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Three Initiatives Enhancing the Mortgage Market and Promoting Financial Stability

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Abstract

In recent years, the government has greatly extended its reach into the mortgage markets with the goals of (1) mitigating the deadweight losses associated with mortgage foreclosures, (2) promoting affordable homeownership, and (3) providing low cost mortgage financing. In this paper, we identify three innovations-one in each of these areas-that could be made to the American mortgage market that would help obtain the government's objectives while enhancing financial market stability-particularly if all are done together. These three innovations are: (1) "buy your own mortgage" options, (2) variable maturity mortgages, and (3) creation of a government mortgage bond insurer, with an emphasis on insuring covered bonds as well as GSE debt. The first innovation would allow homebuyers to repurchase their mortgage at the "market value" of their homes when they move, thereby helping society avoid some of the deadweight losses associated with unnecessary foreclosures. The second innovation would provide a mortgage that could promote affordable housing without unduly raising the default risks of low- and moderate-income families. The third innovation would help create a variety of financing options for mortgages in the United States. Moreover, it could be integrated into the current system of mortgage financing, which would include government-sponsored enterprises (GSEs), in a manner that would help the government manage the systemic risks associated with the quasi-government backing of mortgage credit and mortgage insurance. In particular, we propose that the government explicitly insure pre-designated financial instruments used to fund mortgage credit (such as covered bonds and GSE debt) by creating a government-backed insurance fund similar to that currently used for deposits.

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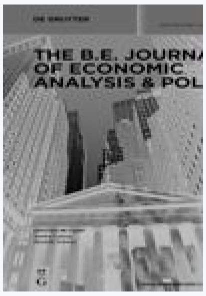

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