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HOMEOWNERSHIP: PATTERNS, TRENDS, AND POLICIES

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Discussion of a "housing bubble" has diverted attention from significant changes in the housing and mortgage markets that have resulted in unprecedented changes in housing tenure. This paper describes the current homeownership picture and the reasons for the increase in ownership. It then discusses various federal policy initiatives to increase homeownership, concluding with recent efforts intended to encourage the Government-Sponsored Enterprises to refocus their activities toward serving first-time homebuyers.

I The Trend Toward Homeownership

Chart 1 shows the overall homeownership rate in the United States since 1965. The rate has been rising strongly for a decade. As of the first quarter of 2006 (the latest available data), the rate is at 68.5 percent of all US households. That is just below the record high of 69.2 percent in the fourth quarter of 2004. As the chart shows, the rate has risen by between four and five percentage points in the last ten years. That represents over five million households.

That is a big increase, and both the level and the growth rate are unprecedented. The homeownership rate fluctuated between 63 and 65½ percent during the 30 years before 1995. Many economists will remember the increase of about 2.5 percentage points during 1965-1980, which certainly seemed large at the time. That increase was driven by the unforeseen, erratically accelerating peacetime inflation that started around 1965; in that environment, owning your own home was the best inflation hedge available to most families, particularly in the 1970s. When inflation came under control in the 1980s, the ownership rate declined.

Now, with much lower inflation, we have seen a much bigger increase in homeownership.

Chart 1 shows the homeownership rate, going as far back as annual and quarterly data were collected. Before 1965, the data consist of the decennial Census of Housing (back to 1940), occasional special surveys, and decennial Census data that were collected as part of the Census of Population. These data show a large increase in homeownership in the

1940s and 1950s, from about 45 percent of all households in 1940 to 63 percent in 1960. Between 1900 and 1940, the homeownership rate fluctuated between about 45 and 48 percent, as best we can tell.

So what we have seen recently is analogous to the exceptional homeownership boom of the postwar period.

The minority homeownership rate over the last decade has paralleled the overall rate. Minority ownership is also increasing, and is also close to a record. Chart 2 shows the homeownership rate for the two largest minority groups – African-American and Hispanic households – since 1994, which is as far back as annual and quarterly data go by race and ethnicity. The increase of about seven percentage points for these groups is somewhat higher than the increase among all households.

It is not explicit on Chart 2, but there is a marked disparity in homeownership between white and minority households. About 75 percent of white households are homeowners, compared to about 50 percent of minority households, and as the chart shows just under 50 percent for both African-Americans & Hispanics.

Chart 2 also shows that the Hispanic homeownership rate has recently passed the African-American rate. That is impressive, given the high rate of Hispanic immigration. We do not expect immigrants to buy homes right away. Instead, we expect that high Hispanic immigration would be pulling the overall Hispanic homeownership rate down.

A partial explanation may be that immigrants do buy homes rather quickly. By the time they become citizens, they are also becoming homeowners. The rate for foreign born citizens is just below the rate for the native-born – 66 percent compared to 67 percent. This is well above the rate for immigrants who are not citizens but have lived in the U.S. long enough to qualify for citizenship(43 percent). For families with the head of household under 30, there is no difference in homeownership between native-born and foreign-born citizens. (Kossoudji, 2006) That is perhaps not surprising; young foreign-born citizens may have come to the US as children or infants and found it easy to assimilate. Even if that is the explanation, the pattern is still impressive.

II. The Disappearing Renter

The flip side of the homeownership boom is the disappearing renter. This is the dark side, if you're a landlord.

Chart 3 shows a decline in the number of renters from 35.5 million in 1995 to 32.5 million by 2004. There has been nothing like that in our lifetimes. Generally, population growth has been high enough so that we have both more owners and more renters, in terms of total numbers, from year to year and decade to decade. There has been an increase since 2004, but the number of renters is still well below the 1995 peak. (The break in data is the 2002 revision by the Census Bureau, using population weights from the 2000 Census instead of 1990. This suggests that the decline was greater in the last half of the 1990s than was evident from the increasingly outdated 1990 weights.)

It is therefore not surprising that we have record rental vacancy rates too. The overall vacancy rate is now close to 10 percent. One out of every 10 rental houses or apartments is vacant – and these are units actively being offered for rent. Chart 4 puts the current situation in a long-term context. We now have a record high rental vacancy rate, certainly a record over the last 40 years, which is as long as we have annual data.

The normal rule-of-thumb is that a six percent vacancy rate is the dividing line between a "tight" and a "loose" market. Rental markets were tight when the baby boomers became young adults, back in the 1970s. They loosened up somewhat in the 1980s, and then have loosened up much more in recent years.

Vacancy rates are pretty similar throughout the distribution of rents. The rate is around 10 percent for expensive units, and around 10 percent for inexpensive units also. This is worth keeping in mind when you read or hear about a shortage of affordable rental housing.

III. Explaining the Homeownership Boom

These unprecedented changes have been caused partly by the revolution in information technology coming to the housing and mortgage markets, and partly by public and private efforts to promote homeownership, taking advantage of the new technology.

Risk Measurement

Thanks to the computer revolution in the mortgage market, lenders are much better able to measure risk than they have been. They can tell better who's likely to default on their mortgage.

When I was at HUD 15 years ago, helping to restructure the FHA program, we focused on initial loan-to-value (LTV) as the best predictor of default. Congress set the FHA premiums as a function of initial LTV. That was the best information available to lenders generally, not just to FHA.

Today, the borrower's credit history is available, and is a better indicator of mortgage performance. If a family wants to buy a home, the mortgage broker or banker will pull a credit report off the web and think nothing of it.

FICO scores were unknown 15 years ago; they are now a standard underwriting tool.

In addition, lenders have automated underwriting systems (AUS) to put together the information about the borrower and the home and the mortgage, and make a fast and generally reliable decision on the mortgage application.

FHA traditionally serves higher-risk homebuyers than do conventional lenders, and FHA has taken advantage of the new technology, in somewhat different ways. A couple of years ago FHA introduced the TOTAL scorecard (Technology Open to All Lenders). TOTAL is an algorithm to assess risk, and enable lenders to determine whether a given loan is automatically insurable by FHA, or whether it requires manual underwriting. It is not an AUS by itself, but it fits into a lender's own AUS

With TOTAL, FHA can do a better job of evaluating risk at the high-risk end of its market. FHA can tell who's a "good" high-risk and who's a "bad" high-risk. FHA can therefore move farther down in the risk spectrum, and farther down in the income distribution.

Subprime lenders have also have taken advantage of the new technology, and they have also extended homeownership opportunities in the process. Subprime lenders take bigger risks and experience bigger defaults, and some take advantage of their borrowers, but by and large they have contributed to the increase in homeownership.

Financial literacy

A second factor contributing to the increase in homeownership is the widespread effort to promote financial literacy for lower-income households who are not well-educated, with a particular effort to help immigrants who are not yet comfortable in the English language.

There are both private and public activities, on both the local and national levels.

The Federal Reserve Bank of Chicago offers a good local example. The Division of Consumer & Community Affairs has a program for "Financial Access for Immigrants." I participated in the 2004 conference here on that subject, and learned about local efforts all over this district.[1]

On the federal level, Congress established the National Commission on Financial Literacy and Education, co-chaired by the Federal Reserve Board Chairman and the Treasury Secretary. The purpose of the commission is to coordinate the efforts of the numerous federal government agencies concerned with consumer financial issues – both regulatory agencies and Cabinet departments.

Homeownership Counseling

A third contributing factor is the growth of housing counseling agencies. These serve renters as well as homebuyers, but helping people understand what they are doing when they are thinking about buying a home. Counseling agencies are located all over the country. HUD has approved 1,700 such agencies, most of them local; among them, these agencies counseled over 1.1 million families in 2004. There are other agencies as well.

Counseling works. FHA has the information as to whether an FHA borrower received counseling before buying a home and taking out an FHA-insured mortgage. FHA data show that those who received pre-purchase counseling have lower default rates, and FHA pays fewer mortgage insurance claims. Freddie Mac has reported the same pattern.

IV. Policy initiatives to promote homeownership

It is a commonplace that housing is not on the national political agenda. During the 2000 Presidential campaign, the only time that housing was discussed in the national media was in stories about how nobody was talking about housing.

Except the candidates. Governor Bush gave three speeches about housing in early 2000, and received only local coverage. He made several specific proposals to promote homeownership. He included one of them in his convention acceptance speech. They were easy to find on his website. He still received no coverage.

For that matter, Vice President Gore had quite a bit to say about housing and urban issues, certainly on his website - mostly about smart growth. Nobody reported his proposals either.

After the election, President Bush offered proposals to promote homeownership in at least two State of the Union speeches, and again in the 2004 campaign, and mentioned homeownership in his second inaugural address in 2005.

In June 2002 he came to HUD, the first President to do so since President Lyndon Johnson, and announced a minority homeownership goal: to add 5.5 million minority homeowners by end of decade. That would be more than a 40% increase in eight years.

The remainder of this section discusses several of these proposals. Some are legislative, others regulatory.

FHA Initiatives

FHA requires legislative authority to insure any specific type of mortgage. In the last few years, FHA has asked for such authority in several instances. It made legislative requests in 2001 and 2002, and eventually received approval, to insure Hybrid ARMS as they developed and won acceptance in the conventional market. More recently, it asked for authority to insure mortgages with no down payment; the down payment and closing costs could be folded into the monthly mortgage payments. This proposal was first offered in 2004, and repeated in subsequent years. It has not yet been approved. There have been other proposals. The Zero Down Payment mortgage, and some other new authorities, have been included in the Bush administration's 2006 legislative proposal to expand FHA's activities.

Separately, FHA has been able to double the funding for housing counseling, from $20 million in 2001 to $45 million by 2004, based on the evidence that counseling promotes homeownership.

Up-Front Costs

For almost 20 years, economists have concluded that up-front costs are a bigger barrier to homeownership than monthly mortgage payments, for most renters who are fairly close to being able to afford a home (e.g. Linneman and Wachter, 1989). In recognition, there have been several efforts to reduce the constraint imposed by down payments and closing costs. The Zero Down Payment mortgage is one such.

Reform of the Real Estate Settlement Procedures Act (RESPA) also falls into this category. RESPA regulatory reform as proposed by HUD in 2002 would have promoted homeownership by cutting closing costs. HUD projected average savings of about $1,000 per loan from two major changes: making yield spread premiums transparent, and permitting settlement services to be combined into a single package with a guaranteed price. HUD withdrew its proposal in 2004, and is now working on an alternative proposal.

Two other proposals date back to President Bush's 2000 campaign. One would permit lower-income families who receive a housing voucher to cover part of their monthly rent to use a year's worth of their voucher payment to cover part of the up-front costs of buying a home. A second provides grants to families who do not have quite enough resources to cover the up-front costs; this American Dream Downpayment Initiative (ADDI) is modeled after a program developed at the Federal Home Loan Bank of Dallas. The downpayment voucher has not been approved by Congress; the ADDI has been, and has been funded at a total of $237 million over the years 2003-2006, enough to help about 50,000 families.

The GSE Affordable Housing Goals

As part of its regulatory responsibilities for Fannie Mae and Freddie Mac, HUD is required to set annual affordable housing goals for each GSE. The three goal categories are established by statute: low- and moderate-income families, underserved areas, and special affordable housing. The first of these is based on the income of the household, the second on the location of the housing, and the third partly on both. HUD both defines "underserved areas" and establishes annual numerical targets for the percentage of a GSE's business that should fall within the goal category; the other two goals are defined by statute, with HUD setting the annual numerical target. HUD also has the authority to establish subgoals within each goal category.

While home mortgages constitute most of the GSEs' business, they do a poor job of serving first-time homebuyers, and a particularly poor job for first-time minority homebuyers. This is shown in Table 1, which reports the GSEs' share of first-time buyers within the conventional conforming market, that part of the home mortgage market in which they operate.

To avoid confusion, it is useful to define the "conventional conforming market." To start with, it does not include FHA, VA or other government-backed mortgages; these are not conventional loans. It does not include the bottom half of the subprime market, so-called "B and C" loans, because these are especially risky loans. At the top end of the market, it does not include loans with principal amounts above the conventional conforming loan limit; these amount to about 10 percent of all home mortgages. It does include better-quality subprime mortgages, "A-" and "alt-a" loans, and it includes loans for owner-occupied manufactured homes, although these have been an unusually small share of the mortgage market in recent years.

Table 1 also excludes refinance loans; it is limited to home purchase mortgages.

Within the conventional conforming market, the GSEs underperform the market in serving families who are buying their first home. Table 1 reports the GSEs' share of loans to first-time homebuyers, compared to the share of first-time homebuyers in the conventional conforming market as a whole.

There are two quite different sources of information, both showing the same result.[2] Panel A is based on the GSEs' own data on the loans they purchase, which is provided to HUD in its capacity as the GSE mission regulator; these GSE data are compared to overall market data from the American Housing Survey (conducted biennially by the Census Bureau for HUD) and the Home Mortgage Disclosure Act filings of lenders. During the years 1999-2003, about 38 percent of all home purchase loans were to first time homebuyers, while only 26 percent of the home purchase loans that the GSEs bought were to first-time buyers.

Panel B is based on a completely separate data source, the Residential Finance Survey (RFS), conducted by the Census Bureau as a supplement to the decennial Census of Housing. The RFS asks both borrowers and lenders about each loan in its sample. Borrowers are asked, for example, whether they are first-time homebuyers; lenders are asked if they sold the loan to a GSE. Panel B shows very similar results from very different data; according to the RFS, 37 percent of all home purchase loans in the conventional conforming market were to first-time homebuyers, compared to only 29 percent of the GSEs' home purchase loans.

The results for minority first-time homebuyers, also shown in Table 1, are similar. Some 11 or 12 percent of homebuyers in conventional conforming market were minority families buying their first home, compared to only 7 or 8 percent of GSE home purchase loans.

Other lenders do a better job than do the GSEs in serving first-time homebuyers, even though these other lenders do not have "agency status," the GSE Charter Act privileges that give them a preferred position in financial markets.

This pattern is not what policymakers have intended, so there have been recent efforts to target the GSEs more toward serving first-time homebuyers.

As the GSE mission regulator, HUD has established home purchase subgoals in each goal category for the years 2005-2008. These subgoals concern the share of each GSE's home purchase mortgages that fall within the goal category. For example, the 2005 low- and moderate-income was set at 45 percent. Of each 100 home purchase mortgages bought by a GSE in 2005, 45 should be for low- and moderate-income homebuyers. This subgoal is not directly precisely at first-time homebuyers, partly because the analysis of the first-time buyer market was just becoming available in 2004, when HUD was required to promulgate new affordable housing goals.

HUD has not yet reported on the GSEs' performance on these subgoals, but Fannie Mae has announced that it missed two of the three subgoals in 2005.[3]

Going beyond regulation, there has been some discussion of establishing first-time homebuyer goals, and perhaps other new goals, as part of the GSE regulatory reform legislation now under consideration in Congress. This idea has come up particularly in Senate discussion.

V. Conclusion

While homeownership is generally regarded as desirable in the US, both private and public cost-benefit analyses are necessary, balancing the advantages of homeownership against the drawbacks that can result.

From the standpoint of the individual family, there are certainly private benefits to owning – a better life for the children, a change to move up into the middle class, acquiring "a stake in America" – but on the other side, there is the risk of defaulting on the mortgage, losing your home, and being worse off instead of better off.

From the public policy standpoint, there are the benefits to society stemming from these private benefits, and those social benefits are real; but a policy of promoting ownership also means that lenders and other participants in the housing finance system incur greater risks. There are greater risks for FHA and VA, and therefore for the taxpayer. And there are greater risks for private lenders, banks and thrift institutions, and therefore concerns for financial regulators – which is a good reason for this conference.

End Notes

[1] A description of many efforts appears in Paulson et al., May 2006.
[2] These tables are based on Bunce and Gardner, 2004.
[3] Greener, Chuck, "Statement from Chuck Greener, Senior Vice President, Communications," February 13, 2006, at http://www.fanniemae.com/media/issues/2006/021206.jhtml?p=Media&s=Current+Issues&t=Statements

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TABLE 1

First-Time Homebuyers in the Conventional Conforming Market

Panel A – GSE, AHS and HMDA data, 1999-2003

	First-Time Homebuyers: All	Minority
Share of all home purchase loans	38%	11%
Share of GSE home purchase mortgages	26%	7%

Panel B – RFS data, 2001

	All	Minority
Share of all home purchase loans	37%	12%
Share of GSE home purchase mortgages	29%	8%

Source: Bunce and Gardner, 2004

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