

A bias against Main Street

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In the throes of the Great Depression, President Franklin D. Roosevelt and Congress helped alleviate a foreclosure crisis by creating Fannie Mae, the first government-sponsored enterprise (GSE).

Fannie Mae effectively established a liquid, national market purchasing existing mortgages, allowing local banks and thrifts to reinvest assets for further lending. This expanded the availability of mortgage credit for Americans. Before that, credit conditions for home loans were essentially local in nature.

Ironically, this solution to the 1930s foreclosure crisis is a central cause in the current foreclosure crisis.

Much debate has occurred about the federal government's implicit backing of Fannie Mae, Freddie Mac and other GSEs that enabled the looser lending standards that fed the housing bubble.

The current focus has been on those who obtained mortgages — many of whom had weak credit histories, unverified income (or income not supportive of home ownership) or made little to no down payment.

But it's also important to ask where these homes occupied by underwater homeowners are located. In some areas, real estate values have been stable and even actually risen.

Why? Remember the adage "location, location, location."

There are common characteristics to those locations holding their value: Walkable areas with mass transit access, a mixture of uses, proximity to employment centers, and, in most cases, a complex mix of housing types and sizes are doing fine.

Meantime, single-use subdivisions have taken the biggest hit, something that hasn't happened before. A large percentage of underwater homeowners with GSE-underwritten mortgages populate the suburban fringe. House prices have fallen 57.8 percent and 54.5 percent, respectively, in the low-density, sprawling Las Vegas and Phoenix metropolises, compared with just 14.9 percent in the denser Philadelphia metropolitan area, according to Case-Shiller.

Historically, the opposite holds true. This partly had to do with a "flight to quality" — when suburban jurisdictions were perceived to have better and cheaper public services and superior quality-of-life. And part had to do with consumer preferences favoring homogeneous suburban living.

Today, neither factor is as strong as before. While suburbs may still carry the public services edge, the same is not necessarily true in the quality of life.

Many urban downtowns and older suburbs have enjoyed a renaissance in dining, retail and entertainment options. Moreover, the negative stigma of urban living held by previous generations is not as prevalent among Gen X and Gen Y.

Housing finance needs to dovetail with current consumer preferences.

Existing federal regulations, particularly those at Fannie and Freddie, hold incentives for sprawl and

disincentives for urbanism. Given the central role these agencies play, liquidating them would send the fragile housing market into freefall. However, regulations based on perceived risk must be re-evaluated.

Because Fannie and Freddie are the primary mortgage market makers, their underwriting criteria influence the types of real estate that banks will finance.

Consider: If a developer wishes to build a mixed-use, high-density project, it is difficult to obtain conventional construction financing and borrowing costs will be higher. These projects often fail to gain Fannie or Freddie "approval" because of restrictions placed on allowable ratios of residential and commercial space. The current ratio permits 20 percent to 25 percent commercial space when building a mixed-use structure. That ratio should be eliminated or raised to at least 50 percent.

This restriction rarely affects large condo buildings because ratio limits can be overcome by building higher. But if a developer enters a low-rise neighborhood where high-rise construction is not appropriate, economical or permitted by zoning, the ratio creates a financial impediment toward mixed-use development.

Say you wanted to develop a building with a coffee shop on the ground floor and two floors of condos above in downtown Lancaster or Easton. Both downtowns have existing pre-World War II buildings, yet under Fannie rules the condos would be ineligible because they share space with a coffee shop that makes up more than 20 percent of the building's value.

Fannie and Freddie have effectively outlawed the financing of America's traditional Main Streets.

This hurts consumers who increasingly prefer Main Street living and taxpayers who oftentimes subsidize redevelopment projects that would be financed privately if Fannie didn't discriminate. Public funding takes the form of complicated tax-increment financing, low-interest loans and outright grants.

Much of this local subsidy would be unnecessary if Fannie and Freddie allowed greater flexibility in housing development.