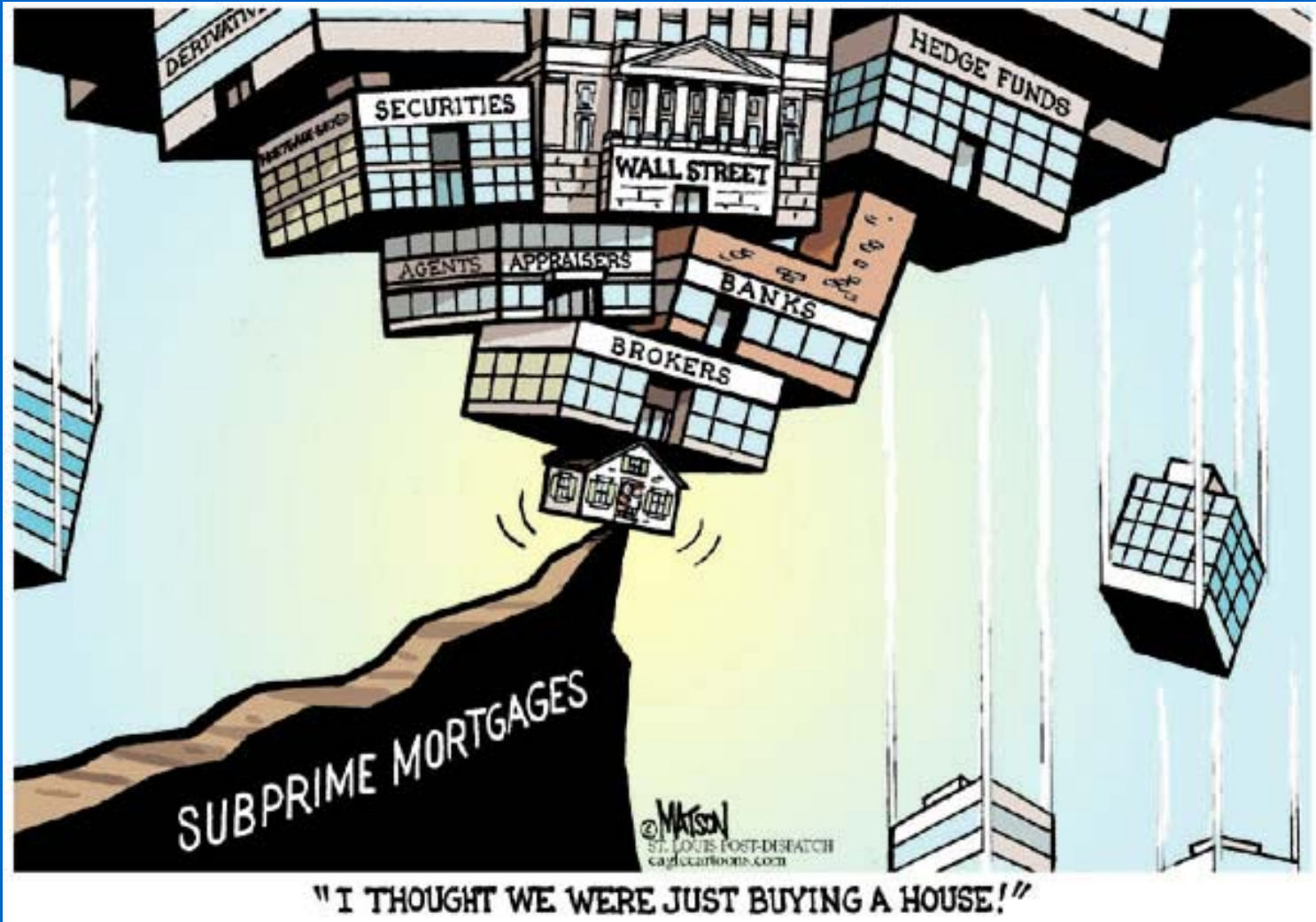


THE U.S. HOUSING FINANCE CRISIS AND IMPLICATIONS FOR AFFORDABLE HOUSING POLICY

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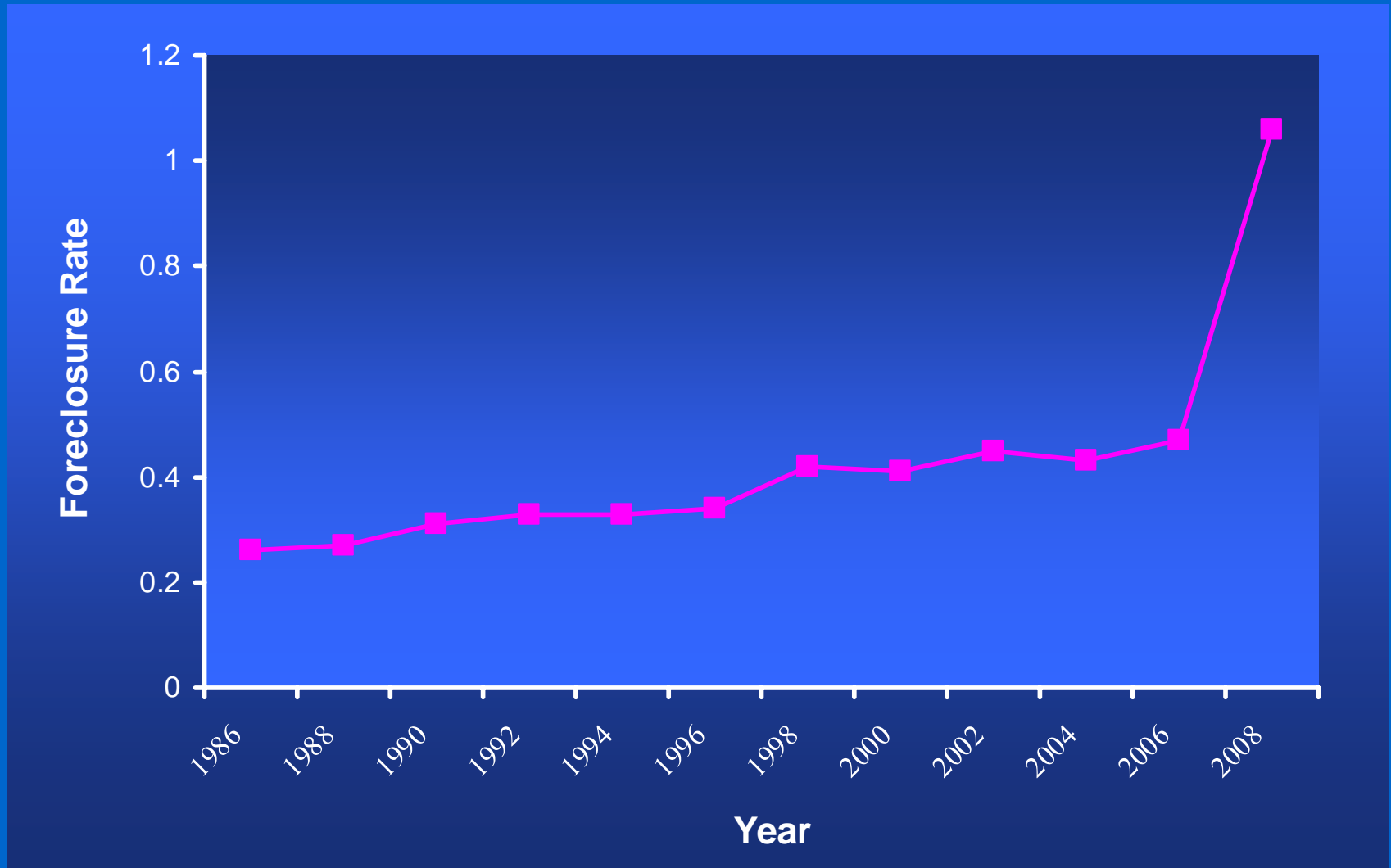
A PICTURE = 1,000 WORDS



A PICTURE = 1,000 WORDS (cont'd.)



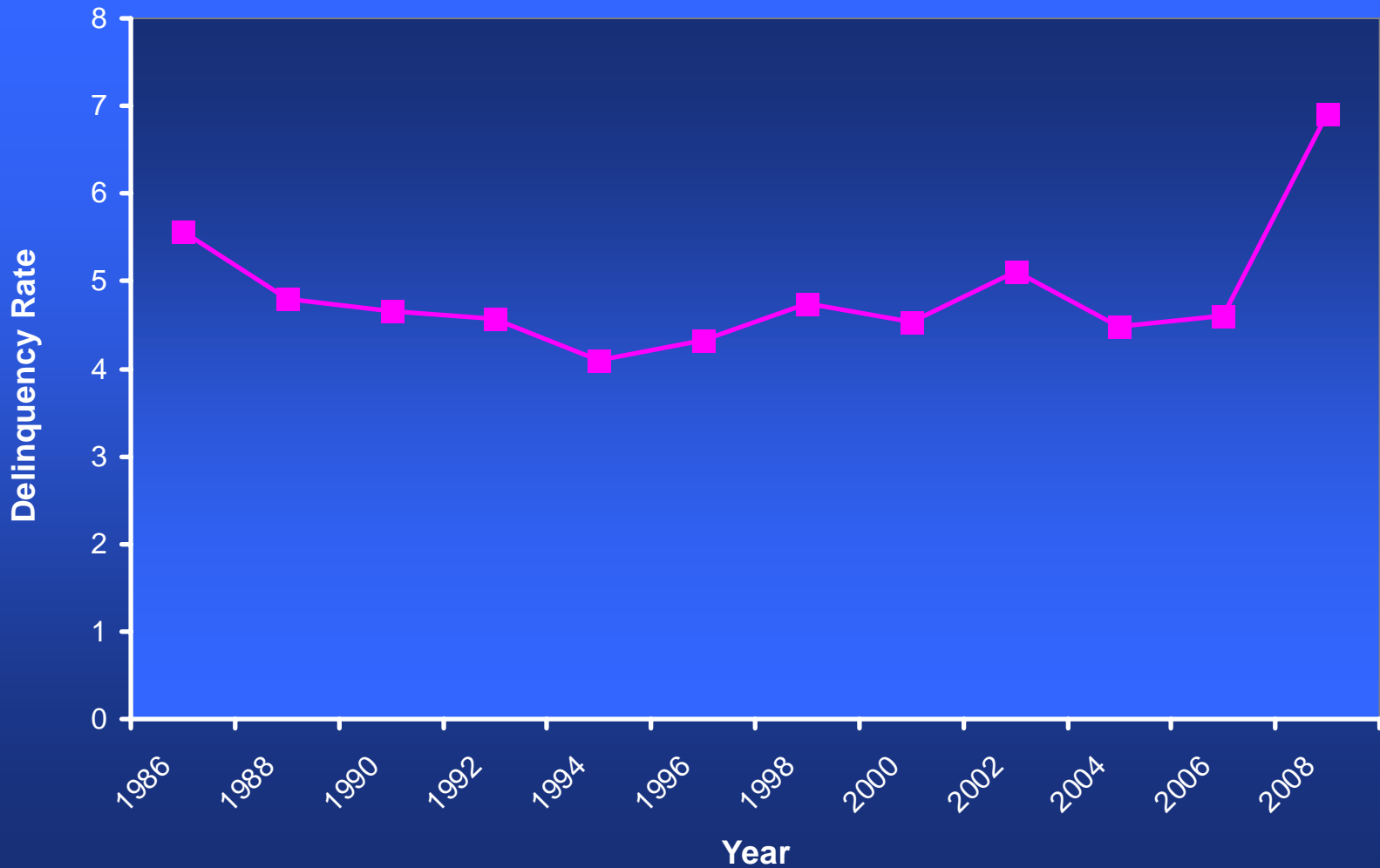
U.S. Housing Foreclosures, 1986-2008: Foreclosure Rates at Historic Highs and Still Increasing



Note: 1-4 unit residential properties.

Source: U.S. Department of Housing and Urban Development (2009).

U.S. Mortgage Delinquencies, 1986-2008



Sources: US Department of Housing and Urban Development (2009). "Table 18: Mortgage Delinquencies and Foreclosures Started: 1986-Present," US Housing Market Conditions, First Quarter.

U.S. Single-Family Home Prices, 1986-2008



Note: inflation adjusted

Sources: National Association of Realtors (2009); U.S. Census Bureau (2009).

Sources of the Housing Crisis

Massive systemic asset devaluation

- Causes: a “perfect storm” of events and policy interventions, many of them well-intended but their consequences not predicted:
 - overly-optimistic expectations of future productivity increases and resulting economic growth
 - too much capital available chasing too few opportunities
 - excessive under-pricing of risk and potential illiquidity
 - belief in the capital markets’ ability to take risk through new products

Dispelling Myths about “The Cause”

Not simply, or solely, caused by subprime loans, or the Community Reinvestment Act, or the secondary mortgage market institutions (“Fannie” and “Freddie”)

- Problems were pervasive throughout the credit and investment markets
- Subprime and the housing “bubble” bursting were only the “canaries in the coal mine”

The Key Causes

1. Lack of regulation by the Federal Reserve (A. Greenspan)
2. The agencies that rate financial institutions and products (e.g., Standard & Poor's) got caught up in the “bubble” mentality
3. The Securities & Exchange Commission (SEC) didn't do proper “due diligence”
4. Avidly pro-homeownership policies, even for those with very poor credit ratings

Sequence of Events that Drove Defaults & Foreclosures to Record Levels

1. 2003-late 2006: proliferation of “alternative mortgage products” (e.g., subprime, ALT-A, option-ARM, no ratio) and increased domination by private issuers
2. Deterioration of underwriting, evidence of fraud, credit quality deterioration not captured in ratings
3. By 2007: evidence of growing defaults, retreat by private issuers, less mortgage credit available and stricter terms
4. Decline in house prices, which in turn reinforced defaults, creating a vicious cycle and “contagion” effects
5. Increasing unemployment rates now hovering above 9 percent, and projected to increase to >10 percent before declining

Spillover Effects of Foreclosures & Defaults

1. Renters in foreclosed multifamily properties face displacement
2. Reduced values of neighboring properties
3. Neighborhoods with concentrations of foreclosures become “hot zones” that suffer abandonment and disinvestment
4. Local governments face increased costs (police, fire, boarding up buildings, demolishing properties)
5. Decreased revenues from property taxes
6. Declines in local services and amenities

Current Predictions: Things Will Get Worse Before Getting Better

1. Single-family home loan default rates expected to peak in 2010, then start to decline
2. Unemployment rate = 9.4 percent. Expected to increase to ~10 percent before declining
3. Expectation of ~300,000 fewer household will be formed in next year. This reduces demand for housing and contributes to price stagnation or decline.

Source: American Real Estate & Urban Economics Association Midyear Meeting, Plenary Session, June 5, 2009, "Four Economists and a Recovery?"

Affordable Housing Policy....Now?

The “Empathic Model”:

- Millions of middle-class homeowners now experiencing the key housing problem of low-income households: affordability
- Seize this “defining moment”

Affordable Homeownership Policy: Illustrative Responses to the Crisis

- 1. Regulatory reform RE: suppliers of mortgage credit**
Assessment:
 - (a) broad consensus supports reforms
 - (b) some concern it will swing too far toward tight restrictions
- 2. Financial and homeownership counseling and education**
Assessment: slim evidence on what constitutes effective counseling; how to fund; how to implement so all who need get?
- 3. Alternative approaches to becoming a homeowner**
e.g.: lease-purchase
Assessment: could be abused by unscrupulous owners
- 4. Alternative forms of homeownership**
e.g.: community land trust; shared/limited equity ownership
Assessment:
 - (a) CLT: undermines wealth accumulation
 - (b) S/L equity: watch out for high vacancy rates

Affordable Homeownership Policy: The Great Debates

Avid promotion of ever-increasing homeownership rates particularly among low-income and minority population

- Some of the gap between minority and majority rates due to discrimination → fair housing laws
- Most of the gap: lower incomes, wealth, credit scores

Affordable Homeownership Policy: The Great Debates (cont'd.)

Responses:

- (a) Improve “consumer sophistication” (*Bostic & Lee, forthcoming; Herbert et al. 2005*)
- (b) HO as “asset building tool”:
 - . Only means of wealth accumulation by low-income
(*Boehm & Schlottmann 2008*)
 - . But house price appreciation plays critical role; if low or absent, HO isn't wealth accumulator
 - . Other savings strategies haven't met with success;
e.g., IDA Demonstration: Tulsa experimental site = no significant effect on overall wealth (*Mills et al. 2008*)
- (c) Social benefits of HO:
 - . New scholarship points to self-selection, not effects of HO *per se*

Bottom Line:

Falling prices question wealth accumulation effects while recent research questions its social benefits

Affordable Rental Housing Policy: Context

Fiscal imbalance between support for HO vs. rental:

U.S. spends 3x as much on tax benefits to homeowners than on housing (primarily rental) assistance to low-income households

Affordable Rental Housing Policy: The Great Debates

First, what is *not* debated: entitlement voucher program (though plenty of debate about its precise form). **This is housing policy's "welfare reform" or "health care reform."**

- Not much disagreement RE: 3 main arguments against supply:
 - (1) cost vis a vis demand-side assistance
 - (2) constrains choice to "a project" in "a location"
 - (3) neighborhood distress of project-based assisted developments

Affordable Rental Housing Policy: The Great Debates (cont'd.)

1. Heart of Debate: Do we need supply subsidies or assistance in tight markets?

Assessment:

- (1) Local housing market conditions have powerful effects on cost-effectiveness of supply subsidies (e.g., LIHTC)
(Deng 2005; DiPasquale et al. 2003)

- (2) But many of these markets are tight because of “home rule” exclusionary land-use regulations. Therefore, if supply constraints are the problem, policy should target these constraints.
 - What policy levers can the federal government use?
 - Need to avoid perverse incentives *(Weicher 2008)*
 - G&G disincentive proposal: “leaning against” local jurisdictions *(Glaeser & Gyourko 2008)*

Affordable Rental Housing Policy: Some “Big Ideas”

2. **Small multifamily rental housing:**

- . accounts for ~50% of rental stock
- . > 2/3 of very low-income unassisted renters live in it
- . being lost to the stock in large numbers

3. **Evidence-based housing policy:**

- . research on housing assistance programs is too rare, and rigorous research is rarer still