AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Edward Pinto

Bass Connections

Duke University

2020

PREFACE

The following Oral History is the result of a recorded interview with Edward Pinto, conducted by Maria Paz Rios on December 9, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

Transcriber: Carolyn Chen	Session: 1
Interviewee: Edward Pinto	Location: By Zoom
Interviewer: Maria Paz Rios	Date: December 9, 2020

Maria Paz Rios: I'm Maria Paz Rios, an undergraduate student and member of the Bass Connections American Predatory Lending and the Global Financial Crisis team, and it is December 9, 2020. I am currently in Miami for an oral history interview with Mr. Edward Pinto, currently Director of the AEI Housing Center at the American Enterprise Institute, who has joined me via Zoom. Mr. Pinto, thank you for joining me today.

Edward Pinto: My pleasure. Thank you, Maria.

Maria Paz Rios: I'd like to start by establishing a bit about your background. I understand you received your B.A. from the University of Illinois at Urbana-Champaign in 1971 before continuing on to get a J.D. from Indiana University. Is that right?

Edward Pinto: That is right.

Maria Paz Rios: After your J.D., when and how did you first get involved with the mortgage market?

Edward Pinto: Right out of law school, my first job was with the Michigan State Housing Development Authority in Lansing, Michigan, which is a state agency involved in affordable housing, and I was there as an attorney. And after about two and a half years, I became general counsel. And I was general counsel for about five and a half years. So, I spent a total of eight years at Michigan State Housing Development Authority. I then left the Michigan State Housing Development Authority and became an attorney at the Mortgage Guaranty Insurance Corporation [MGIC]. My entire career has been in finance and housing. I spent a couple of years there as an attorney, and then left there in 1984 and started at Fannie Mae [Federal National Mortgage Association], in 1984. I was initially a Vice President in negotiated transactions. And then I became the head of marketing and product management as a Senior Vice President. Then for about two and a half years, I was an executive vice president and chief credit officer.

I then left Fannie Mae in 1989 and set up my own business as a consultant and did a consulting practice pretty much full time through about 2010 in the housing finance area, doing a lot of different projects and assignments, but all in housing finance, mostly single-family. I had done some in multi-family earlier in [my] career. And then in 2008, I was still doing my consulting practice, but I started really focusing on the developing financial crisis, particularly on Fannie Mae and Freddie Mac, who ultimately were taken over and put in conservatorship in September of 2008.

So in 2008, I started focusing on what was being said about the developing crisis in the mortgage industry and realized that much of what I was reading didn't

comport with what my knowledge base was on the industry and the depth that I had in that knowledge. So, I started assembling my own research— I did that for about two years. And then in 2010, I joined the American Enterprise Institute as a resident fellow. And in 2013, along with a colleague, we started the Housing Center, which does research into housing markets and housing finance across the entire country. So, that brings us up to the present.

Maria Paz Rios: …[At] Fannie Mae, what were some of your responsibilities as Chief Credit Officer?

Edward Pinto: As the head of marketing and product management, I was responsible for the affordable housing programs, among other things [of] the entire mortgage market, multifamily and single-family, but included the affordable housing efforts that Fannie Mae had. And as Chief Credit Officer, I was responsible for establishing the credit parameters for all of Fannie Mae's products, both multifamily and single-family, including affordable housing products.

Maria Paz Rios: What were some of the affordable housing programs at the time? What did they look like?

Edward Pinto: There [were] two in particular. There was the Community Reinvestment Act and the Home Mortgage Disclosure Act, both passed in the latter part of the 1970s. A woman named Gale Cincotta was instrumental along with Senator Proxmire from Wisconsin in getting those put into legislation. Gale was from Chicago, and I got to meet Gale in about 1985 or 1986. So, we started talking about affordable housing programs and how one might construct them and what the underwriting parameters might be. She was interested, of course, in flexibilities in those parameters. And I was interested in safety and soundness, making sure that the borrowers were protected from needless foreclosures and delinquencies, and that Fannie Mae was also protected. So, we basically ended up with a program that incorporated a number of the features that she was interested in, on a pilot basis. And the lenders, these were banks that were doing those programs, were responsible for the credit risk on them, which helped assure us that loans would be done in a way where credit risk was being evaluated more accurately and precisely, since they were taking on the risk. That continued through my tenure as Chief Credit Officer, and I'll come back to what happened after I left in a moment. At the same time—again, it was around 1986 or so—we started a program to purchase tax-exempt bonds that were used to finance single-family mortgages by state housing finance agencies. [We] started a program that eventually acquired about $2 billion of those types of bonds. Those were two of the explicit affordable housing efforts that were undertaken.

Maria Paz Rios: At that time, how would you describe the internal culture within Fannie Mae?

Edward Pinto: Well, Fannie Mae had just come through, in the early ‘80s, two near-death experiences, financially. One was interest rate risk— Fannie Mae, as a result of the 1968 Housing Act [Fair Housing Act of 1968], which is part of the Great

Society efforts under Lyndon Johnson, was effectively required to purchase about $5 billion of multifamily FHA-insured [Federal Housing Administration] loans in about 1970 to 1971. Those $5 billion—which sounds like a small number today when Fannie Mae and Freddie Mac [Federal Home Loan Mortgage Corporation] have $5 trillion outstanding— [but] $5 billion was a huge number back then. And Fannie Mae bought this $5 billion, put it on their balance sheet—this was before mortgage-backed securities [were] developed—and funded them for about ten years. The interest rates on those loans were subsidized down to about 1%, but the interest rate that Fannie Mae got pre-subsidy was, give or take, 4%.

That was fine as long as interest rates were low, but starting in the '70s, stagflation became a factor. [With] inflation and a stagnant economy, interest rates started going up and up and up. And by the early 1980s, interest rates, short-term, were roughly 16% or 17% and long-term were 16% or 17%. So, it was kind of "choose your poison." Fannie Mae still had, roughly, nearly $5 billion left because these loans had forty-year terms and there were no prepayments on them as they were subsidized down to 1%. And so, the balance left after ten years was about the same as what it started at: about $5 billion. You can do the math. If you're earning 4% and interest rates are say 16%, you're losing 12% on $5 billion or $600 million per year. $600 million is a lot of money when Fannie Mae, in I think 1981, it lost a couple hundred million dollars.

So, the couple hundred million dollars that Fannie Mae lost was due to this affordable housing effort that it had been required to enter into as a result of the 1968 Housing Act. Yet, it basically made Fannie Mae insolvent, and it was losing money for a number of years. In response to that, Fannie Mae decided—this was before I got there—in about 1982, that in order to generate more revenue, it would buy high-risk loans, and then charge a fee upfront from the originator who wanted to sell those high-risk loans, and then book that fee as income. And, therefore, that would be used to offset the negative on this $5 billion of multifamily.

Well, that worked fine in the beginning, but by 1985, those loans were going bad. Delinquency rates were starting to run rampant, and Fannie Mae had many tens of thousands of foreclosures and started losing money on the foreclosures of the loans that were purchased in order to offset the interest rate problem. So, one problem began another problem. At the same time, the Alaska Housing Finance Agency had put together an affordable housing program for the State of Alaska. As many people know, Alaska gets a lot of money—or used to, it gets less now, I think—but a tremendous amount of [tax] money from the oil pipeline. And the oil pipeline money started flowing, no pun intended, I think in the '70s or late '60s, whenever it was, but by the early '70s, it was massive amounts of money. And so the Alaska Housing Finance Agency decided to offset these very high interest rates of 16%, 17%. Even if they were selling tax exempt bonds, tax exempt bonds might yield say 13%.

And so, they decided to buy down the interest rates from 13% to a much lower number— I don't remember what that number might've been. And this is one of the lessons that I learned: that ended up distorting house prices hugely in Alaska, and that's because there were mortgage limits. Mortgages were basically for the full amount of the sales price. $80,000 might be a one-bedroom limit, and $100,000 might be a two-bedroom limit. Well, there was a lack of supply. It's very hard to build up in Alaska. So, what the property owners did was to convert old apartment buildings into condos. And if it was a one-bedroom condo, they priced it at $80,000, and if it was a two-bedroom, they priced it at $100,000. It didn't make any difference where the condo was located. It didn't make any difference what amenities there were. It could be next to the trash container, or it could be across from an open space. They priced them all the same because only a fool would price them less than $80,000 on a one-bedroom because the government was going to provide a subsidy up to $80,000 and only a fool would try to price it more than $80,000 because the subsidy didn't apply for more than $80,000. And this is where I really first learned that when you do a government affordable housing program, and you have a supply constraint, and you create demand, the government subsidy gets capitalized into higher prices. So, rather than making housing more affordable, ironically, it makes it less affordable.

That's a concept a lot of people have a very difficult time getting their arms around. We've proven it time and time again at the Housing Center, but that's what happens. Therefore, you have to be very careful when you're doing affordable housing programs that increase demand against a fixed supply, particularly if that supply is in short supply. And, of course, in Alaska, the supply was incredibly short. With a building season of three or four months, so it's hard to build anything, etc. And there was huge demand because of all of the money flowing from the pipeline and everything else going on in Alaska. Long story short, by 1985, oil prices had collapsed from, I don't remember, $30 a barrel to $8 a barrel—a huge collapse in prices. And house prices collapsed.

Those condos that were selling for $80,000 went down to $20,000. And they had financed a bunch of mobile homes for $40,000, and those actually went down to $0. They actually had negative value because they had to move them and still pay for the pad rent that the mobile homes were on. So, they actually had negative value. I remember talking to the executive director at Alaska and he said, "Yeah, we're trying to interest the Japanese." They were flush with money back in the ‘80s before their market collapsed in the late ‘80s. "Put them on a container ship and maybe they can use them for whatever." They were trying to sell them as hunting lodges that people could just put out in the woods to go hunting bear and moose. They were willing to just ship them anywhere just to get them off the pads and stop the pad fees.

I was up in Alaska a few times during the course of this as Chief Credit Officer to work through the workout issues. And I remember looking at one of these condos. And it was a forty or fifty-year-old two-story apartment building that wasn't in the greatest shape, and it had a double-barreled corridor, apartments

on either side of a hallway. The units had been sold as part of a condominium. And we looked at the unit which was now selling for $20,000. And our servicer, the person who handled servicing up there for us, said, "Oh, yeah, we just got an offer at $20,000." And one of the other executives that was with me turned to me and said, "Boy, based on what I've seen, I don't feel good about this person buying it for $20,000. I think she's overpaying."

So, again, I learned that you can have lots of mistakes with affordable housing programs if they're done improperly or without proper forethought. And secondly, if you drive prices up, they can come down a tremendous amount. A boom can turn into a massive bust. And so, once I left Fannie Mae in 1989—and as I said, I'd been Chief Credit Officer and I had required that, as I mentioned earlier, these affordable housing programs that were done with Gale Cincotta and others had to be guaranteed or the risk had to be undertaken by the originating bank. That requirement was changed within a couple of months after I left to not require that anymore. At the same time, the chairman and CEO I had worked under, retired at the end of 1990. And in 1991, a new chairman and CEO came in, and started expanding tremendously [Fannie's] affordable housing programs. He announced in late 1991, a $10 billion affordable housing program. It had only been a relatively short time since I'd left Fannie Mae, and I remember thinking, "Boy, $10 billion. I wouldn't know where to start on how to put out $10 billion safely." And so, they did the $10 billion, which they were able to do very rapidly in a year to eighteen months.

In 1992, Congress passed the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), which had a requirement that Fannie and Freddie meet affordable housing mandates…

The requirement started out at about 30% and then worked up based on what HUD [Department of Housing and Urban Development] would put in place subsequent to that. In 1994, the same chairman that did the $10 billion program announced a $1 trillion – with a "t"— program. That became the first of many that Fannie did. And then Freddie got into it with its own series of $1 trillion programs, and Countrywide, another infamous lender, over time came up with their multi-trillion-dollar affordable housing programs over the next ten or twelve years. I remember when I saw this $1 trillion program thinking, "Oh my gosh, this is really dangerous. I don't know what's going to happen except it can't be good.…

I was doing consulting work and had my solo firm that was doing that work and really wasn't involved in the public sphere. But I followed the market very closely during that time period. I was actually working with a number of lenders and others for my consulting work and putting together databases to track what was going on and things like that. So, I was more or less familiar with how the market was proceeding. And I also paid a fair amount of attention to what Fannie and Freddie were doing. But I realized that this was going to create problems. When Congress passed this affordable housing requirement in 1992 thinking that housing was "unaffordable." I've since, as part of my research

effort, gone back to 1992, and housing, historically, in 1992 was quite affordable across all price points. In that year the median house relative to income [median house price divided by the median income] across the country was 2.6 times. And by the time the affordable housing effort that was launched in 1992 by Congress—and then additionally launched by other things that CRA [Community Reinvestment Act] and other events that occurred in the ‘90s.By 2006, the house to price income nationally was up to something approaching 5 [times]. The affordable housing effort turned out to be the unaffordable housing effort. And of course, we now know that as a result of that unaffordable housing effort and the roughly 8 million foreclosures that resulted, untold havoc wrecked on millions upon millions of families who lost their homes, many had lost their credit, many who didn't lose their homes, but had to sell and then moved into rentals.

The result was a huge boom and huge bust. And during the entire time from the mid to late ‘90s through 2006, we had a seller's market, which means there are more buyers than sellers, which means there's more demand than supply. And yet, the government was constantly adding additional leverage to the marketplace through these programs, and the private sector was following suit. And at the same time, interest rates were also going down. Interest rates in 1992 were around 9%, maybe even closer to 10%... By the time you got to 2005, you were at 5.5%, maybe 6%...

So, you had a series of events. I call it the two punchbowls. Punchbowl number one is the monetary punchbowl. And the reason it's called a punchbowl is because a long-standing Fed [Federal Reserve System] Chairman from 1951 through the 1960s named William McChesney Martin gave a speech in 1955 in New York. He was in the process of raising interest rates because housing inflation, among other inflation factors, was rampant, and he was trying to tamp down this inflation. He gave a speech in which he said, "I feel like the chaperone at a fraternity party whose job it is to take away the punchbowl just when the party gets going." And that's how he described his job. And for decades after, this metaphor was used to describe how the Fed operated relative to interest rates. We've gotten away from that, big time, in the last three years, but that's another story.

But there's a second punchbowl, the affordable housing or leverage punchbowl. And unfortunately, when the government tries to limit that punchbowl to just certain income groups or certain other characteristics like first-time buyers, they have a very hard time doing that. The entitlements in the United States tend to expand to the middle class. Many of the changes that occurred in the ‘90s and the aught years in terms of underwriting ended up expanding broadly throughout the entire lending landscape. For example, eventually, the government ended up with zero down payments by 2000 on conventional loans, including Fannie and Freddie. But those spread to largely repeat buyers. So, even repeat buyers who were selling a house [and] gaining the equity on the sale, were not putting much of that equity back in. They were taking out very large loans because the interest rate was low and because they could, in earlier

generations, they could not. Likewise, debt-to-income ratios exploded where 28% on a front-end ratio[1], 36% on the back-end ratio[2], was considered the maximums, without compensating factors, that went to 33% and 38%, then forgetting more about the front-end factor and going to the back-end factor, looking at 43%, looking at 45%, looking at 50% as the back-end [factor] where it had been 36%. So, that was another credit expansion.

But then there was a third credit expansion that took place, which was the low doc [low documentation loan], no doc [no documentation loan], which was not validating or verifying income. That is a bad idea. In housing, bad ideas tend to resurface and circle back every seven to ten years, as does another bad idea, which was negatively amortizing loans. And so, the first low doc loan was originated in about 1983, called Mortgage Power by Citibank or Citi Mortgage. And it had a particular purpose. We keep hearing that same purpose even today, thirty-five years later. That purpose is "People who are self-employed and people who are in gig economy have a hard time verifying their income. Therefore, we need a way to get them qualified." Mortgage Power was to do just that. And as often happens in the housing finance area, ideas that start out with a particular purpose end up morphing. Those particular purposes are lost, and they morph into a more general usage. So, by 1989, this very targeted program—maybe 5% or 6% of the population is self-employed, maybe 3% or 4% are gig employees—by 1989, 30% or 40% of people were getting low doc, no doc loans—clearly, not because of the reason that it was originally postulated, but because you can make more loans that way.

Those loans hit the fan. And that program, that availability had to be shut down. Fannie Mae and Freddie Mac shut it down. They were the biggest buyers by about 1990, '91. They shut it down in '90 or '91, and others shut it down. And it was shut down until about 1996, and then it started up again. People forgot what had happened. By the early aught years, it had regained much of its vigor. I think Freddie got back into it in '98. Fannie got back into it maybe a year or two later. By 2003, Fannie and Freddie were once again the largest acquirers of these loans. And throughout the rest of the aught years up until 2007, Fannie and Freddie were the biggest investors and acquirers of these loans.

But the private sector also did a lot of them, particularly, in the private mortgage-backed securities market, although Fannie and Freddie were also the biggest investors in the private mortgage-backed securities markets, both the subprime and low doc, no doc [also called Alt-A] markets. So, it blew up again. And that led, in part, to the Dodd-Frank Act [Dodd-Frank Wall Street Reform and Consumer Protection Act] and the qualified mortgage definition, which requires there be a determination of ability to repay, a concept that seems to go along with getting a loan, but, again, we'd forgotten about it on a couple of occasions.

---

[1] The front-end ratio is also referred to as the mortgage-to-income ratio.
[2] The back-end ratio is also referred to as the debt-to-income ratio.

The result was that this easing of credit along with easing of interest rates allowed house prices against a relatively fixed supply—remember homes were being built at not quite record rates, but quite substantial rates in the aught years, but demand was still going up faster than builders could build them. And so, the month's inventory was still deep in the seller's market area. A buyer's-market-seller's-market equilibrium is around six months. And I believe the lowest it ever got was around three and a half months in 2005. So, even at the height of all of this home building that was going on, in 2005, there was still a very tight market. And so house prices were going up like gangbusters like they are today. They were going gangbusters in 2004, 2005. And in 2006, they didn't. And that didn't end until basically the end of 2006, early 2007. So, I'll end there as background.

Maria Paz Rios: What were the key goals of Fannie Mae while you were an executive there, and did those goals change in any way in the run-up to the crisis? And if so, how did they change?

Edward Pinto: I think that the broader key goal was just survival. When I started, Fannie Mae was losing money because of that multifamily [crisis]. We affectionally called it the block of titanium because it never went away. It didn't amortize. It didn't prepay. It just was there. And it was big. But then we had to shift from buying risky loans. So, when I started in September 1984, I was head of negotiated transactions. And at that point, 80% of Fannie Mae's single-family acquisitions came through a negotiated transaction... I had been there [for] about two weeks, and one of the people that worked for me said, "Oh yeah, we buy cash for trash." I said, "What do you mean we buy cash for trash?"[3] He goes, "Yeah, Fannie may, but Freddie won't. What we buy Freddie won't buy."

Freddie didn't have the problem of the block of titanium. And they didn't have the interest rate problem because they had a very small portfolio relative to their total outstanding, which were in PCs, or participation certificates, a type of mortgage-backed security. And so, they were making money, and they were also part of the government at that point. They were part of the Federal Home Loan Bank Board system. We had to switch gears from cash for trash to lower-risk products, which we did in 1985 while I was head of marketing. We basically rewrote the Fannie Mae selling guides and looked at what had caused this massive increase in defaulted loans in the early ‘80s that I alluded to earlier, and what can we learn from those, and whether we could price for certain risks, but other risks we couldn't price for. And if they were not priceable, then we needed to not do them.

We ended up tightening up a number of areas. The things we found, ironically, were virtually identical with what we found after this last financial crisis. Of course, we didn't have no doc, low doc back then, this predates that, but we found that investor loans on three and four-unit structures—we went up to four units—were much riskier than on one-unit or even two-unit structures. We

[3] “Cash for trash” refers to the purchase of worthless or toxic securities.

found that cash-out refinances, which we had done with some abandon in terms of maximum loan-to-value, were very risky at everything above about a 70% loan-to-value. And we were probably doing them up to 80% or 85%. And those loans had extraordinary default numbers. We found that regular rate-and-term refinances were also, all things were equal, quite a bit more risky than purchase loans, but not as risky as cash-out. Again, these are things were rediscovered in the aftermath of the financial crisis when we started dissecting the loan performance of Fannie and Freddie's books from 1999 on. [In 1985] we found that 95% loan-to-value loans—100% loans and 97% loans were unheard of at that point—also were very risky and that a few months reserves was very important in helping protect the borrower from subsequent foreclosure. Also lower debt ratios gave borrowers more staying power to power through a bit of a financial challenge.

And so, we fine-tuned those items. There were many, many changes we made. We tightened up on the ARMs [adjustable-rate mortgages] that were done. There were lots of ARMs. We eliminated the graduated payment, the negative ARMs that were prevalent back then— most of those had already been tightened up a lot, but these were now wholesale changes where we said, “We're not going to do those anymore.” And that took most of the time period that I was there.

When I became Chief Credit Officer, I was really trying to create a credit culture that hopefully— and unfortunately it was unsuccessful— wouldn't allow what had happened in the early ‘80s to happen again. And unfortunately, in their articles in the *Wall Street Journal*, and I think there's a '93 article where Fannie Mae decided to do 97% [loan-to-value] loans. And the same CEO decided to make that decision. And they interviewed, I believe the Chief Credit Officer, my successor, I think, twice removed, and some senior vice presidents in the regions. And I remember one of the senior vice presidents saying "Doesn't anybody remember what we learned from the ‘80s and what we put in place in 1985? Don't they remember what happened and the defaults that came out of this? This is madness."

Unfortunately, as I said, the credit culture was not robust enough to push back against a leadership that was bound and determined to undertake these massive increases in affordable housing. They actually put out a press release in conjunction with the $1 trillion commitment and the headline was "We are going to—" What's the word? I'll think of it. "—fundamentally revolutionize—" That's not the word but, "—the mortgage industry, but we're going to take the no out of underwriting." I mean, that's a concept that is so beyond the pale that [it] has to be ludicrous. Yet, here you have the CEO of the largest investor in mortgages in the world putting in a press release: our goal was to take the no out of underwriting. We're going to transform the mortgage underwriting process, and we're going to take the no out of underwriting and make this $1 trillion commitment to affordable housing, again, which was just a down payment on subsequent multi-trillion-dollar commitments. So, unfortunately, that was the culture that reignited in the early ‘90s and by about 1992, '93.

Maria Paz Rios: After Fannie Mae, you move on and begin your own private consulting practice. What types of clients did you engage with the most?

Edward Pinto: Initially, I had the Mortgage Information Corporation, which was creating a database to track loan performance, and I was interested in that from my Fannie Mae days and so I started working with that company. That, eventually through a series of things, got sold, and it's now owned by CoreLogic. And their product is called the LLMA [Loan-Level Market Analytics]. LLMA is a servicer-based, loan-level tracking of loan performance. I worked on that for a number of years. I worked with another mortgage insurance company trying to figure out how to streamline the mortgage process. And I worked with a bank that had done a lot of low doc, no doc loans in New York and in Massachusetts, and they were blowing up hugely [in] their portfolio. As I was familiar with their portfolio, the President and CEO asked me to come in as a consultant and try to figure out how to right the ship. I spent a fair amount of time on that. This takes me through '92 or '93.

Then, I shifted to doing consulting gigs where I would come up with a project of my own or product and then take it to a general lender. And I would do part of the work for them, and they would do other parts of the work, and we would implement the idea that way. And I did that for probably most of the rest of the time with a number of different banks, largely, and the Independent Bankers Group [Independent Community Bankers of America] and some other things like that, a credit union. But they were all pretty much depository institutions or associations of depository institutions.

And that takes me up to 2008 when I literally read a *Wall Street Journal* op-ed by the former CEO [of Fannie Mae], a different CEO, a subsequent CEO to the one I alluded to earlier. This CEO had left, I believe, in 2004, 2005. And he wrote an op-ed in July, 2008. This was right after Congress had passed, and the president had signed HERA, the Housing and Economic Recovery Act. Embedded in HERA were major revisions to the Fannie Mae and Freddie Mac charters. This is the same Fannie charter that had been amended back in 1992. There had been a battle going on, a battle that continues to this day, as to how much power a regulator should have over Fannie Mae and Freddie Mac. Back in the ‘80s, the nominal regulators of Fannie Mae and Freddie Mac was part of the government, so, it didn't need a regulator per se. But the nominal regulator of Fannie Mae was HUD and Treasury [Department of the Treasury]. But there wasn't really, what is known in financial institution circles, a safety and soundness regulator, one that was really designed to look at the safety and soundness of the organizations. So, Congress established a regulator in 1992 called OFHEO, Office of [Federal] Housing Enterprises Oversight, but it had been negotiated and diluted in the 1992 statutory enactment process to be very weak—and Fannie Mae had a big hand in that. And a number of interest groups that were trying to really increase the affordable housing part, which was documented in a book written in the mid-aught years, that documents how this happened from the advocacy group side. And so, you ended up with these affordable housing goals being in there, but the safety and soundness part was

put under a very weak regulator who was really beholden to Fannie Mae and Freddie Mac. And it was beholden to them for its budget and was also tasked with coming up with capital rules in 1992. They actually didn't get those capital rules done until either late in the ‘90s or early in the aught years because the industry and Fannie, and then later Freddie, really pushed against it. That then led to even more changes. And it wasn't until about 2004 when they were ready to really put the capital regime in place, and that created such a cry that the OFHEO director was actually fired for trying to do this.

And so, again, lots happened during this time period, but bottom line is, this was so weak that of course we know that Fannie and Freddie had no ability to withstand a financial crisis, much less the one that they faced. Their capital level was considered above adequate on the day before they were taken over. And the day after they were taken over, they were shy a huge amount of capital. They weren't even zero. They were negative by a very large amount. And so they went from positive $80 or $90 billion to negative whatever, literally in twenty-four to forty-eight hours. So, their capital regime was very weak. Lots of reasons for that. Again, most of it was because of the inability of OFHEO to actually have reasonable safety and soundness oversight on them. That safety and soundness oversight was strengthened in the 2008 HERA act, which ironically was passed two months before they were put in conservatorship, just in time.

But before they were put in conservatorship, the former CEO of Fannie Mae wrote this op-ed. The headline was something like, "The Fannie-Freddie Wars are over. Get over it." And I remember the gist of it was, "Well, Fannie and Freddie, you now have HERA. It wasn't necessarily needed, but you have it. It fixes everything. Don't worry about it. Fannie and Freddie will be fine." I had been away from Fannie at that point for 19 years, but as I read it, I thought: “This doesn't comport with anything that I know about how Fannie and Freddie operate, and how they've been operating the last umpteen years.” So I sat down and penned a rebuttal, and then asked myself, "Now what do I do with it? I'm not involved in this. I'm not a public figure. I've been out of Fannie Mae for 19 years. Who do I go to?" And so I contacted someone, it turned out it was at AEI, to talk about it. We became collaborators in late 2008. At first I was doing this on my own nickel and I spent the better part of two years working on it and testifying in Congress, and writing a lot about it. I was offered a position at AEI as a resident fellow 2010. But I spent the two and a half years really developing the history on my own.

I called it a Forensic Study of what had happened because, ironically, to this day, we still don't have a complete accounting of what happened from about '93, '94, in the way of mortgage lending transactions and underwriting, to the onset of the financial crisis and then through the financial crisis. We're getting very close to having that, no thanks to the Financial Crisis Inquiry Commission (FCIC), which undertook a study. But of course, Dodd-Frank got enacted before they published their report. And the purpose of the Financial Inquiry Commission was to come up with what an act should cover. And of course, Congress passed the

act before to—very much out of Alice in Wonderland—chop off their heads, then we'll have the trial. And so, they passed the Dodd-Frank Act, and then they did the report. And the report, in my opinion, did not attempt to go back to the beginning of this and actually determine what had happened starting in the early '90s. And so, I wrote, as I said, a Forensic Study, 150-200 pages, I forget how long it is, that documents, as best I could, based on what was available publicly and what I had knowledge of and files that I had, what had happened over time starting in the early '90s. And as I said, I did the best I could. And then starting in 2011, 2012, Fannie Mae and Freddie Mac started, as a requirement of, the FHFA [Federal Housing Finance Agency], I'm not sure, [to] publish loan-level performance back to around 2000, which still isn't far enough back. But it was progress, but those results that were published were heavily censored. And when Fannie and Freddie published them, they said, "Well, we're not going to publish information about loan programs. We no longer do low doc, no doc and negative ARMs, and interest-only loans and stuff like that. And we're also not going to publish any of the results of our affordable housing programs."

I had my opinions of why they didn't want to publish those. Those loans performed incredibly poorly, no surprise, and they didn't want to fess up to them. And so, this was a convenient way to say, "We're not going publish those." So, here we are in 2020, and a colleague of mine has been working with FHFA researchers who have access to the broader, largely uncensored group of loans. And we're talking, combined for Fannie and Freddie, 150, 180 million loans over this time period. And loan-level detail back to 1994 or so. As you move back, it gets harder and harder to get all the loan-level detail because some things weren't commonplace, like FICO scores were invented in 1989. They don't come into common use until about '94, '95. Some things have been around for a very long time, like loan-to-value.

And then there are things like low doc, no doc that have inconsistent definitions. They meant one thing in 1995; they might've meant something else in 2005. So, they've gone back, and with [a] virtually complete set of Fannie and Freddie data dating back to about '94 and other data that the Housing Center had assembled on private mortgage-backed securities, which is a virtual census, and private lending from that database that I mentioned I got involved in the early 90s that's now CoreLogic, and another database like it that Black Knight has, and that's for private lending, and there's FHA and VA [Veterans Affairs] that are also in those private databases. And the data that we have since 2012 that is the ongoing origination—it's not the historical ones, but the ones that were being done from 2012 on—there's virtually no censoring of those.

So we have good records on the agency business from late 2012 on. And so, Steve, an older colleague, and researchers in FHFA, as I said, have been working [on it], and they're getting very close to finishing this. Literally, it ends up being, I don't know, 250 million loans that they need to track and, in particular, track the performance. So, you need to know the characteristics. Then, you can bucket them into different characteristics so that you can then figure out what characteristics cause loans to go bad and to have, in many cases, very high

default rates. So, we combine all that information with loan performance data, which actually tracks the actual performance of each of those loans from the first month until—the ones from '94, there aren't any left of those but the ones from 2004, there still could be some that are on the books because they were thirty-year mortgages, and they're still there, and they haven't foreclosed. So, you're tracking each of those loans by cohort year and deciding what the ultimate default rate was through 2019 and for all of these buckets.

This will be the definitive work that the Financial Crisis Inquiry Commission should and could have done, and didn't do, I believe, for political reasons. But they could and should have done back in 2009 and 2010. It's now been ten years since they completed their work, and they really blew it. But FHFA and my colleague and the data we have are trying to finally create the record. Here we are, thirteen years after the peak in '06, '07 of house prices, the bust starts after that. And we still don't have this record, and that will be the definitive record of what happened.

Maria Paz Rios: You mentioned briefly that there were some interest groups pushing for affordable housing programs. Could you speak to me a bit more about who those groups were?

Edward Pinto: It was a very varied set of groups. And, again, this book goes through all the groups, and some of them were the Consumers Union, Enterprise Foundation [now named the Enterprise Community Partners]. I can't remember the full name. There were groups that were more interested in higher-risk loans. Consumers Union was more just a general public interest group that somehow attached to this topic, but there were other groups that I'd have to look up the names. I can actually try to find them—hold on a second.

...Greg Squires [Gregory D. Squires]. He's the one who wrote the book... *Organizing Access to Capital: Advocacy and the Democratization of Financial Institutions*. Allen Fishbein, who as of a couple of years ago was still active and worked for the Fed and community development stuff, wrote a piece in this book that's dated to '03. And this book is really what I call the victory lap of the advocacy groups. It's written in '03 while all they're talking about is the great things they've accomplished. They've driven the homeownership rate up to previously unreached levels. First-time home buyers are growing. Down payments are disappeared. Lending is easy to get. And they're taking credit for it—community advocacy is. They redefined public responsibility of government-sponsored housing enterprises, namely Fannie and Freddie. And so, it's what I call a victory lap, but it's before everything implodes. And within a couple of years, the wheels literally come off of all of this. And we're left with 8 million foreclosures.

...So, this was one of the quotes that I had: "Lenders will respond to the most conservative standards unless Fannie Mae and Freddie Mac are aggressive and convincing in their efforts to expand historically narrow underwriting." And this

was Senate Banking Committee 1991, which, again, was a predecessor to passing the 1992 Act.

And... in 1991, the Chairman of the House Banking Committee, now Financial Services [U.S. House Committee on Financial Services], Henry B. Gonzalez, this is a direct quote from Fishbein's article, "informally deputized," and then he lists who they [interest groups] were, from other spots— I just pulled them together here. ACORN—have you heard of ACORN [Association of Community Organizations for Reform Now]?

Maria Paz Rios: I have not.

Edward Pinto: ACORN is really infamous in theis whole thing because they basically created subprime—it's hard to even describe what they did. I wrote a number of op-eds about it and articles about it. Eventually, it was a point where they ended up having to shut down and fold up because they had so many lawsuits going against them and stuff, but it was a community action group called ACORN. Consumers Union, Enterprise Foundation, and Local Issues Support Corporation, or LISC. ACORN was really the one that was really pushing this hard. Again, I don't know, I mean, I know of Consumers Union, but I can't imagine that Consumers Union had much to say about this. In fact, I think, I have in here that I found an ACORN proposal with Fannie Mae, and the things that ended up getting into the 1992 Housing Act and some other stuff ends up mimicking what ACORN had because ACORN was getting approved for lending under that $10 billion program from Fannie Mae as far back as '91, I believe.

...One of the things I want to come back to is how this tied into CRA [Community Reinvestment Act]. So, as early as 1987, ACORN was pressuring Fannie and Freddie to review their standards and results. Now, I was at Fannie Mae at that point. I have no recollection of ACORN. I think what happened, this is my theory, I had, as I said, many interactions and involvement with Gale Cincotta from National People's Action. I believe that ACORN either was behind Gale, so she was the face, and I never met—or the ACORN people might've been there, but they weren't really front and center. She was the leader of the group, and that's who I was largely talking to, or they were operating sort of behind the scenes. And as I said, by 1989, after I left, it turned out...they had gotten Fannie Mae into one of these pilot projects to lower bank lending standards. But by then, they weren't having to guarantee them anymore as I had required when I was Chief Credit Officer.

Maria Paz Rios: I definitely want to touch upon perhaps the role of the government housing policy in promoting [the] high-risk subprime mortgage space. But before that, wrapping up your time as a private consultant, did you ever express concerns about the nature of credit extension during the 2000s to your clients, such as the lenders you mentioned working with? What sort of conversations did that lead to?

Edward Pinto: From about 2003 until about 2010, I was working with the Independent Community Bankers Association, which is an association of many thousands of community banks. We were working on a number of lending programs and things to facilitate lending programs. Not affordable housing lending per se, but appraisals, automated valuations, title insurance, and just different things. This included relationships with Freddie Mac and Fannie Mae, particularly Freddie Mac. Freddie Mac kept coming back at us and saying, "We can cut you a much better deal if you would increase your risk a lot." And we'd go back and say, "No, no, no, we don't want to increase the risk a lot. That's dangerous." And they kept saying, "But then we could cut you a lot better deal."

And so, they kept trying to entice the group into taking on more risk. And fortunately, the community bankers did not do that. They came through the financial crisis pretty much unscathed on the mortgage side. Now, they may have had some other issues due to the financial crisis, liquidity problems or whatever, but that's a different issue. On the mortgages, they suffered very few mortgage foreclosures because they basically kept to the traditional underwriting and didn't take on these high-risk areas. In fact, in about 2009 or so, Sheila Bair, who was the chair of the FDIC [Federal Deposit Insurance Corporation], said in a speech in Philadelphia, and I think it's in that same Forensic Study, "We know how to do this right. We've been doing it right for a very long time. You have to have some down payments. You have to have some credit standards. You have to have some debt-to-income ratio limits. You have to really look at the ability to repay. And we threw all that out the window. It was clear that was going to happen, but we threw it out the window."

In 1999 or 2000, I had a business that I was doing closing loans for lenders closing loans in people's homes. It was called “Fast Doc”. And I had a client, one of the largest mortgage lenders in the country, and it was a household-name lender. And I had to fire them because we found that the quality of the loans, that the credit quality— even though we weren't involved in the credit quality we were sending people to get the loans closed— and the situation when they reported back, they would say, “There's something wrong with these loans. They're not fitting together right.” Because we had really smart people as notaries. And so, we were getting feedback. We went to the lender, and we said, “Look, this is really a problem. And we suggest you do this, this and this.” And they said, “Fine, thank you and goodbye.” And so we decided to fire our largest customer. AmeriQuest wanted to use our services, another storied name for subprime lending, and we refused to do it. So, I wasn't involved in it publicly, but I ran my business in a manner so that my business kept getting smaller and smaller because the availability of really higher quality loans got less and less and less as this whole thing unfolded. And so, I guess that's the answer to the question.

Maria Paz Rios: How would you say lending practices and products changed in the 2000s right before the crisis?

Edward Pinto: There was a continuous process of expansion that occurred, again, starting in '94. It began with expanding high LTV [loan-to-value] lending, reducing down payments. In 1992, a 5% down [payment] on a conventional loan would have been the standard. And there would have been additional compensating factors like, as I mentioned earlier, lower debt-to-income ratios, some reserves, things like that. By 1994, the 97% loan was introduced. By 2000, the 100% conventional loan was introduced. All this time, FHA's getting riskier at the same time. And by the way, FHA is in HUD, and HUD is the regulator, effectively, for both the affordable housing goals, and OFHEO was in HUD, although feels a bit separate, but they're still in HUD. So, HUD was wearing all these hats because you're going to ask about the government's role, and HUD wore three hats. And they used them expertly during this time period. And Andrew Cuomo, who was the undersecretary and then secretary of HUD, and others, used their powers tremendously to forward this whole affordable housing mission that ended so poorly.

So then, once you get to 100% LTV, there's not much more you can do. So, during the ‘90s, there was also an effort to loosen debt-to-income ratios. And as I said, that started out at 28%, 36% and then went to higher numbers and higher numbers. Eventually the back ratio ended up being in the forties and low fifties. But that's through the early aught years. As I said, the low doc, no doc, which is another way of adding more apparent buying power, but if they're liar loans, it's a buying power and a lie, but the lie is based on these expanded debt ratios. So, you're saying, "Well, I have this much income, that qualifies me at 43%." But ten years before, you would have had to qualify at 33% or whatever.

And so this kept expanding. Credit scores were expanded a little bit. They could track that a little bit. The big thing with the credit scores was that the volume of lending exploded. So by 2003, it was a $4 trillion year. Well, that is a big number. And we may exceed that number for the first time since 2003, this year, in originations, in nominal dollars. But what's really significant about that number is [that] the total amount of mortgages outstanding in December 2003 was $8 trillion. So, half of all the loans originated that existed at the end of '03 were originated in '03. So, what does that do? Well, that makes it look like everything's going great. It's that Titanic heading towards the iceberg. “Oh, delinquency rates are really low.” Why are delinquency rates really low? Because the average loan is twenty-four-months old. Loans get delinquent over a period of time. They reach their peak delinquency in years three through seven. Very few loans were five, six, seven years old. So, delinquency rates get tamped down.

Plus, house price appreciation is rampant. Going up by leaps and bounds. That bails out a lot of problems— “Oh, I need to pay off this and this and this—I'll take out a cash-out refinance. My equity went up a lot.” People increased the LTVs. They start by increasing LTVs on purchase loans. They eventually start increasing on rate terms. Remember I mentioned back in '85, we tamped down those things? That all falls by the wayside over the course of this time period. As I said, you then have low doc, no doc starting in '98 and expanding. You've got,

as I said, some stuff going on in credit, but percentagewise, the percentage of loans that were low FICO below 660 didn't change that much. But the volume of loans that was being done in a given year had exploded. So, it ended up there were a lot more subprime loans just because there were a lot more loans being originated, even if the percentage was the same. But then, it wasn't enough that interest rates were going down, and that debt ratios were going up, and that low doc, no doc was rampant. They introduced the interest-only loan. What does that do? Well, it's interest-only for ten years. You don't have to pay any principal. So, you're only paying interest. If your monthly payment would have been, I'm going to make up a number, $600—it's now $500. You're not making that principal payment in the first ten years. Well, it was bad enough that having a thirty-year loan amortized very slowly, an interest-only loan doesn't amortize at all.

And the idea was, again, there was this view that, well, house prices will go up forever. And they're never going to go down everywhere. Well, they did go down everywhere. By 2008 or 2009, every single metropolitan area on a four-quarter rolling average had gone down in value from four quarters before. That had never happened before in the history of the Western world to my knowledge. The most we'd ever gotten to was maybe 35% of the 100 metros, but here we had 100 of 100. I mean, that's across the states. Every single large metro in the United States had price declines. And people said that can't happen. And it happened. The only time it had happened before, we don't know exactly because the data aren't as good, was in the early ‘20s and early ‘30s. We had a similar level of price decline, around a quarter of prices, give or take, back in the ‘20s and early ‘30s. And we had about 25% to 28% in this bust.

And then they had negative am loans [negative amortization loans, i.e. Neg Am]. Those were never huge, but again, there hadn't been a couple of hundred billion dollars of them. Originated where it was, you don't even have to make the interest payment. I remember hearing radio ads where they'd be advertising in California, you could make a payment of $1,000 a month on $1 million. Excuse me, $1,000 a month. And $1 million loan. The interest alone was $48,000. But it was combination of interest-only and Neg Am. And they said, “You decide.” It was called pick-a-pay.[4] And that was Washington Mutual's pick-a-pay loan. You pick your own payment. So, not only did we go from "We're going to take the no out of underwriting”— “We're going to take the payment out of payment. You pick what you want to pay.” That was literally the name pick-a-pay. So, I mean, you almost can't make this stuff up. It was so outrageous what happened.

And the government was involved in this. I talk about it a lot in the Forensic Study, but HUD was wearing three hats at the same time. Number one, they were responsible for the affordable housing goals. They were the only entity that set them, and they set them pretty aggressively over the course. It started

[4] Pick-a-pay loans were a type of adjustable-rate mortgage where borrowers had the option to pay less than the interest due on their loan. However, any unpaid interest was then added to the balance of the loan.

out, as I said, at 30% low and moderate-income, ended up at 56% or 57%, something like that, by 2007 or so. However, what really made it worse was that the low-income piece, which is below 80%, it's very hard to lend without really creating a lot of risk, with a thirty-year loan, to individuals or households with less than 80% of their Area Median Income (AMI). It's just hard to do because their income just isn't high enough relative to the house price. And so, you have to do something to make it easier. And you start with the thirty-year loan, which is the wrong thing to start with.

Maria Paz Rios: Why do you say it's the wrong thing to start with?

Edward Pinto: I'll come back to it in a second… So what HUD did was when the 30% was set, it was almost all moderate-income with a little bit of low-income. By the time they got to the 56%, it was mostly low-income with a little bit of moderate-income. So, the increase, which went from 30% to 56%, was almost all in the low-income, which meant that the affordable housing programs had to get more and more easy in order to attract enough people to get those loans to meet the goals.

I say the thirty-year loan is the wrong place to start because low-income individuals and low-income households have lower incomes. That's by definition. They tend to be more susceptible to unemployment and changes in employment. And if there are two wage-earners, one of them losing a job, having the part-time job, having that go away, having overtime go away — there's more volatility in their income. There's more volatility in health matters. There's more volatility that has a financial impact in family matters. If an upper-income family gets a divorce, that's unfortunate, and it may be mostly unfortunate for the children, but it doesn't usually create financial problems. But if you have a low-income family that gets a divorce or separates, that creates huge problems because one can't live as cheaply as two and with two incomes. And so that's a huge problem.

So, the monitor of the national settlement that was entered into in 2009 or so is Joseph Smith. And Joseph Smith had been the Banking Commissioner in North Carolina and had been nominated by President Obama to be the FHFA Director, but he was never approved by the Senate, so he never became that. He was an attorney, and he was appointed to be the monitor. And in 2013 or so, my colleague Steve and I introduced down in a conference in Raleigh put on by the North Carolina Bankers that Joe Smith was at, we put on what we call the wealth-building home loan, which was based on a twenty-year amortization and a buydown of interest rate. Rather than lower the mortgage, you pay down the interest rate and some other things that made a twenty-year loan have about half the default risk of a thirty-year loan, all things being equal. And Joe, after we presented this, on his own motion, he was a luncheon speaker or something said, "Look, I know a lot of my friends are going to be upset with me for saying this, but the thirty-year loan is just inappropriate for low-income people. Why? If I've learned one thing from being the monitor, which was responsible for millions and millions of settlements and things out of this fund, was the people

that came to me and talked to me about what had happened to them. I learned three things: that they are—" I use the term staying power— “They run into staying power issues of family issues, income issues, and health issues. They just don't have the ability to get through these financial crises that occur periodically."

We're in one today with COVID-19 and the pandemic. And people with a lower debt ratio, even if they're lower income, perform much better than people with higher debt ratios. People with more reserves perform better. And originally, FHA was that. They didn't have thirty-year loans. They had twenty-year loans for existing homes' financing up until 1954. So what happens is, anything that eases credit when there's a shortage of housing gets capitalized at higher prices. Thirty-year mortgage is easing of credit relative to a twenty [year mortgage]. It leads to higher prices. Or in times when there's more housing, it leads to buying bigger houses. Well, buying bigger houses still leaves you potentially stressed when you get the situation where you're in a seller's market. You're not buying bigger houses. You're buying more expensive, the same house.

And so, that's going on right today. Interest rates came down, but house prices are going up 12% year over year, and they're probably going up 14% at the low end. The bottom line is, entry-level buyers are no better off. They may actually, in six months, be worse off than they were before the Fed concocted this reduction in interest rates that were supposed to help you. There's a saying, "I'm from the government, and I'm here to help you." It is one of the three great lies. And the government tends to make mistakes, particularly with their one-size-fits-all approach. And the Fed currently has this one-size-fits-all. Fannie, Freddie, the FHA all had one-size-fits-all.

On to the other two hats that [HUD] had... Again the first was as mission regulator of Fannie and Freddie. The second was as overseer of FHA. FHA is an agency that's part of HUD. The head of FHA is the Assistant Secretary for Housing at HUD. And so, HUD has a lot of impact on FHA and what they do. And then the third was that President Clinton asked HUD to develop a national homeownership strategy, which was released in 1994. And HUD was responsible for implementing that strategy. President Clinton famously said at a conference in '94 or '95, "This is a great plan to increase the homeownership rate tremendously, and it'll never cost the taxpayers one red cent." Well, it cost the taxpayers $180 billion just to bail out Fannie and Freddie, much less all the stuff that had to be done for the rest of the economy. But the view was: “What could go wrong by increasing the homeownership rate?”

The homeownership rate did increase. It went from about 63% to 64%, to about 69% in 2004. And then promptly went back down by the end of the crisis in 2012 or '13 to about 62% to 63%. It's recovered to about 64%. The latest numbers are a little odd because they're taken during the pandemic, and they bounced around a lot. So, I use the numbers that are a few quarters back. So, it's bounced back to about 64.5%, which, ironically, was what it was more or less in 1964. So, it hasn't changed yet. What have we done since 1964? We've

greatly expanded the underwriting. We've taken Fannie Mae and Freddie Mac, which didn't even exist, Freddie Mac in 1970, we turned them into these $5 trillion entities. Ginnie Mae alone is now a couple trillion dollars. And we've increased the debt ratios tremendously. We've reduced the down payment tremendously. House prices are now, as I said, about 3.7 times income. They went up to four something and then back down to, ironically, in 2012, went back down to where it was in 1994, but now it's gone back up again.

And so, that's the problem of when the government sets out to solve a problem, it usually fails in many cases, unless it's a very specific problem. I mean, we're seeing success with the vaccines. That was a very specific issue. I was on a call this morning and developing vaccines in ten months is something to be celebrated because it normally would take six or seven years. This has never been done before. Could it be done more quickly? Yes, but let's revel in the fact that ten months is a near miracle. Everyone said it was impossible back in March and April. And here we have it. So, going to the moon was a very specific task. And it was just one thing. But when you say, "We're going to make housing affordable for all," things get out of hand. And that's what we did in 1968. What's what we did in 1994. And I hope we don't make that same mistake in 2021. Because we've been there, done that.

If we really want to solve this problem, we need to do three things. One is we need to end the competition between Fannie Mae and Freddie Mac with FHA for high-risk lending. That started in 1992. It crescendoed in the early aught years. FHA was almost out of the business because they've been pushed back by Fannie and Freddie so much in competition. Then FHA came back, and then Fannie and Freddie, at the behest of their regulator, in 2013 or '14 so, restarted the competition. They put FHA back again on its heels, and then the current director, Mark Calabria, reversed all that. And that has ended. And so the direct competition between Fannie, Freddie, and FHA has more or less ended, which has helped. Otherwise, we'd have house prices going up even faster. So, that's number one.

Number two is to go to the twenty-year loan, especially for low-income buyers. And we should do that for low-income buyers through a low-income first-time buyer tax credit, which I call LIFT home: low-income, first-time home buyer, LIFT home. But it's not used to pay for a down payment—on a thirty-year loan that will only get capitalized into higher prices. Prices will go up because now you can put down a bigger down payment. And therefore, that will not help low-income individuals and households. But if you tie it to a twenty-year loan and use the money to buy down the rate, you then can equalize the monthly payment, but you now end up with a twenty-year amortization, which is vastly superior in staying power for the homeowners. And now you're actually building what's called intergenerational wealth. Why is it that higher income people can build intergenerational wealth? They can own homes through the cycle. I've owned a home since 1975, and I've never lost a home to foreclosure. I had a home in 1982 when I moved to Milwaukee that went down in value by 10%, but I didn't lose my home because I had staying power. If that had been an 100%

loan or an FHA loan that somebody had gotten in 1981—I had only lived in the house a year and a half—so, if they had gotten an FHA loan in 1981, and they had the same financial thing that I went through, they probably would have lost that home. They wouldn't have had the staying power. And so, my goal with the second point is, let's give them the staying power.

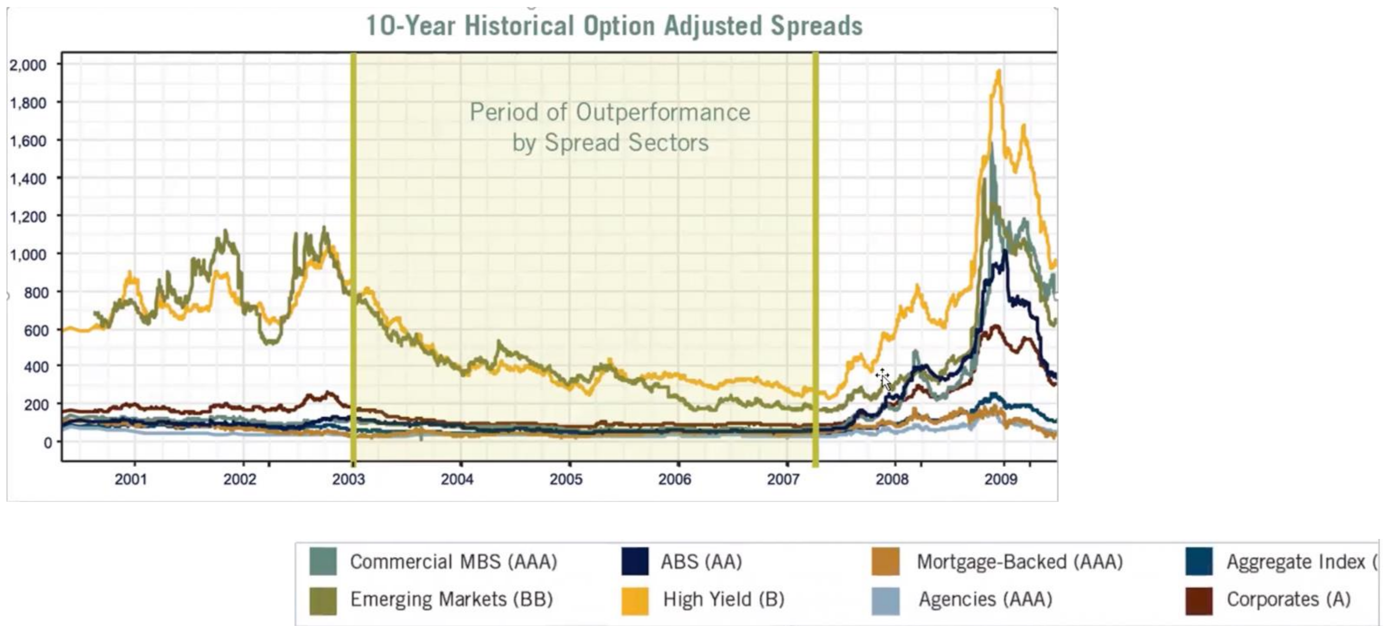
And then the third is: why is it [that] we don't have enough housing? We have enough cars. We have enough computers. We have enough hotel rooms. We have enough cell phones. We have enough of a lot of things. Television sets. Things that cost a lot of money at one point. And cars are still the second biggest purchase you make. Hotels or real estate—well, pre-COVID. You didn't have trouble finding hotel rooms at all kinds of price points. So why is it we have problems with buying houses or apartments? It's because of the NIMBYism—not-in-my-backyard—with the zoning restrictions and other land use restrictions, particularly in places like California out west, and then the Northeast, where it's very difficult to build homes. In the South and Southwest, it's a lot easier. And those places are booming. And they have been booming for decades. Raleigh, North Carolina is the second-fastest growing metro in the country of large metros in terms of job growth since 1990. Yet, its house prices have gone up, relatively speaking, with incomes, which means a lot of new houses get built. And the price of existing houses stays not too much different than the price of new houses. And the new houses are still affordable, relatively speaking. New houses are more expensive. But that's a complete difference than a San Francisco or a San Jose. The median priced house in San Jose is $1,000,050. A tech worker in a San Jose household, we estimate, makes $180,000. That's a lot of money. They could afford 12% of the houses that sold in 2019 in San Jose. Tech worker in San Francisco—15% or 16%. Tech worker in LA—20%. San Diego—25%. So, California is a problem. Why? They have what's called NIMBYism, not-in-my-backyard. They had BANANA—build-absolutely-nothing-anywhere-near-anyone.

If you wanted to start building a subdivision in California, and you started tomorrow within 50 miles of the coast or whatever, it would take you at least ten years to get it done. So, very little housing is built in California, and yet the prices get sky high. Then people leave with those winnings. And then they go to less expensive places. Well, Sacramento is a less expensive place than the coast. And so they go there. And then they drive the prices up in Sacramento because what's paying another $50,000 when I just got $400,000 on my $1 million shack in San Jose? So, I'll pay an extra $50,000 and drive up the price. I don't care. And then people in Sacramento then moved to Boise because Boise is the next place they go to. Or Phoenix. And then they drive the prices up in Boise and Phoenix. That eventually peters out by the time you get to Denver, but you can see that the whole west part of the country, it's got a problem. And now, with the work-from-home movement, which has been going on for some time, but now it's taken a quantum leap— technology now allows workers to trump BANANA. I don't have to stay in those things in California where I have to rent an apartment for $4,000 a month because they can't afford a home, and they're leaving.

They're not leaving all at once, but they're leaving enough that rent in San Francisco dropped 20% at the higher end. And house prices are stagnant, which is actually good because if they're outrageously high, I wouldn't want to wish price decline, but if they stay stagnant and inflation stays 2%, in ten years, the houses will correct 25%, 30% compounded. That's what happened in Connecticut. Connecticut house prices have been pretty stagnant up until very recently for ten years. And so, inflation is 2%. So, the house prices have actually gone down by 25%. Why? Because there was very little demand because the economy wasn't growing in Connecticut. And so, that's now going on in California, and the people are moving away from the coast inland to Sacramento and then further into Idaho and Utah and Nevada and Arizona, and to a much lesser extent, to Texas. Although we now know, Hewlett-Packard just moved to Houston. And Elon Musk just took his company out of California. And so, ironically, California started the tech revolution in 1938, or Hewlett-Packard did in California in a garage, and now, the tech revolution has enabled working from home, which really is the answer to BANANA. So, those are my three answers of what we should do. We shouldn't make the same mistakes we've been making for the last sixty or seventy years. We could learn.

Maria Paz Rios: You spoke about the pressure coming from government policy in loosening credit and creating more of a subprime space. What about pressures from the private side? So, for example, to what extent do you think the rise of private-label securitization and competition from investment banks impacted the underwriting practices of GSEs [government-sponsored enterprises] like Fannie and Freddie?

Edward Pinto: Well, I think it was the other way around— I think Fannie and Freddie impacted the underwriting practices of the others. What would happen, in my opinion, is that the world was basically awash in liquidity in dollars, largely because of the rise of China and the United States taking in imports from China, exports from China, which really started with China becoming part of GATT [General Agreement on Tariffs and Trade] in, I think, 1998. So, that really started kicking in the early aught years, and interest rates were very low. Remember I said they were 9%, 10% in the early 90s. By 2003, they were incredibly low. One of the things that happened in this chart that I found... You'll laugh when you see why it has to be magnified...



This starts, remember I talked about, it starts in about late 2000. the key at the bottom. You'll see mortgage-backed AAA—that's what you were just asking about—is the lighter brown line. And agencies, which are Fannie and Freddie, are the blue line. You can see there was a huge compression of spreads across the board from left to right until 2007. This was because the world was awash in liquidity. And investors were looking for anything that gave them a little bit more yield. So, corporates are this dark brown line. See this light chocolate-colored line here? And you see this blue line here? You see that spread? That was the difference between what you got on a 10-Year Historical Option Spread. That was the difference. So, you could see this as from 0 to 200. So, that difference there might be 20 or 25 basis points. So, back then there was a 25, or 30 basis points difference in the spread that you got on a Fannie-Freddie AAA than what you got on a private AAA. And so, the market for private AAAs was there, but it wasn't as strong as it had been. And over time, that spread...disappeared entirely. That basically meant Fannie and Freddie could no longer easily compete with the private mortgage-backed securities because the spreads were the same. And the investors liked how long the loans would be outstanding, the prepayment speeds, whatever it was, better, they would go with the private mortgage-backed securities.

So, this is the time period that you've probably heard of mortgage-backed securities exploding, right? '03, '04. But what also happens in '03, '04? Well, it actually starts happening back here in '02, but it's happening throughout this time period. Fannie and Freddie become the biggest buyers of those private mortgage-backed securities, both subprime and low dock, no dock, Alt-A. They end up, I think in '04—it's in my Forensic Study—I think they buy 40% of all the mortgage-backed securities that get sold privately, single-family. They buy 40% of them, and the Federal Home Loan Banks buy another 10% or 15% because they're just looking for investments. But in the case of Fannie, which I think is

true on the Federal Home Loan Banks also, they got affordable housing credit for doing that. Not 100%, but enough that they eventually got very good at it in that they could literally cherry-pick the loans they wanted. And then the investment bankers would create the securities that had precisely the loans they wanted that gave them the maximum affordable housing credit, be it for Alt-A or for subprime. And so, this is a much more nuanced story. Remember that 2003, where that was the biggest origination year in history, Fannie and Freddie had by far their biggest market share in 2003. They were on top of the world.

And what happened was the availability of borrowers that were even marginal borrowers was getting smaller and smaller. Remember I said, you're bringing all these people in, and the percentage that are below 660, that percentage stays constant, but the volume keeps exploding. $4 trillion was the biggest year ever— in 2003, it was $4 trillion. In 2004, it drops to, don't hold me to the exact number, $3.2 trillion, something under $3.3 trillion. By all rights, it should have dropped to $2.5 or $2.25 trillion. There weren't enough borrowers to meet that supply that was being created by lenders, and Fannie and Freddie included. But Fannie and Freddie were starting to lose share, and they were making up for some of that share by buying these private mortgage-backed securities.

So, I've talked about HUD having three hats. Fannie and Freddie had three bites at the apple. They could buy the loans on origination. They could buy in just their normal process. They could adjust their automated underwriting on the fly, which they did. They called it expanded approval to buy riskier loans as they were flowing through and getting approved. Actually, they had four ways. That's number two. Number three, they could buy bulk loan packages. Largely, they bought some subprime, but mostly Alt-A, which they bought hundreds and hundreds of billions directly from Wall Street before they were ever put into the mortgage-backed securities. They were called bulk purchases, and they bought hundreds of billions of dollars of those. But then, they still weren't done. Then, they bought hundreds of billions of dollars of the mortgage-backed securities, both Alt-As and subprime. The reason they didn't buy many self-denominated, as I call it, subprime loans is because Fannie and Freddie were leveraged.

Remember the capital battle? What ended up was a very weak capital regime. They failed literally in twenty-four hours. Once the government went in and really looked at what was there, they were taken into conservatorship. And so, they were leveraged on their mortgage-backed security investments 240 to 1. And they were leveraged on their portfolio investments 40 to 1. So, you may have heard of Bear Stearns, and horrible Bear Stearns, and how over-leveraged they were. They were leveraged at like, 10 to 1. Fannie and Freddie were the most over-leveraged financial institutions in the world by probably an order of magnitude. So, they didn't have the riskiest loans, but for their capital level, they had the riskiest loans. And the way I describe it is, think of it like a snowplough. Fannie and Freddie are in this snowplough, and they're pushing the market.

Well, actually I have a better analogy that I use: low-hanging fruit. You have this tree, and the tree has all kinds of loans. And as you get up to the top, the loans are the riskiest. And so, Fannie and Freddie would pick all the very low fruit. That was all the low-risk fruit, which was their normal business that they'd been doing, by and large, up to the late 1980s. But then they started picking a bit higher up in the tree that had lower down payments, higher debt ratios, had no amortization for ten years, some negative am [negative amortization], a little bit of that, investor loans. They started buying low doc, no doc. And they started going up higher and higher in the tree, but they never got to the top of the tree except in buying the private mortgage-backed securities because the private mortgage-backed securities were the top of the tree. And as I said, they bought a lot of that, but on a whole loan basis, which was their core business, they never bought above a certain level of the tree. But by picking all that fruit, private sector was left with the top of the tree, with the exception, largely, of independent community bankers who never left cultivating their trees, [which] were all fruit that was low risk. And so they had orchards elsewhere. They weren't selling much to Fannie and Freddie.

So, their trees, to keep the analogy going, were in a different orchard. And those trees were all low-risk loans. And so, they never lost much money from the loans, but everybody who was dealing with the big tree, including Fannie and Freddie, lost huge amounts.

So what happened? Fannie was in conservatorship. Freddie was in conservatorship. FHA had to be bailed out. WaMu [Washington Mutual] had to be bought out. Countrywide, which was one of the granddaddies of all this, had to be absorbed by Bank of America, which really hurt Bank of America tremendously. You had Wachovia, which had the pick-a-pay. No, Wells Fargo bought WaMu and got the pick-a-pay stuff, but I think Wachovia—

Maria Paz Rios: Wells Fargo bought Wachovia, and I think JP Morgan bought WaMu.

Edward Pinto: …And Wachovia had the Golden State business that had pick-a-pay type loans, but they weren't called pick-a-pay. And so, you had all of these companies. One of the things that I also pointed out in my Forensic Study—again, going back to that book by Squires—there was a brag book that the National Community Reinvestment Coalition would publish every year. And I have the brag book, let me show you...So, these are CRA commitments and how they calculated by state and we'll get to it...

"Community Reinvestment Act encouraged extraordinary levels of collaboration between community groups and banks. Since the passage of CRA in 1977, lenders and community organization have signed 446 agreements totaling more than $4.5 trillion in reinvestment flowing into minority and lower-income neighborhoods." And so again, this is all really before the wheels come off, right? Or the wheels are just starting to come off, and they're bragging about what has been accomplished. And they actually have page after page of what's been accomplished. And if I went back, and I think somewhere there is a history,

here it is. So, it was $4.5 trillion. Look at what it was in 1992, when the Safety and Soundness Act was passed. $42 billion, $33 billion of which was in 1992. So, look at what it was in 1991, $9 billion, which 1% of $4.5 trillion is $45 billion. So, that's two tenths of 1% in 1991 of the total was outstanding debt. So, this whole thing developed during and after the 1992 [Safety and Soundness] Act and accelerated big time.

At the same time, this doesn't even count. The commitments that were done under HUD's—remember I mentioned the national homeownership strategy? They came up with a companion program for CRA for mortgage bankers. I forget the name of it now. And who was the first mortgage banker to sign up? Countrywide, the poster child for this whole mess. Who is Countrywide the biggest customer of? Fannie and Freddie. Who enabled Fannie and Freddie? In 2004, when Angelo Mozilo was feted by the Harvard Joint Center of Housing at a huge party with the Fannie Mae CEO in the front row, with others from Fannie Mae, and Angelo Mozilo says, "I want to thank Fannie Mae and the chairman sitting in the front row because without them, I couldn't have done any of this. And by the way, we should be proud of our subprime business." This is an exact quote, "Only 20% delinquency and foreclosure. That means 80% of them didn't fail. We should do more." And of course, he made good on that promise. His company alone did, I think, something like $2 trillion, or some number like that, in commitments, a lot of which got sold to Fannie and Freddie, a lot of which got put into private mortgage-backed securities.

And so, these multi-trillion-dollar deals, they were all based on the same thing. How easy can you make the credit? So, what I found in that explosion, when you see a number that goes up like a hockey stick—if you were to plot that, it would be a hockey stick—when you see a hockey stick in anything, including credit, you have to say, "What's going on here? Something odd is happening." Because that doesn't happen. I found was that in order for these banks to merge—and there were some changes in the laws that occurred in the later '90s that allowed banks to merge—but in order to merge, they had to get the approval of the community groups for a rating for the bank. And what I found was that if a bank was going to merge and they wanted to keep merging, they needed to have banks that they merged with that were also doing these CRA deals.

…There were 8,000 banks. There might have been a couple hundred that were doing CRA deals. What I found was that virtually every bank that ended up merging, large and small, had done a CRA deal that was documented by NCRC [National Community Reinvestment Coalition]. Why was that? Because the acquiring banks, in my opinion, knew that they needed to have credit departments in the bank they were acquiring that were already familiar with how to loosen credit. And the way that it was done with CRA, which I called the training wheels for subprime, once a bank was doing CRA at below market rates, and you had broken the credit culture to allow loose lending, then all of a sudden, the bank would go, "Wait a minute. Why do we want to do below market rates? We can do subprime private and make more money with the same kind of loose lending." So, you ended up with this subprime business

exploding. But what I found was, and I actually have a chart in my Forensic Study that documents that you had to have gone through this apprenticeship of CRA in order to break the credit culture, in my opinion. And that's what happened.

Maria Paz Rios: If you were to include predatory lending in, let's say, a dictionary, how would you define predatory lending?

Edward Pinto: I define predatory lending as abusive lending. Lending with terms where you know that the default rates under stress are going to be high because the borrowers don't have the ability to withstand that stress. The definition of a good loan is a loan that can withstand stress. The definition of a predatory or abusive loan is one that can't. So, by definition, most FHA lending today is predatory lending.

Maria Paz Rios: And do you believe certain groups, then, are more prone to fall victim to predatory lending practices?

Edward Pinto: It basically ends up, historically, in the United States, low-income, and within low income—minority.

Maria Paz Rios: ...Over the last decade, we've seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused it?

Edward Pinto: I think I've just described it in detail. The government set on a path that was launched in 1992 to force Fannie and Freddie to give up on their lower risk underwriting parameters and expand and ease them into what they called affordable housing. That, combined with the national homeownership strategy, which set a goal of increasing the homeownership rate to about 70% from 63%, along with HUD's other actions that they took in many ways, and the expansion of CRA, which combined with the explosion of acquisitions and mergers, led to a race to originate trillions and trillions of dollars of high-risk loans, all in the name of affordable housing. After driving house prices up because supply couldn't keep up with it, that all came home to roost in the collapse. And 8 million homeowners couldn't survive it, and they lost their homes. Yes, the private sector did get involved in varying points, but my research shows that the private sector, historically, does not do risky housing lending. They only do it when they're either forced to by the federal government or they're forced to by competitive pressures by the likes of Fannie and Freddie.

Maria Paz Rios: Looking back on the crisis over a decade later, what do you see as its most important lessons?

Edward Pinto: The most important lessons are that credit quality matters—that we end up having financial crises periodically in housing. And if you have a mismatch between demand, which is caused by loose credit, and supply, which is caused by NIMBYism and BANANA, then you will end up with cyclical house prices. The

places that have the most cyclical house prices are the places that have the most NIMBYism and BANANA, and they respond to most of the demand. So, where are those places? California, Riverside, San Bernardino. Not San Francisco because San Francisco, the people have a lot of money, relatively speaking. They put a lot of money down. And so, they're not at risk, but people in places like Fresno, and people in Riverside, San Bernardino and places like that have real problems. People in Phoenix, people in Miami, people in the south side of Chicago, Cleveland, Detroit—those are the people that have problems where house prices tend to be much more cyclical. And we need to get out of that cyclicality. We need to learn from the lessons of the financial crisis—what causes that cyclicality and how you prevent it.

Maria Paz Rios: To what extent do you see your personal experience as adding something important to our understanding of what happened in the run-up to the crisis?

Edward Pinto: I think it's very important because not only have I done a lot of research personally, but I've been involved with a lot of the research that I mentioned—the twenty-five-year history, going back with those hundreds of millions of loans, which has never been done, which the Financial Crisis Inquiry Commission failed in their mission to do. They didn't believe because of this false narrative that anything important had happened before 2004. I hope, through the process of this exposition, with all of this data, that people see that a lot happened. And it was really the key, the things that happened. That's why I called my study a Forensic Study. I didn't have all the data that we're getting now, but I looked at the forensics, the clues, and you've seen a number of them as we went through them in the document.

I've done a lot. The Housing Center is ever vigilant to pressures that lead to unsustainable lending and unsustainable home price appreciation. We were founded in 2013. In our very first briefing in December of 2013, we pointed out that—and we were the first ones to do this by a long shot—a boom had already started. Rents were already out of relationship with house prices, and that started seven quarters before in the beginning of 2012. What happened at the beginning of 2012? We flipped from a buyer's market to a seller's market. We had the Fed undertake additional loosening in terms of quantitative easing. This new boom has continued ever since. And we now have a boom that is getting very close to the same level, in nominal terms, as we had in the great boom of the late ‘90s and the aught years. And we may likely surpass it because given the Fed policy of today and the continued high-powered lending—it's a little less than it had been—combined with very low interest rates—it's still pretty high-powered. We now have house prices going up about 12% year over year and about 14% at the low end. And I expect that's going to continue for at least the next twelve to twenty-four months. Those are huge increases on top of a boom that started eight, nine years ago.

Maria Paz Rios: Do you think there is anything else I should have asked, or is there anything else you want to add?

Edward Pinto: No, I am very impressed with your knowledge and questions…

Maria Paz Rios: Thank you for joining us.

[END OF SESSION]