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Chapter 6

EVERYONE THINKS REPUBLICANS CAUSED THE MORTGAGE CRISIS…

Americans wondering who was responsible for the mortgage crisis should ask themselves a question: is owning a home a privilege or a right?

Despite the meltdown in 2008, the seeds for the mortgage crisis were sown much earlier by a Democrat Party long convinced homeownership was an entitlement.

As this chapter shows, once that basic premise became conventional wisdom, it was all downhill from there.

If one listens to the mainstream media and many Democrats, the blame for the mortgage crisis rests with the Republicans and the Bush administration. They've convinced the public that Democrats had nothing whatsoever to do with our current financial woes.

Precisely the opposite is true: Democrats created the lax mortgage policies that precipitated the crisis while simultaneously stifling Republican efforts to prevent it.

The history of the crisis started with the Community Reinvestment Act (CRA), signed into law by Democrat President Jimmy Carter in 1977. The law was designed to foster homeownership in low-income communities by pushing banks to aggressively lend to low and moderate income people. At first, it was easy to comply with the CRA. Banks merely had to demonstrate that they did not discriminate in making loans in poor and black neighborhoods. [1]

When Democrat Bill Clinton became President in 1992, he broadened the Community Reinvestment Act in ways Congress had never intended. In 1995, rather than submit legislation that the Republican-led Congress was certain to reject, Clinton bypassed Congress entirely, ordering the Treasury Department to rewrite the CRA rules. [2]

As a result, banks were forced to fulfill loan "quotas" in low income neighborhoods. [3]

That wasn't the only problem. CRA also allowed community activist groups such as ACORN (Association of Community Organizations for Reform Now), for whom Barack Obama once worked in Chicago, and NACA (Neighborhood Assistance Corporation of America) to file complaints that could affect a bank's CRA rating. Failure to comply with CRA or a bad rating meant a bank might not be allowed to expand lending, add new branches or merge with other companies. Banks with poor CRA ratings were also hit with stiff fines. [4]

This rewrite of CRA gave activist groups like ACORN and NACA unprecedented power. Protests often held in bank lobbies or in front of the homes of bank officials, coupled with threats of litigation, allowed these groups to extort huge sums of money from financial institutions. [5] In response, financial institutions began allocating more funds to low-income, high risk borrowers.

Loans started being funded on the basis of race and often little else.[6] CRA became an excuse for lowering credit standards. Many Democrats have claimed that banks subject to the CRA represented few of the mortgages that led to our current problems. Not true. Nearly 4 in 10 subprime loans made between 2004 and 2007 were funded by CRA-covered banks such as Washington Mutual and Indy Mac. [7] Many other subprime lenders not covered by the Act were, in effect, beholden to CRA mandates because they were owned by banks that were subject to it. [8]

Since CRA only covered banks, the Clinton administration created a separate department at Housing and Urban Development to police "fair lending" policies at other institutions such as Countrywide and lending behemoths, Fannie Mae and Freddie Mac. [9]

The result? Countrywide made more loans to minorities than any other lender, and not surprisingly, was one of the first lenders overwhelmed by loan defaults. [10]

As groups like ACORN ran their intimidation campaigns against local banks, they eventually hit a roadblock. Banks told them they could afford to reduce their credit standards by only a little – since Fannie Mae and Freddie Mac refused to buy up these risky loans for resale on the secondary market. ACORN realized that unless Fannie and Freddie were willing to relax their credit standards as well, local banks wouldn't make enough loans to individuals with bad credit histories or with very little money for a down payment. [11]

Democrats such as Barney Frank (D-MA), Ted Kennedy (D-MA) and Maxine Waters (D-CA) allied with the Clinton administration to broaden the acceptability of these risky mortgage loans. When the Republicans attempted to restore fiscal sanity by paring back the CRA, they were stymied by Democrats — and by ACORN. [12]

In 1995, an unrestrained Clinton administration announced a comprehensive strategy to push homeownership in America to new heights – regardless of the compromise in credit standards that this would require. Fannie and Freddie were given massive subprime lending quotas, which would increase to about half of their total business by the end of the decade. [13]

Then came the single most catastrophic decision leading to the housing crisis: Clinton legalized the securitization of these mortgages, which allowed Fannie and Freddie to finance everything by buying loans from banks, then repackaging and securitizing them for resale on the open market. [14]

Thus began the meltdown. In 1997, Bear Stearns handled the first securitization of CRA loans — $385 million worth — all guaranteed by Freddie Mac. [15] Subsequently, a subprime market that had been a relatively modest part of the mortgage business with $35 billion in loans in 1994 soared to $1 trillion by 2008. [16]

Regrettably, this massive bundling of subprime mortgages wound up poisoning the entire mortgage industry.

Fannie and Freddie used their "affordable housing mission" to avoid restrictions on their accumulation of mortgage portfolios. They argued that if they were constrained, they wouldn't be able to adequately subsidize affordable housing. As a result, by 1997, Fannie was offering mortgages with a down payment of only 3 percent. By 2001, it was purchasing mortgages with "no down payment at all." [17]

By 2007, Fannie and Freddie were *required* by Housing and Urban Development to show that 55 percent of their mortgage purchases were to low and moderate income borrowers, and, within that goal, 38 percent of all purchases were to come from underserved areas (usually inner cities). [18] Meeting these goals almost certainly required them to purchase loans with low down payments and other deficiencies that would characterize them as subprime or Alt-A. [19]

The decline in lending standards was also facilitated by competition. Fannie and Freddie were now competing with private-label mortgage lenders such as investment and commercial banks to fulfill the affordable housing requirements imposed by Congress.

The inevitable result? Everyone was scraping the bottom of the mortgage barrel in search of new borrowers.

Once the looser lending standards were offered to low and middle income buyers, it was naïve to believe that they wouldn't lead to more relaxed standards for higher-income and prime borrowers as well. This spreading of looser standards to the prime market greatly increased the availability of credit for mortgages, and ultimately led to the bubble in housing prices. [20]

Unsurprisingly, Fannie Mae and Freddie Mac were huge campaign contributors to Congress, spending millions to ensure no reform would be implemented to restrict them. In all, 354 members of Congress received funds. The bulk of the money went to Democrats. [21] Between 1989 and 2008, the leading recipient of Fannie/Freddie campaign money was Connecticut Democrat Chris Dodd, the Senate Banking Committee Chairman, who collected more than $165,000. Dodd opposed restrictions on Fannie and Freddie and pushed hard for the continuance of subprime loans. In second place was then-Senator Barack Obama, who, in just three years in the U.S. Senate, took in $126,000. Third, was Massachusetts Democrat John Kerry, who received $110,000. [22]

Since the 1990s, Fannie Mae and Freddie Mac have been run by Democrats. From 1991 to 1998, Fannie Mae was led by James Johnson, a long-time aide to former Democrat Vice President Walter Mondale. Johnson made headlines in 2008 when Barack Obama picked him to chair his vice presidential selection committee. He had to resign in disgrace when it was revealed he had taken out at least five below-market real estate loans totaling more than $7 million from Countrywide Financial Corporation. [23]

Johnson's successor as head of Fannie Mae, Franklin Raines, had previously served as a budget director to President Bill Clinton. From 1995 to 2005, Raines pocketed nearly $100 million in compensation before leaving because of a scandal involving profit and loss reports manipulated to increase his annual bonuses. [24]

Another well-known Democrat, Jamie Gorelick, served as vice chair of Fannie from 1998 to 2003. Prior to that, she was Janet Reno's Deputy Attorney General during the Clinton years, when the Clinton Justice Department was aggressively compelling banks to make subprime loans to unworthy borrowers. [25] And Rahm Emanuel, current White House Chief of Staff, also served as a director at Freddie Mac. [26]

Most Americans are not aware that Fannie and Freddie, while lining the pockets of politicians, also funnels hundreds of millions of dollars to a host of leftist groups and causes promoting the Democrat agenda. [27] The grant-making arms of Fannie and Freddie – specifically the Fannie Mae Foundation and the Freddie Mac Foundation – gives tens of millions of dollars each year to predominantly left-wing organizations such as the American Civil Liberties Union; the NAACP and National Urban League; the left-wing financier the Tides Foundation; pro-illegal immigration groups like the Mexican American Legal Defense and Education Fund, and the National Council of La Raza; pro-Democrat community activist groups like ACORN; and former president Jimmy Carter's Carter Center. [28]

The Republicans were not oblivious to Fannie and Freddie's problems. Bush's 2001 budget called runaway subprime lending a "potential problem" and warned of "strong repercussions in financial markets." [29] In July 2003, Senators Chuck Hagel (R-NE), Elizabeth Dole (R-NC) and John Sununu (R-NH) introduced legislation to address regulation of them. The bill was blocked by the Democrats. [30] In September 2003 Bush's Treasury Secretary, John Snow, proposed what *The New York Times* called "the most significant regulatory overhaul (of Fannie and Freddie) in the housing finance industry since the savings and loan crisis a decade ago." [31]

Did the Democrats in Congress welcome reform? Here's how Barney Frank

(D-MA), the ranking Democrat on the Financial Services Committee, responded:

“I do not think we are facing any kind of a crisis. That is, in my view, the two government sponsored entities we are talking about here, Fannie Mae and Freddie Mac, are not in crisis.... I do not think at this point there is a problem with a threat to the Treasury.... I believe that we, as the Federal Government, have probably done too little rather than too much to push them to meet the goals of affordable housing and to set reasonable goals.” [32]

In 2005, Republican Senators Hagel, Sununu, Dole, and later John McCain reintroduced legislation to once again address regulation of Fannie and Freddie. In essence, the bill would have required Fannie and Freddie to eliminate their investments in risky subprime loans.[33] According to Kevin Hassett, writing in *Bloomberg.com*, “if that bill had become law, then the world today would be different.” [34]

But the legislation didn’t become law for a single reason: Democrats opposed it on a party-line vote in the Senate Banking Committee, signaling that this would be a partisan issue. Republicans, tied in knots by the tight Democrat opposition, couldn’t even get the Senate to vote on the bill. [35]

Had the bill passed in 2005, the mortgage meltdown would have been far less intense. In 2005, 2006 and 2007, approximately $1 trillion of these terrible mortgage loans were funded by Fannie and Freddie at a time when housing prices were at their highest. When housing prices fell dramatically, losses from those mortgages turned out to be tremendous.

Bottom line: if Fannie Mae and Freddie Mac weren’t buying these subprime loans, the market for them would likely not have existed.

Rep. Artur Davis (D-AL) now admits Democrats were in error:

“Like a lot of my Democratic colleagues, I was too slow to appreciate the recklessness of Fannie and Freddie. I defended their efforts to encourage affordable home ownership when in retrospect I should have heeded the concerns raised by the regulator in 2004. Frankly, I wish my Democratic colleagues would admit when it comes to Fannie and Freddie, we were wrong.” [36]