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Testimony
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Hearing on "How Private Equity Landlords are Changing the Housing Market"

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Introduction

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

It is always convenient to blame "Wall Street" and "speculators" for economic difficulties because those terms obscure the human component that drives specific economic outcomes, thus making it easy to deflect blame away from individuals and difficult to objectively evaluate particular claims. As evident by this hearing, the tactic is very effective – recent stories have stoked fears that large institutional investors (private equity firms) are causing rapid price increases in single family housing markets.[1]

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

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

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

up by 4.04 percentage points."[3] The authors claim that "despite the rise that began after 2010, in 2014 their shares remained small: The average share of large institutions as buyers was 1.47 percent."[4] Additional research by the Federal Reserve indicates that institutional investors comprised "1 to 2 percent of all single-family purchases from 2012 to 2014," while "purchases by other investors accounted for 18 to 19 percent of single-family home purchases during the same period," and that "buy-to-rent investors owned about 0.14 percent of the housing stock in 2014, whereas corporate investors owned 6 percent and individual investors owned 6 percent."[5]

Despite the small share, the evidence also suggests that "institutional investors contribute to the improvement of the local housing market by reducing vacancy rates as they shorten the amount of time distressed properties stay in REO [real estate owned foreclosure]," and that "institutional investors help lower local unemployment rates by increasing local construction employment."[6] Citing other research, the Urban Institute's Laurie Goodman argues that institutional investors "grew up in 2010-2013 buying distressed properties that no one else would buy and in fact put a floor on the market, so they provided a very, very valuable service and they basically cleaned up the distressed market, a lot of which required repairs."[7] Goodman also cites evidence that "institutional operators owned just 300,000 single-family units in 2019," approximately 2 percent of the roughly 15 million one-unit detached single-family *rental* homes in the United States, and less than 0.5 percent of the total number (80 million) of detached single-family homes in the United States.[8] More recent research by the National Rental Home Council (NRHC) estimates that 0.74 percent of single-family home purchases in the second quarter of 2021 were made by "large investors."[9] Put differently, the

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

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

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

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

[7] Jerusalem Demsas, "Wall Street Isn't To Blame For The Chaotic Housing Market," *Vox*, June 11, 2021, https://www.vox.com/22524829/wall-street-housing-market-blackrock-bubble. Also see Laurie Goodman and Edward Golding, "Institutional Investors Have a Comparative Advantage in Purchasing Homes That Need Repair," *Urban Wire*, October 20, 2021, https://www.urban.org/urban-wire/institutional-investors-have-comparative-advantage-purchasing-homes-need-repair.

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

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

NRHC estimates that 99.26 percent of single-family homes purchased in the second quarter of 2021 "were made by someone, or some entity, other than a large investor."[10]

In contrast, the federal government is heavily involved in the single-family home market, particularly in ways that increase demand by making it easier to obtain home mortgages. Given that housing markets are consistently supply constrained, there is little doubt that federal housing finance policies contribute greatly to higher home prices. Unfortunately, several new Biden administration policies, as well as multiple proposals being considered in the budget reconciliation process, promise to implement the same types of failed housing policies of the past. Collectively, these policies will further expand government intervention in housing markets at a great cost to millions of Americans, pushing up prices as well as rental rates, wasting taxpayers' money and making housing less affordable.

Excessive Government Involvement in U.S. Housing Markets

Federal intervention has increasingly become the norm in housing markets since the 1930s, and the perceived success of these policies has helped perpetuate and expand that involvement. The United States is the only major country in the world with a federal government mortgage insurer, government guarantees of mortgage securities, *and* government-sponsored enterprises (GSEs) in housing finance. As of 2010, comparing the United States with 11 other industrialized countries, only two have a government mortgage insurer (Netherlands and Canada), two have government security guarantees (Canada and Japan), and two have GSEs (Japan and Korea).[11] Denmark even maintains a prepayable fixed-rate 30-year mortgage without the need for GSEs or other government support, and at a lower cost to borrowers than in the United States.[12]

Most federal intervention in housing finance boosts demand, typically by making it easier to obtain a home mortgage. Federal policies encourage borrowing by supporting the operations of Fannie Mae, Freddie Mac, and Ginnie Mae, and by providing loan insurance through the Federal Housing Administration (FHA), the Veterans Affairs (VA) home-lending program, and the U.S. Department of Agriculture's Rural Development Program. Historically, the federal tax code has also promoted housing investment and consumption by allowing taxpayers to deduct mortgage interest and capital gains from the sale of a home from their

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[10] National Rental Home Council, "NRHC Analysis of Data."

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

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

federal income tax liability. Additionally, the Basel capital requirements have long provided financial institutions with capital relief for holding mortgage-backed-securities (MBS) rather than whole loans, while Fannie Mae and Freddie Mac have long enjoyed lower equity requirements than banks.[13]

Prior to the 2008 financial crisis the federal government controlled a dominant share of the U.S. housing finance system, and that share has expanded. As of December 31, 2020, Fannie and Freddie (both of which remain in government conservatorship) had combined total assets of $6.6 trillion, representing approximately 42 percent of the nation's outstanding mortgage debt.[14] From 2008 to 2019, the FHA's annual market share of purchase loans ranged from 16.49 percent to 32.6 percent.[15] From 2009 to 2020, Fannie and Freddie's annual share of the total MBS market averaged 70 percent. Including Ginnie Mae securities, those that are backed by FHA mortgages, the federal share of the MBS market averaged 92 percent per year.[16]

Yet, the evidence suggests that the expansive federal role has done little to expand homeownership. Robust mortgage financing exists in virtually every developed nation of the world without the high degree of government involvement found in the United States, but the overall U.S. homeownership rate is below average among developed nations (64.5 percent in the United States versus 68.1 percent for Organisation for Economic Co-operation and Development (OECD) countries).[17] And even though the U.S. ownership rate has changed little since the 1960s, volatility of home prices and home construction in the United States were

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

[14] For the fiscal year ending December 31, 2020, Fannie Mae reported $4 trillion in total assets while Freddie Mac reported $2.6 trillion. See Federal National Mortgage Association, "Annual Report," December 31, 2020, p. 61, https://www.fanniemae.com/media/38271/display. p. 61; and Federal Home Loan Mortgage Corporation, "Annual Report," December 31, 2020, p. 34, http://www.freddiemac.com/investors/financials/pdf/10k_021121.pdf, p. 34. The 42 percent figures it is the author's estimate using the Federal Reserve's (now discontinued) 2019 reported total for mortgage debt outstanding ($15.8 trillion). See Board of Governors of the Federal Reserve System, "Mortgage Debt Outstanding, All holders (DISCONTINUED) [(MDOAH])," retrieved from FRED Economic Data, Federal Reserve Bank of St. Louis, October 15, 2021, https://fred.stlouisfed.org/series/MDOAH, October 15, 2021.

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

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

[17] These figures represent the combined ownership rate for people who own their home outright and those who own a mortgage, for both the United States and all Organisation for Economic Co-operation and Development (OECD) countries, using 2019 data, as reported in the OECD Affordable Housing Database, October 15, 2021, available at https://www.oecd.org/housing/data/affordable-housing-database/.

among the highest in the industrialized world from 1998 to 2009.[18] Federal housing finance policies have, at the very least, magnified economic instability by inducing higher home prices.[19] Federal involvement expanded after the most recent financial crisis, for instance, and home prices have risen to 43 percent *more* than where they peaked prior to their 2007 crash.[20] The fact that prices are so far from the bottom of a housing cycle is worrisome, especially since empirical evidence links large increases in housing prices to banking crises.[21]

Other research, when examining asset price booms and busts in the OECD countries from 1970 to 2001, estimates that the probability of a real estate boom ending in a bust is 53 percent, whereas stock market booms have just a 13 percent probability of ending in a crash.[22] Another study estimates that a 1 percentage point increase in real home prices raises the probability of a U.S. financial crisis by 0.07 percent.[23] Moreover, the role of housing prices in U.S. financial crises is linked to high-leverage lending, where policies ensure that both borrowers and those who fund mortgages can do so with relatively little loss-absorbing equity. For decades, U.S. housing finance policy has helped increase the number of mortgages requiring low down payments used for financing homes, even though evidence clearly indicates that the risk of loan default increases (particularly among first-time home buyers) as the loan-to-value ratio increases.[24]

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[18] Dwight M. Jaffee, "Reforming the U.S. Mortgage Market Through Private Market Incentives," in Satya Thallam, ed., *House of Cards: Reforming America's Housing Finance System*, George Mason University, Mercatus Center, March 2012, pp. 23-25, http://mercatus.org/sites/default/files/House_of_Cards_March_2012.pdf (accessed March 6, 2014).

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

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

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

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

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

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

Owning one's own home is commonly viewed as part of the American Dream, and policymakers – as well as special interest groups – regularly promote building wealth through buying a home. They also tout beneficial "spillover effects" from homeownership, such as increased engagement in civic institutions, greater political participation, and positive educational outcomes for children. However, much of the evidence for causal spillover effects – that is, the notion that owning a home *causes* people to change their behavior in beneficial ways – is weak, and the size of such spillover effects, where they do exist, does not appear to justify the historical level of government involvement.[25] Furthermore, other research has suggested that homeownership is associated with *negative* spillover effects, such as higher unemployment due to an incentive against relocating.[26] Finally, although home equity frequently represents a large portion of many Americans' wealth, purchasing a home can be a risky investment that depends entirely on home price appreciation, an attribute fundamentally in conflict with housing becoming more affordable.[27]

Price Appreciation and Ownership Rates: A Closer Look

While government intervention in housing has steadily increased, the overall rate of U.S. homeownership has remained nearly constant over the past 50 years.[28] On the other hand, the level of residential mortgage debt has increased more than fivefold – Federal Reserve data show that inflation-adjusted mortgage debt increased from about $3 trillion in 1970 (two years

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[25] Jane R. Zavisca and Theodore P. Gerber, "The Socioeconomic, Demographic, and Political Effects of Housing in Comparative Perspective," *Annual Review of Sociology*, July 2016, Vol. 42, pp. 347-367, https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6078393/; David R. Barker, "The Evidence Does Not Show That Homeownership Benefits Children," *Cityscape*, 2013, Vol. 15, No. 2, pp. 231-234, https://www.jstor.org/stable/41959125; and, Edward L. Glaeser and Jesse M. Shapiro, "The Benefits of the Home Mortgage Interest Deduction," National Bureau of Economic Research Working Paper no. 9284, October 2002, https://www.nber.org/system/files/working_papers/w9284/w9284.pdf.

[26] David G. Blanchflower and Andrew J. Oswald, "Does High Home-Ownership Impair the Labor Market?," National Bureau of Economic Research Working Paper no. 19079, May 2013, https://www.nber.org/system/files/working_papers/w19079/w19079.pdf.

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

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

after Fannie Mae became a GSE) to $15.8 trillion in 2019. While countless government programs are touted as boosting homeownership, these policies have tended to increase *mortgage* ownership. According to the Census Bureau, the homeownership rate was 64 percent in 1970. That's basically where it hovered for most of the 1980s and 1990s, higher than where it bottomed out in 2016, and almost exactly where it stood in the middle of 2019.[29]

There is, of course, much more to the home ownership story than just the national rate. For instance, the Census Bureau's American Community Survey (ACS) reports homeownership rates by core-based statistical area (CBSA), a statistic that can be paired with each CBSA's median price-to-income ratio.[30] These figures show a national ownership rate of 63.3 percent for 2019.[31] However, for the 25 CBSAs with the highest price-to-income ratios (the least affordable homes), the average ownership rate is just 61.8 percent. In San Jose and Los Angeles, both among the three CBSAs with the least affordable homes, the ownership rates are 56.6 percent and 48.6 percent, respectively. For the 25 CBSAs with the lowest price-to-income ratios (the *most* affordable homes), the average rate is 69.5 percent. For at least the last decade, federal policies have fueled debt and correspondingly rapid home price appreciation at a much higher rate in the entry-level segment (lower-priced homes) of the market.[32]

Overemphasis on Rates and Demand Rather Than Supply

Even if the aforementioned positive spillover effects from home ownership clearly outweighed the negative ones, it would not automatically follow that the federal government should undertake a policy of actively encouraging people—especially those with low wealth—to finance home purchases with low-equity long-term debt. Such mortgages are risky for both borrowers and lenders, and the ability to consistently repay a mortgage in timely fashion – or consistently pay rent in a timely manner – is dependent on broad economic and social factors. Those factors, including education quality and regulatory barriers that hamper employment, ultimately determine the ownership and rental rates in the economy, and it is a mistake to assume that any particular ownership rate is the "correct" one. Policies that simply target the ownership rate are destined to fail precisely because they do nothing to change the underlying economic factors that govern the long-term rate of home ownership.

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

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

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

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

In 1994, President Clinton launched National Partners in Homeownership, a private–public cooperative, with an explicit goal of raising the U.S. homeownership rate from 64 percent to 70 percent by 2000.[33] Although the rate increased from 64 percent in 1994 to 69 percent in 2004, at a time when Fannie and Freddie went from holding (combined) 35 percent of the nation's mortgages to more than 43 percent,[34] more than 4 million people lost their homes during the 2008 financial crisis, and the rate fell back to 65 percent – only 1 percentage point higher than in 1968. This episode is emblematic of longstanding federal housing finance policy with a misplaced emphasis on the rate of ownership and federal intervention that boosts the quantity of home mortgages.

These demand-side policies have been particularly problematic because, compared to increasing the supply of housing, it is rather easy to boost demand. Housing supply is always relatively constricted in the sense that available land (in locations that people most desire to live) is a prerequisite for large scale home building, and also because a new home (or apartment building) takes at least several months to construct. In many areas, state and local regulatory restrictions have contributed heavily to supply constraints in housing markets, often by limiting the amount of land that can be used for particular types of housing.[35] Inducing demand in supply-constrained markets can only serve to put upward pressure on prices, and housing markets are no exception. Thus, federal housing finance policies have typically made it more expensive (everything else constant) to either buy or rent a dwelling. Nonetheless, inducing demand is precisely what federal policies have done for decades, and there appears to be no desire in Congress (or the administration) to reverse, or even slow, that trend.

Congress and Biden Administration Set To Further Interfere With Housing Markets While Increasing Risky Debt and Prices

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

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

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

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

govern the conservatorships of Fannie Mae and Freddie Mac.[36] The PSPAs are key to protecting taxpayers against future bailouts and ensuring that Fannie and Freddie (the enterprises) do not further crowd out private capital,[37] but the administration has weakened those protections by suspending the provisions that capped the enterprises' purchases of multifamily housing loans, as well as single-family loans "with higher risk characteristics," second homes, and investment properties.[38] These last two provisions have nothing to do with helping people become homeowners, and they represent a naked give away to special interests that lobby to maximize real estate lending. Uncapping the enterprises' multifamily loan purchases is also a giveaway to corporate rent seekers and will likely do little, if anything, to increase the amount of housing that would otherwise go unbuilt.

Separately, the FHFA announced a new notice of proposed rulemaking to amend the Enterprise Regulatory Capital Framework (ERCF) enacted in 2020.[39] The ERCF framework was designed to strengthen the enterprises and protect taxpayers, and was among the most meaningful housing finance reforms since 2008. Yet, the administration wants to lower the enterprises' prescribed leverage buffer amount (PLBA) *and* the floor on the risk weight assigned to any retained credit risk transfer (CRT) exposures. Just as with weakening the PSPA provisions, it makes zero sense to lower the GSEs' capital requirements, especially when home prices have risen so much. Aside from the potential effect on home prices, rolling back these reforms will weaken the enterprises' capital position and force taxpayers to back more high-risk loans, thus increasing the risk of future bailouts. Of course, reducing the capital requirements is precisely what various special interest groups have been calling for since the FHFA originally proposed the ERCF. For instance, the cottage CRT industry, ironically a group that consists mostly of large investors and Wall Street firms, has long called for *no risk weight floor* on CRT exposures, which is equivalent to treating them as risk-free investments as safe, or safer, than U.S. Treasuries.

From a safety and soundness standpoint, the idea that CRTs completely eliminate the enterprises' risk is pure fantasy – they increase the enterprises' financial obligations and their

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

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

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

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

value to either the enterprises or taxpayers is highly questionable.[40] Similarly, it makes little sense to lower the existing leverage buffer, a mechanism that serves as a part of a backstop to the enterprises' risk-based capital requirements. In addition to the tier 1 leverage ratio, the GSEs are supposed to maintain a fixed buffer of at least 2.5 percent tier 1 capital to adjusted total assets, and lowering this amount – or any of the risk-based requirements – cannot legitimately be described as improving the enterprises' safety and soundness because it does the exact opposite. If anything, the original rule should have required *higher* capital ratios, so that the enterprises' requirements were more in line with those of the Global Systemically Important Banks (GSIBs).

Nonetheless, the administration is now proposing to replace the fixed buffer with "a dynamic leverage buffer determined annually and tied to the stability capital buffer," a change that the FHFA estimates will reduce the enterprises' leverage buffers by about two-thirds.[41] Perhaps worse, the administration is setting up an even larger reduction in capital. The new proposal asks for comments on whether "the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures [is] appropriately calibrated,"[42] a clear signal that the administration wants to lower the enterprises' overall capital requirements.

Harmful Programs Included in Reconciliation Package

Aside from these risky housing finance provisions, the administration and Congress are trying to use the budget reconciliation bill to implement multiple housing policies that will waste taxpayers' money and make housing *less* affordable. For instance, the House Financial Services Committee inserted $10 billion for the First-Generation Downpayment Assistance Fund, a program loosely designed to provide downpayment assistance to first-time homebuyers.[43] There is no doubt that it is difficult to save a large downpayment for a

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

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

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

[43] House Financial Services markup providing for reconciliation pursuant to S. Con. Res. 14, the Concurrent Resolution on the Budget for Fiscal Year 2022, Section 40201, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408300. Also see Norbert Michel, "House Financial Services Is Pushing For A Downpayment Assistance Program, Another Failed Policy From The Past," *Forbes*, September 17, 2021, https://www.forbes.com/sites/norbertmichel/2021/09/17/house-financial-services-is-pushing-for-a-downpayment-assistance-program-another-failed-policy-from-the-past/?sh=777c8ec94394.

mortgage, but it does not follow that the federal government should provide even a portion of those funds. Among other problems, subsidizing downpayments puts upward pressure on home prices, making it more expensive for everyone who buys a home and for those who rent. The way the proposal is written, there is little doubt that federal agencies will define *first time homebuyer* broadly, so that anyone who has not owned a home during the past few years will still qualify. Moreover, the funds will be available to states as well as *eligible entities*, including those who provide grants to buy shared equity homes, those for which lenders provide a second mortgage to the homeowner in return for sharing any profits when the home is later sold. Naturally, the best chance for earning a profit in this case is if home prices rise, so the policy design is all but an admission that the program helps put upward pressure on prices.

Unsurprisingly, downpayment assistance programs have a miserable track record in the United States, and in 2008 Congress eliminated the FHA's seller-funded downpayment assistance program because it was such a disaster.[44] A 2007 Government Accountability Office report showed that "the probability that loans with seller-funded downpayment assistance would result in claims against the [FHA's insurance] fund was 76 percent higher in the national sample and 166 percent higher in the MSA sample than it was for comparable loans without such assistance."[45] Separate from loans in that failed FHA program, delinquencies of single-family FHA loans with downpayment assistance are consistently higher than FHA loans without such assistance.[46] In fact, there is evidence that borrowers who provide even small downpayments from their own savings display lower default rates than those who receive downpayments from an outside source, possibly suggesting that *the act of saving* the money is an important signal of underlying attributes.[47] The following list provides several additional examples of harmful housing policies proposed in the reconciliation bill.[48]

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

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

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

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

[48] All references herein refer to the House Financial Services markup providing for reconciliation pursuant to S. Con. Res. 14, the Concurrent Resolution on the Budget for Fiscal Year 2022, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408300.

- Provides $80 billion for public housing "preservation and creation," with $66.5 billion to be allocated at the discretion of the Housing and Urban Development Secretary.[49] This funding level is troubling on its own, given the abject failure of public housing,[50] but it is even more disturbing given Senator Chuck Schumer's recent public plea for $80 billion to "help bring much-needed change to the housing authority in New York City."[51] In a 2018 lawsuit, the federal government detailed the decrepit conditions that the New York City Housing Authority trained its employees to hide from HUD inspectors, thus protecting their $2 billion per year transfer from federal taxpayers.[52] The markup also includes a separate $750 million appropriation for the HUD Secretary to "oversee the implementation" of these funds.
    - Another troubling component of the bill is a provision (Section 40001(d)(2)) that amounts to a functional repeal of the Faircloth amendment, a change that would allow a *net increase* in public housing project construction.[53] Allowing a net increase in public housing projects would be a major reversal of federal housing policy, one that upends a longstanding bipartisan agreement that public housing projects were a major failure.[54]
- Includes $72 billion for "activities and assistance" for the HOME Investment Partnerships Program,[55] a federal block grant program created by the Cranston-Gonzalez National Affordable Housing Act of 1990. Typically, Congress appropriates between $1.5 and $2 billion per year for this program.[56] The program has a troubling track record of fraud even at its existing level of funding,[57] and it already funds duplicative programs including downpayment assistance plans.[58] This total also includes $36 billion for the Housing Trust Fund, as well as $50 million for "existing technical

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[49] Section 40001.
[50] See Howard Husock, "Public Housing and Rental Subsidies," *Manhattan Institute*, February 24, 2017, https://www.manhattan-institute.org/html/public-housing-and-rental-subsidies-10055.html.
[51] Charles Schumer, "NYCHA Needs Big Money For Major Progress," September 21, 2021, https://www.cityandstateny.com/opinion/2021/09/nycha-needs-big-money-major-progress/185481/.
[52] Kaja Whitehouse, Nolan Hicks, Yoav Gonen and Bruce Golding, "Feds: NYCHA Covered Up Public Housing Dangers For Years," *New York Post*, June 11, 2018, https://nypost.com/2018/06/11/feds-city-covered-up-public-housing-dangers-for-years/.
[53] The provision reads "Paragraph (3) of section 9(g) of the United States Housing Act of 1937 (42 U.S.C. 1437g(g)(3)) shall not apply to new funds made available under this section."
[54] Jenny Schuetz, "Four Reasons Why More Public Housing Isn't The Solution To Affordability Concerns," *Brookings Institute*, January 14, 2021, https://www.brookings.edu/blog/the-avenue/2021/01/14/four-reasons-why-more-public-housing-isnt-the-solution-to-affordability-concerns/.
[55] Section 40002.
[56] Katie Jones, "An Overview of the HOME Investment Partnerships Program," *Congressional Research Service*, R40118, January 4, 2021, https://sgp.fas.org/crs/misc/R40118.pdf.
[57] Joint Hearing entitled "Fraud in the HUD HOME Program," House Financial Services Committee, November 02, 2011, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=401964.
[58] Department Of Housing And Urban Development, Office Of Community Planning And Development, Home Investment Partnerships Program, Summary Of Resources, https://www.hud.gov/sites/dfiles/CFO/documents/20_2022CJ-HOME.pdf.

assistance providers" and $300 million for the HUD Secretary to oversee the implementation of these funds. The Housing Trust Fund is rife with waste – even though it received more than $1 billion since 2016, more than 65 percent of those funds were not disbursed, and the Fund completed production of 800 housing units, representing a cost of "one completed unit of housing for every $1.5 million in the fund."[59]

- Establishes a new Housing Investment Fund with an appropriation of $9.6 billion.[60] This fund is "a special account within the Community Development Financial Institutions Fund," and the appropriation includes $360 million for the CDFI Fund to administer and oversee the new Fund.[61]
- Includes $6 billion for the HUD Secretary to provide "direct loans, grants, and direct loans that can be converted into grants…to fund projects that improve the energy or water efficiency, implement green features, including clean energy generation or building electrification, electric car charging station installations, or address climate resilience of multifamily properties." The appropriation includes $76 million for the HUD Secretary to oversee the implementation of these funds, as well as $360 million for "expenses of contracts administered by the Secretary."[62]
- Appropriates $4 billion for the purpose of "providing direct loans, which may be forgivable, to owners of distressed [multifamily] properties for the purpose of making necessary physical improvements."[63] The appropriation includes $130 million for the HUD Secretary to oversee the implementation of these funds.
- Provides up to $75 billion for Section 8 rental housing vouchers,[64] an amount that is more than three times current federal assistance levels for tenant-based rentals.[65] This change will magnify upward pressure on rental prices.[66] The appropriation also includes $750 million for the HUD Secretary to oversee the implementation of these funds.

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[59] Rep. Patrick McHenry (R-NC), "HUD's Housing Trust Fund Falls Short of Objective to Provide Support to Low-Income Americans," Press Release, April 15, 2021, https://republicans-financialservices.house.gov/news/documentsingle.aspx?DocumentID=407961.

[60] Section 40003.

[61] Community Development Financial Institutions are certified by the Community Development Financial Institutions Fund (the CDFI Fund), established in the U.S. Department of the Treasury. CDFIs are mainly private firms that receive public money from the CDFI Fund. CDFIs have been around since at least the 1930s (although not in their current form), but they proliferated in the 1960s and 1970s; more than 1,000 now exist. There is a dearth of academic literature on CDFIs partly because their operations are so diffuse and difficult to track. See Lehn Benjamin, Julia Sass Rubin, and Sean Zielenbach, "Community Development Financial Institutions: Current Issues and Future Prospects," *Journal of Urban Affairs*, 2004, Vol. 26, no. 2, pp. 177-195, https://www.tandfonline.com/doi/abs/10.1111/j.0735-2166.2004.00196.x.

[62] Section 40006.

[63] Section 40007.

[64] Section 40010.

[65] Peter G. Peterson Foundation, "How Does The Federal Government Support Housing For Low-Income Households?," July 29, 2020, https://www.pgpf.org/blog/2020/07/how-does-the-federal-government-support-housing-for-low-income-households.

[66] The larger the rental subsidy program becomes, in terms of number of renters and size of the subsidy, the more upward pressure the program will have on rental rates. A similar policy problem exists with military housing

- Separately appropriates $15 billion for Section 8 project-based rental assistance, with up to $348 million to provide technical assistance to recipients, and $40 million for the HUD Secretary to oversee the implementation of these funds.[67]
- Includes $4.5 billion to establish the Unlocking Possibilities Program, for the purpose of "awarding planning grants to develop and evaluate housing policy plans and substantially improve housing strategies," and for "awarding planning grants to streamline regulatory requirements and shorten processes."[68] The appropriation includes $70 million for the HUD Secretary to provide technical assistance to grantees, and also $150 million for the HUD Secretary to oversee the implementation of these funds.
- Appropriates $7.5 billion for a Community Restoration and Revitalization Fund, established to award grants for "community-led projects that create civic infrastructure to support a community's social, economic, and civic fabric, create fair, affordable and accessible housing opportunities, prevent residential displacement, acquire and remediate blighted properties, and promote quality job creation and retention."[69] The amount includes $1 billion for the HUD Secretary to provide technical assistance to grantees, and also $300 million for the HUD Secretary to oversee the implementation of these funds.
- Separately appropriates $1.99 billion to the HUD Secretary for the purpose of "administering and overseeing the implementation of [this bill] and the Department's programs generally, including information technology, inspections of housing units, research and evaluation, financial reporting, and other costs.[70]
- Separately appropriates $100 million to the HUD Secretary "to competitively award funds for technical assistance and capacity building to non-Federal entities, including nonprofit organizations that can provide technical assistance activities to community development corporations."[71]
    - Just the funds allocated (in the above-listed provisions) to HUD for "overseeing and implementing" sum to $4.5 billion, representing 8 percent of HUD's FY 2022

allowances in severely supply-restricted areas, such as the Hawaiian Islands. See Eric Pape, "Living Hawaii: How Military Policies Drive Up Rents on Oahu," *Honolulu Civil Beat*, June 17, 2015, https://www.civilbeat.org/2015/06/living-hawaii-how-military-policies-drive-up-rents-on-oahu/. For a more general view of how housing vouchers can lead to higher rental rates, see Robert Collinson and Peter Ganong, "How Do Changes in Housing Voucher Design Affect Rent and Neighborhood Quality?," *American Economic Journal: Economic Policy*, 2018, Vol. 10, no. 2, pp. 62-89, https://www.aeaweb.org/articles?id=10.1257/pol.20150176.

[67] Section 40011.

[68] Section 40104.

[69] Section 40106.

[70] Section 40301.

[71] Section 40302.

budget ($56.5 billion).[72]

Conclusion

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

Rather than focus on underlying economic and social problems, and removing regulatory barriers that restrict supply, federal policies have consistently increased demand by making it easier to obtain home mortgages. There appears to be no momentum in Congress to reverse these trends. In fact, the new Biden administration policies, and multiple proposals being considered in the budget reconciliation process, will implement the same types of failed housing policies of the past. Collectively, these policies will further expand government intervention in housing markets at a great cost to millions of Americans. They will put even more upward pressure on prices and rental rates, waste taxpayers' money, and ultimately make housing less affordable.

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

[72] U.S. House Committee on Appropriations, "Appropriations Committee Releases Fiscal Year 2022 Transportation, and Housing and Urban Development, and Related Agencies Funding Bill," *Press Release*, July 11, 2021, https://appropriations.house.gov/news/press-releases/appropriations-committee-releases-fiscal-year-2022-transportation-and-housing.