Chapter 6

Housing

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The middle-class squeeze on housing is real

- Mortgage originations are at their lowest level in 17 years,[1] with many middle-class families locked out of the market, and cash buyers accounting for more than 40 percent of all home purchases at the end of 2013.[2]

- Half of all renters spend more than 30 percent of their income on housing while 27 percent spend more than 50 percent of their income—both sharp increases over the past decade.[3]

- The median household lost 31 percent of its home-equity wealth between 2005 and 2011,[4] and 13 percent of all mortgaged homes are still underwater—their owners owe about $380 billion more than their homes are actually worth.[5]

Understanding how we got here

Triggered by the burst of a housing bubble inflated by predatory and dangerous mortgage loans, the financial crisis of 2008 led to the most severe recession and loss of middle-class wealth since the Great Depression.

Consequences included the loss of millions of homes to foreclosure—frequently due to the unavailability of loan workout options—and widespread, severe housing-price declines that put millions more homes at risk. Cash investors—including traditional mom-and-pop landlords as well as private equity funds and other large institutional investors—have capitalized on bargain prices for homes across the country, purchasing millions of homes that they are then renting out. These investors have helped to reverse home-price declines—in some cases, potentially re-inflating bubbles—which has helped some homeowners recover their home equity but, ironically, may be locking potential homeowners out of the market. Even with this investment, many communities are still struggling with the legacy of blight and disinvestment wrought by the crisis.

For an example middle-class family of four, housing costs rose by 28 percent in 12 years.
See figure 1.3

Concurrently, rental cost burdens have increased across the country due to an increase in the number of renters, declining incomes for all but the most well off, and inadequate programs to assist renters or to support the construction and preservation of affordable housing.

In the aftermath of the crisis, private capital has been less willing to take mortgage credit risk, leaving Fannie Mae, Freddie Mac, and the Federal Housing Administration to fill the void. Stung by the massive capital influx Fannie and Freddie required from the U.S. taxpayer, their regulator—the Federal Housing Finance Agency—has operated the companies in a very conservative manner, returning substantial profits to the U.S. Treasury but failing to support potential homeowners and the struggling housing market adequately.

Policy recommendations

We can help address the middle-class squeeze on housing by increasing access to affordable credit, providing more affordable rental housing, and ensuring that cash investors do not lock potential homeowners out of the market. To do so, we suggest the following:

- The Federal Housing Finance Agency should require Fannie Mae and Freddie Mac to support a healthier and more equitable housing market by increasing both access to and affordability of mortgages, providing struggling borrowers with better loan modifications that include principal reductions, and capitalizing the National Housing Trust Fund and Capital Magnet Fund.
- Congress should reform the housing finance system to realign incentives, enable broader access to affordable and sustainable mortgages, and support the creation of more affordable rental housing.
- Regulators as well as state and local policymakers should closely monitor cash investor activity in the single-family rental market; evaluate its potential on tenants, rents, neighborhoods, and homeownership opportunities; and consider whether there are any policy changes needed.

Housing

Whether they rent, own, or hope to own their home, middle-class families are increasingly feeling squeezed when it comes to finding affordable housing. The middle-class squeeze in housing can be seen in a few key ways:

- Potential buyers find it hard to obtain a mortgage
- Renters face escalating cost burdens
- The foreclosure crisis continues for many

Potential buyers find it hard to obtain a mortgage

Many households who want to buy a home—whether they want to stabilize their cost of housing, put down roots in a community, or benefit from the wealth gains that homeownership can enable—are finding that they cannot do so either because mortgage lenders have placed overly strict requirements on who can qualify for a mortgage or because they are competing with cash investors.

In March 2014, the average borrower credit score for a purchase mortgage was 728, and for Fannie Mae and Freddie Mac financing it was more than 750. Given that 63 percent of the population have a score below 750 and the median score is 711, many middle-class borrowers find themselves locked out of the market either because they cannot get a mortgage or can only get one at a higher-than-desirable interest rate.[6]

Additionally, as lenders look for higher down payments, borrowers with good credit scores and incomes but who hail from a lower-wealth background—including many people of color—often have more trouble qualifying for a loan as it can take decades to save for a 20 percent or even 10 percent down payment, especially in areas where home prices are higher.

> Investors have been buying houses across the country at an alarming clip: More than 40 percent of home purchases were made with cash at the end of 2013.

The result of tight credit has been a smaller home-purchase market. Comparing mortgage originations in 2012 to those in 2001—generally regarded as the last year of "normal" mortgage activity before the expansion of predatory lending and the growth of the housing bubble—the Urban Institute found that tight credit meant that 1.2 million fewer households received mortgages to buy a home in 2012 than would have been the case if lending standards had been more typical of the prebubble years.[7]

This historically tight credit has decreased the number of potential buyers of homes, unnecessarily dampening our housing recovery and constraining economic growth. As a result, we have missed out on the economic multiplier effects of a strong housing market, including construction jobs and local and state tax revenue. Likewise, creditworthy households who wish to buy a home, yet cannot, have lost out on the ability to build wealth by buying a home at a time of historically low prices.

Seeing the steep decline in home prices and their ability to beat out potential owner-occupants, investors have been buying houses across the country at an alarming clip: More than 40 percent of home purchases were made with cash at the end of 2013.[8] In the past few years, the larger, institutional investors in this market have built a new industry based on buying up and renting out single-family homes—an industry that, if it grows unchecked, could have a large effect on tenants and neighborhoods.[9]

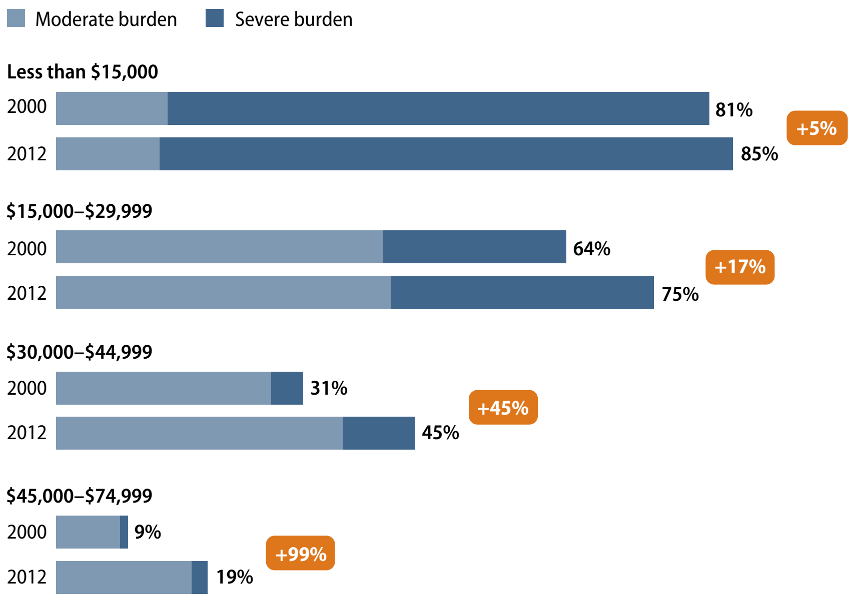
Renters face escalating cost burdens

For the one-third of Americans who rent their home, the situation has not been much better. Based on the federal standard of housing affordability—defined as housing that costs less than 30 of household income—more than half of all renters are cost burdened, or paying more than 30 percent of their income on rent.[10]

FIGURE 6.1

The cost of renting is increasingly burdening middle-class households

Percent burdened, by household income



Note: Numbers may not add up due to rounding

Source: Center for American Progress analysis of Minnesota Population Center, "Integrated Public Use Microdata Series," available at https://usa.ipums.org/usa/ (last accessed June 2014). All data adjusted based on 2012 CPI-U.

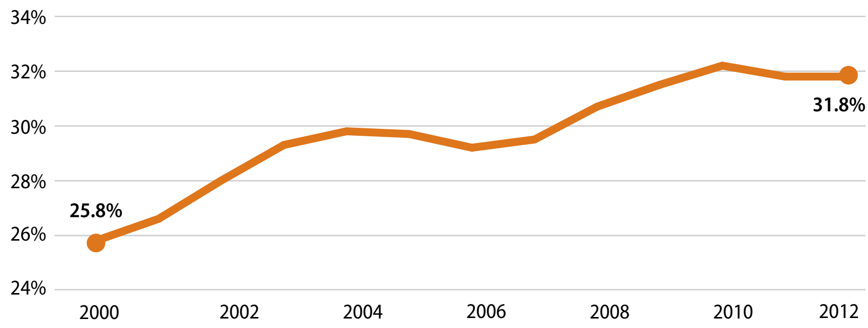
These cost burdens have effects both on family budgets and throughout the economy. The typical lower- middle-income renter who is severely cost burdened can only afford three-quarters of what her unburdened counterpart spends on food and less than half of what her counterpart spends on health care.[11] These statistics suggest that housing-cost burdens place great strains on households' abilities to afford basic goods and services.

These cost burdens are not likely to ease any time soon: None of the sources of increased demand for rental housing are expected to ease in the coming years.[12] While builders have stepped up their construction of apartment buildings, new units are still entering the market at a slow pace due to the low levels of construction during the market downturn,[13] and barely a third of new rental units are affordable to the median renter.[14] Perhaps most alarming, our nation is losing its lowest-cost rental units—the only homes very-low-income families can afford—at more than double the rate of typical rental units, largely because this housing stock is aging rapidly and not getting the maintenance required to keep it habitable.[15]

FIGURE 6.2

Rent costs are rising more quickly than renters' incomes

Median gross rent as a percentage of median renter's income



Note: All figures are in 2012 dollars and indexed based on weighted combination of housing, energy, and water/sewer costs.

Source: Calculations based on Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Evolving Markets and Needs" (2013), Table A-1, available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs_americas_rental_housing_2013_1_0.pdf.

The foreclosure crisis continues for many

The foreclosure crisis wreaked havoc on neighborhoods and household finances across the country. Since the start of the crisis, there have been 5 million completed foreclosures, and about 650,000 homes are in some stage of foreclosure.[16] At least 1.4 million households have managed to avoid foreclosure through tools such as short sales but still lost their homes and any equity they had accumulated in it.[17] These foreclosures have cost homeowners, neighborhoods, and investors dearly: A typical foreclosure costs borrowers up to $7,000 in administrative costs alone,[18] costs investors more than $75,000,[19] reduces the value of neighboring homes,[20] and costs local governments through reduced property taxes and increased anti-blight expenditures.[21] A recent study even linked foreclosures to declines in neighbors' health.[22]

What's more, the wealth effects of the crisis were staggering, especially for households of color. The median white household lost 29 percent of their home-equity wealth between 2005 and 2011, while the median African American household and the median Hispanic household lost 38 percent and 55 percent of their home-equity wealth, respectively.[23] Loss of home equity can be seen directly in overall asset reductions: Whites lost about 26 percent of their net worth during this period, while African Americans lost 50 percent and Hispanics lost 61 percent.[24] For many households of color, their home is their largest asset: For African American families, homes account for more than half of all wealth, compared to 39 percent for whites.[25]

In recent years, home prices have been improving across the country, reducing the share of borrowers who are underwater, or owe more on their property than it is worth. But as of the first quarter of 2014, 13 percent of mortgaged homes are still underwater; while this is a marked improvement from a year earlier, when 20 percent of these properties were underwater, a significant number of borrowers still face the increased risk of foreclosure that being underwater brings.[26]

Additionally, this national figure obscures the fact that many communities are still struggling through a significant foreclosure crisis: More than 10 million Americans live in ZIP codes where between 43 percent and 76 percent of homeowners are underwater.[27] These neighborhoods are primarily communities of color, as in almost two-thirds of them, African Americans and Latinos account for at least half of the population. Many of these neighborhoods were once middle class but had been targeted by predatory lenders during the housing bubble. Neighborhoods like these have yet to benefit from the housing recovery, and they illustrate the importance of a robust policy response to our continuing foreclosure crisis.

How we got here

Despite popular perceptions to the contrary, the shoddy and frequently predatory mortgage lending in the 2000s did very little to increase homeownership rates. Between 1998 and 2006, only 9 percent of subprime loans were used for first-time home purchases, while more than half were refinancings, many of which drained equity from existing homes. Fairly soon after home prices flattened and began their decline, the resulting foreclosures outnumbered first-time home purchases.[28]

But in large part due to an insatiable appetite for these risky mortgages from Wall Street, their prevalence grew. Complex Wall Street financial products then spread the risk on these mortgages throughout the financial system, putting the global economy at risk when home prices began to flatten out. When homeowners began defaulting on their mortgages, it triggered the financial crisis along with the resulting recession and massive job losses.

When the mortgage-backed securities market collapsed and private capital markets retreated, the government stepped in to keep the market operational by bailing out and placing into conservatorship both Fannie Mae and Freddie Mac—the government-sponsored mortgage giants that guarantee payments to investors on mortgage-backed securities. For the first five years after the crisis, the agency serving as conservator—the Federal Housing Finance Agency, or FHFA—operated the companies in a conservative manner, reducing access to credit and trying to wind down the government-sponsored enterprise's businesses.

At the same time, the Federal Housing Administration, which has historically played a niche role supporting underserved and first-time homebuyers, played a crucial countercyclical role after the crisis[29]—its share of home-purchase originations shot as high as 40 percent.[30] But stung by losses, the agency has raised its fees significantly, leading to decreased market share and less demand for the mortgages it insures.

While the federal government enacted some programs to help borrowers refinance and provided incentives for private entities to modify mortgages, homeowners still need additional help. Currently, mortgage servicers—the parties that administer mortgages that are placed in securities and handle loan modifications—have no regulatory obligation to modify a loan, even when doing so would save investors money. Many loan modifications contain planned increases in interest rates that will increase the amount borrowers will need to pay in the future. And the tool that is frequently most effective in preventing unnecessary foreclosures—principal reduction—remains unavailable for many troubled borrowers, including those with loans owned by Fannie Mae and Freddie Mac and fully under the control of a federal agency.

Our housing finance system has also failed to produce and preserve enough affordable rental housing. This problem is particularly acute for very- and extremely-low-income households,[31] since the economics of rental housing production for these income levels require subsidies that are rapidly disappearing. But this is a growing problem for middle-class families as well: For renting households earning between $15,000 and $30,000, the share facing cost burdens increased 17 percent between 2000 and 2012. For those with incomes between $30,000 and $45,000, the share increased 45 percent.[32] When families spend an outsize portion of their budgets on housing, they have less to spend on food, medical care, and higher education, among other things, and they are also unable to save adequately to meet emergency needs.

Policy recommendations

To restore greater health to the mortgage market and to protect homeowners, we suggest a number of policy changes.

First, we think FHFA has the ability to make a series of policy changes that will encourage homeownership and protect homeowners. This agency, which is now under new leadership, has recently signaled that it would like to see Fannie Mae and Freddie Mac support a healthier and more equitable housing market.[33] For example, FHFA has clarified the rules under which it requires lenders to buy back loans, which should help encourage them to lend more broadly, and it will no longer require Fannie and Freddie to reduce their share of the multifamily market, where most of their work supports affordable housing. The agency also is embarking on new initiatives to stabilize hard-hit neighborhoods and has announced that it will finalize new affordable housing goals and revisit a never-finalized rulemaking implementing a duty for Fannie and Freddie to serve certain underserved markets.

These changes are all excellent, but they should not stop there. In the short term, the FHFA should also:

- Change its pricing rules so that mortgages are equally affordable to all qualified borrowers. Right now, Fannie Mae and Freddie Mac charge higher fees to all but the most pristine borrowers. This policy drives up the cost of credit for many potential homeowners, pushes these borrowers to government-insured mortgages, and dampens demand for mortgages overall.

- Permit Fannie and Freddie to offer loan modifications with principal reductions. Principal reductions help keep borrowers in their homes,[34] encourage those borrowers to maintain their homes properly, and save money for the taxpayer by reducing the costs Fannie and Freddie have to bear when mortgages they guarantee go through foreclosure.[35]

- Allow Fannie Mae and Freddie Mac to make their contributions to the National Housing Trust Fund, which assists states in meeting the housing needs of very-low-income families, and the Capital Magnet Fund, which helps community-development financial institutions provide such housing. FHFA suspended these statutorily mandated contributions when Fannie and Freddie required taxpayer funds to stay afloat, but now that both companies are reporting profits, the suspension should be lifted.

Additionally, state and local officials should ensure adequate protections for tenants in single-family rental homes, and federal regulators should monitor cash investor activity in the single-family rental market; measure its impact on tenants, rents, neighborhoods, and homeownership opportunities; and take action as needed. In areas with a significant amount of cash investment, there are risks of home-price bubbles, a renewed cycle of price declines if the investors sell in bulk, or locking potential homeowners out of the purchase market if they are unable to compete with investors buying in cash.

To ease the middle-class housing squeeze in the long term, Congress should reform Fannie and Freddie to realign incentives, enable broader access to affordable and sustainable mortgages, and support the creation of more affordable rental housing. The new system should preserve the important functions Fannie and Freddie have played while eliminating the flawed ownership structure that led them to take excessive risk before the housing crisis. It should also more fully support affordable rental housing with financing programs aimed at building, operating, and preserving such housing.

Conclusion

People require access to affordable housing—whether owned or rented—if they are to enter or stay in the middle class. Shelter is a basic human need, and when too great a share of a family budget goes toward housing, less remains for other priorities. No other single investment has done as much as homeownership to improve the financial circumstances and economic mobility of America's families, and countless studies have demonstrated that appropriate housing opportunities play a unique role in ensuring strong and healthy families, strengthening neighborhoods, and boosting the overall economy. For these reasons, it is important that policymakers ensure a strong housing market and access to affordable housing opportunities for all.

Endnotes

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