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# CONGRESSIONAL TESTIMONY

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## How Institutional Landlords are Changing the Housing Market

### Testimony before U.S. Senate Committee on Banking, Housing, and Urban Affairs

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Chair Brown, Ranking Member Toomey, Members of the Senate Committee on Banking, Housing, and Urban Affairs.

My name is Joel Griffith. I am a Research Fellow in Financial Regulations at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

#### What Is Happening with Housing Prices?

Echoing the last housing bubble, government policies are once again artificially driving up housing prices. Spanning the pandemic era from February 2020 through September 2021,

home prices soared 27.1 percent.<sup>1</sup> Over the past 12 months, home prices are up 19.5 percent, dwarfing the prior 12 months jump of 7.1 percent, while residential property prices in the United States adjusted for inflation are now just 2.2 percent below the all-time record levels of the 2006 bubble.<sup>2</sup> Home prices are increasing far greater than family income growth is. The home-price-to-median-income ratio now stands at more than 7.2 (eclipsing the 7.03 peak in late 2005), significantly higher than the levels of well under 5.0 experienced from 1980 to 2000.<sup>3</sup>

**Home Mortgages.** The decline in long-term interest rates has induced and enabled

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<sup>1</sup>Federal Reserve Bank of St. Louis, “S&P Dow Jones Indices LLC, S&P/Case-Shiller U.S. National Home Price Index [CSUSHPINSA],” <https://fred.stlouisfed.org/series/CSUSHPINSA> (accessed December 13, 2021). The Case-Shiller Home Price Index tracks home prices given a constant level of quality. See S&P Dow Jones Indices, “Real Estate: S&P CoreLogic Case-Shiller Home Price Indices,” <https://us.spindices.com/index-family/real-estate/sp-corelogic-case-shiller> (accessed January 10, 2022).

<sup>2</sup>Federal Reserve Bank of St. Louis, “Real Residential Property Prices for United States Data (QUSR628BIS),” <https://fred.stlouisfed.org> (accessed December 14, 2021).

<sup>3</sup>Longtermtrends, “Home Price to Income Ratio (US & UK),” Home Price to Median Household Income Ratio (US) Data, 1980 to 2005, <https://www.longtermtrends.net/home-price-median-annual-income-ratio/> (accessed December 14, 2021).

borrowers to take out bigger loans, feeding the rise in prices.<sup>4</sup> The impact of the surge in home prices is now eclipsing the cost savings of lower interest rates. The mortgage-payment-to-income ratio hit 32.7 percent in September 2021—the highest level since 2008.<sup>5</sup> A return to 6.6 percent 30-year fixed mortgage rates (still below the historical average) from current rates of near 3.0 percent would increase a mortgage payment for a new borrower by 50 percent even with no increase in home prices.<sup>6</sup>

**Rental Prices.** Median apartment rental costs have jumped more than 15 percent this past year.<sup>7</sup> Because leases often roll over annually, the Consumer Price Index (CPI) data from the Bureau of Labor Statistics (BLS) does not yet fully reflect this surge. Numerous cities experienced rent increases well in excess of 30 percent. For the past 20 years, rental prices have increased at a greater pace than inflation has. Nationally, rental prices increased 38 percent in just the past decade.<sup>8</sup> Some urban areas have experienced far steeper jumps in rent. For instance, rental prices in the Seattle metro area jumped 58 percent over the past decade.<sup>9</sup> And rents in the largely rent-controlled San Francisco metro area soared 51

percent—both nearly triple the overall rate of inflation.<sup>10</sup>

## Why Are Housing Prices Rising Faster Than Usual?

### The Scapegoat: Institutional Single Family Residence (SFR) Investors

“Institutional owners” of rental properties are being scapegoated for the rise in home prices and rental costs. But institutional investors own fewer than 2 in 1000 (0.2 percent) of all single-family homes (SFR) and just 1 percent of all rental homes.<sup>11</sup> In fact, not in single state do institutional investors own more than 1 in 100 of all available housing in the state. Despite the intense media focus, institutional investors purchased only 1 in 1000 (0.1 percent) of homes sold in the United States in 2020—a smaller share than in 2006 just prior to the prior housing market peak.<sup>12</sup>

In fact, of the 10 states with no institutional SFR ownership, 7 rank in the top 10 of recent home price appreciation—with Idaho in the lead at 24 percent.<sup>13</sup>

<sup>4</sup>Interest rates for 30-year fixed mortgages fell from 3.5 percent pre-pandemic to just 2.65 percent at the beginning of 2021 and now hover near 3.0 percent. Freddie Mac, “30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US],” retrieved from Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/MORTGAGE30US> (accessed December 15, 2021).

<sup>5</sup>Federal Reserve Bank of Atlanta, “Metro Area Home Ownership Affordability Monitor Index,” September 2021, <https://www.atlantafed.org/center-for-housing-and-policy/data-and-tools/home-ownership-affordability-monitor.aspx> (accessed December 13, 2021).

<sup>6</sup>Author calculations using Bankrate, “Amortization Schedule Calculator,” <https://www.bankrate.com/calculators/mortgages/amortization-calculator.aspx> (accessed December 10, 2021).

<sup>7</sup>Chris Salviati et al., “December Apartment List National Rent Report,” Apartment List, November 29,

2021, <https://www.apartmentlist.com/research/national-rent-data> (accessed December 14, 2021).

<sup>8</sup>Federal Reserve Bank of St. Louis, “Consumer Price Index for All Urban Consumers: Rent of Primary Residence in U.S. City Average Data (CUSR0000SEHA),” <https://fred.stlouisfed.org/series/CUSR0000SEHA> (accessed December 13, 2021).

<sup>9</sup>Federal Reserve Bank of St. Louis, “Consumer Price Index for All Urban Consumers: Rent of Primary Residence in San Francisco-Oakland-Hayward, CA (CBSA) Data (CUURA422SEHA),” <https://fred.stlouisfed.org/series/CUURA422SEHA> (accessed December 13, 2021).

<sup>10</sup>Ibid.

<sup>11</sup>National Rental Home Council, *Institutional Owners of Single-Family Rental Homes*.

<sup>12</sup>National Rental Home Council, *Institutional Owners of Single-Family Rental Homes*.

<sup>13</sup>National Rental Home Council, *Institutional Owners of Single-Family Rental Homes*.

The bottom line is that institutional SFR ownership is not measurably impacting local home price dynamics to the upside. In fact, the opposite may be occurring. RealtyTrac reports, “On a national basis, investors across the country paid an average 29.4% less than homeowners in Q2 2021...”<sup>14</sup>

**The reality: Primary Drivers of Rising Prices Nationally are Government Subsidies, the Federal Reserve, and Local Regulations**

**Government-sponsored enterprises (GSEs)—namely, Fannie Mae and Freddie Mac—continue to dominate the mortgage market.** Investors who purchased Fannie Mae and Freddie Mac bonds and mortgage-backed securities (MBSs) ultimately provide funds for people to finance homes, and these bondholders and MBS investors enjoy implicit government backing. Investors in MBSs receive cash flows from interest and principal payments on the pool of mortgages comprising the MBSs. With the GSEs under continued conservatorship, it is common knowledge that taxpayers will make good on promised cash flows if either Fannie or Freddie were to ever fail again financially. The moral hazard created by government backing leads to riskier lending, because it allows investors to ignore the true

financial risks of those underlying mortgages and securities.<sup>15</sup>

**The Federal Reserve Continues to Purchase MBSs.**

Since March 2020, the Federal Reserve has driven down mortgage interest rates and fueled a rise in housing costs by purchasing \$1.2 trillion of MBSs from Fannie Mae, Freddie Mac, and Ginnie Mae. The \$2.6 trillion now owned by the Federal Reserve is 88 percent higher than the levels of March 2020.<sup>16</sup>

Proponents of such intervention often argue that it is necessary to increase the rate of home ownership. However, robust homeownership was established in the United States long before the government became heavily involved in the housing market. From 1949 to 1968 (the year that Fannie Mae was allowed to purchase non-government-insured mortgages), government-backed mortgages never accounted for more than 6 percent of the market in any given year.<sup>17</sup> Yet the homeownership rate was 64 percent in 1968, virtually identical to what it is now.

On the local level, stringent zoning restrictions, density limitations, and aggressive environmental regulation limit the supply of housing while increasing the costs of construction. Regulations often account for more than 30 percent of the costs of rental housing construction.<sup>18</sup> Rent control further

<sup>14</sup> RealtyTrac Investor Purchase Report, Fall 2021. <https://www.realtytrac.com/blog/realtytrac-investor-purchase-report-fall-2021>.

<sup>15</sup>“The unpriced implicit guarantee, which reduced interest rates for mortgage borrowers, helped cause more of the economy’s capital to be invested in housing than might otherwise have been the case.”

Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*, August 2018, p. 7, <https://www.cbo.gov/system/files?file=2018-08/54218-GSEupdate.pdf> (accessed January 6, 2022).

<sup>16</sup>Board of Governors of the Federal Reserve System (US), Assets: Securities Held Outright: Mortgage-

Backed Securities: Wednesday Level [WSHOMCB], retrieved from Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/WSHOMCB>, December 14, 2021.

<sup>17</sup>Norbert J. Michel and John Ligon, “GSE Reform: The Economic Effects of Eliminating a Government Guarantee in Housing Finance,” Heritage Foundation *Backgrounder* No. 2877, February 7, 2014, p. 6, <https://www.heritage.org/housing/report/gse-reform-the-economic-effects-eliminating-government-guarantee-housing-finance>.

<sup>18</sup>Paul Emrath and Caitlan Walter, “Regulation: Over 30 Percent of the Cost of a Multifamily Development,” National Association of Home Builders and National

compounds the problem by deterring new construction, giving landlords fewer incentives to spend on upkeep and remodeling, and reducing the future supply of housing.

Congressional inaction has expanded the government's role in the wake of the prior financial crisis. Government subsidies have increased borrowing and demand for housing without increasing supply, leading once again to higher home prices and increased taxpayer risk. Subsidies and government guarantees of MBSs will perpetuate inflated prices, deprive other sectors of needed financial resources, and place the burden of catastrophic risk on the federal taxpayer. It is difficult to argue that these policies improve the status quo for anyone other than the lenders, securitizers, and MBS investors who will gain additional federal protections. Optimally, Congress would gradually remove federal mortgage guarantees and subsidies and narrow the scope of business for the GSEs.

### **Policy Recommendations to Address Housing Prices**

Policymakers should:

- **Sever the special status given to the GSEs.**

This approach would communicate to the market that this implicit guarantee is terminated and allow MBS prices to more fully reflect the risk involved. Continuation of these guarantees leads to excessive risky debt. Private investors, not federal taxpayers, should bear the financial risks.

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Multifamily Housing Council, June 2018, <https://www.nmhc.org/contentassets/60365effa073432a8a168619e0f30895/nmhc-nahb-cost-of-regulations.pdf> (accessed December 15, 2021).

<sup>19</sup>Federal Housing Finance Authority, "Fannie Mae and Freddie Mac Conforming Loan Limits for Mortgages Acquired in Calendar Year 2022 and Originated after 10/1/2011 or before 7/1/2007," November 2021, <https://www.fhfa.gov/DataTools/Downloads/Documents/Conforming-Loan->

- **Raise Fannie Mae and Freddie Mac mortgage guarantee fees immediately while the GSEs remain in conservatorship.**

This fee is paid by the lender seeking the federal guarantee, although it is effectively passed along to the borrower in the form of a higher interest rate. Raising the fees on defaults would make the rates available on non-government-guaranteed mortgage loans more competitive, scaling back the role of the GSEs. Some potential borrowers may choose to forgo homeownership for the time being, alleviating some of the artificially induced housing demand.

- **Eliminate the geographic price differentials for conforming loan limits for loans purchased by the GSEs.**

Limits in high-cost areas are up to 50 percent higher than the baseline. In 2022, the baseline conforming loan limit will jump a record 18 percent from \$548,250 for a single-family residence to \$647,200. In high-cost areas, the maximum will rise from \$822,375 to \$970,800.<sup>19</sup> The GSEs should also gradually reduce the baseline conforming loan limits.

- **Narrow the GSEs' focus to financing primary home purchases.**

Approximately 90 percent of GSE volume is currently devoted to refinances, investor purchases, lower loan-to-value loans, and pricier homes purchased by higher-income earners. This support should be eliminated. In particular, subsidizing cash-out refinances<sup>20</sup>

[Limits/FullCountyLoanLimitList2022\\_HERA-BASED\\_FINAL\\_FLAT.pdf](#) (accessed December 15, 2021).

<sup>20</sup>To learn more about cash-out refinancing, see, for example, Zach Wichter, "Cash-Out Mortgage Refinancing: How It Works and When It's the Right Option," Bankrate, November 11, 2021, <https://www.bankrate.com/mortgages/cash-out-refinancing/> (accessed January 6, 2022).

impedes middle-class families from accumulating net worth.

- **Reject eviction moratoria.**

Initially, the decrease in cash flow from an eviction moratorium affects the landlord only. However, landlords will increase rents to mitigate the heightened risk of future moratoria and to recoup revenue already lost. Prospective renters may find themselves subject to increased security deposits and tighter credit checks. Ultimately, fewer affordable housing units may be constructed.

- **Consider the impact of local regulations on housing affordability.**

By reforming land-use laws—in effect, increasing supply—rental prices could plateau or even decline. Likewise, repealing rent control would incentivize construction of additional housing units.

- **Discontinue state and local rent control.**

Rental costs reflect the supply limitations and costs imposed by stringent zoning restrictions, density limitations, and aggressive environmental regulation. Capping rent increases does nothing to make housing less costly to build. But it will have the perverse effect of shrinking future supply by deterring new construction and incentivizing landlords to spend less money on upkeep and remodeling.

With rents capped, demand likely will increase further, but with supply unable to keep up with demand, housing shortages will likely continue.

Criticism of rent control as bad economics is hardly limited to landlords or to free-market conservatives. As far back as 1965, [Gunnar Myrdal](#), one of the visionaries behind Sweden’s welfare state, warned, “Rent control has in certain Western countries constituted, maybe, the worst example of poor planning by governments lacking courage and vision.”

Economics professor Assar Lindbeck, Myrdal’s fellow Swede, cautioned in 1972, “In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing.”

In 1989, communists running Vietnam linked the abject condition of Hanoi’s housing directly to rent control. Then-Foreign Minister Nguyen Co Thach said, “The Americans couldn’t destroy Hanoi, but we have destroyed our city by very low rents. We realized it was stupid and that we must change policy.”

Rent control may score cheap political points, but rent control and handcuffing property managers does nothing to solve the affordable housing problem. Adding new controls will only force renters to live in more dilapidated conditions and preclude additional units from being built.

- **Refrain from offering conforming loan amortization options beyond the traditional 30-year repayment term.**

Fannie Mae and Freddie Mac extending the maximum amortization to 480 months from the current 360 months will encourage riskier lending and incentivize borrowers to overleverage their finances. Although the monthly payment may be lower, the borrower accrues substantially higher total interest payments. These extended amortization schedules result in upward price pressure as borrowers become more willing, and more able, to borrow more money.

- **Terminate the Federal Reserve’s monthly purchases of MBSs and begin diminishing the size of its MBS portfolio.**

Artificially increasing the amount of capital available for the residential home mortgage market and distorting interest rates is exacerbating home unaffordability.

**Conclusion:**

Optimally, Congress will work to make housing more affordable by gradually removing federal guarantees and subsidies and eliminating federal mandates. The economy

will further benefit as the artificially large flow of capital to the housing market is allocated to other sectors. State and local governments share a responsibility to eliminate artificial barriers to housing affordability.

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