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Testimony
Before the United States House of Representatives Subcommittee on Housing and Insurance of the Committee on Financial Services, Hearing on "Housing Affordability: Governmental Barriers and Market-Based Solutions"

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December 2, 2023

Introduction

Chairman Davidson, Ranking Member Cleaver, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Norbert Michel and I am Vice President and Director for the Center for Monetary and Financial Alternatives at The Cato Institute. The views I express in this testimony are my own and should not be construed as representing any official position of The Cato Institute.

It is always convenient to blame "Wall Street," interest rates, or "speculators" for economic difficulties, including impediments to housing affordability. These terms obscure the human component that drives specific economic outcomes, thus making it easy to deflect blame away from individual policies. The tactic is very effective. In the last few years, for instance, stories have stoked fears that large institutional investors caused rapid price increases in single family housing markets.[1]

Yet, research demonstrates that institutional investors play a very small role in the single family housing market – both in absolute terms and relative to large multifamily housing companies and other single family home investors.[2] A Philadelphia Federal Reserve Bank paper, for example, shows that from 2006 to 2014, the share of large institutional buyers of mortgages increased "from virtually zero to 1.47 percent" and the share of small institutional buyers

[1] Ryan Dezember, "If You Sell a House These Days, the Buyer Might Be a Pension Fund," *The Wall Street Journal*, April 4, 2021, https://www.wsj.com/articles/if-you-sell-a-house-these-days-the-buyer-might-be-a-pension-fund-11617544801; Staff, "Institutional Investors, Higher Material Costs Lead To Rising Home Prices," *The Real Deal Real Estate News*, April 13, 2021, https://therealdeal.com/national/2021/04/13/institutional-investors-higher-material-costs-lead-to-rising-home-prices/; and, Staff, "Investors, Speculators Plow Into US Housing Market: Report," *The Real Deal Real Estate News*, June 21, 2019, https://therealdeal.com/national/2019/06/21/investors-speculators-plow-into-us-housing-market-report/

[2] For a list of the largest multifamily companies, see "The Top 15 Multifamily Property Managers of 2021," Multifamily.loans, January 22, 2021, https://www.multifamily.loans/apartment-finance-blog/the-top-15-multifamily-property-managers-of-2019.

increased “by 4.04 percentage points.”[3] The authors claim that “despite the rise that began after 2010, in 2014 their shares remained small: The average share of large institutions as buyers was 1.47 percent.”[4]

Additional research by the Federal Reserve indicates that institutional investors comprised “1 to 2 percent of all single-family purchases from 2012 to 2014,” while “purchases by other investors accounted for 18 to 19 percent of single-family home purchases during the same period,” and that “buy-to-rent investors owned about 0.14 percent of the housing stock in 2014, whereas corporate investors owned 6 percent and individual investors owned 6 percent.”[5] Although more recently interest in this specific topic seems to have subsided among economics researchers, these figures are consistent with some newer reports, and the total share for large investors appears to have remained small through at least 2021. For instance, as reported by the United States Department of Housing and Urban Development in 2023, data show that “institutional investors purchased 3 percent of homes sold in 2021, three times their typical share in prior years.”[6]

Despite the small share, the evidence also suggests that “institutional investors contribute to the improvement of the local housing market by reducing vacancy rates as they shorten the amount of time distressed properties stay in REO [real estate owned foreclosure],” and that “institutional investors help lower local unemployment rates by increasing local construction employment.”[7] Citing other research, the Urban Institute’s Laurie Goodman argues that institutional investors “grew up in 2010-2013 buying distressed properties that no one else would buy and in fact put a floor on the market, so they provided a very, very valuable service and they basically cleaned up the distressed market, a lot of which required repairs.”[8]

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[3] Lauren Lambie-Hanson, Wenli Li, and Michael Slonkosky, “Institutional Investors and the U.S. Housing Recovery,” *Federal Reserve Bank of Philadelphia*, WP 19-45, November 2019, p. 17, https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2019/wp19-45.pdf.

[4] Lambie-Hanson, et al., pp. 10-11.

[5] James Mills, Raven S. Molloy, and Rebecca E. Zarutskie, “Large-Scale Buy-to-Rent Investors in the Single-Family Housing Market: The Emergence of a New Asset Class?,” *Federal Reserve Board*, Working Paper 2015-084, p. 2, https://www.federalreserve.gov/econresdata/feds/2015/files/2015084pap.pdf.

[6] “Institutional Investors Outbid Individual Homebuyers,” Office of Policy Development and Research, United Sates Department of Housing and Urban Development, Winter 2023, https://www.huduser.gov/portal/periodicals/em/winter23/highlight1.html. The article refers to CoreLogic data, as reported in Tim Henderson, “Investors Bought a Quarter of Homes Sold Last Year, Driving Up Rents,” Stateline, Jully 22, 2022, https://stateline.org/2022/07/22/investors-bought-a-quarter-of-homes-sold-last-year-driving-up-rents/.

[7] Lambie-Hanson, et al., p. 1. Separately, an Urban Institute report quotes Lambie-Hanson saying that “there really isn’t any evidence in our research that institutional investors led to higher rents or greater eviction rates for our sample of counties tracked through the recovery.” See Caitlin Young, “Institutional Investors Brought Higher Home Prices and Lower Vacancies to the Housing Recovery,” *Urban Wire*, March 5, 2020, https://www.urban.org/urban-wire/institutional-investors-brought-higher-home-prices-and-lower-vacancies-housing-recovery.

[8] Jerusalem Demsas, “Wall Street Isn’t To Blame For The Chaotic Housing Market,” *Vox*, June 11, 2021, https://www.vox.com/22524829/wall-street-housing-market-blackrock-bubble. Also see Laurie Goodman and Edward Golding, “Institutional Investors Have a Comparative Advantage in Purchasing Homes That Need Repair,”

Goodman also cites evidence that "institutional operators owned just 300,000 single-family units in 2019," approximately 2 percent of the roughly 15 million one-unit detached single-family *rental* homes in the United States, and less than 0.5 percent of the total number (80 million) of detached single-family homes in the United States.[9] Separately, research by the National Rental Home Council (NRHC) estimates that 0.74 percent of single-family home purchases in the second quarter of 2021 were made by "large investors."[10] Put differently, the NRHC estimates that 99.26 percent of single-family homes purchased in the second quarter of 2021 "were made by someone, or some entity, other than a large investor."[11]

In contrast, the federal government is heavily involved in the single-family home market, particularly in ways that increase demand by making it easier to obtain home mortgages. Given that housing markets are consistently supply constrained, there is little doubt that federal housing finance policies contribute greatly to higher home prices.[12] Unfortunately, there appears to be no appetite in Congress to move away from these types of failed housing policies. Collectively, these policies will further expand government intervention in housing markets at a great cost to millions of Americans, pushing up prices as well as rental rates, wasting taxpayers' money and making housing less affordable.

The U.S. Government is Heavily Involved in Housing Markets

Federal intervention has increasingly become the norm in housing markets since the 1930s, and the perceived success of these policies has helped perpetuate and expand that involvement. 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

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Urban Wire, October 20, 2021, https://www.urban.org/urban-wire/institutional-investors-have-comparative-advantage-purchasing-homes-need-repair.

[9] Demsas, "Wall Street Isn't To Blame For The Chaotic Housing Market."

[10] National Rental Home Council, "NRHC Analysis of Data Shows Just 0.74% of Home Purchases in Second Quarter of 2021 Made by Large Investors," October 15, 2021, https://www.rentalhomecouncil.org/wp-content/uploads/2021/10/Investor-purchases-Blog-Oct-2021.pdf.

[11] National Rental Home Council, "NRHC Analysis of Data." Though causal studies with quantitative estimates are not plentiful, one study estimates that "A 10% increase in the percentage of houses purchased by investors in a census block leads to a 0.20% increase in house prices." Marcus T. Allen, Jessica Rutherford, Ronald Rutherford, and Abdullah Yavas, "Impact of Investors in Distressed Housing Markets," *The Journal of Real Estate Finance and Economics*, (2018), Vol. 56, pp. 622–652.

[12] For a discussion of how supply constraints affect housing affordability, see Raven Molloy, "The Effect of Housing Supply Regulation on Housing Affordability: a Review," Federal Reserve Board, March 31, 2017, https://www.aei.org/wp-content/uploads/2017/04/Overview-Talk-Panel-5.pdf; and Raven Molloy, Charles G. Nathanson, and Andrew Paciorek, "Housing Supply and Affordability: Evidence from Rents, Housing Consumption and Household Location," Finance and Economics Discussion Series 2020-044, Board of Governors of the Federal Reserve System, 2020, https://www.federalreserve.gov/econres/feds/files/2020044pap.pdf.

(Netherlands and Canada), two have government security guarantees (Canada and Japan), and two have GSEs (Japan and Korea).[13] 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.[14]

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, and Ginnie Mae, 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. Historically, the federal tax code has also promoted housing investment and consumption by allowing taxpayers to deduct mortgage interest and capital gains from the sale of a home from their federal income tax liability. Additionally, the Basel capital requirements have long provided financial institutions with capital relief for holding mortgage-backed-securities (MBS) rather than whole loans, while Fannie Mae and Freddie Mac have long enjoyed lower equity requirements than banks.[15]

Prior to the 2008 financial crisis the federal government controlled a dominant share of the U.S. housing finance system, and that share has expanded. As of December 31, 2020, Fannie and Freddie (both of which remain in government conservatorship) had combined total assets of $6.6 trillion, representing approximately 42 percent of the nation's outstanding mortgage debt.[16] From 2008 to 2019, the FHA's annual market share of purchase loans ranged

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[13] Michael Lea, "International Comparison of Mortgage Product Offerings," *Research Institute for Housing America Special Report*, September 2010, https://business.sdsu.edu/_resources/files/real-estate/research/10122_research_riha_lea_report.pdf.

[14] Jesper Berg, Morten Bækmand Nielsen, and James Vickery, "Peas in a Pod? Comparing the U.S. and Danish Mortgage Finance Systems," Federal Reserve Bank of New York, *Economic Policy Review*, Vol. 24, no. 3, December 2018, https://www.newyorkfed.org/research/epr/2018/epr_2018_US-danish-mortgage-finance_berg; Frances Schwartzkopff, "World's Cheapest Mortgage May Be Around the Corner in Denmark," *Bloomberg*, March 21, 2019, https://www.bloomberg.com/news/articles/2019-03-21/world-s-cheapest-mortgage-may-be-around-the-corner-in-denmark; and, Frances Schwartzkopff, "20-Year Mortgages Hit Zero for First Time in Danish Rate History," Bloomberg, August 7, 2019, https://www.bloomberg.com/news/articles/2019-08-07/nordea-offers-20-year-mortgages-at-zero-interest-as-rates-plunge.

[15] Norbert J. Michel and John Ligon, "Basel III Capital Standards Do Not Reduce the Too-Big-to-Fail Problem," Heritage Foundation Backgrounder no. 2905, April 23, 2014, http://thf_media.s3.amazonaws.com/2014/pdf/BG2905.pdf; and, Norbert J. Michel, "Strict Bank-Like Capital Rules Needed for Fannie Mae and Freddie Mac," Heritage Foundation Backgrounder no. 3474, March 9, 2020, https://www.heritage.org/sites/default/files/2020-03/BG3474.pdf.

[16] For the fiscal year ending December 31, 2020, Fannie Mae reported $4 trillion in total assets while Freddie Mac reported $2.6 trillion. See Federal National Mortgage Association, "Annual Report," December 31, 2020, p. 61, https://www.fanniemae.com/media/38271/display. p. 61; and Federal Home Loan Mortgage Corporation, "Annual Report," December 31, 2020, p. 34, http://www.freddiemac.com/investors/financials/pdf/10k_021121.pdf, p. 34. The 42 percent figures it 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])," retrieved from FRED Economic Data, Federal Reserve Bank of St. Louis, October 15, 2021, https://fred.stlouisfed.org/series/MDOAH, October 15, 2021.

from 16.49 percent to 32.6 percent.[17] From 2009 to 2020, Fannie and Freddie's annual share of the total MBS market averaged 70 percent. Including Ginnie Mae securities, those that are backed by FHA mortgages, the federal share of the MBS market averaged 92 percent per year.[18] Moreover, from 2008 to 2020, the Federal Reserve went from holding zero MBS to more than $2 trillion (combined Fannie, Freddie, and Ginnie MBS).[19]

Yet, the evidence suggests that the expansive federal role has done little to expand homeownership. Even though robust mortgage financing exists in virtually every developed nation, without the high degree of government involvement found in the United States, the overall U.S. homeownership rate is below average among developed nations (64.5 percent in the United States versus 68.1 percent for Organisation for Economic Co-operation and Development (OECD) countries).[20] And even though the U.S. ownership rate has changed little since the 1960s, volatility of home prices and home construction in the United States were among the highest in the industrialized world from 1998 to 2009.[21] Federal housing finance policies have, at the very least, magnified economic instability by inducing higher home prices.[22] Federal involvement expanded after the most recent financial crisis, for instance, and home prices rose to 43 percent *more* than where they peaked prior to their 2007 crash.[23] Separately, research demonstrates that 22 percent of the FHA's first-time homebuyers "failed to sustain their homeownership" between 2011 and 2016.[24] Regardless, the fact that prices are so far

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[17] See United States Department of Housing and Urban Development, "FHA Single Family Market Share, 2020 Q1," p. 4, https://www.hud.gov/sites/dfiles/Housing/images/FHASFMarketShare2020Q1.pdf.

[18] These figures include both single-family and multi-family MBS. Securities Industry and Financial Markets Association, "US MBS Securities: Issuance, Trading Volume, Outstanding," October 13, 2021, https://www.sifma.org/resources/research/us-mortgage-backed-securities-statistics/us-mortgage-backed-securities-statistics-sifma/; and, Ginnie Mae, *Insurance Summary*, March 2021, https://www.ginniemae.gov/data_and_reports/reporting/MonthlyIssuanceReports/Mar21_ISS.pdf.

[19] Board of Governors of the Federal Reserve System, "Assets: Securities Held Outright: Mortgage-Backed Securities: Wednesday Level [WSHOMCB]," retrieved from FRED, Federal Reserve Bank of St. Louis, June 26, 2022, https://fred.stlouisfed.org/series/WSHOMCB.

[20] 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, available at https://www.oecd.org/housing/data/affordable-housing-database/.

[21] 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*, George Mason University, Mercatus Center, March 2012, pp. 23-25, http://mercatus.org/sites/default/files/House_of_Cards_March_2012.pdf (accessed March 6, 2014).

[22] Broadly, federal housing policies have caused more than their share of economic turmoil. See Alex J. Pollock and Edward J. Pinto, "Political Disasters in US Housing: The Lessons of History," *Housing Finance International*, AEI Op-Ed, September 30, 2021, https://www.aei.org/op-eds/political-disasters-in-us-housing-the-lessons-of-history/.

[23] This 43 percent figure refers to the S&P/Case-Shiller U.S. National Home Price Index. See S&P Dow Jones Indices LLC, "S&P/Case-Shiller U.S. National Home Price Index [(CSUSHPISA])," retrieved from FRED Economic Data, Federal Reserve Bank of St. Louis, October 15, 2021, https://fred.stlouisfed.org/series/CSUSHPISA.

[24] Donghoon Lee and Joseph Tracy, "FHA First-Time Buyer Homeownership Sustainability: An Update," Federal Reserve Bank of New York Liberty Street Economics, November 30, 2023, https://libertystreeteconomics.newyorkfed.org/2023/11/fha-first-time-buyer-homeownership-sustainability-an-update/.

from the bottom of a housing cycle is worrisome, especially since empirical evidence links large increases in housing prices to banking crises.[25]

Other research, when examining asset price booms and busts in the OECD countries from 1970 to 2001, estimates that the probability of a real estate boom ending in a bust is 53 percent, whereas stock market booms have just a 13 percent probability of ending in a crash.[26] Another study estimates that a 1 percentage point increase in real home prices raises the probability of a U.S. financial crisis by 0.07 percent.[27] Moreover, the role of housing prices in U.S. financial crises is linked to high-leverage lending, where policies ensure that both borrowers and those who fund mortgages can do so with relatively little loss-absorbing equity. For decades, U.S. housing finance policy has helped increase the number of mortgages requiring low down payments used for financing homes, even though evidence clearly indicates that the risk of loan default increases (particularly among first-time home buyers) as the loan-to-value ratio increases.[28]

Owning one's own home is commonly viewed as part of the American Dream, and policymakers – as well as special interest groups – regularly promote building wealth through buying a home. They also tout beneficial "spillover effects" from homeownership, such as increased engagement in civic institutions, greater political participation, and positive educational outcomes for children. However, much of the evidence for causal spillover effects – that is, the notion that owning a home *causes* people to change their behavior in beneficial ways – is weak, and the size of such spillover effects, where they do exist, does not appear to justify the historical level of government involvement.[29] Furthermore, other research has

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[25] Carmen M. Reinhart and Kenneth S. Rogoff, "Is the 2007 US Sub-prime Crisis so Different? An International Historical Comparison," *American Economic Review*, 98, no. 2 (May 2008): 339–44.

[26] Michael D. Bordo and Olivier Jeanne, "Boom-Busts in Asset Prices, Economic Instability, and Monetary Policy," NBER Working Paper no. 8966, June 2002, pp. 9–10.

[27] See Ray Barrell et al., "Bank Regulation, Property Prices and Early Warning Systems for Banking Crises in OECD Countries," *Journal of Banking and Finance*, Vol. 34, no. 9 (September 2010): 2255–64. Also see Mark Calabria, "The Role of Mortgage Finance in Financial (In)Stability," in *Homeownership Built to Last: Balancing Access, Affordability, and Risk after the Housing Crisis*, ed. Eric S. Belsky, Christopher E. Herbert, and Jennifer H. Molinsky (Washington: Brookings Institution Press, 2014), pp. 372–93.

[28] "Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets," Testimony Before the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity, 112th Cong., First Session, (September 8, 2011)(statement of Carol J. Galante), https://financialservices.house.gov/uploadedfiles/090811galante.pdf, pp. 14–15; Patric H. Hendershott and William R. Schultz, "Equity and Nonequity Determinants of FHA Single-Family Mortgage Foreclosures in the 1980s," NBER Working Paper no. 4440, August 1993, https://www.nber.org/papers/w4440; George M. Von Furstenberg, "Default Risk on FHA-Insured Home Mortgages as a Function of the Terms of Financing: A Quantitative Analysis," *Journal of Finance*, 1969, Vol. 24, no. 3 (June 1969), pp. 459-4–77; and Morris A. Davis et al., "A Quarter Century of Mortgage Risk," AEI Economics Working Paper no. 2019-04, May 2021, https://www.aei.org/research-products/working-paper/mortgage-risk-since-1990/.

[29] Jane R. Zavisca and Theodore P. Gerber, "The Socioeconomic, Demographic, and Political Effects of Housing in Comparative Perspective," *Annual Review of Sociology*, July 2016, Vol. 42, pp. 347-367, https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6078393/; David R. Barker, "The Evidence Does Not Show That Homeownership Benefits Children," *Cityscape*, 2013, Vol. 15, No. 2, pp. 231-234, https://www.jstor.org/stable/41959125; and, Edward L. Glaeser and Jesse M. Shapiro, "The Benefits of the Home

suggested that homeownership is associated with *negative* spillover effects, such as higher unemployment due to an incentive against relocating.[30] Finally, although home equity frequently represents a large portion of many Americans' wealth, purchasing a home is a risky investment that often depends entirely on home price appreciation, an attribute fundamentally in conflict with housing becoming more affordable.[31]

Price Appreciation and Ownership Rates: A Closer Look

While government intervention in housing has steadily increased, the overall rate of U.S. homeownership has remained nearly constant over the past 50 years.[32] On the other hand, 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. While countless government programs are touted as boosting homeownership, these policies have tended to increase *mortgage* ownership. According to the Census Bureau, the homeownership rate was 64 percent in 1970. That's 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.[33]

Mortgage Interest Deduction," National Bureau of Economic Research Working Paper no. 9284, October 2002, https://www.nber.org/system/files/working_papers/w9284/w9284.pdf.

[30] See David G. Blanchflower and Andrew J. Oswald, "Does High Home-Ownership Impair the Labor Market?," National Bureau of Economic Research Working Paper no. 19079, May 2013, https://www.nber.org/system/files/working_papers/w19079/w19079.pdf; Jennifer Brown and David Matsa, "Locked in By Leverage: Job Search During the Housing Crisis," *Journal of Financial Economics*, Vol. 136, No. 3, June 2020, pp. 623-648; Sewin Chan, "Spatial Lock-in: Do Falling House Prices Constrain Residential Mobility?," Journal of Urban Economics, Vol. 49, No. 3, May 2001, pp. 567-586; and, Fernando Ferreira, Joseph Gyourko, and Joseph Tracy, "Housing Busts and Household Mobility: An Update," Federal Reserve Bank of New York Economic Policy Review, November 2012, pp. 1-15, https://www.newyorkfed.org/medialibrary/media/research/epr/12v18n3/1210ferr.pdf.

[31] For *at least* the past 20 years, home prices have exhibited similar volatility to equity markets. Joe Cortright, "Why Homeownership Is Frequently A Bad Bet," *City Commentary*, July 15, 2019, https://cityobservatory.org/why-homeownership-is-frequently-a-bad-bet/. Also see Daniel Indiviglio, "Should the Government Encourage Home Ownership?," *The Atlantic*, June 17, 2010, https://www.theatlantic.com/business/archive/2010/06/should-the-government-encourage-home-ownership/58320/; and, Daniel Indiviglio, "The Fallacy of Eternal Home Price Appreciation," *The Atlantic*, April 6, 2010, https://www.theatlantic.com/business/archive/2010/04/the-fallacy-of-eternal-home-price-appreciation/38546/.

[32] Between 1940 and 1960 the U.S. homeownership rate increased from 44 percent to 62 percent. Research suggests that it is "likely that there was some commonality between the drivers of the increases in non-farm home ownership in the pre-1930s and the post-1940 periods." See Daniel K. Fetter, "The 20th-Century Increase in US Home Ownership: Facts and Hypotheses," *National Bureau of Economic Research*, July 2, 2013, p. 5, http://www.nber.org/chapters/c12801.pdf. One key factor—which explains approximately 17 percent of the homeownership rate increase from 1940 to 1960—was that people began buying homes at much younger ages than previously. Research also suggests that increasing income accounted for up to 50 percent of the increase from 1940 to 1960, and up to 20 percent may have resulted from tax benefits becoming more pronounced as income increased. See Daniel K. Fetter, "The 20th-Century Increase in US Home Ownership: Facts and Hypotheses," pp. 16-18.

[33] U.S. Census Bureau, Homeownership Rate in the United States [RHORUSQ156N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RHORUSQ156N, October 15, 2021. After bottoming

There is, of course, much more to the home ownership story than just the national rate. For instance, the Census Bureau's American Community Survey (ACS) reports homeownership rates by core-based statistical area (CBSA), a statistic that can be paired with each CBSA's median price-to-income ratio.[34] These figures show a national ownership rate of 63.3 percent for 2019.[35] However, for the 25 CBSAs with the highest price-to-income ratios (the least affordable homes), the average ownership rate is just 61.8 percent. In San Jose and Los Angeles, both among the three CBSAs with the least affordable homes, the ownership rates are 56.6 percent and 48.6 percent, respectively. For the 25 CBSAs with the lowest price-to-income ratios (the *most* affordable homes), the average rate is 69.5 percent. And, of course, federal policies have fueled debt and correspondingly rapid home price appreciation at a much higher rate in the entry-level segment (lower-priced homes) of the market for at least the last decade.[36]

Overemphasis on Rates and Demand Rather Than Supply

Even if positive spillover effects from home ownership clearly outweighed the negative ones, it would not automatically follow that the federal government should undertake a policy of actively encouraging people—especially those with low wealth or volatile income—to finance home purchases. The fact that the federal government encourages home financing through low-equity long-term debt further strengthens this argument. Such mortgages are risky for both borrowers and lenders, and the ability to consistently repay a mortgage—or consistently pay rent in a timely manner—is dependent on broad economic and social factors.

Those broad factors, including education quality and regulatory barriers that hamper employment and opportunity, ultimately determine the ownership and rental rates in the economy, and it is a mistake to assume that any ownership rate is the "correct" one. Policies that simply target the ownership rate are destined to fail precisely because they do nothing to change the underlying economic factors that govern the long-term ability to successfully finance large dollar purchases.

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out at 65.4 percent after the COVID-19 pandemic shutdowns (in the first quarter of 2022), the rate stood at 66 percent in the third quarter of 2023.

[34] These figures were provided to the author by the AEI Housing Center.

[35] According to Census data, the African American ownership rate in 2000 was 46.3 percent, *higher* than the 2019 rate of 44 percent. See United States Census Bureau, "Historical Census of Housing Tables: Homeownership by Race and Hispanic Origin," 2000, https://www2.census.gov/programs-surveys/decennial/tables/time-series/coh-ownershipbyrace/ownershipbyrace-tab.txt; and, United States Census Bureau, "Quarterly Residential Vacancies And Homeownership, Second Quarter 2021," July 27, 2021, Table 7, https://www.census.gov/housing/hvs/files/currenthvspress.pdf.

[36] See Edward J. Pinto, Norbert J. Michel, and Tobias Peter, "Comment Letter for Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z), Consumer Financial Protection Bureau, Docket No. CFPB-2019-0039," September 18, 2019, https://www.aei.org/research-products/report/comment-letter-on-the-qualified-mortgage-definition/.

In 1994, President Clinton launched National Partners in Homeownership, a private–public cooperative, with an explicit goal of raising the U.S. homeownership rate from 64 percent to 70 percent by 2000.[37] Although the rate increased from 64 percent in 1994 to 69 percent in 2004, at a time when Fannie and Freddie went from holding (combined) 35 percent of the nation's mortgages to more than 43 percent,[38] more than 4 million people lost their homes during the 2008 financial crisis, and the rate fell back to 65 percent–only 1 percentage point higher than in 1968. This episode is emblematic of longstanding federal housing finance policy with a misplaced emphasis on the rate of ownership and federal intervention that boosts the quantity of home mortgages.

These demand-side policies have been particularly problematic because, compared to increasing the supply of housing, it is rather easy to boost demand. Housing supply is always relatively constricted in the sense that available land (in locations that people most desire to live) is a prerequisite for large scale home building, and because a new home (or apartment building) takes at least several months to construct. In many areas, state and local regulatory restrictions have contributed heavily to supply constraints in housing markets, often by limiting the amount of land that can be used for particular types of housing.[39] Inducing demand in supply-constrained markets can only serve to put upward pressure on prices, and housing markets are no exception. Thus, federal housing finance policies have typically made it more expensive (everything else constant) to either buy or rent a dwelling. Nonetheless, inducing demand is precisely what federal policies have done for decades, and there appears to be no desire in Congress (or the administration) to reverse, or even slow, that trend.

Further Interference with Housing Markets Will Increase Risky Debt and Prices

Recent moves by the Biden administration, as well as multiple congressional proposals, demonstrate a clear commitment to implementing the same types of failed housing policies that have consistently expanded government intervention in housing markets at a great cost to millions of Americans. For instance, the Treasury and the Federal Housing Finance Agency (FHFA) announced (on September 14, 2021) that they would suspend certain conditions (added in 2021) to the Preferred Stock Purchase Agreements (PSPAs) that govern the conservatorships

[37] Norbert Michel and John Ligon, "Fannie and Freddie: What Record of Success?," Heritage Foundation Backgrounder no. 2854, November 7, 2013, https://www.heritage.org/housing/report/fannie-and-freddie-what-record-success.

[38] These figures refer to *Total Mortgages Held or Securitized by Fannie Mae and Freddie Mac, as a Percentage of Residential Mortgage Debt Outstanding,* as reported by the FHFA. See Federal Housing Finance Agency, Data, *Enterprise Share of Residential Mortgage Debt Outstanding 1990 – 2010*, 2021, https://www.fhfa.gov/DataTools/Downloads/Pages/Current-Market-Data.aspx.

[39] Lee Ohanian, "Common-Sense Policy Reforms for California Housing," Cato Policy Analysis no. 920, August 31, 2021, https://www.cato.org/policy-analysis/common-sense-policy-reforms-california-housing; and, Vanessa Brown Calder, "Zoning, Land-Use Planning, and Housing Affordability," Cato Policy Analysis no. 823, October 18, 2017, https://www.cato.org/policy-analysis/zoning-land-use-planning-housing-affordability.

of Fannie Mae and Freddie Mac.[40] The PSPAs are key to protecting taxpayers against future bailouts and ensuring that Fannie and Freddie (the enterprises) do not further crowd out private capital,[41] but the administration weakened those protections by suspending the provisions that capped the enterprises' purchases of multifamily housing loans, as well as single-family loans "with higher risk characteristics," second homes, and investment properties.[42] These last two provisions have nothing to do with helping people become homeowners, and they represent a naked give away to special interests that lobby to maximize real estate lending. Uncapping the enterprises' multifamily loan purchases is also a giveaway to corporate rent seekers and will likely do little, if anything, to increase the amount of housing that would otherwise go unbuilt.

Separately, the FHFA amended the Enterprise Regulatory Capital Framework (ERCF) enacted in 2020.[43] The ERCF framework was designed to strengthen the enterprises and protect taxpayers and was among the most meaningful housing finance reforms since 2008. Yet, the administration lowered the enterprises' prescribed leverage buffer amount (PLBA) *and* the floor on the risk weight assigned to any retained credit risk transfer (CRT) exposures. Just as with weakening the PSPA provisions, it makes zero sense to lower the GSEs' capital requirements, especially when home prices have risen so much.

Aside from the potential effect on home prices, rolling back these reforms will weaken the enterprises' capital position and force taxpayers to back more high-risk loans, thus increasing the risk of future bailouts. Of course, reducing the capital requirements is precisely what various special interest groups have been calling for since the FHFA originally proposed the ERCF. For instance, the cottage CRT industry, ironically a group that consists mostly of large investors and Wall Street firms, has long called for *no risk weight floor* on CRT exposures, which is equivalent to treating them as risk-free investments as safe, or safer, than U.S. Treasuries.

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[40] Federal Housing Finance Agency, "FHFA and Treasury Suspending Certain Portions of the 2021 Preferred Stock Purchase Agreements," *News Release*, September 14, 2021, https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-and-Treasury-Suspending-Certain-Portions-of-the-2021-Preferred-Stock-Purchase-Agreements.aspx.

[41] Joel Griffith and Norbert Michel, "Revising the Preferred Stock Purchase Agreements of Fannie Mae and Freddie Mac May Be the Biggest GSE Bailout Yet," Heritage Foundation Backgrounder no. 3448, November 4, 2019, https://www.heritage.org/sites/default/files/2019-11/BG3448.pdf.

[42] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Final Rule, Federal Register, Vol. 87, No. 51, Wednesday, March 16, 2022, https://www.govinfo.gov/content/pkg/FR-2022-03-16/pdf/2022-04529.pdf. For the original rule proposal, see Federal Housing Finance Agency, "FHFA and Treasury Suspending Certain Portions of the 2021 Preferred Stock Purchase Agreements," *News Release*, September 14, 2021, https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-and-Treasury-Suspending-Certain-Portions-of-the-2021-Preferred-Stock-Purchase-Agreements.aspx.

[43] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of proposed rulemaking, *Federal Register*, Vol. 86, no. 184, September 27, 2021, https://www.govinfo.gov/content/pkg/FR-2021-09-27/pdf/2021-20297.pdf.

From a safety and soundness standpoint, the idea that CRTs eliminate the enterprises' risk is pure fantasy – they increase the enterprises' financial obligations and their value to either the enterprises or taxpayers is highly questionable.[44] Similarly, it makes little sense to lower the existing leverage buffer, a mechanism that serves as a part of a backstop to the enterprises' risk-based capital requirements. In addition to the tier 1 leverage ratio, the GSEs were originally required to maintain a fixed buffer of at least 2.5 percent tier 1 capital to adjusted total assets.[45] Lowering this amount–or any of the risk-based requirements–cannot legitimately be described as improving the enterprises' safety and soundness because it does the exact opposite. If anything, the original rule should have required *higher* capital ratios, so that the enterprises' requirements were more in line with those of the Global Systemically Important Banks (GSIBs).

Nonetheless, the administration replaced the fixed buffer with "a dynamic leverage buffer determined annually and tied to the stability capital buffer," a change that the FHFA estimates will reduce the enterprises' leverage buffers by about two-thirds.[46] Perhaps worse, the administration appears to be setting up an even larger reduction in capital. The new proposal asked for comments on whether "the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures [is] appropriately calibrated,"[47] a signal that the administration wants to lower the enterprises' overall capital requirements.

Harmful Programs Included in Reconciliation Package

Aside from these risky housing finance provisions, advocates are trying to implement multiple housing policies that will make housing less affordable. For instance, on June 21, 2023, Ranking Member Maxine Waters (D-CA) introduced the Downpayment Toward Equity Act, a bill that would provide downpayment assistance grants to people who (among meeting other

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[44] Federal Housing Finance Agency, "Performance Of Fannie Mae's And Freddie Mac's Single-Family Credit Risk Transfer," May 2021, https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-05172021.pdf. The report also explains (see page 23) that "CRT investors and counterparties are projected to receive a simple return [interest and premiums received less write downs and reimbursements divided by risk in force at issuance] of about 26 percent on the original reference pool UPB in the baseline scenario and 16 percent in the 2007 Replay."

[45] The original ERCF required the GSEs to maintain a leverage ratio of tier 1 capital to adjusted total assets of at least 2.5 percent, as well as a fixed tier 1 capital prescribed leverage buffer amount (PLBA) of at least 1.5 percent of adjusted total assets. The final rule replaced the GSE's fixed leverage buffer (the PLBA, equal to 1.5 percent of a GSE's adjusted total assets) with a "dynamic leverage buffer equal to 50 percent of the Enterprise's stability capital buffer." See Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Final Rule.

[46] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Figure 2, p. 53237.

[47] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," p. 53238. Even the Financial Stability Oversight Council (FSOC) officially stated that the enterprises' capital requirements should not be lower than those in the 2020 ERCF. United States Department of the Treasury, "Financial Stability Oversight Council Issues Statement on Activities-Based Review of Secondary Mortgage Market Activities," September 25, 2020, p. 4, https://home.treasury.gov/news/press-releases/sm1136.

requirements) earn up to 1.2 times their area median income.[48] There is no doubt that it is difficult to save a large downpayment for a mortgage, but it does not follow that the federal government should provide even a portion of those funds. Among other problems, subsidizing downpayments puts upward pressure on home prices, making it more expensive for everyone who buys a home *and* for those who rent.[49]

Unsurprisingly, downpayment assistance programs have a miserable track record in the United States, and in 2008 Congress eliminated the FHA's seller-funded downpayment assistance program because it was such a disaster.[50] A 2007 Government Accountability Office report showed that "the probability that loans with seller-funded downpayment assistance would result in claims against the [FHA's insurance] fund was 76 percent higher in the national sample and 166 percent higher in the MSA sample than it was for comparable loans without such assistance."[51]

Separate from loans in that failed FHA program, delinquencies of single-family FHA loans with downpayment assistance are consistently higher than FHA loans without such assistance.[52] In fact, there is evidence that borrowers who provide even small downpayments from their own savings display lower default rates than those who receive downpayments from an outside source, possibly suggesting that *the act of saving* the money is an important signal of underlying attributes.[53]

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[48] See Downpayment Toward Equity Act of 2023, H.R.4231. This bill is similar to a policy that House Financial Services attempted to enact through the Concurrent Resolution on the Budget for Fiscal Year 2022 (Section 40201), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408300. Also see Norbert Michel, "House Financial Services Is Pushing For A Downpayment Assistance Program, Another Failed Policy From The Past," *Forbes*, September 17, 2021, https://www.forbes.com/sites/norbertmichel/2021/09/17/house-financial-services-is-pushing-for-a-downpayment-assistance-program-another-failed-policy-from-the-past/?sh=777c8ec94394.

[49] In October 2023, the Biden administration also proposed a $10 billion down payment assistance program. See White House, "White House Announces New Actions on Homeownership," October 16, 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/10/16/white-house-announces-new-actions-on-homeownership/.

[50] Legislative Proposals To Determine The Future Role Of FHA, RHS, and GNMA In The Single- And Multi-Family Mortgage Markets, Hearing Before The Subcommittee On Insurance, Housing, And Community Opportunity Of The Committee On Financial Services, U.S. House Of Representatives, 112th Congress, First Session, May 25, 2011, https://www.govinfo.gov/content/pkg/CHRG-112hhrg66870/html/CHRG-112hhrg66870.htm.

[51] U.S. Government Accountability Office, "Seller-Funded Down-Payment Assistance Changes the Structure of the Purchase Transaction and Negatively Affects Loan Performance," GAO-07-1033T, June 22, 2007, https://www.gao.gov/assets/gao-07-1033t.pdf; and, Bruce Foote, "Treatment of Seller-Funded Downpayment Assistance in FHA-Insured Home Loans," *Congressional Research Service*, March 11, 2009, https://www.everycrsreport.com/files/20090311_RS22934_8a19891e362701515226541e1e64be0c057e3d02.pdf.

[52] The monthly FHA Single-Family Loan Performance Trends Report is available online as far back as 2013, and it shows similarly above average delinquencies throughout the years. For one example, see U.S. Department of Housing and Urban Development, *Federal Housing Administration, Annual Report, Fiscal Year 2020*, p. 39, https://www.hud.gov/sites/dfiles/Housing/documents/2020FHAAnnualReportMMIFund.pdf.

[53] Austin Kelly, "'Skin in the Game': Zero Downpayment Mortgage Default," *Journal of Housing Research*, Vol. 17, no. 2, 2008, https://www.tandfonline.com/doi/abs/10.1080/10835547.2008.12091991.

Small Changes Would Go a Long Way to Reducing Federal Intervention

In the wake of the COVID-19 pandemic, Congress has continued its trend of adding harmful federal policies to the U.S. housing market. These policies compound the negative effects of other harmful policies, such as the Federal Reserve's support of the secondary mortgage market, federal intervention in housing markets at the agency level, and state and local supply constraints.

All the average American has to show for decades of failed federal housing policies is excessive debt, high housing costs, volatile home prices, overregulation, distorted markets, and a trail of federal bailouts. The U.S. homeownership rate is almost exactly where it was in the 1960s, home prices have consistently outpaced income growth, and taxpayers have been forced to shell out hundreds of billions of dollars. Although it may be convenient to blame "Wall Street," interest rates, or "speculators" for distorted housing markets, the truth is that the federal government is–and has been for some time–the dominant force in U.S. housing markets.

Rather than focus on broad underlying economic and social problems that make it difficult to sustainably earn higher income and build wealth, federal policies have consistently increased housing demand by making it easier to obtain home mortgages. There appears to be no momentum in Congress to reverse these trends. If Congress is unwilling to end federal intervention in housing markets, as it should, several small changes would go a long way toward reducing price pressures from the demand side of the (nearly always) supply-constrained housing market, thus making housing more affordable. The following list provides just a few examples of such policy changes:

- **Limit federal mortgage insurance**. Congress should limit the FHA's single-family insurance portfolio to first-time homebuyers, without any refinance eligibility (through the FHA) over the tenure of the loans in force. That is, FHA insurance should be provided only to people who have never owned a home, rather than those who have not owned a home during the last several years. Congress should also reduce the loan-loss coverage in the FHA's single-family mortgage insurance program from the current 100 percent to 50 percent.[54] Federal mortgage insurance has the added negative effect of crowding out private financial market solutions to mortgage insurance, thus reducing economic opportunity. Additionally, the FHA should decrease the value of loan limits eligible for FHA single-family mortgage insurance to (at most) the first quartile of home prices.

[54] John Ligon and Norbert Michel, "The Federal Housing Administration: What Record of Success?," Heritage Foundation Backgrounder no. 3006, May 11, 2015, https://www.heritage.org/housing/report/the-federal-housing-administration-what-record-success.

- **Limit GSE activity**. Congress should define (and enforce) the "excessive use" provisions in Fannie and Freddie's charters, revoke Fannie and Freddie's exemption from the requirements to register their securities offerings under the 1933 Securities Act, and narrow the GSEs' focus to the financing of primary homes. The FHFA should raise Fannie and Freddie's mortgage guarantee fees, eliminate the geographic price differentials for the GSEs' conforming loan limits, and gradually reduce conforming loan limits. Banking regulators should adjust risk-weighted capital rules so that financial institutions cannot treat GSE debt and mortgage-backed securities as if they are U.S. government obligations.

Without reversing course, federal policies will further expand government intervention in housing markets at a great cost to millions of Americans. They will put even more upward pressure on prices and rental rates, waste taxpayers' money, and ultimately make housing less affordable. Ideally, the federal government would end policies that favor ownership over renting *and* stop intervening in housing markets.

Thank you for the opportunity to provide this information. I welcome any questions that you may have.