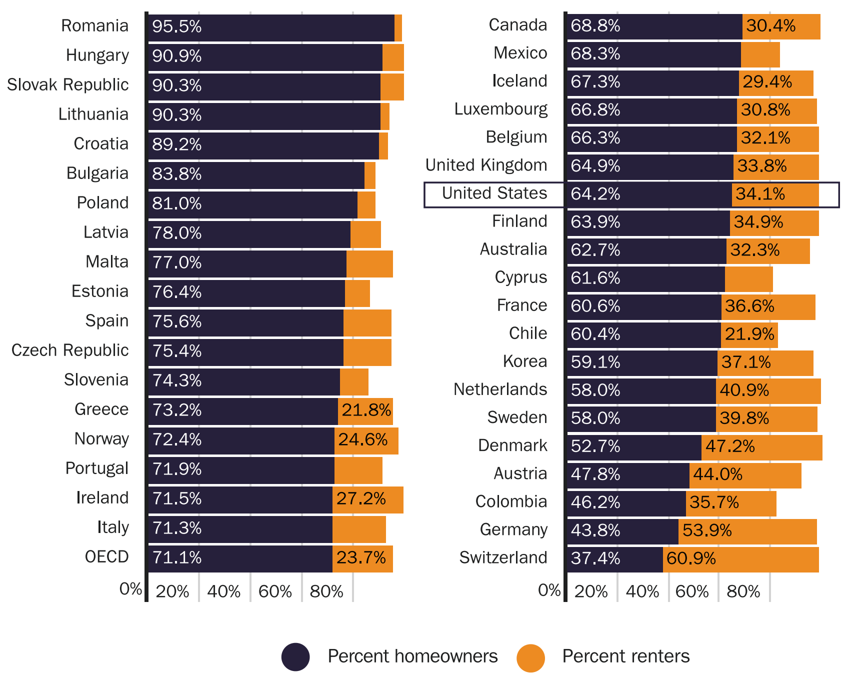
HOMEOWNERSHIP

BY NORBERT MICHEL

THE ISSUE: THE FEDERAL GOVERNMENT'S INVOLVEMENT IN HOUSING FINANCE HAS CAUSED AMERICAN WORKERS TO TAKE ON MORE DEBT WHILE NOT INCREASING HOMEOWNERSHIP

The U.S. government has become increasingly involved in housing finance since the 1930s. While the perceived success of this involvement has helped create the belief that the private housing market cannot properly function without extensive federal involvement, the historical record demonstrates the opposite. Robust mortgage financing exists in virtually every developed nation of the world without the degree of government involvement found in the United States. Yet, as shown in Figure 1, the U.S. homeownership rate remains below average among developed nations: 64.2 percent in the United States versus 71.1 percent for Organisation for Economic Co-operation and Development (OECD) countries.[1]

FIGURE 1 The U.S. homeownership rate is in the bottom half of OECD countries



Source: Organisation for Economic Co-operation and Development.
Note: Homeownership rates include those with a mortgage. Data are from 2019 or latest available data. Those who are not renters or homeowners are categorized by the OECD as "other."

Furthermore, even though the U.S. ownership rate has changed little since the 1960s, volatility of American home prices and construction were among the highest in the industrialized world from 1998 to 2009.[2]

The United States is the only major country in the world with a federal government mortgage insurer, government guarantees of mortgage securities, *and* government-sponsored enterprises (GSEs) in housing finance. As of 2010, comparing the United States with 11 other industrialized countries, only two have a government mortgage insurer (Netherlands and Canada); two have government security guarantees (Canada and Japan); and two have GSEs (Japan and Korea).[3] Denmark even maintains a prepayable fixed-rate 30-year mortgage without the need for GSEs or other government support, and at a lower cost to borrowers than in the United States.[4]

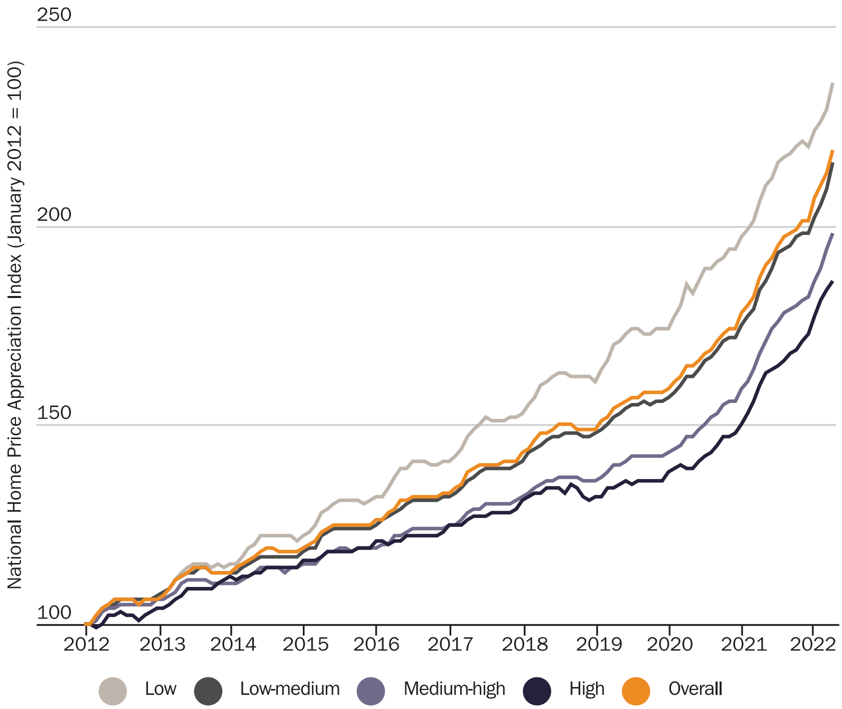
Most federal intervention in housing finance boosts demand, typically by making it easier to obtain a home mortgage. Federal policies encourage borrowing by supporting the operations of Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Home Loan Banks and by providing loan insurance through the Federal Housing Administration (FHA), the Veterans Affairs (VA) home-lending program, and the U.S. Department of Agriculture's Rural Development Program. Prior to the 2008 financial crisis, the federal government controlled a dominant share of the housing finance system, and that share has since expanded. The operations of Fannie and Freddie (the two main GSEs) and the FHA account for the bulk of this federal intervention.

As of December 31, 2020, Fannie and Freddie had combined total assets of $6.6 trillion, representing approximately 42 percent of the nation's outstanding mortgage debt.[5] From 2008 to 2019, the FHA's annual market share of purchase loans ranged from 16.5 percent to 32.6 percent.[6] From 2009 to 2020, Fannie and Freddie's annual share of the total mortgage-backed security (MBS) market averaged 70 percent. Including Ginnie Mae securities, those that are backed by FHA mortgages, the federal share of the mortgage-backed security market averaged 92 percent per year.[7]

Rather than increase homeownership, the FHA has accelerated it for individuals who would otherwise obtain home loans later in the conventional market. Similarly, Fannie and Freddie have cost federal taxpayers billions of dollars and done little to measurably increase homeownership rates. The GSEs have, however, helped to enrich the politically connected and to increase both consumer debt and housing prices, putting sustainable homeownership out of reach for many lower-income households. The wedge between wage gains and home price appreciation, driven largely by government-induced leverage in housing markets, has been especially large for lower-priced homes (see Figures 2 and 3.) After the GSEs imploded in 2008, triggering a major recession and financial crisis, Congress could have shut them down. Instead, Congress chose to prop up the companies indefinitely, and now they remain under government conservatorship.

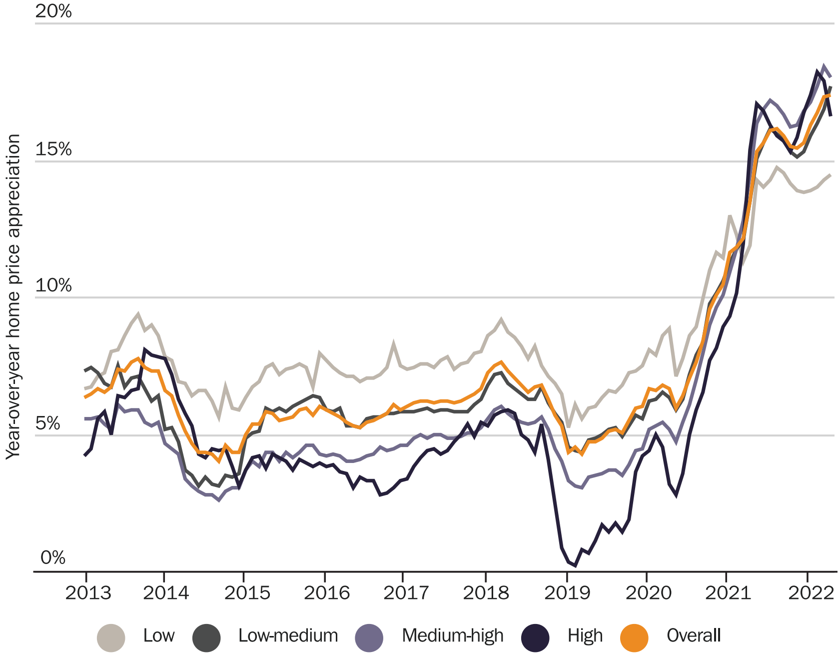
Broadly, federal policy should not prioritize owning a home. Even where homeownership has been shown to correlate with positive spillover effects, such as lower crime and better schools, it has not been shown to cause those spillovers. Regardless, even if homeownership *did* cause such spillovers, it would not follow that everyone should own a home. Buying a home—even without a mortgage—is risky for anyone with variable income or job prospects, and it imposes costs, such as taxes, insurance, and maintenance, that renters would otherwise not incur. Homeownership also can inhibit geographic mobility, especially for people with significant mortgage debt or living in struggling localities. Analyzing data from the Netherlands, Bernstein and Struyven (2022) suggested, in fact, that having a mortgage can be a serious impediment to geographic mobility when a loan exceeds a home's value (known as "negative equity," which often occurs during economic downturns).[8] Moreover, even in the absence of the FHA, the GSEs, and other federal programs, there would be no "correct" level of homeownership to target.

FIGURE 2 The cheapest U.S. homes have appreciated the most



Source: American Enterprise Institute Housing Center.
Note: Data are for the entire country. April 2022 data are preliminary.

FIGURE 3 The cheapest U.S. homes typically experience the highest appreciation



Source: American Enterprise Institute Housing Center.
Note: Data are for the entire country. April 2022 data are preliminary.

Nevertheless, countless government efforts to boost homeownership have not been successful and have instead tended to increase only *mortgage* ownership. Even as federal intervention in housing finance has steadily increased, the overall rate of homeownership has remained nearly constant over the past 50 years.[9] According to the Census Bureau, the homeownership rate was 64 percent in 1970. That is basically where it hovered for most of the 1980s and 1990s, higher than where it bottomed out in 2016, and almost exactly where it stood in the middle of 2019.[10] At the same time, the level of residential mortgage debt has increased more than fivefold—Federal Reserve data show that inflation-adjusted mortgage debt increased from about $3 trillion in 1970 (two years after Fannie Mae became a GSE) to $15.8 trillion in 2019.

THE POLICY SOLUTIONS: GET THE FEDERAL GOVERNMENT OUT OF HOUSING FINANCE

Federal policies have caused American workers to take on more long-term fixed-debt obligations while not increasing their net homeownership. This arrangement endangers workers' ability to build wealth and accumulate assets, especially in turbulent labor markets. Workers have also been paying more for housing because the increased use of long-term debt at lower interest rates has caused home prices—even those that are used for rental homes—to rise more than they would have otherwise. Evidence also suggests that these federal housing policies have created additional incentives for workers to remain in a particular geographic location—a "lock-in effect"—rather than relocate to adapt to changing job markets.[11]

Thus, the ideal solution would be to remove the federal government entirely from the housing finance industry. Many foreign governments are minimally involved in housing finance, and there is no "market failure" in this industry that necessitates government intervention. Should policymakers nevertheless insist on some level of federal involvement in the market, several discrete reforms are recommended in the following section. These reforms would help American workers by reducing home price growth and rental rates, lowering total consumer debt and increasing consumers' net worth, and providing more flexibility to move as job market conditions change.

ACTION PLAN

Multiple agency-level reforms can help reduce federal involvement in housing finance to the benefit of American workers. Ultimately, though, major reductions in the level of federal involvement will require Congress to act.

Thus, Congress should

- limit the FHA's single-family insurance portfolio to first-time homebuyers, without any refinance eligibility over the tenure of the loans in force. Additionally, the value of loan limits eligible for FHA single-family mortgage insurance should decrease to (at most) the first quartile of home prices in a given locality;
- end FHA multifamily mortgage insurance;
- at a minimum, reduce the FHA's level of loan coverage in the single-family mortgage insurance program from the current level (approximately 100 percent of the loan) to the private industry standard of 20 percent;
- eliminate any semblance of affordable housing goals for all financial institutions;
- eliminate the ability-to-repay standard, the qualified mortgage standard,

and all the mortgage servicing rules imposed by the Dodd–Frank Act; and

- shut down Fannie Mae and Freddie Mac and all their subsidiaries. Any legislation to close Fannie and Freddie should avoid creating a smaller version of the GSEs under a new name.

While the GSEs continue to exist, the Federal Housing Finance Agency should

- raise Fannie and Freddie's mortgage guarantee fees; and
- eliminate the geographic price differentials for the GSEs' conforming loan limits, narrow the GSEs' focus to the financing of primary homes, and gradually reduce conforming loan limits. (The GSEs should no longer support financing for second homes, vacation homes, investment properties, or cash-out refinancing.)

NOTES

1. These figures represent the combined ownership rate for people who own their home outright and those who own a mortgage, for both the United States and all Organisation for Economic Co-operation and Development (OECD) countries, using 2019 data, as reported in the OECD Affordable Housing Database, October 15, 2021.
2. Dwight M. Jaffee, "Reforming the U.S. Mortgage Market through Private Market Incentives," in Satya Thallam, ed., *House of Cards: Reforming America's Housing Finance System* (Arlington, VA: Mercatus Center at George Mason University, 2012), pp. 23–25.
3. Michael Lea, *International Comparison of Mortgage Product Offerings* (Washington: Research Institute for Housing America, September 2010).
4. Jesper Berg, Morten Bækmand Nielsen, and James Vickery, "Peas in a Pod? Comparing the U.S. and Danish Mortgage Finance Systems," *Economic Policy Review* 24, no. 3 (December 2018): 63–87; Frances Schwartzkopff, "World's Cheapest Mortgage May Be around the Corner in Denmark," *Bloomberg*, March 21, 2019; and Frances Schwartzkopff, "20-Year Mortgages Hit Zero for First Time in Danish Rate History," *Bloomberg*, August 7, 2019.
5. For the fiscal year ending December 31, 2020, Fannie Mae reported $4 trillion in total assets, while Freddie Mac reported $2.6 trillion. See "Fannie Mae 2020 Form 10-K," Fannie Mae, February 12, 2021, p. 61; and "2020 Annual Report on Form 10K, Fourth Quarter 2020 and Full Year Financial Results," Freddie Mac, February 11, 2021, p. 34. The 42 percent figure is the author's estimate using the Federal Reserve's (now discontinued) 2019 reported total for mortgage debt outstanding ($15.8 trillion). See Board of Governors of the Federal Reserve System, "Mortgage Debt Outstanding, All Holders (DISCONTINUED) [(MDOAH])," Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis, October 15, 2021.
6. See Office of Risk Management and Regulatory Affairs, Office of Evaluation, Reporting and Analysis Division, *FHA Single Family Market Share, 2020 Q1* (Washington: Department of Housing and Urban Development, 2020), p. 4.
7. These figures include both single-family and multifamily mortgage-backed securities. See Securities Industry and Financial Markets Association, "US MBS Securities: Issuance, Trading Volume, Outstanding," October 13, 2021; and Ginnie Mae, *Issuance Summary,* March 2021.
8. Asaf Bernstein and Daan Struyven, "Housing Lock: Dutch Evidence on the Impact of Negative Home Equity on Household Mobility," *American Economic Journal: Economic Policy* 14, no. 3 (August 2022): 1–32.
9. For more information on U.S. homeownership rates between 1940 and 1960 (which increased from 44 percent to 62 percent), see *How Private Equity Landlords are Changing the Housing Market, Before the United States Senate Committee on Banking, Housing, and Urban Affairs Hearing,* 117th Cong. 1st Sess. (October 21, 2021)(statement of Norbert J. Michel).
10. U.S. Census Bureau, "Homeownership Rate in the United States [RHORUSQ156N]," FRED, Federal Reserve Bank of St. Louis, October 15, 2021.
11. For examples, see Jennifer Brown and David Matsa, "Locked in by Leverage: Job Search during the Housing Crisis," *Journal of Financial Economics* 136, no. 3 (June 2020): 623–48; Sewin Chan, "Spatial Lock-in: Do Falling House Prices Constrain Residential Mobility?," *Journal of Urban Economics* 49, no. 3 (May 2001): 567–86; and Fernando Ferreira, Joseph Gyourko, and Joseph Tracy, "Housing Busts and Household Mobility: An Update," *Federal Reserve Bank of New York Economic Policy Review* 18, no. 3 (November 2012): 1–15.