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- › Multimedia
- › Media Kit
- › Speeches
- › Press Releases
- › In the News

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### John McCain Addresses the Housing Crisis

*John McCain Addresses the Orange County Hispanic Small Business Roundtable*

March 25, 2008

Thank you for joining me here today. I just returned from a trip overseas that included assessing the state of affairs in Iraq, the Middle East, and Europe. I will have more to say on those important issues in the days and weeks to come.

While I was traveling overseas, our financial markets experienced another round of upheaval. This market turmoil leaves many Americans feeling both concerned and angry. People see the value of their homes fall at the same time that the price of gasoline and food is rising. Already tight household budgets are getting tighter. A lot of Americans read the headlines about credit crunches and liquidity crises and ask: "How did we get here?" In the end, the motivation and behaviors that caused the current crisis are not terribly complicated, even though the alphabet soup of financial instruments is complex. The past decade witnessed the largest increase in home ownership in the past 50 years. Home ownership is part of the American dream, and we want as many Americans as possible to be able to afford their own home. But in the process of a huge, and largely positive, upturn in home construction and ownership, a housing bubble was created.

A bubble occurs when prices are driven up too quickly, speculators move into markets, and these players begin to suspend the normal rules of risk and assume that prices can only move up - but never down. We've seen this kind of bubble before -- in the late 1990s, we had the technology bubble, when money poured into technology stocks and people assumed that those stock values would rise indefinitely. Between 2001 and 2006, housing prices rose by nearly 15 percent every year. The normal market forces of people buying and selling their homes were overwhelmed by rampant speculation. Our system of market checks and balances did not correct this until the bubble burst.

A sustained period of rising home prices made many home lenders complacent, giving them a false sense of security and causing them to lower their lending standards. They stopped asking basic questions of their borrowers like "can you afford this home? Can you put a reasonable amount of money down?" Lenders ended up violating the basic rule of banking: don't lend people money who can't pay it back. Some Americans bought homes they couldn't afford, betting that rising prices would make it easier to refinance later at more affordable rates. There are 80 million family homes in America and those homeowners are now facing the reality that the bubble has burst and prices go down as well as up.

Of those 80 million homeowners, only 55 million have a mortgage at all, and 51 million are doing what is necessary -- working a second job, skipping a vacation, and managing their budgets -- to make their payments on time. That leaves us with a puzzling situation: how could 4 million mortgages cause this much trouble for us all?

The other part of what happened was an explosion of complex financial instruments that weren't particularly well understood by even the most sophisticated banks, lenders and hedge funds. To make matters worse, these instruments -- which basically bundled together mortgages and sold them to others to spread risk throughout our capital markets -- were mostly off-balance sheets, and hidden from scrutiny. In other words, the housing bubble was made worse by a series of complex, inter-connected financial bets that were not transparent or fully understood. That means they weren't always managed wisely because people couldn't properly quantify the risk or the value of these bets. And because these instruments were bundled and sold and resold, it became harder and harder to find and connect up a real lender with a real borrower. Capital markets work best when there is both accountability and transparency. In the case of our current crisis, both were lacking.

Because managers did not fully understand the complex financial instruments and because there was insufficient transparency when they did try to learn, the initial losses spawned a crisis of confidence in the markets. Market players are increasingly unnerved by the uncertainty surrounding the level of risk, liability and loss currently in the financial system. Banks no longer trust each other and are increasingly unwilling to put their money to work. Credit is drying up and liquidity is now severely limited -- and small business and hard-working families find themselves unable to get their usual loans.

The net result is the crisis we face. What started as a problem in subprime loans has now convulsed the entire financial system.

Let's start with some straight talk:

I will not play election year politics with the housing crisis. I will evaluate everything in terms of whether it might be harmful or helpful to our effort to deal with the crisis we face now.

I have always been committed to the principle that it is not the duty of government to bail out and reward those who act irresponsibly, whether they are big banks or small borrowers. Government assistance to the banking system should be based solely on preventing systemic risk that would endanger the entire financial system and the economy.

In our effort to help deserving homeowners, no assistance should be given to speculators. Any assistance for borrowers should

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be focused solely on homeowners, not people who bought houses for speculative purposes, to rent or as second homes. Any assistance must be temporary and must not reward people who were irresponsible at the expense of those who weren't. I will consider any and all proposals based on their cost and benefits. In this crisis, as in all I may face in the future, I will not allow dogma to override common sense.

When we commit taxpayer dollars as assistance, it should be accompanied by reforms that ensure that we never face this problem again. Central to those reforms should be transparency and accountability.

Homeowners should be able to understand easily the terms and obligations of a mortgage. In return, they have an obligation to provide truthful financial information and should be subject to penalty if they do not. Lenders who initiate loans should be held accountable for the quality and performance of those loans and strict standards should be required in the lending process. We must have greater transparency in the lending process so that every borrower knows exactly what he is agreeing to and where every lender is required to meet the highest standards of ethical behavior.

Policies should move toward ensuring that homeowners provide a responsible down payment of equity at the initial purchase of a home. I therefore oppose reducing the down payment requirement for FHA mortgages and believe that, as conditions allow, the down payment requirement should be raised. So many homeowners have found themselves owing more than their home is worth, because many never had much equity in the house to begin with. When conditions return to normal, GSEs (Government Sponsored Enterprises) should never insure loans when the homeowner clearly does not have skin in the game.

In financial institutions, there is no substitute for adequate capital to serve as a buffer against losses. Our financial market approach should include encouraging increased capital in financial institutions by removing regulatory, accounting and tax impediments to raising capital.

I am prepared to examine new proposals and evaluate them based on these principals. But I think we need to do two things right away. First, it is time to convene a meeting of the nation's accounting professionals to discuss the current mark to market accounting systems. We are witnessing an unprecedented situation as banks and investors try to determine the appropriate value of the assets they are holding and there is widespread concern that this approach is exacerbating the credit crunch.

We should also convene a meeting of the nation's top mortgage lenders. Working together, they should pledge to provide maximum support and help to their cash-strapped, but credit worthy customers. They should pledge to do everything possible to keep families in their homes and businesses growing. Recall that immediately after September 11, 2001 General Motors stepped in to provide 0 percent financing as part of keeping the economy growing. We need a similar response by the mortgage lenders. They've been asking the government to help them out. I'm now calling upon them to help their customers, and their nation out. It's time to help American families.

More important than the events of the past is the promise of the future. The American economy is resilient and diverse. Even as financial troubles weigh upon it other parts of the economy hold up or even continue to grow. I have spoken at length in other settings about the need to keep taxes low on our families, entrepreneurs, and small businesses; to make the tax code simpler and fair by eliminating the Alternative Minimum Tax that the middle class was never intended to pay; to improve the ability of our companies to compete by reducing our corporate tax rate, which today are the second highest rates in the world; to provide investment incentives; to control rising health care costs that threaten the budgets of our businesses and families; to improve education and training programs; and to ensure our ability to sell to the 95 percent of the world's customers that lie outside U.S. borders.

These are important steps to strengthen the foundations of the millions of businesses small and large that provide jobs for American workers. There is no government program or policy that is a substitute for a good job. These steps would also strengthen the U.S. dollar and help to control the rising cost of living that hurts our families. These are important issues in this campaign and the debate with my Democrat rivals. But I will get my chance to talk further another day. Now I look forward to hearing from our small business owners -- the very lifeblood of our economy.

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