the Program, but the low participation numbers suggest an awareness problem.

While the problems of awareness and stringent refinancing terms are significant barriers to entry, the Program's requirements regarding the disposition of future home equity are far more problematic. These requirements are a barrier to entry and also a setback to the future use of the property. Homeowners desiring to enter into the HOPE Program must agree to share any equity that accrues to their property between the time of refinance and the time of a future sale with the FHA.¹⁰³ The idea behind this policy is to ensure that borrowers are not gaining a windfall and that they pay for the FHA insurance.¹⁰⁴ Indeed the Senate Committee on Banking, Housing and Urban Affairs estimates that the Program will actually make a profit for taxpayers

codified at 12 U.S.C. §§ 5201-02, 5211-53, 5261) (amending the HOPE for Homeowners Act to provide the FHA with the authority to change some of the terms of the HOPE Program) [hereafter Stabilization Act of 2008].

99. HOPE for Homeowners Act sec. 1402(a) sets the ratio at 90%. HOPE for Homeowners Act sec. 1402(a), § 257(e)(2)(B). However, the Stabilization Act of 2008 section 124 amends the Act to read: "90% or such higher percentage as the Board determines, in the discretion of the Board." Stabilization Act of 2008 sec. 124, § 257(e)(2)(B).

100. FED. HOUS. FIN. OVERSIGHT BD., HOPE FOR HOMEOWNERS PROGRAM MONTHLY REPORT TO CONGRESS FOR NOVEMBER 2008 3-4 (2008), available at http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/h4h_monthly_reports_to_congress/H4H%20Report%20to%20Congress%20November.pdf.

101. *Id.* at 4.

102. JANUARY 2009 REPORT TO CONGRESS, *supra* note 94, at 3.

103. HOPE for Homeowners Act sec. 1402(a), § 257(k).

104. Summary of HERA, *supra* note 82.

through the equity transfer.¹⁰⁵ The homeowner's share of any equity that is created through the sale or refinance of their HOPE insured property is to be phased in over the course of five years.¹⁰⁶ The homeowner will receive an increasing chunk of the equity each year until the fifth year. Any equity created by a refinance or sale after the fifth year will be shared equally between the homeowner and the FHA.¹⁰⁷

In addition to the sharing of equity created through refinancing or sale, appreciation in value to the property is also to be shared. The FHA and the homeowner shall "upon any sale or disposition of the property to which such mortgage relates, each be entitled to [50%] of any appreciation in value of the appraised value of such property that has occurred since the date that such mortgage was insured under this section."¹⁰⁸

This is a significant portion of equity and could constitute a substantial return to the government far in excess of its original investment in insuring the mortgage. Because the HOPE Program offers lenders an opportunity to refinance the borrower's mortgages on terms of up to forty years, the possibility of properties acquiring significant equity due to appreciation of the home's value is almost assured. It would appear the only way that a homeowner could avoid the government getting half of their equity would be to carry the

105. *Id.*

106. HOPE for Homeowners Act sec. 1402(a), § 257(k).

107. HOPE for Homeowners Act sec. 1402(a), § 257(k). Section 257(k) provides the exact break down of equity sharing between the homeowner and the FHA:

(k) EQUITY AND APPRECIATION. —

(1) FIVE-YEAR PHASE-IN FOR EQUITY AS A RESULT OF SALE OR REFINANCING. — For each eligible mortgage insured under this section, the Secretary and the mortgagor of such mortgage shall, upon any sale or disposition of the property to which such mortgage relates, or upon the subsequent refinancing of such mortgage, be entitled to the following with respect to any equity created as a direct result of such sale or refinancing:

(A) If such sale or refinancing occurs during the period that begins on the date that such mortgage is insured and ends [one] year after such date of insurance, the Secretary shall be entitled to [100%] of such equity.

(B) If such sale or refinancing occurs during the period that begins [one] year after such date of insurance and ends [two] years after such date of insurance, the Secretary shall be entitled to [90%] of such equity and the mortgagor shall be entitled to [10%] of such equity.

(C) If such sale or refinancing occurs during the period that begins [two] years after such date of insurance and ends [three] years after such date of insurance, the Secretary shall be entitled to [80%] of such equity and the mortgagor shall be entitled to [20%] of such equity.

(D) If such sale or refinancing occurs during the period that begins [three] years after such date of insurance and ends be entitled to [70%] of such equity and the mortgagor shall be entitled to [30%] of such equity.

(E) If such sale or refinancing occurs during the period that begins [four] years after such date of insurance and ends [five] years after such date of insurance, the Secretary shall be entitled to [60%] of such equity and the mortgagor shall be entitled to [40%] of such equity.

(F) If such sale or refinancing occurs during any period that begins [five] years after such date of insurance, the Secretary shall be entitled to [50%] of such equity and the mortgagor shall be entitled to [50%] of such equity.

Id.

108. *Id.* at sec. 1402(a), § 257(k)(2).

refinance HOPE mortgage out to its closure forty years later. There is no clause in the legislation specifying what amount of equity the government would get in that scenario. However, most people will refinance, sell their home, or move long before the end of the forty years.

The equity sharing principle is not beneficial for long-term capital accumulation as explored in the section on the Homestead Act. The equity sharing provisions could theoretically be justified on two grounds: First, they could be a way to keep the HOPE Program from being a net loss to taxpayers. The initial tax money used for the program will be recouped through the equity sharing.¹⁰⁹ Second, equity sharing could be seen as a way of ensuring that homeowners who use the program stay committed to it. By phasing the equity sharing in over five years there is an incentive for homeowners to stick with it.¹¹⁰ However, it is in the national interest to subsidize the mortgages even if it costs taxpayers more now.

By requiring homeowners who refinance with a HOPE insured mortgage to hand over so much of their future equity, the Program is, in effect, taking away much of the long-term economic benefits of homeownership. First, the statute prohibits the property owners from taking out any secondary, or equity, mortgages for the first five years after refinancing with HOPE.¹¹¹ This means that for those five years the property owner cannot utilize any capital that accumulates within their home value. Considering that these homeowners are currently in extremely tight financial situations, that extra restriction may be quite significant. The fifty-fifty equity sharing agreement for any appreciation of the property has the same drawbacks but on a potentially larger scale. For many homeowners whose mortgages are currently greater than their actual home value, the restrictions in the first five years could conceivably be a worthwhile tradeoff. However, because the equity that builds up in homeownership is one of the primary sources of capital for the American family, this equity sharing restriction takes a drastic cut out of their potential to access the American dream.

A few practical examples of the impact of the equity sharing restriction can help to illustrate the point. A homeowner with a HOPE insured mortgage could not “trade up” for a bigger house when they sell their current one, because the equity that a normal homeowner would use for the larger home will belong to the FHA instead. Homeowners frequently refinance their homes with new lenders when interest rates drop, and often they are able to obtain a substantial chunk of their built-up equity as cash in such a refinance. As discussed in the section on democratization of land ownership, this capital is an important source of funding for a number of activities, including home improvements, education and small business start-up funding. However, for a HOPE insured homeowner, that extra cash will be cut in half, substantially reducing their capital and future financial independence.

109. Summary of HERA, *supra* note 82.

110. See HOPE for Homeowners Act sec. 1402(a), § 257(k).

111. *Id.* at sec. 1402(a), § 257(e)(7).

Another structural factor that will prevent the HOPE Program from having a significant widespread impact is the securitization of mortgages. Securitization is a relatively recent phenomenon in the mortgage industry.¹¹² In the past, lenders originated loans and then kept the loans on their balance sheets.¹¹³ However, securitization has changed that practice. Today, lenders will originate loans and then transfer the right to those loans to a third party, sometimes a subsidiary corporation of the originating company.¹¹⁴ The third party takes the individual loans, packages them together and then sells the right to collect the payments on the pool of mortgages.¹¹⁵ This packaging process is known as securitization. It has become very popular because it allows the originator of the loan to quickly recoup its investment, and it spreads the risk of default on mortgages widely among investors.¹¹⁶ Many of the at-risk mortgages are sub-prime, and a very high proportion of these loans have been securitized.¹¹⁷

It may be difficult for many of the borrowers of securitized loans to take advantage of the HOPE Program. The third parties that hold the securitized loans may not have the capacity to renegotiate the terms of the securitized mortgages they hold.¹¹⁸ They may simply be holding companies, not set up for interacting with the borrowers other than to collect monthly payments. Additionally, third party holders of the mortgages may have entered into contractual obligations with the purchasers of the securities not to modify the terms of the underlying loans.¹¹⁹ If HOPE is to be effective for homeowners with loans that have been securitized, some structural changes to the Program will be required.

2. Assessing HOPE: How Might It Be Reformed?

The HOPE Program does serve as an excellent base from which to help homeowners. With some modifications, it could do the work of saving homes and also lay the groundwork for the future economic strength for those homeowners.

The HOPE Program's first strength is its eligibility requirements and

112. See *Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit: Hearing Before the H. Subcommittee on Financial Institutions and Consumer Credit*, 108th Cong. 2 (2003) (statement by Cameron L. Cowan, Chair, Legislative and Judicial Subcommittee, American Securitization Forum) ("The first mortgage-backed securities arose from the secondary mortgage market in 1970.").

113. See Carole O. Heyward, *HOPE for Homeowners: Too Little, Too Late*, 18 J. AFFORDABLE HOUS. & CMTY. DEV. L. 27, 33 (2008) (explaining the securitization process and analyzing its effect on the success of the HOPE Program). Heyward's article was not available when research on this Note was initiated. There is some overlap in our criticism of the HOPE program. This Note adds suggestions for programmatic modifications that should make the Note of some value, notwithstanding the overlap in analysis.

114. See *id.* at 33.

115. See *id.*

116. *Id.* at 32-35.

117. *Id.* at 32.

118. See *id.* at 34.

119. See *id.*

screening program. One option for bailing out homeowners would be for the government to simply make payments on behalf of households at risk of default. The government could also underwrite current at-risk mortgages held by lenders and, as a condition of that underwriting, require the lenders to hold off from foreclosing on the borrowers. Such plans may be attractive to advocates of homeowner rights, especially those who ask why the big banks should get a bailout when the average citizen is struggling from paycheck to paycheck. However, such schemes are rife with the potential for significant abuse, fraud and free rider problems.

The eligibility requirements of the HOPE Program address the potential for fraud and abuse relatively well, by requiring certification of an inability to pay and putting specific penalties in place for fraud.¹²⁰ The FHA's monthly reports to Congress on the implementation of the Program indicate that reviews of applicants are being done to ensure compliance with the certification process.¹²¹ The FHA has created an automated fraud detection tool to ensure compliance with the statutory provisions and identify cases where owner-occupancy may be in question.¹²² The tool has been made available to private lenders as well.¹²³ The FHA has reported that the fraud prevention screening process takes a significant amount of time,¹²⁴ but the delay seems to be an acceptable trade-off to prevent abuse. This functioning screening program could be used as an excellent basis for selecting at-risk homeowners for government assistance.

Though the HOPE eligibility requirements are a good place to start, the terms of HOPE are currently not optimal and should be changed for eligible borrowers. Congress needs to amend the terms of the equity sharing agreement so that homeowners who enter into the HOPE Program are not denied the benefits of their ownership. In the interest of ensuring that the Program is not abused, the five-year phase for equity sharing should be

120. See HOPE for Homeowners Act of 2008, Pub. L. No. 110-289, sec. 1402(a), § 257(e)(1), 122 Stat. 2809 (West Supp. 2008).

121. FED. HOUS. FIN. OVERSIGHT BD., HOPE FOR HOMEOWNERS PROGRAM MONTHLY REPORT TO CONGRESS FOR DECEMBER 2008 4 (2008), *available at* http://www.google.com/url?sa=t&source=web&ct=res&cd=1&ved=0CAcQFjAA&url=http%3A%2F%2Fportal.hud.gov%2Fpls%2Fportal%2Furl%2FITEM%2F605F0BE3363B7042E04400144F9D3D85&ei=DdlZS_-RL426Nui9kPwO&usg=AFQjCNEUdj19RX3WImbCEVfU10mKXIUffg&sig2=Y58dn5PB4PCjhUowTs8wnw.

122. See FED. HOUS. FIN. OVERSIGHT BD., HOPE FOR HOMEOWNERS PROGRAM: MONTHLY REPORT TO CONGRESS FOR DECEMBER 2008 4 (2008), *available at* http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/h4h_monthly_reports_to_congress/H4H%20Report%20to%20Congress%20December.pdf. The FHA reports:

Each of the 300 cases has been run through the automated fraud detection tool. . . . Ninety have been flagged for possible non-compliance under one or more of the following statutory requirements: owner occupancy, ownership of no more than one residential property, and no fraud convictions over the previous [ten] years. An additional 181 cases required a manual search for fraud conviction, as an automated search is unavailable in approximately [ten] states due to privacy restrictions.

Id.

123. *Id.*

124. *See id.*

maintained.¹²⁵ However, the fifty-fifty equity sharing requirement for the life of the loan should be dropped.¹²⁶ Congress also needs to amend the sunset horizon for the legislation, because the process takes significant time. The full effects of the economic crisis are still playing out; as a result, eligibility for HOPE should be extended past its current expiration date in September 2011.¹²⁷

The fact that many of the at-risk mortgages have been securitized also calls for modification of the HOPE Program if it is to be successful. Because the third party holders of the securitized mortgages do not have the institutional capacity to modify loans, they will be unwilling or unable to enter into HOPE's voluntary program. Nonetheless, these holders are facing high default rates and potential losses, and it may be in their economic interest to see the underlying mortgages refinanced on the HOPE Program's terms. Congress should amend HOPE to create a program under the FHA's direction that will actually do the work of negotiating new terms between the borrower and the third party holders. Interested third parties would sign up with the FHA program and borrowers would then work with the FHA instead of the third party, thus removing the institutional problems that are currently in place.

The importance of homeownership for individual and collective economic strength makes it essential that changes be made to the HOPE Program to widen participation and assist more homeowners. Hopefully, this work can be done quickly, but even if it is successful, the reality is that many families have already lost their homes. Action should be taken to create incentives for them to be able to purchase again after the economic crisis is over.

The main objection that can be raised to any of these changes is that taxpayers will be asked to pay for the bad financial decisions of others. Usually such a concern would be quite a valid check. However, because homeownership is so central to the American dream and is actually so beneficial to the nation's future economic strength, this concern should be set aside. The Homestead Act provided a significant transfer of wealth from the state to individuals, simply by virtue of the individual being willing to move and care for the land. While granting land to the homesteaders did not directly cost taxpayers money when the Homestead Act was in place, it was undeniably a wealth transfer.

One major segment of American society missed out on this wealth transfer, though. African-Americans were initially ineligible for making Homestead Act claims, as they were not considered citizens until midway through the Civil War. Trina Williams Shanks' writing on the Homestead Act points out that, even after the war, "the situation of black freedmen and women often depended upon local leadership and conditions."¹²⁸ Very few were able to take advantage of the Homestead Act. Even the Southern Homestead Act of 1866,¹²⁹

125. See HOPE for Homeowners Act sec. 1402(a), § 257(k)(1)(A)–(E).

126. See *id.* at sec. 1402(a), § 257(k)(2).

127. *Id.* at sec. 1402(a), § 257(r).

128. Shanks, *supra* note 17, at 35.

129. Law of June 15, 1866, ch. 124, 14 Stat. 66–67 (1866) (repealed 1876). See Shanks, *supra* note 17, at 35–36 (describing impact of Southern Homestead Act).

which was designed to transfer about forty-six million acres of land in five southern states to the landless freedman, ended up having a limited impact. The land was "was primarily swamp land and pine trees that would have required much capital to improve."¹³⁰ The Act was repealed after about ten years, and it appears that fewer than 30,000 claims were successful.¹³¹

Unfortunately, a disproportionate percentage of the current at-risk mortgages are held by African-Americans. A 2006 study found that nearly 50% of loans given to African-Americans were subprime,¹³² and subprime mortgages account for a disproportionately high percentage of the mortgages currently in foreclosure.¹³³ So African-Americans have been doubly hit in the history of American land ownership: first, by being denied the benefits of the Homestead Act and, now, by bearing the brunt of the subprime mortgage losses.

Despite the fact that an amended HOPE Program would cost taxpayers money, considering the segment that will benefit, it will be well be worth the investment, both for the future economic strength and for correcting a historical injustice.¹³⁴

3. Making Home Affordable

Though the HOPE Program is still in effect, the new MHA has vastly outperformed and essentially replaced HOPE. MHA is an executive branch effort rather than congressional effort to address the housing crisis. It is administered by the Department of the Treasury under a program that the Treasury refers to as the Homeownership Affordability and Stability Plan. Its main components are the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP). It is hoped that these programs will help up to nine million homeowners. There are \$75 billion available for assisting in refinancing and modifying mortgages under MHA's two components.¹³⁵ The \$75 billion consist of a \$50 billion contribution from the Troubled Asset Relief Program funds that were made available to the Treasury as part of the Emergency Economic Stabilization Act of 2008 and a \$25

130. *Id.* at 35.

131. *Id.* at 36.

132. Rachel D. Godsil & David V. Simunovich, *Protecting Status: The Mortgage Crisis, Eminent Domain, and the Ethic of Homeownership*, 77 *FORDHAM L. REV.* 949, 964 (2008) (citing Alan Zibel, *40 Percent of Mortgages Given to Blacks, Hispanics 'High Cost,'* S. FLA. TIMES, Mar. 17, 2008, at http://www.sfltimes.com/index.php?option=com_content&task=view&id=595&Itemid=185).

133. *Id.* at 963.

134. *See id.* at 958 (discussing the racial disparities in homeownership in the United States).

Along with class disparities in homeownership rates, there are considerable racial disparities. White households are most likely to own homes--with 75% of whites owning in contrast to 60% of Asian Americans, 58% of American Indians and Native Alaskans, 49% of Latinos, and 48% of blacks in the [United States].

Id. (citing U. S. Census Bureau, *Housing Vacancies and Homeownership: Annual Statistics tbl.20* (2006), www.census.gov/hhes/www/housing/hvs/annual06/ann06t20.html).

135. *See TARP Oversight Hearing*, *supra* note 80, at 9.

billion contribution from the GSEs.¹³⁶ HARP is structured to help homeowners who are current on their mortgages but whose homes have fallen in value below their current mortgage levels to refinance at lower interest rates.¹³⁷ It is hoped that HARP will help refinance the mortgages of about four to five million homeowners.¹³⁸ In contrast to HARP, HAMP is structured to assist homeowners who are in more complicated financial situations: those for whom a simple refinance will not suffice.

While wading through the various acronyms of MHA can be difficult, homeowners have fortunately found the programs quite accessible. MHA was launched in March 2009, and by July about 235,000 homeowners had already begun the process of modifying their loans under HAMP.¹³⁹ Additionally, over 1.8 million mortgages had been refinanced by the GSEs under HARP.¹⁴⁰

The significantly higher success rate of HAMP and HARP as compared to HOPE is due to the much simpler requirements for homeowner qualification and better incentives for mortgage holders—the banks and the GSEs—to work with homeowners rather than simply foreclose. Homeowners are eligible for HARP if they meet the following conditions: 1) they own a single-family one- to four-unit home, 2) they have a current mortgage guaranteed by Fannie Mae or Freddie Mac, 3) they are current on their payments and 4) the current value of their mortgage does not exceed 125% of the fair market value of their home.¹⁴¹ Since the goal of HARP is primarily to assist homeowners with high interest rates to seek out a refinance, the program need not be too complicated.

HAMP, on the other hand, attempts to modify the structure of homeowners' mortgages much more fundamentally, by reducing the principal, interest rates and monthly payments below certain thresholds.¹⁴² Correspondingly, HAMP eligibility requirements are more complicated. The home must be an owner occupied, single-family one- to four-unit property.¹⁴³ It must be the homeowner's primary residence and still be occupied by the homeowner.¹⁴⁴ The unpaid balance on the home mortgage must be under

136. *Id.*

137. U.S. DEP'T OF THE TREASURY, MAKING HOME AFFORDABLE: UPDATED DETAILED PROGRAM DESCRIPTION 2 (2009), www.treas.gov/press/releases/reports/housing_fact_sheet.pdf [hereinafter MAKING HOME AFFORDABLE: DETAILS].

138. See *TARP Oversight Hearing*, *supra* note 80, at 9.

139. U.S. DEP'T OF THE TREASURY, MAKING HOME AFFORDABLE: SERVICER PERFORMANCE REPORT THROUGH JULY 2009 2 (2009), http://www.treas.gov/press/releases/docs/MHA_public_report.pdf.

140. FED. HOUS. FIN. AGENCY, REFINANCE REPORT: AUGUST 2009 2 (2009), www.fhfa.gov/webfiles/14764/FHFARefiRpt81309F.pdf.

141. See MAKING HOME AFFORDABLE: DETAILS, *supra* note 137, at 2 (explaining the general eligibility guidelines for HARP); see also Making Home Affordable, Home Affordable Refinance: Are You Eligible?, http://www.makinghomeaffordable.gov/refinance_eligibility.html (last visited Oct. 15, 2009) (helping homeowners determine if they are eligible for refinancing under HARP's current eligibility requirements).

142. The target is to get the homeowner's monthly payments on the mortgage to within 31% of their monthly income. See U.S. DEP'T OF THE TREASURY, HOME AFFORDABLE MODIFICATION PROGRAM GUIDELINES 1 (2009), http://www.treas.gov/press/releases/reports/modification_program_guidelines.pdf.

143. *Id.* at 2.

144. *Id.*

\$729,750.¹⁴⁵ Homeowners who are in bankruptcy or are already in litigation over defaulting on their mortgage may still be eligible.¹⁴⁶

If the homeowner meets these requirements and their mortgage servicer is willing, they can access HAMP. The mortgage servicer is then given substantial flexibility under the Program to change the interest rates and repayment timeline in order to reduce monthly payments for the homeowner.¹⁴⁷ The mortgage servicer is required to do its modification in such a way that the new monthly payments will be equal to 38% of the homeowner's monthly income.¹⁴⁸ HAMP will then match dollar-for-dollar with the mortgage servicer to further reduce the monthly payment to equal 31% of the homeowner's monthly income.¹⁴⁹ HAMP also provides upfront incentive payments to the mortgage servicers to induce participation. These payments are usually \$1,000 per successful HAMP application.¹⁵⁰

It is instructive to consider who bears the various costs of this modification process. To a large extent the homeowner is still responsible for most of the mortgage. The mortgage servicer is allowed to amortize outstanding interest, late fees, and other expenses that the homeowner would normally owe into the new principal amount. This means that the homeowner still has to pay almost all his original mortgage balance; he is just getting a very substantial modification of the interest rate, and the term of the loan could be extended as far as forty years. It may be that the mortgage servicer will have to contribute some money in matching dollar-for-dollar with HAMP to lower monthly payments to the required 31% level.

The government also faces costs through HAMP. The first cost is the incentive payment to encourage mortgage servicer participation in the Program. The second cost is the dollar-for-dollar matching that is committed to bringing the homeowner's monthly payment to the 31% requirement. These costs are likely to be substantial over time, especially if participation numbers increase to several million as predicted. Indeed, the fact that there are \$75 billion available for the Program speaks to the large cost commitment that the government is making through these programs.

Though the cost of MHA may stretch into the billions of dollars, the cost is, in reality, only a small part of the money committed to help restart the economy. Additionally, if the analysis in the first section of this Note continues to hold true, then this commitment to maintain homeownership will translate into future economic flexibility and strength for these homeowners and for the country.

145. *Id.*

146. *Id.*

147. *Id.* at 6–8.

148. *Id.* at 1.

149. *Id.*

150. *Id.*

4. Assessing MHA: A Great Place to Start!

MHA has been markedly more successful than HOPE in actually providing options that keep at-risk homeowners out of foreclosure. It would appear from the Program's requirements that the ownership provided by the Program is free and full, just like that of the Homestead Act. Unlike HOPE, MHA does not have equity sharing requirements with the government. This means that, when homeowners who refinanced through MHA sell, refinance, or take out home equity loans on their property, they will have the full use of that equity. This is precisely the beneficial reserve of capital that in the past has been a fertile ground for financing new business ventures, schooling, and other beneficial social goods.

One of the only strong criticisms that can currently be leveled against MHA is that it has not had even higher participation rates. If there are indeed millions of eligible at-risk homeowners who could benefit greatly from a MHA refinance or loan modification, then greater efforts should be made to encourage both the homeowners and the mortgage servicers to participate. It is likely that the mortgage servicers rather than the homeowners are the reticent party, because the homeowners have relatively more to gain from a refinance than the mortgage servicers. Additional financial inducement may be necessary to encourage mortgage services to participate. In this regard, a lesson could be taken from HOPE. The addition in MHA of paying the \$1,000 fee to the servicers for every successful application appears to have been a successful inducement, one which was absent in HOPE. In terms of the millions of dollars that each mortgage servicer has on its books, this \$1,000 fee does not appear very large, but if it has garnered such a response to date, it might be quite beneficial to further increase the fee by a few hundred dollars.

MHA is still a young program, though, and the economic turmoil of 2008 has not completely worked itself out of our economy. Many homeowners still face foreclosure, and it may be that many homeowners who are now current on their loans will have trouble in the coming years if the economic situation causes them to lose their jobs or face other unexpected expenses. Under such conditions, it would be beneficial for MHA to remain flexible and prepared to step up efforts to sweep in more homeowners.

CONCLUSION

Homeownership has played a vital role in spreading the benefits of capitalism to the American people, and it has served as a central source of vital capital for the economic engine. The United States has a proud and long tradition of promoting homeownership with roots stemming back to the founding and blossoming in the passage of the Homestead Act. Since the passage of the Homestead Act, the proportion of American families owning their own homes has been steadily growing. However, the fallout from the mortgage and economic crisis of 2008 greatly threatens some hard won ownership gains. Some important efforts have been started to protect those gains, but it remains to be seen how effective they will be. Significant changes

to the HOPE Program are needed to make it relevant, and flexibility in MHA may be needed if the economic conditions do not improve. Even if support for homeowners comes at the taxpayers' expense, history has shown that, where individual property ownership is concerned, the investment will be well worth it.

