Obama Wrong: Clinton Era Housing Policy Caused Recession, Not Bush Era Tax Cuts

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Investor's Business Daily

President Obama argues Republicans want to go back to pre-recession policies of cutting "taxes for the folks at the very top" and rolling back "regulations on big banks."

He warned: "We tried that top-down approach. It's what caused the mess in the first place."

Did it, though?

Most economists agree the recession was caused by the subprime mortgage crisis, which had little if anything to do with tax policies.

In fact, real economic growth accelerated after 2003, when the Bush tax cuts for top earners and small businesses fully went into effect. The 73-month economic boom of the 2000s didn't end until December 2007, when the housing market collapsed.

So what killed housing?

To hear Obama, greedy bankers were allowed to run amok, rubber-stamping loans for practically anyone with a pulse.

He's right that underwriting was a joke, and as someone who advocated for easier home lending, he would know.

Clinton's Role

Only, it wasn't because regulators looked the other way. Quite the opposite; they encouraged lenders to make risky loans.

Shoddy subprime lending expanded due in large part to federal housing regulations that institutionalized "flexible" mortgage underwriting standards for loan originators and government-backed mortgage giants Fannie Mae and Freddie Mac.

And they, under pressure from Congress and their Housing and Urban Development "mission" regulators, wound up underwriting nearly half the risky subprime and other nonprime mortgages outstanding, fueling the financial market for subprime securities.

While Bush is commonly blamed for the historic housing bubble that burst in 2007, housing experts now agree it began 10 years earlier in 1997 — under a Democratic administration.

The easy-credit orgy that took place over that decade was fed by federal housing policies designed to pump up homeownership rates.

It had a name: the National Homeownership Strategy.

In the mid-1990s, for his part, President Clinton took more than 100 specific executive actions to pry bank lending windows open for previously unqualified borrowers.

For starters, he marshaled 10 federal agencies under the little-known Interagency Task Force on Fair Lending to enforce new "flexible" mortgage underwriting guidelines to combat "lending discrimination in any form."

For the first time, banks were ordered to qualify low-income minorities with iffy credit.

Greenspan's Order

The 1994 policy, which remained in effect during the Bush administration, planted the seeds of the mortgage crisis, as lenders abandoned traditional underwriting standards altogether. Clinton even convinced Federal Reserve Chairman Alan Greenspan to appear in a video commanding all member banks to comply with the administration's new minority-friendly lending guidelines.

The next year, Clinton set numerical targets for lending in predominantly minority Census tracts under a revised **Community Reinvestment Act** (CRA), and added several hundred bank examiners to enforce the tougher CRA rules. Banks that failed had their expansion plans put on hold, a slow death sentence in an era of frenzied bank mergers and acquisitions.

For the first time, CRA ratings were made public, egging on Acorn and other radical inner-city groups that used the reports to extort banks for more than $6 trillion in subprime and other loan set-asides by 2008.

When bankers resisted being saddled with so many additional risky loans, Clinton tapped Fannie Mae and Freddie Mac to take them off their books, while freeing bankers to originate more of the political loans. He directed HUD to hike Fannie's and Freddie's goals for underwriting affordable loans, which remained in force throughout the 2000s.

When the mortgage giants pushed back, complaining it would be hard to meet the higher targets, Clinton had HUD Secretary Andrew Cuomo push them to load up, specifically, on subprime loans.

"In the (October 2000) rule, HUD identifies subprime borrowers as a market that can help Fannie Mae and Freddie Mac meet their goals and also help to establish more standardization in the subprime market," a HUD report (http://www.huduser.org/Publications/pdf/subprime.pdf) stated.

Clinton also authorized Fannie and Freddie for the first time to buy subprime securities to earn credits against the HUD goals.

The mortgage agencies jumped at the chance, since it let them meet the onerous new goals in wholesale fashion.

HUD Quotas

A 2005 HUD report attributed the explosion in subprime securities from 2001 to 2004 to HUD's tougher goals, along with tougher CRA enforcement.

From 2004 to 2006, moreover, the mortgage giants together bought $613 billion, or 20%, of the private-market securities created to meet their demand under HUD rules.

"Lenders have been encouraged by HUD and banking regulators to increase lending to low-income and minority households," the HUD report stated.

"Sometimes these borrowers are higher risk, with blemished credit histories and high debt or simply little savings for a down payment."

For good measure, Clinton late in his second term installed several political appointees — including Franklin Raines and Jamie Gorelick — on the inside of Fannie and Freddie. They in turn bought loans from Countrywide Financial and other subprime lenders that signed "fair lending" contracts with HUD obligating them to meet separate urban lending quotas.

"We want your CRA loans because they help us meet our housing goals," Fannie Vice Chairwoman Gorelick implored lenders gathered at an American Bankers Association conference in October 2000, just after HUD hiked its affordable housing quotas to 50%. "We will buy them from your portfolios or package them into securities."

She described "CRA-friendly products" as mortgages with less than "3% down" and "flexible underwriting."

By 2004, powerful Democrats in Congress such as Rep. Barney Frank were ratcheting up pressure to buy riskier mortgages for the "underserved."

That year, Fannie Chairman Raines begged mortgage bankers gathered in San Francisco for more subprime loan production: "We have to push products to people who have lesser credit quality."

In 2007, even as subprime mortgages were defaulting, Fannie CEO Daniel Mudd assured Frank in testimony in front of his House Financial Services Committee that Fannie had continued its "entry into the subprime market, which helped us meet our HUD affordable housing requirements."

Freddie CEO Richard Syron also loaded up on subprime securities to meet HUD quotas.

"We bought them for goal purposes," he explained to investors gathered at a Goldman Sachs & Co. Financial Services Conference in New York in December 2007.

Earning Points

Thus the government, through its housing policies, created a feeding frenzy for subprime loans.

In fact, it put Fannie and Freddie and private lenders in competition for them. All were under pressure to hit affordable housing targets enforced by HUD and by Treasury (through its army of CRA examiners), with intense oversight from affordable-housing advocates in Congress. The more subprime mortgages they underwrote, the more points they earned with regulators.

The Justice Department also played a key role in the subprime scandal.

Federal prosecutors sued banks and lenders for allegedly discriminating against minority borrowers, driving banks and mortgage lenders alike deeper into risky territory.

Another Chance

Aggressive action in the 1990s under Attorney General Janet Reno — and her deputy, Eric Holder — led to permanent changes in lending practices.

To guard against charges of racial bias, lenders set up "fair lending review boards" solely for the purpose of giving rejected minority loan applicants a "second look."

Together, these federal policies for the first time threw millions of previously unqualified buyers into the mortgage mix.

"Over the past 10 years, there has been a 'revolution in affordable lending' that has extended homeownership opportunities to historically underserved households," HUD trumpeted in 2004. "Fannie Mae and Freddie Mac have been a substantial part of this 'revolution.' During the mid-to-late 1990s, they added flexibility to their underwriting guidelines (and) introduced new low-down-payment products.

"Data suggest that the industry and (Fannie and Freddie) initiatives are increasing the flow of credit to underserved borrowers," the HUD report continued. "Between 1993 and

2003, conventional (non-FHA) loans to low-income and minority families increased at much faster rates than loans to upper-income and non-minority families."

Consequently so did delinquency rates. By the mid-2000s, many of these families had refinanced into even riskier adjustable-term subprime loans, which defaulted in droves in 2007 and 2008.

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So who cares about this now? Answer: Certainly NOT Obama and the Democrats.