Statement before the Senate Committee on Banking, Housing, and Urban Affairs

How Institutional Landlords are Changing the Housing Market

How the Federal Government's Policies Are Crowding out Lower Income Americans Out of the Housing Market

And how federal agencies and regulators are in the process of doubling down on failed policies, putting low-income and minority borrowers needlessly in harm's way

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Chairman Brown and Ranking Member Toomey, and distinguished Members of the Committee, thank you for the opportunity to testify today.

Executive Summary:

The housing market is changing and the real culprit is a massive house price boom fueled by federal housing and monetary policies, which is increasingly crowding out lower-income Americans out of the housing market.

Institutional landlords, particularly on the multifamily side, are taking advantage of more liberal credit terms provided by Fannie Mae and Freddie Mac (the GSEs) than the private sector, which is a violation of their Charters. They use their taxpayer guarantee and other advantages to greatly expand their business, while crowding out multifamily private investors. Since 2014 outstanding multifamily mortgage debt has doubled, with the GSEs accounting for most of the growth. At the same time they tout that they are supporting affordable rental housing, but in reality they create government profit seeking.

The current single-family housing boom, which began in 2012, was entirely foreseeable and was noted by the AEI Housing Center beginning in 2013. Since then, the housing market has been marked by too much demand chasing too little supply. Yet the policy response was to boost demand even more: Federal housing agencies have loosened underwriting and the Fed has pursued multiple rounds of quantitative easing, continuing even when the housing market was already appreciating over 10% per year. In 2021, home price gains were 16%, and in 2022 are expected to come in at around 12%, the third year of breakneck growth.

As a result, homeownership has gotten further out of reach for many lower-income, minority Americans. Consider that since 2012, wages have grown 40% but entry-level home prices have increased over 100%.

This out of control price spiral means increased competition for fewer and fewer affordable homes. Potential entry-level buyers are increasingly pushed to the sidelines as they cannot compete with more deep pocketed individuals, who experience the same competition only higher up the price spectrum.

This is creating knock-off effects for people downstream. Left unable to buy a home, they remain in the rental pool, helping to drive up rents, which are now increasing at 12% nationwide. Many who cannot afford these rent hikes will be pushed into homelessness.

If that were not enough, inflation is now running at 7%. A Gallup survey from last month finds "49% of Americans saying rising prices have caused hardship for their family… Lower-income Americans are suffering the most from inflation. Two-thirds of U.S. adults with an annual household income of less than $40,000 say they have experienced hardship, with 20% describing it as severe."[1]

Inflation is a regressive tax and getting by – not to mention building savings to buy a home – is becoming increasingly difficult. Thus, misguided policies have severely hamstrung lower-income Americans, in

[1] https://news.gallup.com/poll/389129/americans-expect-inflation-persist-next-six-months.aspx

particular minorities, which severely lag White Americans in homeownership and intergenerational wealth. If they can no longer reach the first rung of the housing ladder, how will they ever catch up?

The solutions are straightforward. First and foremost, we need more supply. However, federal mandates are not the answer. Zoning and land use policies are fundamentally a state and local issue and should be addressed at those levels. We are already seeing promise across the country, even in California, where the legislature has recently passed laws, which could meaningfully encourage new construction activity.

At the same time, demand boosters have shown to be counterproductive. The Fed has belatedly realized that it needs to tighten the monetary spigot. But its policies have already done a lot of damage and they will continue to haunt lower income Americans in the form of higher home prices, inflation, and rents.

The signals from federal agencies and regulators are less than encouraging. Rather than shrinking the government's footprint and reducing risk, Fannie Mae is again increasing its share of risk layered loans, where one risky loan product feature is layered on top to ultimately make a very risky loan. More could be in store: FHFA recently made policy changes that increases GSE competition with the private sector and will lead to greater risk-layering. The GSE affordable housing goals may be increased and other policies are being discussed. The FHA is also considering changes that will increase its competition with the GSEs, which does not bode well.

Equally worrisome are increases to the GSEs appraisal waiver practices, particularly purchase loans. In the past, human appraisals on purchase loans have successfully alerted lower-income and minority borrowers when they were overpaying. An appraisal waiver may simply confirm the negotiated sale price, while the competition between Fannie and Freddie for market share may create a race to the bottom on standards – not to mention that these processes can be gamed, which was commonplace with respect to the GSEs automated underwriting systems in the lead up to the Financial Crisis.

The compounding effect of these changes will mean less resiliency for borrowers and neighborhoods, many of which are lower-income and minority, to withstand an economic stress event. With many economic dangers from rising interest rates, inflation, and sky-high home prices, lurking, regulators should do more to protect borrowers and taxpayers, rather than lowering lending standard. We have seen this movie before and we know how it ends. It should not be allowed to happen again.

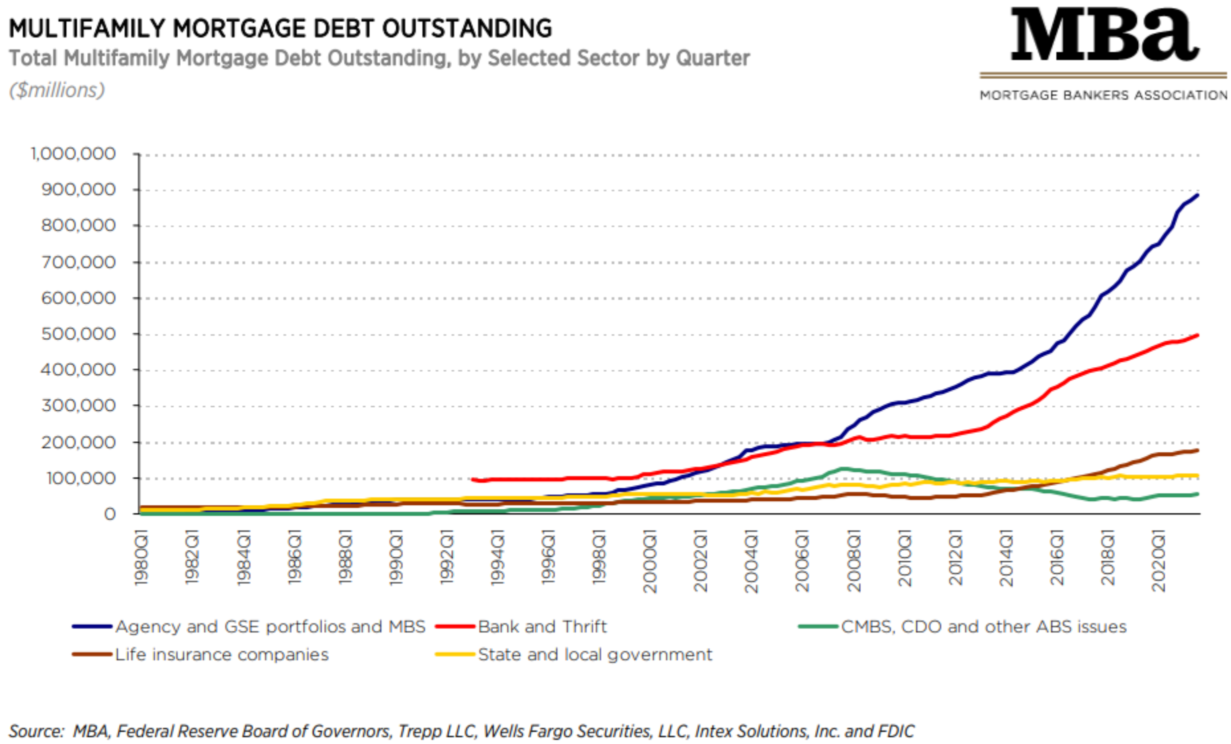
1) Institutional landlords:

Multi-family

The GSEs have seen an explosion of multifamily mortgage debt outstanding. According to the MBA, the GSE's multifamily debt outstanding has grown from \$50 billion before 2000, to \$400 billion in 2013, before taking off again in 2014.[2] As of 2021:Q3, it stands at \$900 billion. This growth has far outpaced other market participants, such as banks and thrifts or life insurance companies (see chart). At the same

[2] MBA "Commercial / multifamily mortgage debt outstanding" Q3 2021. https://www.mba.org/news-research-and-resources/research-and-economics/commercial/-multifamily-research/commercial/multifamily-mortgage-debt-outstanding.

time, the GSEs market share now stands at around 50%, up from around 38% in 2013 and around 20% before 2000.



We found this case in Florida where Freddie touted its preservation of low income rentals, while the property owner bragged about the ability to raise rents:

- The buyer/investor finds a property that already provides work force/low-income housing at well below 80% of area median income (AMI).
- The GSEs requires that tenants earn below <80% of AMI.
- Due to liberal GSE lending terms, the buyer/investor is able to load up the property with debt.
- The buyer/investor then makes renovations to take advantage of an "extraordinary value-add opportunity" to “significantly enhance revenue”. This allows a repositioning to a higher income tenants.
- Occupants are still generally below 80% AMI so Freddie gets to tout its "preservation success," while the owner brags about its financial acumen.[3]

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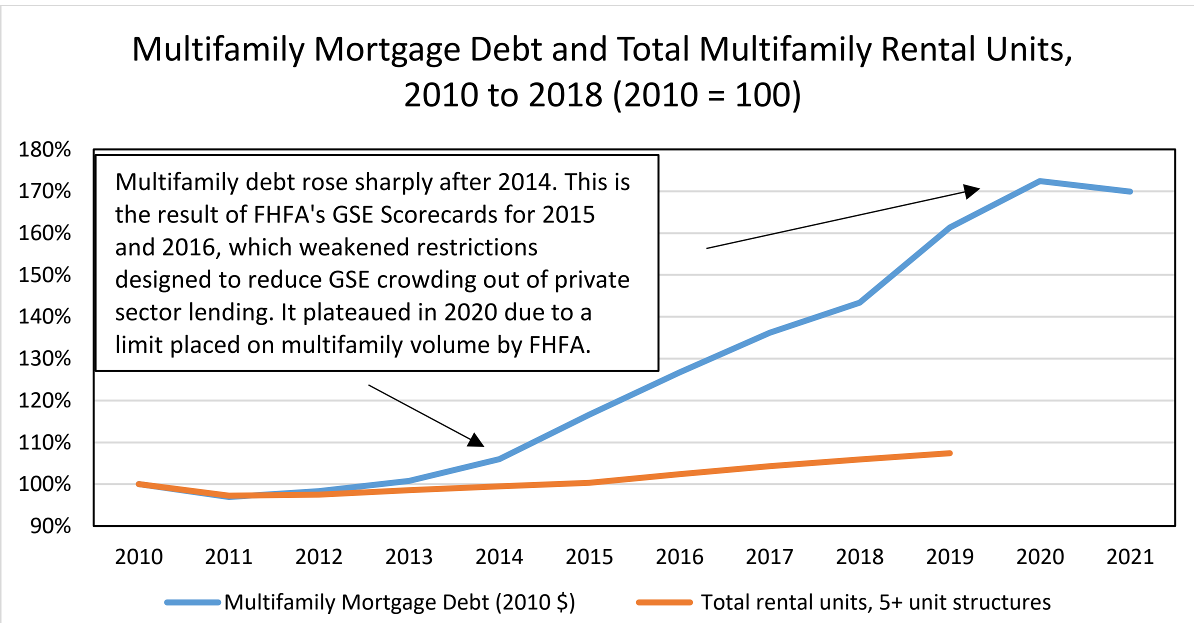
[3] For example, according to a Wall Street Journal article on a 352-unit complex in the Tampa area that was purchased in the spring of 2018 by Bridge Investment Group. The development is named Plantation at Walden Lake, in Plant City, FL, "Freddie Mac, the country’s largest backer of apartment loans, will offer low-cost loans to real-estate owners willing to keep their buildings affordable to middle-class families for years to come.” Bridge Investment Group, the investor, said about its plans for this development that was 95% leased back in the spring of 2018: "Over the last three years, Mercury Investment implemented a multimillion dollar capital improvement program that included enhancements to the community’s pool and other shared amenities, as well interior upgrades. The remaining renovated units present a significant value-add opportunity for the buyer. 'Plantation at Walden Lake’s strong occupancy and potential for further renovation make it an extraordinary value-add

- Of the seven institutional landlords mentioned during the Senate Banking Committee Member and Staff Listening Session on "Renters Who Live in Housing Owned by Corporate Owners" from February 8, 2022, four received financing through either Fannie Mae or Freddie Mac.[4]

This system is putting taxpayers at risk under the guise of "affordable" lending without delivering meaningful results. The next chart shows the growth in GSE multifamily mortgage debt and the growth in total rental multifamily units from 2010 to 2021. While debt had grown over 60% by 2019 compared to 2010, rental units have only grown around 10% over the same time.

Since the GSEs activities in the multifamily sphere crowd out private business without delivering any meaningful supply addition, it would best to end GSEs financing of multifamily homes.



Source: ACS, Federal Reserve Flow of Funds Data, and AEI Housing Center.

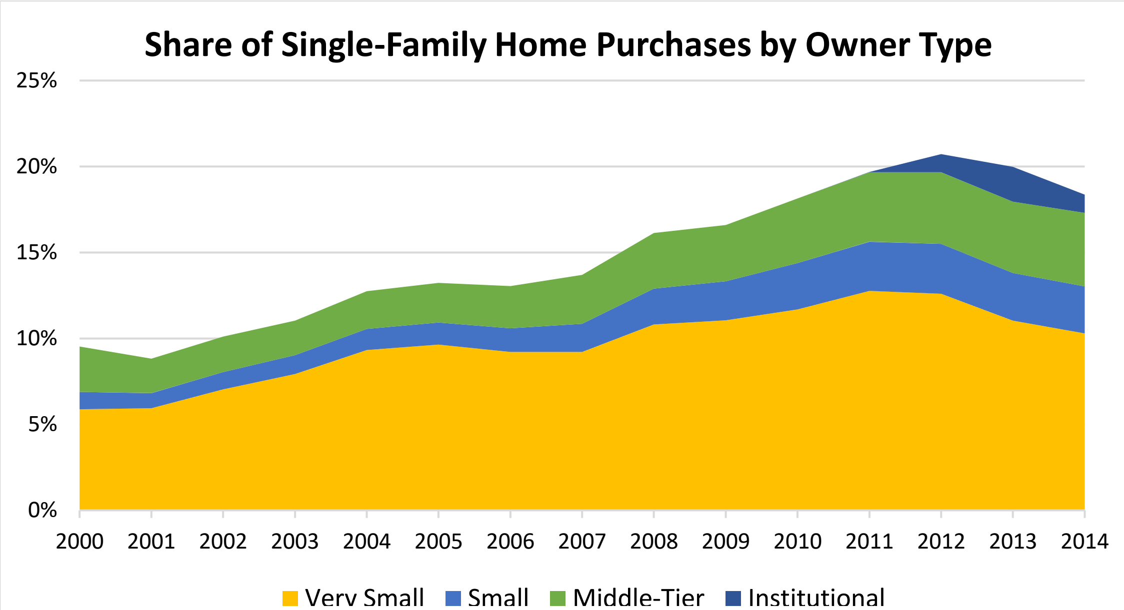
Single-Family

opportunity,' said Elorza. 'Renovating the remaining units will help the property compete with newer communities nearby, and will significantly enhance revenue.'" https://www.tampabaynewswire.com/2018/04/26/cushman-wakefield-negotiates-35-7m-sale-of-tampa-area-apartment-community-for-mercury-investment-67396

[4] A number of institutional investors buying single and multifamily homes have agreements with the GSEs. Invitation Homes, the largest institutional investor in single family housing, signed an agreement that Fannie Mae would guarantee up to 1$ billion in debt. Other major players in the single-family rental market, saw this is as a green-light to the institutional rental-home business: the CEO of progress residential stated in the WSJ "This is a great outcome not just because it obviously will reduce the cost of our financing, but it puts a further stamp of approval on this industry." Front Yard Residential, another large player in the single-family rental business, acquired HavenBrook partners as part of a $508.7 10-year loan backed by Freddie Mac through their affordable single-family rental pilot program. Havenpark capital, which has been cited for buying mobile home parks and hiking rents, use loans guaranteed by Fannie and Freddie.

Single-family institutional landlords have received a lot of attention, yet a review of the data indicate there is little evidence that they are having a measurable impact on either rents or home prices. Here is a summary of key findings from various research studies:

- Institutional landlords accounted for around 1% of America's single family rental homes.[5]
- Lambie-Hansen et al. (2019) find that institutional landlords helped to stabilize the housing market during 2006-2014.[6]
- Mills et. al. (2015) find that institutional landlords are a relatively recent phenomenon and account for a small share (~1%) of purchases over time (see next chart).[7]



Source: James Mills, at al. (2015). Classifications based on Freddie Mac.

- More recent data find that institutional landlords acquired about 4,000 homes in 2021 (through September) or about 0.1% of all sales.[8] According to industry figures, their stock of total U.S. housing units accounted for about 0.2%.[9]
- Amherst Capital finds:
    - "Institutional purchases have been somewhat concentrated in a few geographies. … the top 10 metro areas account for about 63% of all 2016 purchases by institutions. However, even in such higher ranking metro areas, institutional purchases only represented 1–3% of total annual homes sales."
    - The report however cautions that parts of a metro could have higher shares.

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[5] Freddie Mac Spotlight on Underserved Markets: Single-Family Rental, An Evolving Market. The data are most likely for 2016.
[6] Institutional Investors and the U.S. Housing Recovery
[7] James Mills, Raven S. Molloy, and Rebecca E. Zarutskie (2015). "Large-Scale Buy-to-Rent Investors in the Single-Family Housing Market: The Emergence of a New Asset Class?," Finance and Economics Discussion Series 2015-084. Washington: Board of Governors of the Federal Reserve System, http://dx.doi.org/10.17016/FEDS.2015.084
[8] John Burns Single Family Rental Market Index 20021:Q4 cited in National Rental Housing Council Single-Family Rental Home Companies, iBuyers, and the Market for Home Purchases 2021:Q3.
[9] National Rental Home Council

- And concludes that "given the generally small share in metro area sales, any broad-based narrative suggesting that institutions are driving up prices and crowding out retail buyers seems rather stretched, in our opinion." [10]

The recent emergence of institutional landlords in the single-family sphere begs the question why this is happening. The main reasons are:

- New opportunity created by the collapse in home prices after a government affordable housing policy-induced lending boom and subsequent price collapse.
    - Institutional landlords purchased mainly fixer-uppers or foreclosures at rock-bottom prices.[11]
    - Analysis by Amherst Capital seems to support this: "institutional investors have tended to concentrate their investment in certain markets in Southeast Texas, and parts of the Midwest such as Atlanta; Dallas-Fort Worth, Texas; Chicago; and Indianapolis, particularly where there was a low price-to-rent ratio and where properties had experienced substantial declines in value during the Great Recession."[12]
- Search for yield due to central banks holding down interest rates.
    - Steady stream of income in a low interest rate environment.
    - Home price appreciation of over 100% since 2012 due to government policies (more below), which could be higher on foreclosures and fixer-uppers.
    - Stable demand from a growing population and would-be homebuyers getting priced out of the market.
- Investment diversification and safe haven due to impact of pandemic.
- More recently, hedge against COVID stimulus inflation risk from expansive monetary and fiscal policies.

Some of these reasons beg the question as to whether institutional landlords would be in existence today had government polices not created a housing crash and then engineered a subsequent house price boom.

2) The housing market is becoming less affordable, not because of institutional landlords, but rather misguided policies

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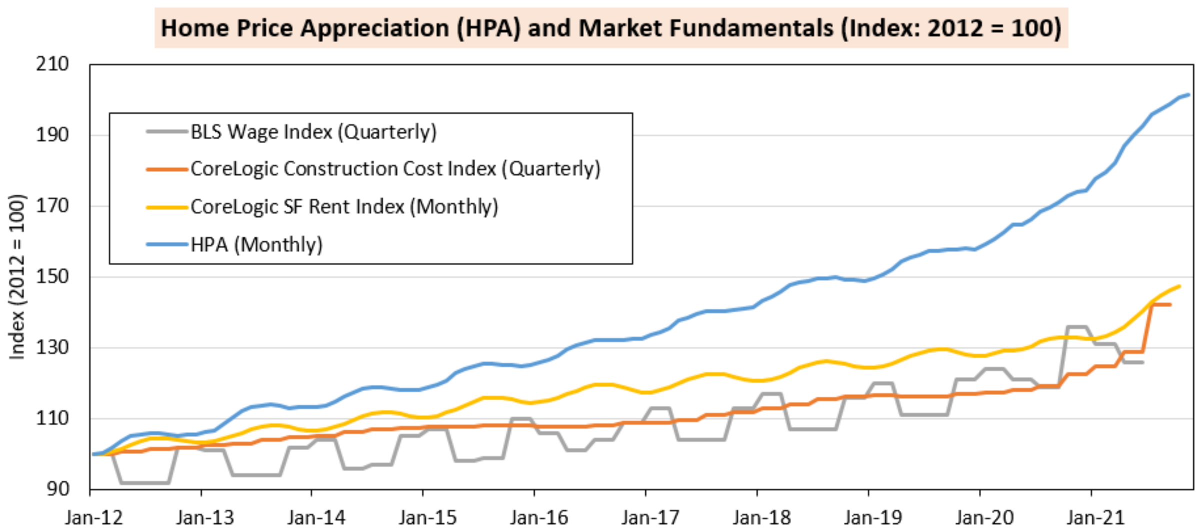
[10] AMHERST CAPITAL MARKET UPDATE U.S. Single Family Rental—Institutional Activity in 2016/2017, | AUGUST 2017.
Particularly, the point about moving the market seems plausible to us given that our research on FHA's mortgage insurance premium cut from 2015 found that in order to move the market, FHA's concentration in a census tract needed to be around 20%. For more, see Davis, Oliner, Peter, and Pinto, The impact of federal housing policy on housing demand and homeownership: Evidence from a quasi-experiment, http://www.aei.org/wp-content/uploads/2018/01/Oliner-homeownership-WP-Update.pdf?x91208

[11] See https://www.urban.org/urban-wire/institutional-investors-have-comparative-advantage-purchasing-homes-need-repair or Institutional Investors and the U.S. Housing Recovery and James Mills, Raven S. Molloy, and Rebecca E. Zarutskie (2015). "Large-Scale Buy-to-Rent Investors in the Single-Family Housing Market: The Emergence of a New Asset Class?," Finance and Economics Discussion Series 2015-084. Washington: Board of Governors of the Federal Reserve System, http://dx.doi.org/10.17016/FEDS.2015.084

[12] Freddie Mac Spotlight on Underserved Markets: Single-Family Rental, An Evolving Market

Here is a list of data on the recent single-family housing boom, which started in 2012:

- Uninterrupted seller's market since 2012, which is now the longest ever recorded.
- Housing supply is currently at its lowest level ever. In December 2022 the months' supply of low- and low-median price tiers was 0.9 and 1.0 months respectively. Traditionally about 75% of homes at these price points are first-time buyers.
- Since 2012, home price appreciation has far outpaced the growth in market fundamentals (wages, construction cost, rents).



Note: Data are for the entire country. Wage data come from the Quarterly Census of Employment Wages (QCEW).
Source: CoreLogic, BLS, and AEI Housing Center, www.AEI.org/housing.

- Since 2012, home prices have appreciated 102%. Entry-level prices are up even more (118%).
- Home price appreciation (HPA) has further accelerated in the aftermath of the pandemic.
  - Since Jan. 2020 prices are up 27%.
- Affordability has been worsening with the median price to median income ratio increasing from 3.42 in 2012 to 4.37 in 2020.[13]
- There are anecdotal reports that first-time home buyers are increasingly waiving home inspections or overbidding. Yet, they have fewer financial resources to handle the fallout if the home requires repairs that would have been found during an inspection.[14]

Because of this boom, home prices levels will be higher for years, which means that all subsequent buyers have to match that level.

3) Lower income Americans are getting crowded out of the housing market

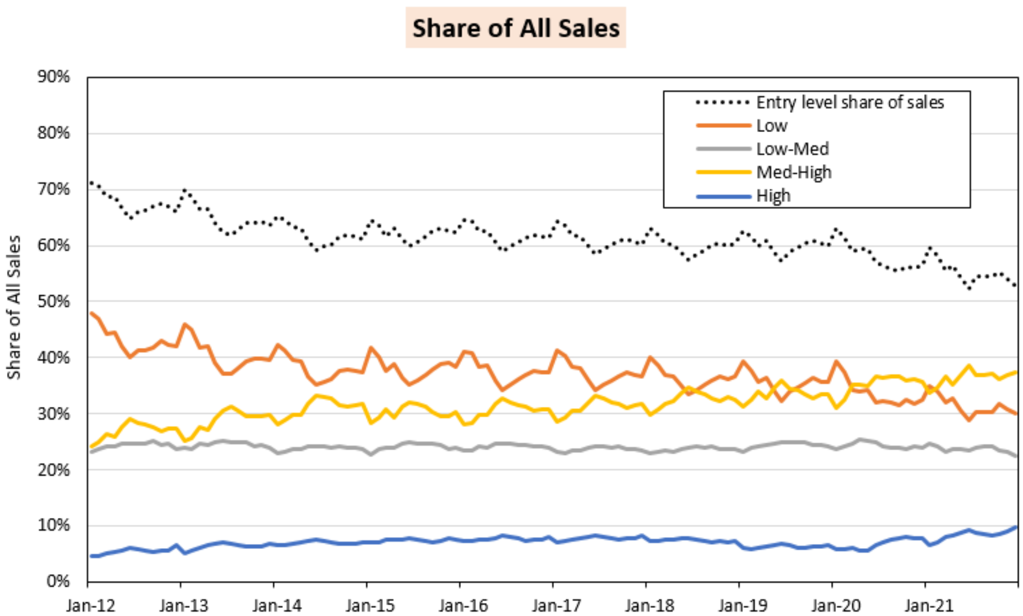
Due to the rapid home price appreciation, potential buyers that otherwise would have been able to buy a home are getting crowded out of the market. Just this week the Wall Street Journal reported on the middle class getting priced out of the housing market. But while borrowers with incomes of $75,000 to

[13] Harvard Joint Center for Housing Studies, State of the Nation's Housing 2021
[14] https://www.forbes.com/advisor/mortgages/homes-for-sale-hit-record-low/

$100,000 have the option to buy a lower-priced home. Low-income and many minority Americans may be squeezed out of the market entirely. .[15]

Example 1:

- The entry-level share of home sales has been declining from 71% in Jan. 2012 to 53% in Dec. 2021.



Source: AEI Housing Center.

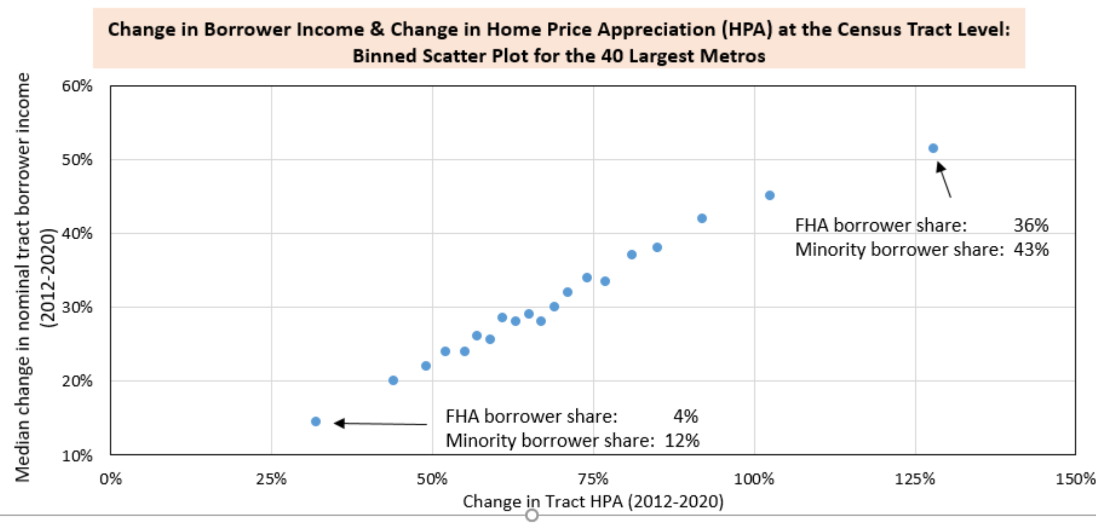
Example 2:

- For census tracts with the fastest HPA (+125% since 2012), we observe borrower income growth (+50%) twice the rate of the national income growth (~27%).
    - Unfortunately, it is highly implausible that the incomes for this group of borrowers has gone up that fast.
    - What is more likely happening is that due to the rapid price spiral, a different mix of buyers is buying in these neighborhoods.
    - For example:
        - In 2012, the borrowers purchasing in census tract A had a median income of $40,000.
        - By 2020, these borrowers should be making $51,000 according to wage statistics from the Atlanta Fed.
        - However in 2020, we observe that the borrowers now purchasing in census tract A have a median income of $61,000.

[15] https://www.wsj.com/articles/in-covid-19-housing-market-the-middle-class-is-getting-priced-out-11644246000?mod=mhp

- Had the borrowers from 2012 not purchased in 2012, but rather tried to purchase in 2020, their income would not have sufficed to compete with the higher income borrowers that actually purchased in 2020.

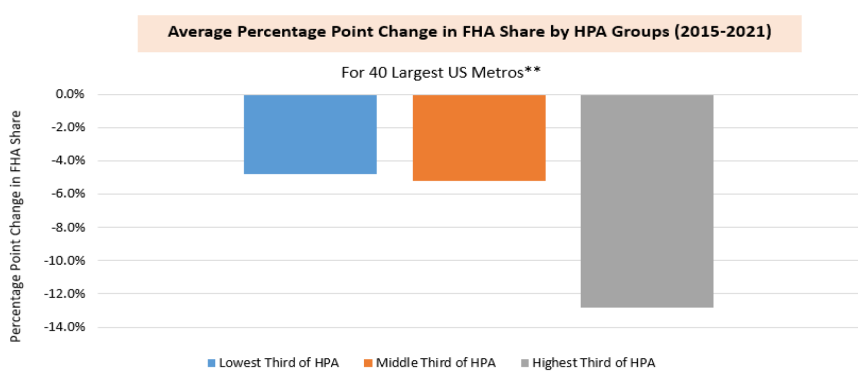
- The census tracts with the fastest HPA also had the highest share of FHA purchase loans (an indicator for lower-income) and minority borrowers.



Note: Tracts are weighted by their respective loan counts. Binned scatter plot accounts for differences in metros. FHA and minority borrower shares are for 2020. HPA stands for constant-quality home price appreciation
Source: HMDA and AEI Housing Center, www.AEI.org/housing. 23

Example 3:

- The top one-third of large metros with the highest growth in HPA have seen a 13 percentage point reduction in FHA purchase loan share compared to a 6 percentage point reduction for the two-thirds of metros with lower levels of HPA.
- Since FHA is a proxy for lower-income and minority borrowers, this trend is indicative of substantial crowding out of low income and minority potential home buyers.



* FHA purchase share is used as a proxy for lower income, minority, first-time, and first-generation borrowers
****Metro Cities in Lowest Third HPA Category**: Baltimore, MD; Chicago, IL; Cincinnati, OH; Cleveland, OH; Houston, TX; Kansas City, MO; New York, NY; Philadelphia, PA; Pittsburgh, PA; Raleigh, NC; San Antonio, TX; St. Louis, MO; Virginia Beach, VA; Washington, DC.
Metro Cities in the Middle Third HPA Category: Austin, TX; Boston, MA; Cape Coral, FL; Charlotte, NC; Columbus, OH; Dallas, TX; Detroit, MI; Indianapolis, IN; Jacksonville, FL; Los Angeles, CA; Miami, FL; Minneapolis, MN; North Port, FL.
Metro Cities in Highest Third HPA Category: Atlanta, GA; Denver, CO; Las Vegas, NV; Nashville, TN; Orlando, FL; Phoenix, AZ; Portland, OR; Riverside, CA; Sacramento, CA; San Diego, CA; San Francisco, CA; Seattle, WA; Tampa, FL.

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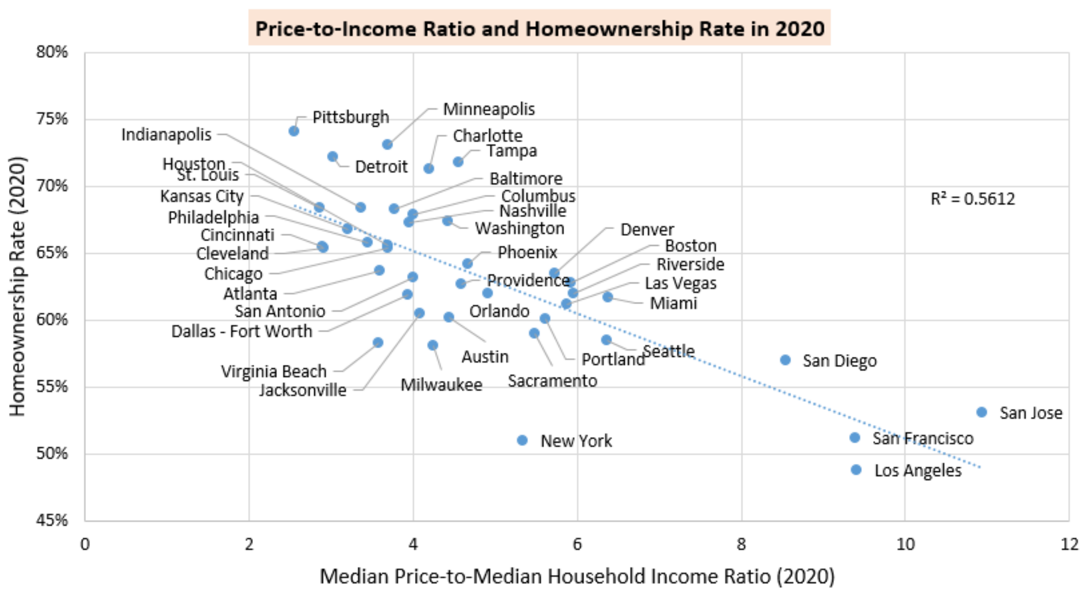
Source: American Community Survey, Public Records, and AEI Housing Center, www.AEI.org/housing.

The rapid home price appreciation, which is beyond market fundamentals, is primarily affecting lower income, first-time, and first-generation home buyers.

The conclusion is that because of an out of control price spiral there is increased competition for fewer and fewer affordable homes. Potential entry-level buyers are increasingly pushed to the sidelines as they cannot compete with more deep pocketed individuals, who experience the same competition only higher up the price spectrum, and so on. These trends are indicative of the crowding out of low income and minority potential home buyers, which results from the house price boom due to federal monetary and housing policies. It is a violation of the Fair Housing Act.

When would be buyers are being crowded out of the market, it creates problems downstream:

- If potential buyers can no longer afford homeownership, they continue to rent, which lowers the homeownership rate.
    - There is already a noticeable correlation between home prices and the homeownership rate for the largest metros. The higher prices are, the lower the homeownership rate is.

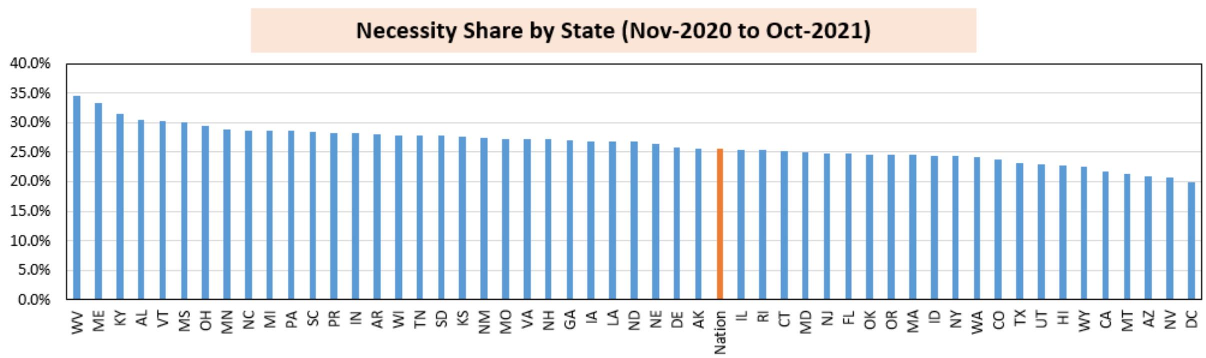


Note: Data are for the largest 40 metros based on the number of households.
Source: Harvard Joint Center for Housing Studies, Census Bureau, and AEI Housing Center, www.AEI.org/housing.

- With more borrowers being crowded out, there is additional demand for rentals, which increases rents.
    - Rents are now going up at 12% nationally and are expected to remain elevated for years to come.[16]
- Higher rents mean potentially higher rates of homelessness.
- Higher inflation, now running in the 7% range, further threatens people's paychecks, especially lower income ones.

[16] See https://www.zumper.com/blog/rental-price-data/ and https://www.dallasfed.org/research/economics/2021/0824.

- A Gallup survey from Jan. 3-13, 2022 finds:
    - "49% of Americans saying rising prices have caused hardship for their family, including 9% who say it has caused 'severe' hardship affecting their ability to maintain their current standard of living."
    - "As would be expected, lower-income Americans are suffering the most from inflation. Two-thirds of U.S. adults with an annual household income of less than $40,000 say they have experienced hardship, with 20% describing it as severe."[17]
- The effect will be particularly high on people spending a higher shares of their incomes on necessities such as spending at Discount Stores, Drug Stores, Food Stores, Gas Stations, and Utilities.
- Certain states, which a higher share of necessity spending will be more affected than others:



* Necessities are defined as spending at Discount Stores, Drug Stores, Food Stores, Gas Stations, and Utilities.
Note: Spending refers to national household credit card and debit card total spending.
Source: Commerce Signals, a Verisk Analytics business, BLS, and AEI Housing Center.

4) Policies by the federal government and Federal Reserve have been the culprit for crowding lower-income Americans out of the housing market

Economics 101 teaches that more demand against a limited supply will drive up prices.

In housing, when supply is constrained (as it has been since 2012), credit easing will make entry-level homes less affordable. This is the paradox of accessible lending.

Yet there have been plenty of demand boosters, which have powered the current housing boom are crowding out lower-income and minority Americans:

- Federal Reserve – Easy monetary policy during a seller's market has contributed to rapidly rising home prices and also, more recently, inflation.
    - Quantitative Easing (QE) 3 announced in September 2012: coincides with the start of the current housing boom.

[17] https://news.gallup.com/poll/389129/americans-expect-inflation-persist-next-six-months.aspx

- QE4 announced in March 2020: While justified at the beginning of the pandemic, it became quickly clear that the housing and labor markets did not need the massive support. The Fed is finally, albeit belatedly and slowly, unwinding the GSE asset purchases.
- Artificially low interest rates: All else equal a 1 ppt. drop in the mortgage rates translate into a 9% increase in buying power. Since all borrowers, as well as anyone shopping in the market benefits from it, most of the benefit gets capitalized into higher home prices, thus benefitting the home seller, not the buyer. In addition, lower rates attract new buyers into the market (second or investment home buyers, renters, etc.), thus also increasing the pool of potential buyers.

The outcomes for the housing market have been outlined above. But there are also other effects on inflation and rents.

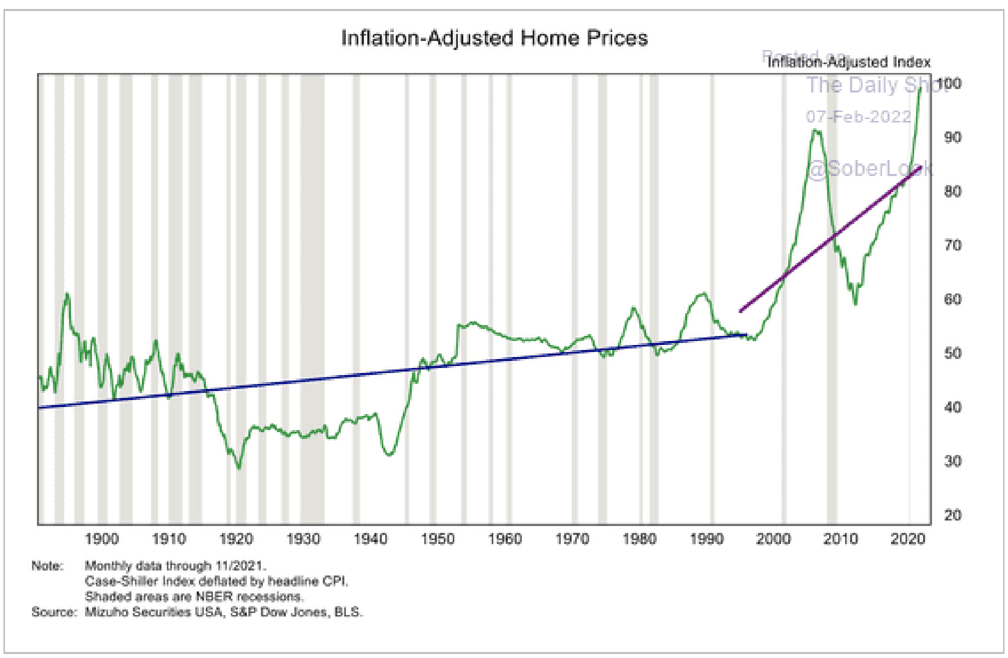
- My colleague Ed Pinto estimates that just since the beginning of the pandemic, the Fed's monetary policies have contributed about $1 trillion in wealth effects available to be used for additional spending.[18]
- Researchers at the Dallas Fed have found a "high correlations between current house price growth and future inflation of rent and [owners'-equivalent rent] OER" and predict rent and OER inflation to reach 6-7% by 2023, up from around 2% today.[19] According to data from CoreLogic, Zillow, and Zumper, rents are already increasing 11-14% year-over-year.[20]
- It is highly likely that inflation will be more sustained than anticipated. Since inflation is a regressive tax, it will predominantly hurt renters and low-income Americans.
    - Larry Summers just this week warned that "And housing — one-third of the CPI — has been a transient factor holding down measured inflation, as the CPI's housing component has increased less than the overall index even as measures of homes prices and rents have risen at rates approaching 20 percent. Even if all other prices were flat and housing prices stabilized, housing alone will likely be enough to push core CPI above 2 percent in 2022."[21]
    - He continued with "Macroeconomic policies that push demand well past the economy's capacity, such as those we have pursued over the past year, do not just lead to inflation but rather to increasing inflation — with the inflation rate accelerating for as long as the economy overheated. The painful lesson of the 1960s, 1970s and the 1982 recession is that excessive demand stimulus leads not just to inflation, but to stagflation and ultimately recession, as inflation must eventually be brought under control. Overly easy policies also lead to bubbles in

[18] About $420 billion ($15 trillion in stock market valuation increase since end of 2019 x 2.8 cents per year in increased consumption), about $180 billion (home equity gains over the last 18 months yields an average $2,200 per household in additional consumption spending over the next couple years, or about $180 billion of additional spending summed up across all homeowners, about $280 billion/year from monthly payment savings on Rate and term refinances, and about 90 billion/year from equity extraction on cash out refinance loans. CITE CONFERENCE
[19] https://www.dallasfed.org/research/economics/2021/0824
[20] For CoreLogic: see chart above, for Zillow: https://www.zillow.com/research/data/ (ZORI series), for Zumper: https://www.zumper.com/blog/rental-price-data/
[21] https://www.washingtonpost.com/opinions/2022/02/03/inflation-warning-history-lawrence-summers/

financial markets that ultimately burst with catastrophic consequences for unemployment and poverty."[22]

- Agencies (primarily GSEs and FHA) – Looser government underwriting policies during a seller's market have contributed to increasing house prices, not to better housing outcomes.
  - Leverage, albeit lower than during the 2000s, has been increasing.[23] The AEI National Mortgage Default Rate (NMDR) -- which measures underwriting standards or leverage—increased from 2012 until efforts by FHFA Director Mark Calabria and FHA leadership started to rein it in starting around mid-2019.[24] The pandemic has further contributed to a tightening of underwriting, however, there are worrying signs again:
    - FHA's NMDR is close to matching its series' high.
    - The NMDR is likely lower because of the crowding out of the riskiest borrowers. However, there are concerted efforts under way to bring them back into the market. The proposals brought forth have focused on further credit easing (discussed below).
    - Because supply is at an all-time low, any increases in leverage will likely push home prices even higher, thus extending the current housing boom and further worsening affordability.

The confluence of monetary and government policies have contributed to increasing house prices, which – by historical standards – is highly unusual. In addition, the increase in housing wealth has furthered inequality.



Source: Mizuho Securities USA

[22] IBID

[23] Davis, M.A., Larson, W.D., Oliner, S.D. and Smith, B.R., 2019. A Quarter Century of Mortgage Risk. American Enterprise Institute, working paper, 4.

[24] https://www.aei.org/housing/mortgage-risk-index/

5) How to build sustainable generational wealth for lower-income and minority Americans

There is a growing consensus that to make housing more affordable is to increase supply, not to ease credit, increase government subsidies, or suppress interest rates. Even a few progressive think tanks and cities have come around to this view.[25] In order to stop the price spiral that is pricing lower-income Americans out of the housing market and driving up rents, we need to address the following issues:

- More supply:
    - Federal mandates are not the answer. They have crashed and burned every time (more below).
    - Zoning and land use policies are fundamentally a state and local issue and should be addressed at those levels. Fortunately, many cities and states are already experimenting with increasing housing supply. California's ADUs law and SB-9, for example, relax single-family zoning by restoring property rights and relying on private enterprise. If California can pass this, then this should be the blueprint for others too.
    - One needs to be both patient and careful, reversing the effects of 100-year-old policies on zoning will take decades.
- Eliminate demand boosters as they create unaffordability until balance between supply and demand has been restored:
    - Congress should task FHA, not the GSEs, with guaranteeing loans for high-risk, low-income borrowers.
        - FHA should limit mortgage default risk at loan origination through the use of shorter loan terms.
        - HUD should study how to increase borrower resiliency by examining the effectiveness of the residual income test, month's reserves at closing, the Massachusetts Housing Finance Agency unemployment program, and a loan with a reserve accumulation component. In all cases, the data should be made available to private researchers for independent study and evaluation.
    - FHFA should set a limit on mortgage default risk at loan origination.
        - The MDR is a comprehensive stressed default rate, which represents the worst-case scenario stress test similar to a car crash test or a hurricane safety rating. The NMDR has shown to be incredible predictive of loan defaults during the COVID- 19 pandemic.[26]
        - The MDR would also help end policies, especially risk layering, that have had a disparate impact on low-income households, especially ones of color, and would therefore affirmatively further fair housing under the Fair Housing Act.
- Shrink the government's footprint in the housing market:

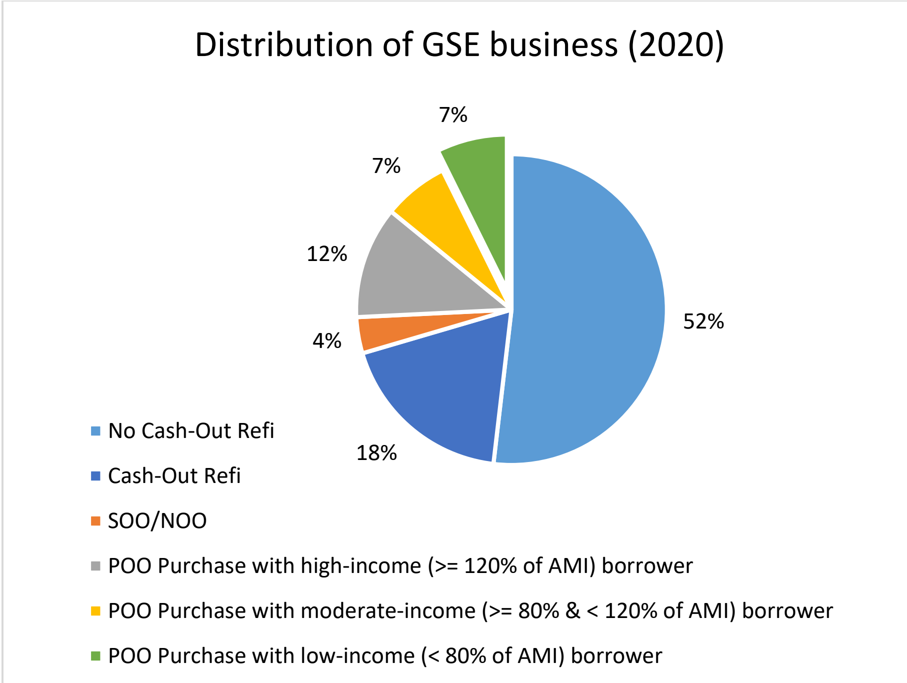
[25] Sightline Institute has tackled that notion directly. Not only can you build your way to affordable housing, in fact, building more supply may be the only effective way to reduce the pressure that is driving up rents and producing displacement. There's ample evidence for this position, but there's still the strong sense that addressing our housing problem by building more high end housing is a cynical and ineffective kind of "trickle down" economics. "The battle cry of the low income housing advocates is "you can't build your way to affordability."" See for example https://cityobservatory.org/the-end-of-the-housing-supply-debate-maybe/ and https://www.sightline.org/2017/09/21/yes-you-can-build-your-way-to-affordable-housing/.

[26] https://www.aei.org/housing/mortgage-risk-index/

- The rational for doing so is that
    - Despite the government's efforts over the last 60 years, homeownership today stands at about the same level as in 1964.
    - The GSEs continue to dominate lending with about 50% market share, with total government involvement at about 80%. This is not allowing the private sector to gain more than a foothold, much less grow.
    - GSE subsidies are not well targeted to helping low- and moderate-income, first-time buyers. The lion's share of the benefit is going to existing middle- and increasingly upper income homeowners, as evidenced by conforming loan limits of almost $1 million used by the GSEs.
    - Housing finance policy is on autopilot, creating harmful market distortions while failing to deliver meaningful results.
    - The private sector can actually compete with the GSEs. Since 2013 (excluding a year interruption due to the pandemic), jumbo portfolio loans have consistently had lower mortgage rates of about 25 basis points than GSE conforming loans.[27] Yet, despite a higher mortgage rate, most borrowers opt for a GSE loan because of the looser underwriting terms, which is a violation of their Charters.
    - If the goal is to have the GSEs accumulate enough capital so they are no longer too big to fail and release the them out of conservatorship, the acting FHFA commissioner Sandra Thompson has made it clear in her confirmation hearing that she would "defer to Congress" on such action.[28] This adds renewed urgency to the task of shrinking the GSEs' footprint through legislative, rather than administrative means.
- Latest HMDA data show that 70% of the GSEs 2020 business were refinances. This is not an aberration. Since 2012, about 60% of the GSEs' acquisitions have been refinance loans. And only 14% of acquired loans went to low- or moderate-income borrowers who were purchasing a home.

[27] Fisher, L.M., Fratantoni, M., Oliner, S.D. and Peter, T.J., 2021. Jumbo rates below conforming rates: When did this happen and why?. Real Estate Economics, 49(S2), pp.461-489.

[28] https://www.tradingview.com/news/reuters.com,2022:newsml_W1N2SF00I:1-u-s-housing-agency-nominee-thompson-says-will-defer-to-congress-on-fannie-freddie-conservatorship/



Source: HMDA and AEI Housing Center.

- How to gradually shrink the GSE footprint while ensuring access to housing finance:
    - Communicate to the market place that the following changes will arrive sequentially and according to a fixed timetable.
    - Remove high-cost loan limits, which are now approaching $1 million. These limits were intended to be temporary.
    - Reduce or cap national loan limits.
    - Eliminate GSE loans for second and investor homes, which do not increase homeownership.
    - Eliminate Cash-out refinances, which do not promote homeownership.
        - The gradual nature of this plan ensures that it can easily be paused and reversed, if the private sector fails to step in.
        - One should also consider that the current system has not materially increased the homeownership, not to mention, closed the racial homeownership gap.
- Build resiliency in neighborhoods and borrowers by reducing the loan term on high risk loans to 20- or 15-years on high-risk loans:
    - The FHA should implement LIFT Home for low-income, first-time, first-generation home buyers.[29]

[29] LIFT loans should be structured as an interest rate buy down on a 20-year loan made to first-generation homebuyers, rather than down payment assistance. The rate buy down, combined with a slightly lower rate due to the shorter term, along with a lower mortgage insurance cost, allows LIFT Home to have the same buying power as a 30-year loan. For the rate buy down, assistance should be provided as compensation to HUD/Rural Housing/Treasury for buying a below market yield Ginnie MBS.

- The GSEs should implement the Wealth Building Home Loan to reduce risk to taxpayers and to encourage borrowers to build equity.[30]
- The advantages are:
  - A shorter term loan builds equity much faster than a traditional 30- year loan.
  - The earlier pay-off date provides access to additional cash flow to pay children's post-high school education, and fund retirement.
  - The 20-year term reduces default risk by about 50%, which allows for lower FICO score loans to be made more safely.
  - This is a big boost to expanding Black and Hispanic home ownership, as a low credit score is a major impediment.
  - The 20-year term has better default mitigation and remediation options compared to 30-year.
  - The rate buy down limits the subsidy from being capitalized into higher prices, thus limiting the potential for crowding out.

6) How to avoid unintended consequences

Relaxing underwriting requirements in an overheated housing market has been tried many times since 1954 and has not worked.

There is a growing consensus that the way to make housing more affordable is to increase supply, not to ease credit, increase government subsidies, or suppress interest rates.

Yet, rather than shrinking the government's footprint or reducing risk, Fannie has already increased risk layering and FHFA has recently made policy changes that increases GSE competition with the private sector and will lead to greater risk-layering. Many other changes are being discussed.

The most significant policy and regulatory changes are listed below:

- June 2021: CFPB delayed the mandatory compliance data of the QM rule until Oct 1, 2022. The CFPB's 2020 replacement of the QM rule with a new standard based on the Average Prime Offer Rate) would similarly relax underwriting requirements and thus promote higher risk loans and unsustainable home price appreciation. The same applies to an expansive stand-alone DTI limit.
- August 2021: FHA updated its student loan monthly payment calculations.
- August 2021: FHFA proposed new benchmark level for minority & low-income tracts home purchase in 2022-24.

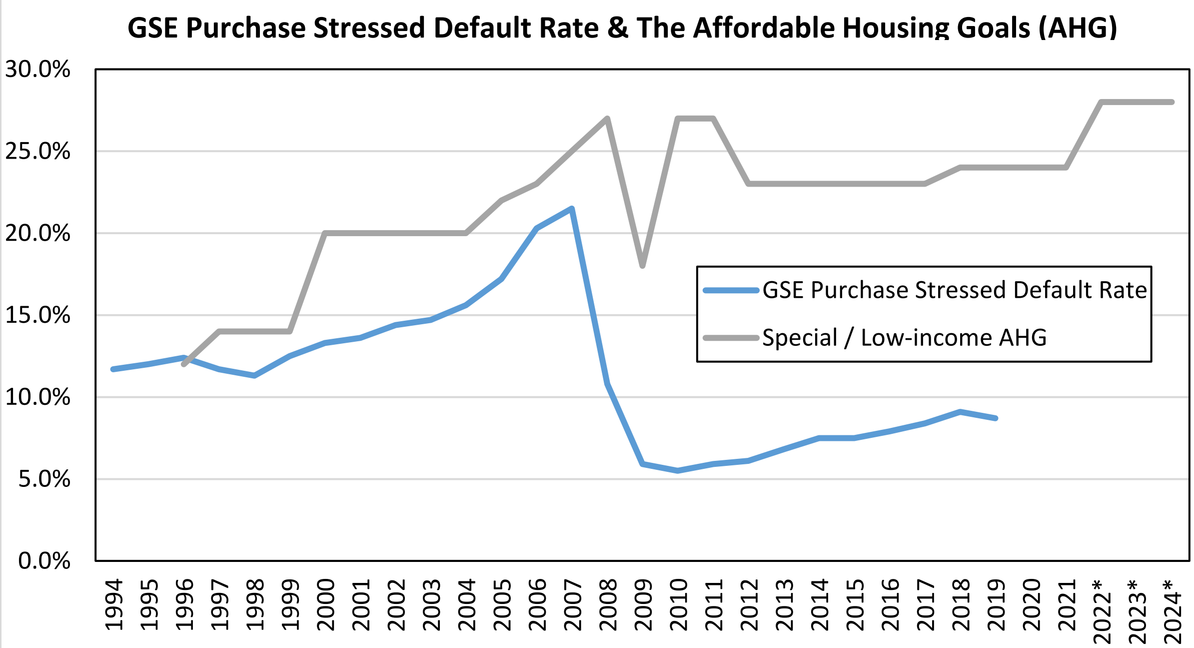
FHFA proposed to raise the Low-Income Home Purchase Goals affordable housing goals for low-income 2022-2024 to 28%, up from the current 24% level. The risk of this approach becomes obvious when compared to the period before the last financial crisis when the affordable housing goals were last raised.

[30] Applies the same concepts as LIFT Home, but runs through conventional loans and without federal subsidy.

From 1996 to 2008, the Special Affordable Housing Goals for purchase loans were raised from 12% to 27%. At the same time, the GSE purchase stressed default rate increased from 11.7% to 21.5% in 2007, before lending standards were significantly tightened. The tight correlation between both lines becomes evident in the chart below.

Due to the ever increasing Housing Goals, the GSEs were forced to lower their underwriting criteria in order to fulfill those goals. The result, of course, was a massive build-up of risk, which eventually ended in 8.6 million foreclosures and other forced dispositions, which were proportionally higher in low-income and minority neighborhoods.

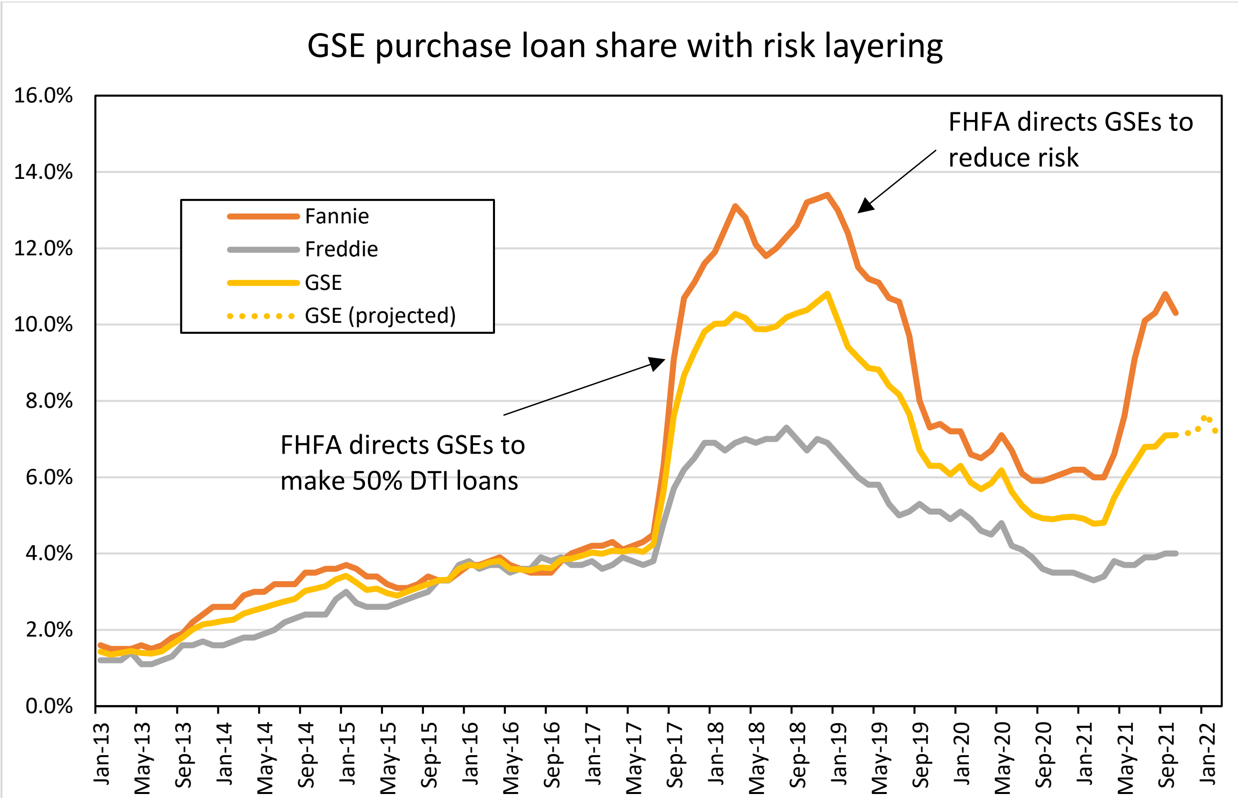
By historical standards today's GSE mortgage risk looks fairly benign, but FHA's mortgage risk is about at the same level as in 2006. These loans are highly geographically concentrated and the GSEs will be forced to compete with FHA when the goals are raised.



* proposed.
Until 2008, the Low-income Home Purchase Goals were known as the the Special Home Purchase Goals.
Source: FHFA

- <u>September 2021</u>: Fannie and Freddie suspended limits on second homes and investment properties, and risk layering limits on loans due to higher risk characteristics

There has already been a troubling increase in the share of GSE purchase loans with risk layering, which may have been anticipated by Fannie or been connected to a change in its Desktop Underwriting (DU) system.



Note: Risk layering is defined as having a credit score < 680, a DTI > 45, and a CLTV > 90 present in the same loan.
Source: AEI Housing Center.

- September 2021: Fannie started to include rental payment history in its risk assessment processes.
- Possible for 2022:
    - Pressures on FHA are building to lower FHA's current level of mortgage insurance premiums (MIP). Secretary Fudge has for the moment ruled out a cut to the MIP, but if a cut were to be implemented during an overheated housing market, it would have similar consequences as the 2015 MIP cut, which drove up prices and did not materially expand homeownership.[31] A move such as this would restart a dangerous bidding war

[31] At the time, the FHA claimed that the premium drop would result in 250,000 new first-time buyers over the next three years, and save each FHA buyer $900 annually. Our research found that home prices went up by about 2.5% for FHA borrowers. These borrowers had to use part their new found "wealth" — obtained by paying lower FHA insurance premiums —to pay for the higher house price. Prices also went up for non-FHA buyers in neighborhoods with FHA insured sales. After all, it is one housing market, where borrowers, no matter the financing, compete for houses. This caused the non-FHA buyers, who did not receive the benefit of lower premiums, to largely offset the price increase by buying a home of lesser quality (perhaps a smaller home, a smaller lot, or in a different location) – they were the clear losers. We estimate that about 500,000 of these non-FHA borrowers were first-time homebuyers. Each of these non-FHA homebuyers paid approximately $6,200 extra per house, a total extra payment of about $3.1 billion. From a cost-benefit perspective, this averages to an incredible $180,000 for each of the roughly 17,000 new FHA first-time buyers! The big winners were the realtors who received hundreds of millions of dollars in higher commissions from higher prices. For more, see Davis, Oliner, Peter, and Pinto, The impact of federal housing policy on housing demand and homeownership: Evidence from a quasi-experiment, http://www.aei.org/wp-content/uploads/2018/01/Oliner-homeownership-WP-Update.pdf?x91208

between FHA and the GSEs, who would be facing higher affordable housing goals for low-income and minority borrowers, which leads a race to the bottom in terms of lending standards.

- Acting FHFA Director Thompson announced in September 2021 that "the agency is weighing changes to the loan-level price adjustments enacted in 2008 to help the government-sponsored enterprises manage risk."[32]
- Expanding the Community Reinvestment Act (CRA) to non-depository institutions. Due to its opaqueness, CRA lending has not properly been evaluated, however, it will likely lead to an expansion of credit as non-depositories with less reputational risk "sell what they originate and originate what they can sell." Such proposals have already been implemented in New York and are being discussed by Fed Governor Lael Brainard.[33]
- Research from at least one think tank is pushing for looser underwriting relating to the Three Cs of Mortgage Credit (Credit, Capacity, and Collateral) under the guise of "closing the homeownership gap" and "rooting systemic racism out of mortgage underwriting". The proposed policies largely mirror similar 1999 research by the same think tank to loosen the Three Cs lending standards. That research was funded by HUD and had devastating results.[34]
- Others, like the Underserved Mortgage Markets Coalition would push the GSEs into riskier loan types, and looser underwriting.[35]

Each one of these proposals on its own seems innocuous. However, the accumulation and combination of them should raise alarms.

With new leadership at federal agencies and regulators, a concerted effort to lower underwriting standards again – as happened during the 1990s and 2000s – seems to be underway.

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[32] https://www.americanbanker.com/news/fhfa-weighs-cutting-price-adjustment-fees-on-fannie-and-freddie-loans

[33] See https://www.governor.ny.gov/news/governor-hochul-signs-legislation-expanding-new-york-community-reinvestment-act-non-depository and https://www.federalreserve.gov/newsevents/speech/brainard20200921a.htm.

[34] For 2022, see" https://www.urban.org/urban-wire/closing-homeownership-gap-will-require-rooting-systemic-racism-out-mortgage-underwriting. In April 1999 the Urban Institute released a report commissioned by HUD two years earlier. The report, entitled "A Study of the GSEs' Single-Family Underwriting Guidelines"[1] advised: "Almost all the informants said their opinion of the GSEs has changed for the better since both Fannie Mae and Freddie Mac made substantive alterations to their guidelines and developed new affordable loan products with more flexible underwriting guidelines." … "Informants did express concerns about some of the GSEs' practices. The GSEs' guidelines, designed to identify creditworthy applicants, are more likely to disqualify borrowers with low incomes, limited wealth, and poor credit histories; applicants with these characteristics are disproportionately minorities." By 2000, the GSEs had largely done away with down payments, raised debt ratios, entered the "A-minus" and "B" subprime market and re-entered the low doc/no doc market. http://www.urban.org/publications/1000205.html

[35] Policies advocated include a "substantially increase the number of purchased mortgage loans secured by manufactured real property," that "Fannie and Freddie should revive their plans to begin to purchase chattel loans", "offering exceptions for the income limits in the HNRRs," "targeted use of credit exceptions," "instituting a 4% deferred second mortgage to cover closing costs and boosting the seller concession from 3% to 6%," or that the "GSEs eliminate their loan-to-value limits to better align with FHA rules." See https://www.insidemortgagefinance.com/articles/223669-nonprofit-coalition-offers-blueprint-to-improve-fanniefreddie-dts-plans?v=preview.

Raising the Affordable Housing Goals requires lessening criteria on risk layering, otherwise the goals could not achieve much. At the same time, the effort to bring in higher-risk borrowers requires larger cross-subsidies, which requires lower changes to the LLPAs.

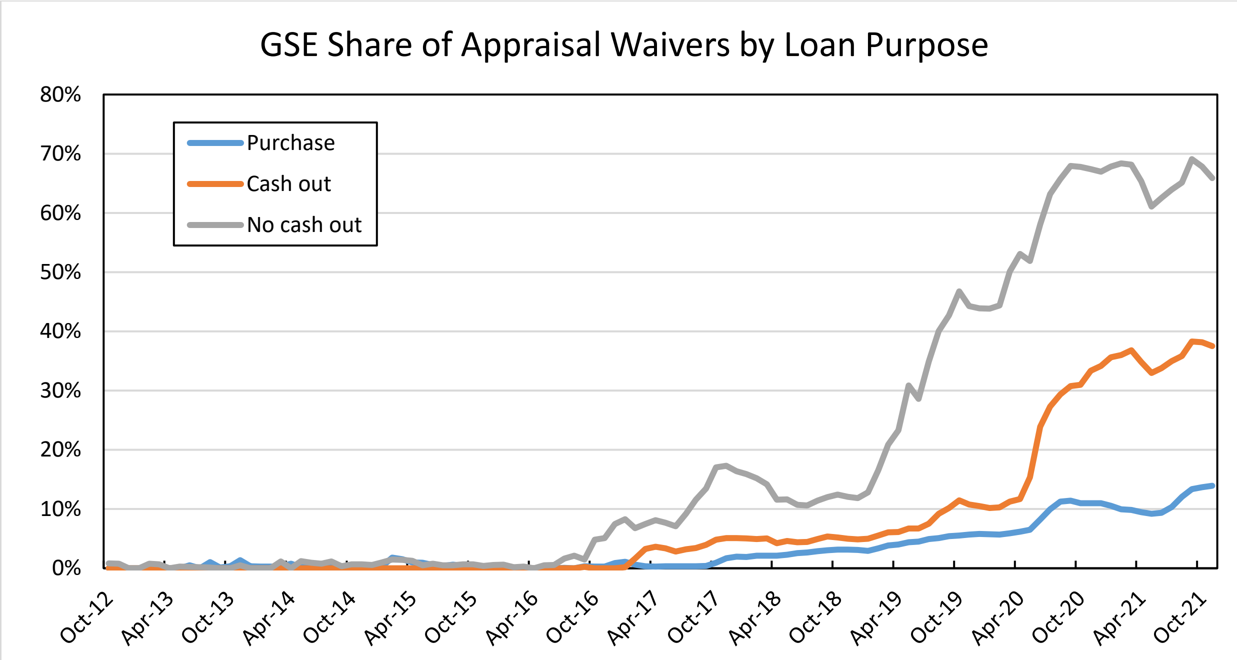
While lower-income Americans are being crowded out of the housing market, bringing them back by lowering underwriting standards through a concerted efforts by federal agencies and regulators is a recipe for disaster and risks creating more housing risk. This will put the exact people the policies are intended to help into harm's way.

Be mindful of automated system and competition between Fannie Mae and Freddie Mac

The GSE's use of automated system such as appraisals waivers, which rely on a proprietary model to establish the value range of a property, have grown tremendously over the last 4 years (See chart below). While we have only looked in detail at refi waivers, we found a salutary effect for the time being. Our concern for both refis and purchase waivers relates to gaming:

1) The GSEs are constantly competing with each other.
2) Each one thinks they can devise a better model than the other. This breeds overconfidence and creates a race to the bottom on standards, particularly when market participants, who can become aware of gaming opportunities, exploit them. History tells us that their automated processes can be gamed. This happened with automated underwriting systems during the 2000s.[36]
3) This result is inevitable given their low capitalization and duopolistic nature.

[36] "At the behest of Congress, HUD and the GSEs played the central role in weakening lending standards and increasing leverage. The community groups responsible for drafting the affordable housing portion if the GSE Act of 1992 knew that unless and until the GSEs were forced to loosen their underwriting standards, the primary market would 163 maintain their conservative standards. The GSEs started loosening their underwriting standards early in the 1990s. By the late 1990s their automated underwriting systems had become the industry standard, effectively replacing many proprietary ones. By the early 2000s much of the industry was using the GSEs' automated systems regardless of whether the loan was destined for purchase by the GSEs. Each time the GSEs loosened their guidelines, originating lenders both knew what new flexibilities were now "acceptable" to the GSEs and what flexibilities they would need to implement in order to maintain or grow their market share of loans sold away from the GSEs." See Pinto, E., 2010. Government housing policies in the lead-up to the financial crisis: A forensic study. Available at SSRN 1675959.



Note: For the appraisal waiver charts, we are assuming a one month shift between first payment date and origination date. Data are for November 2021.
Source: AEI Housing Center.

Equally worrisome are increases to the GSEs appraisal waiver practices, particularly purchase loans. In the past, human appraisals have successfully alerted lower-income and minority borrowers when they were overpaying. [37] An appraisal waiver may simply confirm the negotiated sale price, while the competition between Fannie and Freddie for market share may create a race to the bottom on standards – not to mention that these processes can be gamed, which was commonplace with respect to the GSEs automated underwriting systems in the lead up to the Financial Crisis.

Vilifying institutional landlords distracts from the underlying issues facing the housing market.

These landlords are a symptom of the housing boom and bust cycle created by the government, rather than the cause for today's unaffordability.

Institutional landlords, particularly on the multifamily side, are taking advantage of more liberal credit terms provided by Fannie Mae and Freddie Mac (the GSEs) than the private sector, which is a violation of their Charters, which stipulate that they shall adhere to the same lending standards as imposed by the private sector with the objective of purchasing loans "at such prices and on such terms as will

[37] See for example: https://www.aei.org/research-products/report/aei-housing-center-critique-of-freddie-macs-note-on-racial-and-ethnic-valuation-gaps-in-home-purchase-appraisals/ and Fout, Hamilton, Nuno Mota, and Eric Rosenblatt. "When Appraisers Go Low, Contracts Go Lower: The Impact of Expert Opinions on Transaction Prices." The Journal of Real Estate Finance and Economics (2021): 1-41. and Fout, Hamilton, and Vincent Yao. Housing market effects of appraising below contract. Working paper, available at: http://www.fanniemae.com/resources/file/research/datanotes/pdf/fannie-mae-whitepaper-060716.pdf, 2016.

reasonably prevent excessive use of the corporation's facilities."[38] They use their taxpayer guarantee and other advantages to greatly expand their business, while crowding out multifamily private investors. Since 2014 outstanding multifamily mortgage debt has doubled, with the GSEs accounting for most of the growth. At the same time they tout that they are supporting affordable rental housing, but in reality they create government profit seeking.

On the single-family side, they account for too small a share of purchases and of the housing stock nationally. Even in the few metros where their share is higher, it is not enough to move the price needle, especially at the low end of the market.

An overly narrow focus on racial equity is not based on the data and such a focus in federal housing policies could do lasting harm to minority borrowers.

The Biden administration and the media have concluded that there is racial discrimination in the housing market, including systemic racism and bias in housing valuations and property appraisals.

On June 1, 2021 President Biden established the Property Appraisal and Valuation Equity (PAVE) Task Force to be directed by HUD Secretary Marcia Fudge:

> "The Administration will take action to address racial discrimination in the housing market, including by launching a first of-its-kind interagency effort to address inequity in home appraisals, and conducting rulemaking to aggressively combat housing discrimination…."[39]

The readout from PAVE's first meeting held on August 5, 2021 stated:

> "Task Force members discussed how current appraisal practices are a significant contributor to the disparity in housing values. The practice of comparing properties within similar neighborhoods can be a proxy for racial demographics, which leads to the perpetuation and exacerbation of the legacy of segregation and redlining."[40]

Rather than systemic racism and bias, the issue is about systemic disadvantage.

The view of systemic racism and bias in housing is based on a couple recent studies and reports by:

[38] For example, Fannie Mae charter stipulates that "… the operations of the corporation under this section shall be confined so far as practicable, to mortgages which are deemed by the corporation to be of such quality, type, and class as to meet, generally, the purchase standards imposed by private institutional mortgage investors. In the interest of assuring sound operation, the prices to be paid by the corporation for mortgages purchased in its secondary market operations under this section, should be established, from time to time, within the range of market prices for the particular class of mortgages involved, as determined by the corporation. The volume of the corporation's purchases and sales, and the establishment of the purchase prices, sale prices, and charges or fees, in its secondary market operations under this section, should be determined by the corporation from time to time, and such determinations should be consistent with the objectives that such purchases and sales should be effected only at such prices and on such terms as will reasonably prevent excessive use of the corporation's facilities,…" (Fannie Mae's Charter (12 U.S.C. 1719)).

[39] https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/01/fact-sheet-biden-harris-administration-announces-new-actions-to-build-black-wealth-and-narrow-the-racial-wealth-gap/

[40] https://www.whitehouse.gov/briefing-room/statements-releases/2021/08/05/readout-of-the-first-interagency-task-force-meeting-on-property-appraisal-and-valuation-equity-pave/

- Brookings, Howell & Korver-Glenn, Redfin
- Freddie Mac
- Media reports on refi appraiser bias
- The MarkUp/Associated Press (AP)

However, these studies are not based on rigorous data analysis. As work by the AEI Housing Center has shown, these studies conflate race with socio-economic status (SES), i.e. income, buying power, marriage rates, credit scores, etc.

- Race-based gaps found in the Brookings and Freddie Mac studies either entirely or substantially disappear when adjusting for differences in SES.
- Furthermore, our analyses show that similar gaps are present in majority White or White-only tracts when across different SES levels, raising serious questions regarding a race-based explanation.

Thus, systemic disadvantage has more explanatory power than systemic racism and bias.

- We are mindful that lower SES certainly reflects a legacy of past racism and lingering racial bias, leaving Blacks at a large income and wealth disadvantage relative to most Whites.
- Recognizing the importance of SES factors is key to fashioning appropriate public and private responses.
- The overarching policy goal should be to promote sustainable access to housing finance and support opportunities for income and wealth growth among lower income households.
- In so doing, we must be mindful that many public policies aimed at addressing racial discrimination have had unintended consequences that have done substantial harm to low-income households generally, and minority households in particular.
    - At least one think tank is pushing for looser underwriting under the guise of "rooting systemic racism out to mortgage underwriting", which risks a repeat of the failed policies that produced the last financial crisis.[41]

The following table provides a summary of studies and findings on racial bias in the housing market:

Bias in …	**Study by**	**Type**	**Finding**
Home valuation	Brookings	Original	Large and systemic differences, which can only be due to race.
	Howell & Korver-Glenn	Original	Large and systemic differences, which can only be due to race.
	Redfin	Original	Large and systemic differences, which can only be due to race.
	AEI	Rebuttal to the other studies	Differences can be explained by socio-economic status (SES).
	Brookings	Rebuttal to AEI	Raises objections to SES variable selection and methodology.

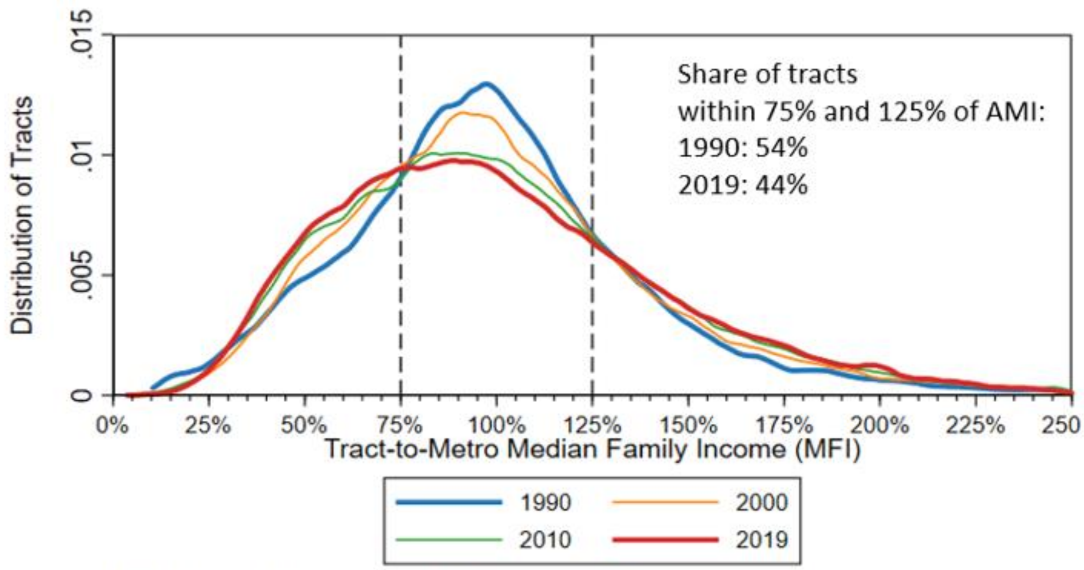
[41] See https://www.urban.org/urban-wire/closing-homeownership-gap-will-require-rooting-systemic-racism-out-mortgage-underwriting.

	AEI	Response to Brookings	Differences can be explained by socio-economic status (SES); Brookings rebuttal shows as much. Refutes their claims.
Appraisers (refinance loans)	Media stories*		Imply a persistent and large gap.
	AEI	Original	Racial bias by appraisers on refinance loans is uncommon and not systemic.
	Ambrose et al. (2021)	Original	"We do not observe large, systematic differences in the ratio of appraised values."
	Fannie	Original	Black borrowers received on average received a "slightly lower appraisal value relative to automated valuation models."
Appraisers (purchase loans)	Freddie	Original	"Substantial appraisal valuations gaps" for minority versus White tracts.
	AEI	Rebuttal to Freddie	Gap can be largely explained by differences in SES; appraiser may be providing a consumer benefit.
	Fannie	Comment in study on bias in Appraisers (refinance loans)	Inappropriate to examine appraisal differences using purchase transactions due to Fannie research showing likely substantial consumer benefit, which grows with price vs. value differential.
Lending	MarkUp/AP	Original	"Lenders were still more likely to deny people of color home loans than White applicants."
	AEI	Rebuttal to MarkUp/AP	MarkUp/AP fail to consider credit scores and lending outcomes. On aggregate, there is no evidence of systemic bias by mortgage lenders.

*Examples of initial media stories include the NYT, Denver News Channel 7, or the Chicago Sun.
Source: AEI Housing Center, www.AEI.org/housing.

Public policy should focus on SES rather than race. Income stratification has been increasing. The next chart measures the share of tracts within 75% and 125% of area median income, which is a proxy for the middle class. By this simple measure we can see that 54% of tracts in 1990 were within this range, compared to 44% in 2019. Income stratification has grown in virtually all of the largest 100 metros and does not appear to be correlated with a metro's minority share.

Chart: Distribution of Census Tracts by Income Level and Year (Largest 100 Metros)



Notes: Largest 100 metros are determined by total sales over 2012-2019 from public records. Sample of tracts is limited to tracts with nonmissing income data and below 250% of the area MFI. Dashed lines indicate income levels at 75% and 125% of the area MFI. Kernel bandwidth is 2.5%.

Note: MFI stands for Median Family Income and AMI stands for Area Median Income.
Source: Census, FFIEC, and AEI Housing Center, www.AEI.org/housing.

Increasing income stratification by geography is a poor policy outcome and threatens the ability of low-income households to build wealth. As home prices rise faster than incomes, it will permanently price low-income and minority households out of areas of opportunity.

Simply spending more has not worked in the past and has had unintended consequences.

If government spending were the problem to ensure affordability, hearings such as this would be superfluous. Plenty of programs already exist, they are just not well targeted or properly evaluated.

On the supply side, Congress should avoid funding programs that have a poor track record (see appendix):

- Stop pouring tens of billions of dollars into public housing, in a futile effort to get public housing right.
- Stop providing tens of billions in subsidies to build or rehabilitate millions of homes, in a futile effort to subsidize our way out of our housing supply problems.
- Stop expanding the LIHTC program which has worked to reinforce racial discrimination and crowd out naturally affordable housing that could be built by the private sector.

Another example is the passage of the Housing and Community Development Act of 1968, the last time Congress provided subsidies to build or rehabilitate millions of homes. This 1973 book's title sums up devastation that followed the 1968 Act: Cities Destroyed for Cash: The FHA Scandal at HUD. The 1968 Act contributed to unprecedented levels of FHA foreclosures.[42]

Similarly, thirty-five years ago, Congress established the Low-Income Housing Tax Credit (LIHTC). Yet the LIHTC program has worked to reinforce racial discrimination. Just last month the City of Chicago reported that "since 2000, the majority of Chicago's LIHTC developments have been new construction located in high-poverty, majority Black areas, with a quarter located in higher-income "opportunity" areas." (See for the appendix for more examples.)

On the demand side, programs currently debated will similarly fail unless the supply shortage is addressed first:

- Refrain from providing first-time buyer down payment assistance in an overheated housing market.
- Refrain from forgiving student loan debt during an overheated housing market, which would increase first-time buyer buying power and increase demand, which would result in higher home prices.
- Refrain from Build Back Better's many demand-side subsidies (e.g., BBB's down payment assistance and rental assistance). My colleague Ed Pinto has completed list of troubled programs that were considered for funding under Build Back Better.

The Build Back Better Act as passed out by the Rules Committee contained about $184 billion in housing related funding (including additional funding of $10 billion for the Low Income Housing Tax Credit). These appropriations would largely go to fund either programs that a have a troubling history of scandal and failure or support programs that will promote house price and rent inflation.

- Public Housing Investments: $65 billion (see NYT: The Rise and Fall of New York Public Housing: An Oral History)
- Investments in Affordable and Accessible Housing Production: $10 billion (see Washington Post: They found dream homes through D.C.'s first-time homeowners program. Now they have to evacuate)

[42] Pinto and Pollock document this in detail: "The first time began in 1968 when HUD developed a "10-year housing program to eliminate all substandard housing." Since there were then, like now, very large budget deficits, this program was implemented off-budget. The answer was the 1968 Housing and Urban Development Act, which had FHA insuring the 10-year plans' subsidized single- and multifamily loans and Fannie funding them. Fannie was up to then a government agency with its debt on-budget. The 1968 Act converted it to an off-budget GSE. Now it was in a position to fund the largest expansion of newly built and rehabilitated subsidized housing in the nation's history with up to 40-year fixed-rate loans. There have been only two years where privately owned single- and multifamily housing completions exceeded 2 million: 1972 (2.00 million) and 1973 (2.10 million)—when the population was 210 million and the number of households was 67 million, 36% and 48% respectively and smaller than today. As a reference, in 2006, at the peak of the Housing Bubble, there were 1.98 million completions. In just a few years, HUD's program turned into a disaster for cities and their residents, as described in the book Cities Destroyed for Cash: The FHA Scandal at HUD written in 1973. Detroit, Chicago, Cleveland, and many other cities never fully recovered from the effects of HUD's scheme. By the early 1980s, Fannie's investment in these loans had suffered huge interest rate risk losses that left it effectively insolvent. It was only able to continue in business given its GSE status and backing by the Treasury." https://lawliberty.org/the-next-housing-bust/.

- Housing Vouchers and Project-Based Rental Assistance: $25 billion (see City Journal – Glaser: Don't Universalize Housing Vouchers; Subsidizing demand in America's constrained housing markets will further increase rents.
- Low Income Housing Tax Credit (LIHTC): $10 billion (see ProPublica: Separated by Design: Why [LIHTC-Supported] Affordable Housing Is Built in Areas With High Crime, Few Jobs and Struggling Schools and NPR: Affordable Housing Program Costs More, Shelters Fewer)
- Community Development Block Grant Funding: $3.05 billion (see Urban Institute: Community Development Block Grant (CDBG) is an important potential source of LIHTC funding)
- National Flood Insurance Program Forgiveness: $20.5 billion (see R Street: Risky business, reforming America's flood insurance model)
- First-Generation Down payment Assistance: $10 billion (see: Higher demand could lead to higher home prices throughout the market. If you are already dealing with a hot market in your area, the competition could increase even further)
- Miscellaneous other programs: Community Restoration and Revitalization Fund: $3 billion, Housing investment Fund: $750 million, Section 811 Supportive Housing for People with Disabilities and Section 202 Supportive Housing for People with Disabilities: $500 million for each, Improving Energy or Water Efficiency or Climate Resiliency: $2 billion, Revitalization of Distressed Multifamily Properties: $1.6 billion, Investments in Rural Rental Housing: $2 billion, Investments in Native American Communities: $1 billion, Unlocking Possibilities Program: $1.75 billion