Testimony

# Testimony on: The State of Housing in America

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**The views expressed here are my own and not those of the American Action Forum. I thank Thomas Wade for his assistance.*

## Introduction

Chairman Brown, Ranking Member Toomey, and members of the committee, thank you for the opportunity to discuss the state of U.S. housing markets. In this testimony, I hope to make three main points:

- The dominant characteristic of owner-occupied and rental housing is high and rising prices, despite a recent construction boom. This suggests that the primary underlying cause of stress is demand stimulus from federal subsidies, especially those from the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.
- Before looking to new initiatives, Congress would be better served by a more complete understanding of the current state of existing subsidies, both from existing Housing and Urban Development initiatives and COVID-19 grants, from which a significant amount of funding remains unspent.
- To the extent that Congress attempts to meaningfully impact supply, it may look to remove tariffs that increase the cost of construction materials, expand the workforce of skilled construction workers, and reduce bureaucratic barriers such as unwanted land-use restrictions and the permit process.

Let me discuss each of these in greater detail.

## The State of Housing Markets

House prices and rents rose rapidly in 2021. These price increases reflect some combination of slow expansion in the supply of units and rapid expansion in the demand for units. Supply has been at the center of attention. The total inventory of homes available for sale fell? 26 percent in January 2021 year-over-year [1]. At its lowest point, the Federal Reserve Bank of St. Louis estimated that there remained only three and a half months of total housing inventory – in other words, there would be only three and a half months without construction until there would be no homes available in the United States. Housing inventory remains stressed following COVID-19-related eviction moratoria and forbearances.

Nevertheless, in the main, U.S. price pressures seemingly reflect growth in demand. According to the Joint Center for Housing Studies: “Single-family starts hit 1.1 million in 2021, exceeding the million-unit mark for the first time in 13 years. Multifamily starts were also at a 30-year high of 470,000 units.” [2]

If a record pace of construction is unable to alleviate price pressures, policymakers must be cautious about interventions that boost demand further. Unfortunately, these efforts continue. Demand has in part been fueled by Federal Reserve policy. As part of its monetary stimulus, the Fed purchased $30 billion monthly in mortgage-backed securities (MBS), pumping $30 billion in capital into the mortgage market each month. This reduced the cost of mortgage capital, subsidized mortgages, and stimulated demand.

Looking forward, the Fed will have to take aim at housing as a matter of fighting inflation; this will be part of its approach to broadly slowing the economy and will have a disproportionate effect on housing markets.

The shelter component of the Consumer Price Index (responsible for one-third of the index) has exhibited an uninterrupted rise in inflation, from 1.6 percent in January 2021 to 5.6 percent in June 2022, with no signs yet of peaking. Notice that if shelter inflation gets to 6 percent, inflation on?everything else?must be zero for the Fed to hit its 2 percent target.

Next, note that as housing starts and residential construction decline, so does the demand for all sorts of goods and services associated with homebuilding – durable goods such as furnaces, air conditioners, ovens, and the like; household items such as furniture, carpeting , curtains,  and so forth; and services such as inspections, landscaping, and others. Housing has always been an important channel for the transmission of monetary policy and slowing the housing market reduces demand in a broad swath of the economy.

Finally, the Fed’s plan cannot avoid affecting housing especially strongly. As the Fed raises the federal funds rate, all interest rates will rise. Credit cards and auto loans will go up, and so will mortgage interest rates. (Indeed, mortgage rates have already risen sharply.) But there is a second channel of impact. As noted above, the Fed purchased $30 billion monthly in MBS. As part of tightening financial conditions, this will no longer occur.?That means to get the same total amount of funds into the mortgage market, rates will have to rise even further to attract the $30 billion in capital. But it doesn’t end there. The Fed intends to draw down its holdings of MBS by $35 billion a month, essentially pulling $35 billion in capital out of the market. The upshot is that rates would need to rise even a bit more to completely offset the $65 billion (roughly 20 percent of mortgage funds at 2021 rates) net swing in mortgage funds.

## Government Intervention in Housing Has Frequently Done More Harm Than Good

Housing finance was at the center of the 2008 financial crisis that visited substantial economic stress on Americans and spawned dramatic government intervention. Yet more than a decade later, the central actors in the crisis and response – Fannie Mae, Freddie Mac, and the Federal Housing Finance Administration (FHFA) – remain essentially unchanged.

Fannie Mae and Freddie Mac need to be wound down and closed as a matter of both policy and politics. From a policy perspective, the GSEs were central elements of the 2008 crisis. First, they were part of the securitization process that lowered mortgage credit quality standards. Second, as large financial institutions whose failures risked contagion, they were massive and multidimensional cases of the too-big-to-fail problem. Policymakers were unwilling to let them fail because financial institutions around the world bore significant counterparty risk to them through holdings of GSE debt, certain funding markets depended on the value of their debt, and ongoing mortgage market operation depended on their continued existence. They were by far the most expensive institutional failures to the taxpayer and are an ongoing cost.

Moreover, despite 14 years under the conservatorship of the FHFA, “each Enterprise remains undercapitalized .” Nevertheless, the FHFA just moved to relax the capital requirements. Worse, the FHFA announced it would require Fannie and Freddie to put in place Equitable Housing Finance Plans that would deploy a number of “special purpose credit program”?that?would assist racial minorities and particularly African American borrowers with home buying costs such as title insurance, appraisals, and down payments. Typically, these costs are the responsibility of the homebuyer and in the case of down payments, some of the capital risk is taken by private mortgage insurance for borrowers who do not provide 20 percent down. This approach takes capital that is supposed to protect taxpayers to subsidize home purchases by borrowers who simply don’t have the financial preparation to do so.

This strategy seems destined to repeat the errors of the past that yielded a wave of foreclosures that wiped out millions of homeowners, hurting many minority families that were beginning to accrue generational wealth. Congress should urge the FHFA to reconsider these housing subsidy plans. It risks setting up another generation of minority borrowers for failure.

These plans also suggest a return to GSE mission creep. Instead, the FHFA should finalize the rulemaking on Prior Approval of Enterprise Products, which was proposed in October 2020 and would ensure there is adequate oversight and transparency around new products and activities the GSEs bring to the market.

Efforts such as the Equitable Housing Finance Plans are simply demand subsidies by another name. They build upon the questionable track record of the housing trust fund, the HOME program, and Community Development Block Grants and will not serve to alleviate house price pressures. Instead, they will simply exacerbate the problem. Similarly, the Biden Administration’s Housing Supply Action Plan contains as many demand subsidies as ideas to expand housing supply. These are steps in the wrong direction.

## Multiple Avenues for Congressional Support Already Exist

The federal government already provides multiple avenues of support for the construction of affordable housing and assistance for low-income renters and homebuyers, including seniors. The most prominent of these is the Low-Income Housing Tax Credit (LIHTC). Unfortunately, a recent review by Desai, Dharmapala, and Singhal casts considerable doubt on the efficacy of this program. In addition, the federal government provides appropriated funding through more than 30 programs within the Department of Housing and Urban Development, tax credits and deductions for both corporations and individuals, housing programs for veterans through the Department of Veterans’ Affairs, rural housing programs through the Department of Agriculture, and mortgage insurance programs through the Federal Housing Administration and government corporation Ginnie Mae.

The failures of this overly complex constellation of programs not performing as designed are clear. House price indices are at record highs, housing affordability indices are declining [3], and homeownership rates have barely changed since the 1970s [4]. The housing market is under considerable stress, further impacted by the challenges of the recent pandemic. It is difficult, however, to point to stressed markets as a justification for further government intervention if the government itself is responsible for significant portions of that stress. There is less evidence of market failure than there is of government failure.

## Policies to Alleviate Housing Prices

Even if Congress could design legislation that does not duplicate existing efforts, works perfectly as intended, creates sensible market incentives, and empowers private actors, while at the same time not putting overt pressure on inflation and the deficit, any legislative solution focusing on demand rather than supply will only exacerbate the high prices facing Americans.

Housing demand is especially high as a result of low mortgage rates and a coronavirus-inspired flight from large urban centers and into homes better suited to remote work [5]. Despite these high prices, the risks of an economic crash as a result of a collapse of the housing market appear low due to the low availability of mortgage credit and better underwriting standards. The rate of homeownership is on track to fall, however, and housing inequalities, felt disproportionately by seniors and other vulnerable populations, will be exacerbated.

Housing supply is constrained by low labor availability, the high cost of materials, and restrictive local regulations. Existing homes are not returning to the market at typical rates as economic stresses, the low mortgage rate environment, and the unknowns of listing a home in the backdrop of a global pandemic caused homeowners to delay or cancel their plans to list. Housing inventory, while on track to rise, is at historic lows.

Fortunately, there exist positive steps Congress could take to alleviate some of short-term stresses on the housing market. Congress could take steps to reduce tariffs that raise the prices of key construction materials, most obviously those on Canadian lumber [6]. Congress can investigate the labor market forces leading to an estimated shortfall of 650,000 skilled construction workers in 2022 [7]. Finally, Congress can work to reduce the red tape requirements of new construction, ranging from the building permit process to unwanted land-use restrictions.

Outside of short-term fixes, the most effective action Congress can take to improve the overall health of the housing market is to continue the effort to reform the GSEs. The United States does not have a functioning private secondary mortgage market and has a distorted primary market thanks to Fannie and Freddie. If Congress seeks a healthy and functioning housing market that benefits all participants, including seniors, then it must continue its efforts to reform the GSEs. Instead, this administration has reversed previous improvements, decreasing the amount of capital the GSEs are required to hold and once again allowing them to purchase the riskiest mortgages. [8]

Thank you and I look forward to your questions.

[1] https://www.bankrate.com/real-estate/why-are-house-prices-going-up/

[2] https://www.jchs.harvard.edu/sites/default/files/reports/files/Harvard_JCHS_Nations_Housing_2022.pdf

[3] https://www.americanactionforum.org/chartbook/housing-chartbook-q4-2021/

[4] https://www.census.gov/housing/hvs/data/histtabs.html

[5] https://www.americanactionforum.org/insight/understanding-the-national-increase-in-house-prices/

[6] https://www.nahb.org/blog/2022/01/nahb-welcomes-biden-administration-move-to-lower-lumber-tariffs/

[7] https://www.abc.org/News-Media/News-Releases/entryid/19255/abc-construction-industry-faces-workforce-shortage-of-650-000-in-2022

[8] https://www.americanactionforum.org/insight/fhfa-reverses-previous-housing-market-reform-progress/