The Affordable Mortgage Depression

Government policies were designed to increase homeownership. Affordable Mortgages, created to realize this goal, were responsible for the Housing Bubble and distorted the economy. The unwinding of these distortions will result in a Global Depression.

Origin of the Housing Bubble: “The National Homeownership Strategy”

More than 4 years into the collapse of the Housing Bubble much has been written and spoken on the subject. A Google search for “housing bubble” yields 1,110,000 results. Economists have debated why the event occurred. The media has covered its aftermath exhaustively. Politicians and bureaucrats have implemented the most aggressive public policy response since The Great Depression.

Genuine economic understanding has proven to be elusive.

A Google search for the term “national homeownership strategy” yields 9,040 results. Only a tiny percentage of these references are from recognizable media sources written in the past decade (estimated to be less than 5%). The overwhelming majority of listings are Government sources, library archives, catalogued books or dated materials.

A Historical Introduction

“In the Spring and Summer of 1994, Secretary Henry Cisneros met with leaders of major national organizations from the housing industry to solicit their views about establishing a national homeownership partnership.”
- HUD, "Partners in the American Dream", May 1995

“In 1994, at the President’s request, the U.S. Department of Housing and Urban Development (HUD) began work to develop a National Homeownership Strategy with the goal of lifting the overall homeownership rate to 67.5 percent by the end of the year 2000. While the most tangible goal of the National Homeownership Strategy was to raise the overall homeownership rate, in presenting the strategy HUD pointed explicitly to declines in homeownership rates among low-income, young, and minority households as motivation for these efforts.” - U.S. Department of Housing and Urban Development Office of Policy Development and Research website

"At the request of President Clinton, HUD is working with dozens of national leaders in government and the housing industry to implement the National Homeownership Strategy, an unprecedented public-private partnership to increase homeownership to a record-high level over the next 6 years." - Urban Policy Brief Number 2, August 1995

“Federal institutions, policies, and programs alone cannot meet President Clinton's goal of record-high levels of homeownership within the next 6 years. HUD has forged a nationwide partnership that will draw on the resources and creativity of lenders, builders, real estate professionals, community-based nonprofit organizations, consumer groups, State and local governments and housing finance agencies, and many others in a cooperative, multifaceted campaign to create ownership opportunities” - The National Homeownership Strategy

The Housing Bubble’s Rosetta Stone

The National Homeownership Strategy (NHS) may have been the most comprehensive, pervasive, impactful and transformational public policy initiative in U.S. history. Yet only a small percentage of Americans have ever heard of it. Even fewer understand the NHS’ stated goal of record homeownership or are able to confirm whether those objectives were met.

Results from a recent AMD.com survey confirm this unfamiliarity: Link to Survey Results

The NHS was a massive, complex, coordinated undertaking.

The public policy initiative consisted of 100 distinct action items detailed within “The National Homeownership Strategy: Partners in the American Dream” released by HUD in May 1995. Specific examples of these action items include the following subject titles:

Action 11: Removing Barriers to Mortgage Financing for Starter Homes
Action 29: Alternative Approaches to Homebuying Transactions
Action 35: Home Mortgage Loan-to-Value Flexibility
Action 36: Subsidies to Reduce Downpayment and Mortgage Costs
Action 44: Flexible Mortgage Underwriting Criteria
Action 45: Public-Private Leveraging for Affordable Home Financing

The NHS’ integrated effort included alliances with influential public, private and non-profit entities. At the time of publication in 1995 there were 56 “National Partnerships” including the American Bankers Association, Appraisal Institute, Fannie Mae, Federal Home Loan Bank System, Freddie Mac, Mortgage Bankers Association of America, Mortgage Insurance Companies of America, National Association of Home Builders, National Association of Real Estate Brokers, National Foundation of Consumer Credit, National Urban League and HUD.

More broadly The National Homeownership Strategy encompassed parallel regulatory and legislative reforms during 1994 and 1995. Examples include:

- The Community Reinvestment Act (CRA) was revised to force lenders to make loans to uncreditworthy borrowers as a cost of doing business

- The Riegle-Neal Act was passed making compliance with The Community Reinvestment Act a prerequisite for banks to expand, make acquisitions or operate in more than one state

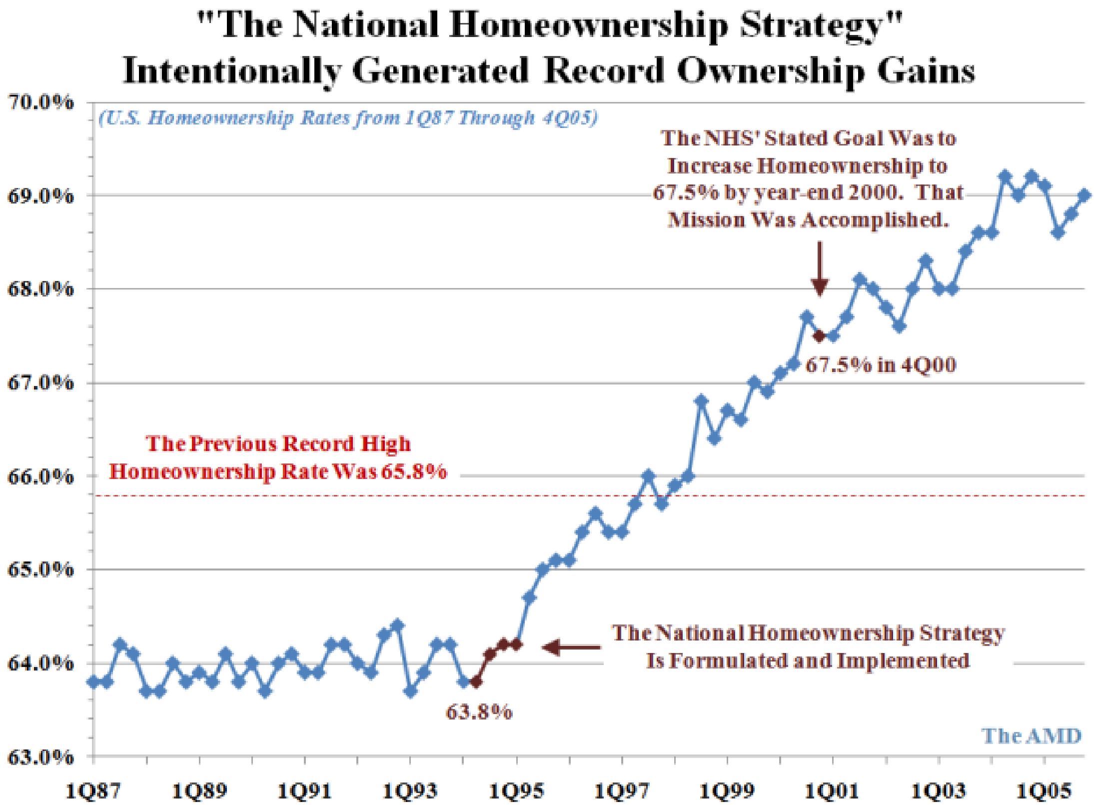
These initiatives transformed the purpose of bank regulators. Since The Great Depression the goal of bank regulation had been to ensure the solvency of lending institutions. After 1994 regulators were tasked also with implementing and enforcing the NHS’ social agenda. Extending loan access to the uncreditworthy was in direct opposition to bank solvency.

Under the NHS the considerable resources of the Federal Government were brought to bear on expanding homeownership. In 1994 HUD directed Fannie Mae and Freddie Mac to proliferate subprime lending. These combined Government Sponsored Entities (GSEs) act as a functional monopoly within the mortgage market. As such, they enjoyed substantial influence over lending standards, credit availability and the private-sector mortgage industry which was directly dependent upon the GSE’s for profitability. By 1996, HUD was directing Freddie and Fannie to provide at least 42% of their mortgage financing to low-income borrowers and 12% of their portfolios to “special affordable” loans.

The Homeownership Bubble

The effect of the NHS’ coordinated effort was to dramatically increase access to credit and demand for houses. Upon implementation homeownership accelerated in historic fashion. This record pace of gains would continue almost linearly through the entirety of the Housing Bubble.

The speed and abruptness of these concocted homeownership gains was extraordinary in the context of an enormous, national housing market defined by glacial trends. The market reaction to the NHS was even more spectacular given the relative stability of homeownership rates over the prior 35 years.



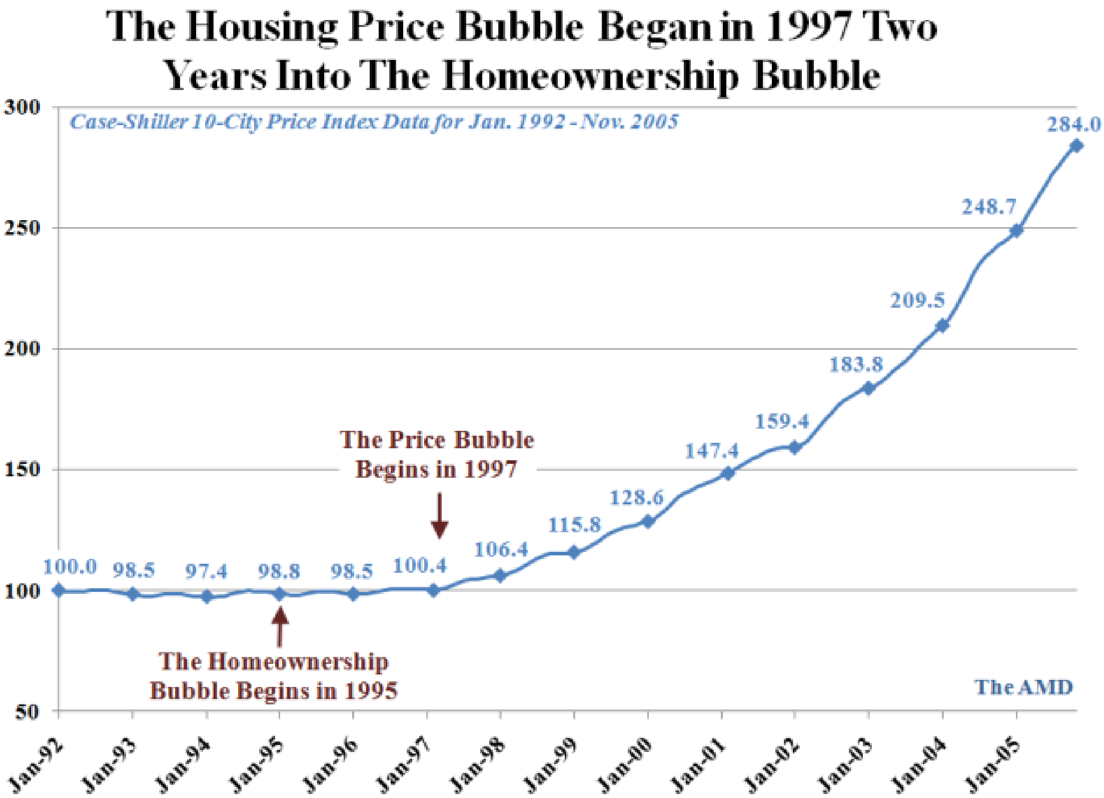
The National Homeownership Strategy achieved its stated goal of lifting homeownership rates from 63.8% in 1994 to 67.5% by the end of 2000. In six years the NHS accomplished the most extraordinary expansion of homeownership in U.S. history eclipsing the previous record of 65.8%.

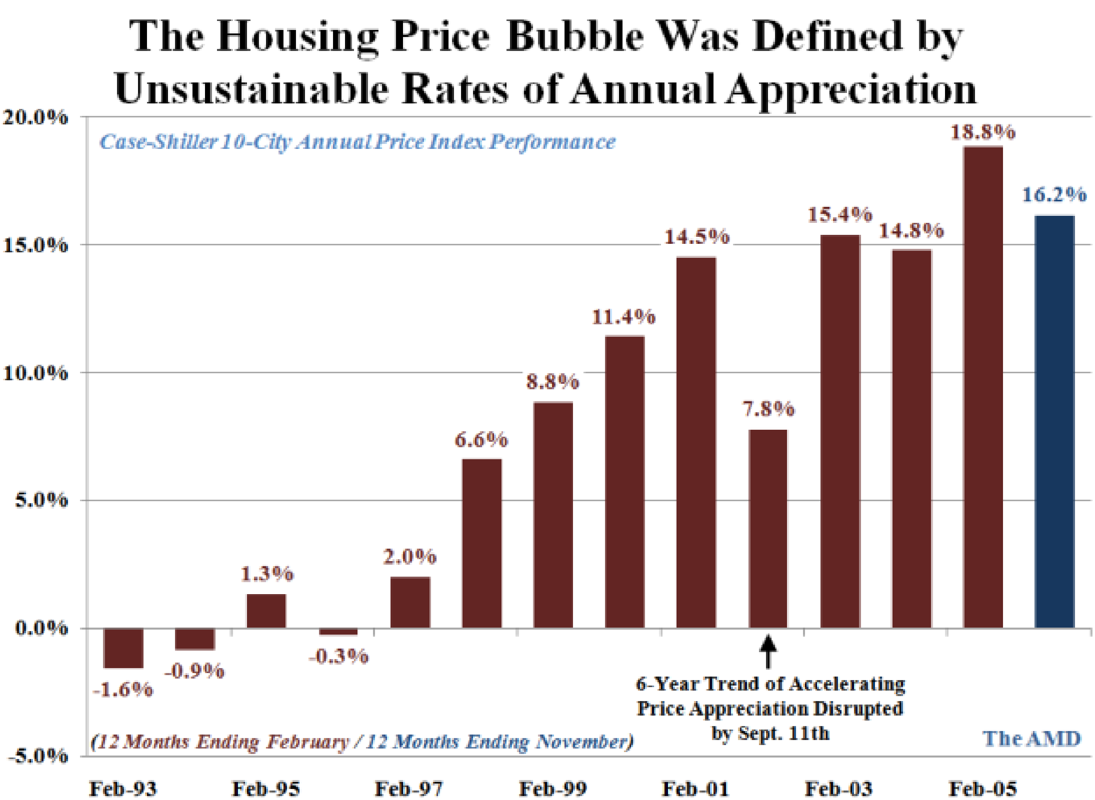
Link to a graphical analysis of The Homeownership Bubble.

Prelude to a Housing Price Bubble

Loosened lending standards, increased access to credit and a massive reallocation of capital dramatically expanded demand for houses. As would be expected anytime demand grows faster than supply creating relative scarcity, prices started to rise.

Housing appreciation began to steadily accelerate in 1997, two years after the NHS originated a Homeownership Bubble, and continued at an unsustainable pace through the entirety of the Housing Price Bubble.





The historical evidence is compelling. While the NHS achieved its objective of record homeownership gains, in doing so it also originated a housing price bubble which distorted economic activity for a decade and ultimately caused the ongoing Affordable Mortgage Depression.

Link to graphical analysis of The Housing Price Bubble.

Dismal Reality

The National Homeownership Strategy:

- Was the most transformational housing public policy in U.S. history
- Originated the largest asset price and credit bubbles in human history by:
    - Overtly manufacturing The Homeownership Bubble
    - Inadvertently creating The Housing Price Bubble
- Massively distorted national investment, saving and consumption behavior
- Distorted capital flows
- Dramatically increased the level of debt capitalizing housing
- Unsustainably bloated federal, state and local government spending
- Is directly responsible for the most damaging economic downturn since The Great Depression

And only a small fraction of Americans have ever heard of it.

Rationale, Expectations and The Law of Unintended Consequences

"This unprecedented public-private partnership is founded on a deeply rooted and almost universally held belief that homeownership provides important advantages that merit continued public support. The National Homeownership Strategy cites four fundamental benefits:" <u>*Urban Policy Brief Number 2, August 1995*</u>

- *"Through homeownership, a family...invests in an asset that can grow in value and... generate financial security."*

- *"Homeownership enables people to have greater control and exercise more responsibility over their living environment."*

- *"Homeownership helps stabilize neighborhoods and strengthen communities."*

- *"Homeownership helps generate jobs and stimulate economic growth."*

TheAffordableMortgageDepression.com observes that the net effect of The National Homeownership Strategy was to:

- Create overvalued and overleveraged housing assets that are falling in value and undermining financial security

- Encourage people to behave irresponsibility and undermine control over living environments

- Destabilize neighborhoods and weaken the communities dependent upon them

- Destroy jobs and disrupt economic growth

The Affordable Mortgage Depression

Blog's original subtitle:

"The Housing Bubble and an impending "Affordable Mortgage Depression" are the result of government intervention intended to realize a social agenda. Legislation distorted market forces and the economic incentives of mortgage lenders and home buyers. Affordable Mortgages, necessary for subprime borrowers to access homeownership, decoupled housing prices from the fundamentals of value. The unwinding of these economic distortions will result in a Global Depression."

While these observations grossly oversimplify the economic phenomena of the last 15 years, one cannot fluently understand The Housing Bubble, its collapse, current economic conditions, formulate an adequate response, or identify inevitable events to come without understanding the origin of the economic distortion.

The conditions which enabled The Housing Bubble to develop and persist were established in 1994 and 1995. Much of what transpired afterwards, especially post September 11th, is secondary to understanding why the decade-long economic distortion developed. Many of these later events were vital to perpetuating prices but largely inevitable, resulting from a primordial environment established years earlier. Mania-era developments allowed prices to continue to decouple from the fundamentals of value, and provided the Housing Bubble with a widely recognizable face, memorable characters, story-lines, heroes, villains and a narrative for the history books. *(paragraph revised 3/15/10 for the sake of improved clarity)*

But the prerequisites necessary to understand The Housing Bubble and its aftermath are contained within its origin. Without knowledge of these pervasive forces and the distortions which they inevitably wrought it is not possible to fully understand what is transpiring within the economy or correctly prescribe an effective course of action to assuage the downturn. This is the tragic flaw of our Government's response to the Housing Collapse since 2007 and the reason that this blog exists.

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Posted by Whitney Ross at 3/11/2010 3:03 PM
Categories: Government Action is Counter Productive,The National Homeownership Strategy,Housing Bubble Origins,Lessons From History

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Kelli wrote: *3/11/2010 3:57 PM*
This is one of the most insightful, thought-provoking pieces I have read on the roots of the housing crisis.

Thanks.
Reply to this

steve bourg wrote: *3/12/2010 7:10 AM*
GR8 article. In '08 when the calamity was hitting, I searched diligently and finally found a Rosetta Stone of understanding -- same as you have -- but I stopped when I saw the printed Regulations Clinton enacted and enforced 7/1/95 with his minions. The regulations were to the CRA, and would make the Russian Politburo proud. They had teeth, and number-forcing requirements to make x % of loans to the poorest y% in a bank's community, and on and on. What a distortion of the purpose of govt! Too bad the media has had 2 years to look for this and announce it, but they have not. And Barney Frank, Andrew Cuomo, et al have "blood on their hands" as well as Clinton. Anyway, GR8 article Ross!!
Reply to this

IrvineRenter wrote: *3/12/2010 9:21 AM*
This is an interesting article, and there is likely some contribution to the bubble from this program; however, you place too much blame on this program for causing something far larger. Your argument is a classic example of correlation without causation.

BTW, you can make all the same arguments about the repeal of welfare which also happened at the same time.

A more robust correlation exists between the growth in subprime lending and the housing bubble, and with that correlation exists some causation.
Reply to this

Whitney Ross wrote: *3/12/2010 12:50 PM*

Thanks for reading and I appreciate your comment but I do not understand your logic. I may not have been clear enough regarding how overtly the Government stated its intention to manufacture a housing bubble.

I am not observing a correlation between The National Homeownership Strategy and the Housing Bubble. I am highlighting the Government's clearly articulated intent in 1994/95 to create a homeownership bubble and their written arguments as to why this would be a wonderful thing for the economy.

You cite the growth of subprime as a cause of the bubble. What do you think "caused" subprime to grow so dramatically. Clearly written Government mandates directed massive amounts of Federal capital into increasing subprime lending. Parallel legislative and regulatory reforms required the expansion of subprime within the private sector. This is not conjecture, but based on historical documentation.

"The National Homeownership Strategy: Partners in the American Dream" is effectively a how-to book for creating a housing bubble.

"This report identifies specific actions that the federal government, its partners in state and local government, the private, nonprofit community, and private industry will take to lower barriers that prevent American families from becoming homeowners. Working together, we can add as many as eight million new families to America's homeownership rolls by the year 2000." - Bill Clinton, May 2, 1995

The intent of the NHS was to make homeowners out of 8 million individuals who could not afford to purchase a house and service a mortgage. Mission accomplished.

Reply to this

C B thompson wrote: *3/13/2010 10:19 AM*
As with most such "causation vs. correlation" arguments ... the "truth" lies somewhere in between. In this case no doubt the Clinton NHS paved the way for the "housing bubble." But the initiative for the NHS came from the private sector. The lobyists for the banking institutions (arguably the most powerful of all) together with those of the other related "free-market" adherents (builders, mortgage lenders, Realtors, etc.) that stood to gain from this market stimulating (distorting) initiative ... did their usual lobbying "thing" and the public sector (Congress, the White House, the bureaucracy, etc.) responded as it most always does.

The challenge for our so-called "free-market" system continues to be ... should we really try to practice what we preach ... or just preach what we practice? From my experience I would say the private sector (and that includes "main street" as well as "Wall Street") made the public sector what it is today! Good thought provoking article.
Reply to this

IrvineRenter wrote: *3/13/2010 2:36 PM*
"Clearly written Government mandates directed massive amounts of Federal capital into increasing subprime lending."

No, it didn't.

First, Government capital does not go into the mortgage market -- at least it wasn't during the bubble. Government insurance programs facilitate private money going into mortgages, but Federal money doesn't go there. During the housing bubble, the only government insurance program that could have insured bubble loans was the FHA, and their market share dropped to less than 2%. The GSEs, which have subsequently fallen under government conservatorship, were not insuring loans with explicit government backing during the bubble -- and even then, the GSEs did not lead the charge, they were overtaken by private capital sources and then foolishly tried to catch up in 2005-2006 which bankrupted them and prompted a government takeover.

The report you cite certainly did represent the desires of our Federal Government to increase home ownership -- a goal I find of dubious value -- but pie-in-the-sky reports are what the government does. Bullshit for political pandering is a government staple. What the report does not provide, and where your argument falls apart, is that the government provided no mechanism for this to occur. At the time, the GSEs were independent entities, and they often failed to meet government mandates. The flow of capital that inflated the bubble was private money.

Look, I share your revulsion of government props in the housing market, and I would be happy to see the GSEs and other government mortgage programs disappear. However, they did not inflate the housing bubble.

Most of the attempts to link happenings in the 90s to a housing bubble in the 00s is political nonsense primarily put forth by Republicans hoping to deflect blame for a catastrophe that occurred under their watch. Kernels of truth are present, but the cause and effect you believe is solid is pretty weak.

Think about it: how does a policy from the 90s create havoc years later without the new administration and Congress being able to stop it? Don't you think a report from 1995 could have been overridden or a new policy instituted once it became obvious there was a problem?
Reply to this

Whitney Ross wrote: *3/15/2010 11:42 AM*

With respect, massive amounts of federal capital were directed into subprime mortgages.

I quote from "Fannie Mae and Freddie Mac: Past, Present, and Future" produced by HUD:

"In 1995, HUD began issuing affordable housing goals requiring the GSEs to purchase (1) mortgages made to low- and moderate income families, (2) mortgages on properties located in underserved areas, and (3) mortgages made to very low-income families and low-income families in low-income areas."

In 1996 40% of Fannie and Freddie's capital was being allocated to financing low- and moderate-income mortgages.

As to your observation:

"Think about it: how does a policy from the 90s create havoc years later without the new administration and Congress being able to stop it? Don't you think a report from 1995 could have been overridden or a new policy instituted once it became obvious there was a problem?"

When pray tell did "*it become obvious there was a problem"?* The Chairman of the Federal Reserve didn't acknowledge a problem until late 2007. ("Ignorance is Bliss")

The real estate market is a massive, slow moving entity defined by decade long business trends. It took two years of record homeownership gains to begin home price acceleration. Conversely, it took almost two years for prices to collapse following the peak of the Housing Bubble.

Do you recall the Government attempting to stop the Internet Bubble? They certainly were not going to stop a housing bubble from which they directly benefitted. Homeownership was increasing, unemployment falling, tax receipts surging to all-time highs. Politicians like homeownership gains and economic growth regardless of source (see recent concocted GDP gains). In fact, the Government has been engineering "affordable housing" and mortgage access for 70+ years.

Congress had no interest in stopping the bubble. I can produce hundreds of quotes from congressmen thrilled by the event and mortally opposed to reigning it in.

The Bush Administration was equally enamored of and thrilled by homeownership gains. They enacted equally silly public policy that was largely irrelevant because during the mania the private sector was providing mortgage products far more accommodating than any offered by the Federal Government. Bush did pay lip service to reigning in Freddie and Fannie but was forestalled by Congress. He couldn't have been happier about record low unemployment and distorted consumer spending.

Your argument doesn't resonate because politicians had no interest in slowing, much less stopping, the Housing Bubble.

The perceived economic benefits of homeownership have been reiterated by a dozen Presidential Administrations in the last century. The National Homeownership Strategy skillfully articulates these perspectives in specific detail.

The problem being that the pillar upon which the free-lunch of homeownership was based is the assumption that housing prices could not decline nationally. During the Housing Bubble no influential politician, policy maker or Federal Reserve banker articulated the possibility that housing prices could fall. This belief is also well documented. And why not? Prices hadn't declined in 70 years since the aftermath of The Great Depression.

Without risk of declining prices the Government's policies were riskless and beneficiary. Unfortunately these policy makers were wrong and their assumption created a dynamic which ensured that housing prices would eventually collapse.

Reply to this

Ron Veelik wrote: *3/12/2010 11:01 AM*
Good clear Economics. Understandable by the man on the street. Good Job.

Ron Veelik
Reply to this

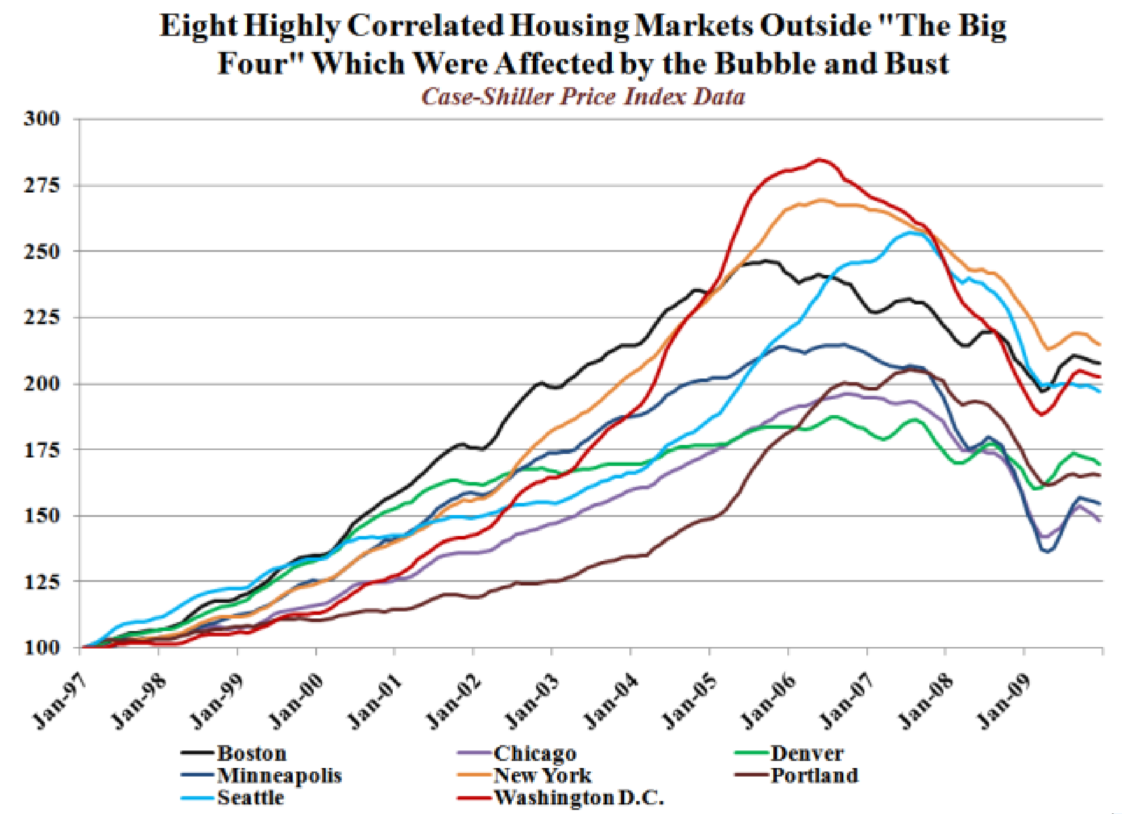
Jeff wrote: *3/12/2010 12:59 PM*
The housing bubble was not a national problem. It was located primarily in 4 states; Arizona, California, Florida, and Nevada. The article takes aim at overarching Federal policies, yet the most of the nation achieved higher levels of home ownership without a collapse of pricing. For the other 46 states, housing price decreases were along the lines that one sees as normal.

The collapse never happened in many areas. Upstate NY has seen price appreciations in the past few years. The article paints the nation's housing issues with too broad a brush in an attempt to find a bogeyman.

In my opinion, there were organized efforts in the 4 states mentioned above that were criminal in order to prices up. The greedy got theirs while the getting was good and now taxpayers bail out the carnage left in their wake.
Reply to this

Whitney Ross wrote: *3/19/2010 10:02 AM*
You are right in that there were many cities and states whose housing prices were unaffected by the Housing Bubble and its collapse. You are correct that the most extreme price swings were in select states and restricted to a few dozen cities.

You are wrong that the Housing Price Bubble occurred primarily in only 4 states as it effected prices nationally. Below is a chart of 8 markets outside "The Big Four" you mention. Price declines are far from normal since values hadn't dropped nationally in 70 years prior to 2006.



What is most interesting is the undeniable correlation between all of these markets nationally during the Bubble, its Bust, the Government's recent failed attempt to prop up prices and the ongoing collapse. As you argue housing is local, but for 70 years the correlation has been increasing as financing has become more federalized. There are always market-specific exceptions. But mortgage rates in Upstate NY declined as the Fed subsidized rates this past year and the FHA is handing out 3% down payment loans just as in CA, FL or AZ.

It is wonderful that upstate NY has seen price appreciation recently. But it is also irrelevant to conversations about the Bubble and ongoing Depression. The Housing Bubble did occur and did create a decade long NATIONAL economic distortion.

Even people in upstate NY were affected by it. The National Savings rate collapsed because housing prices were rising and the Stock Market (correlated to the Housing Bubble) rallied for years. Businesses nationally, including in NY, benefitted both from home construction and a decade long distortion to consumer spending. People in AZ with condos in CA used HELOC loans to travel to upstate NY for vacation. People in upstate NY with condos in FL spent more freely because of leveraged equity gains. Businesses in NY which built doors, windows, flooring, roofing, carpeting, underwrote mortgages, etc... beneffited. How much Wall Street bonus money do you think was spent Upstate from 2002 through 2005?

I have never denied that prices in hundreds of markets and several states were unaffected by the Bubble due to local economic conditions and specific supply/demand dynamics. But I have yet to understand why that reality is relevant to understanding the Housing Bubble, its collapse or what will result from the inevitable resolution of a decade-long, national economic distortion.
Reply to this

R. Stockwell wrote: *3/13/2010 3:21 AM*
Why not mention Clinton and the 1999 repeal of the Glass Stegal act also.
Reply to this

mark wrote: *3/13/2010 3:23 AM*
I agree with Irvine Renter. The degree of the gov't emphasis on increasing home ownership may have been ill advised. But anyone who has read extensively about the housing bubble and crash knows that this "cause" was a drop in the bucket compared to the other complex factors contributing to the CREDIT BUBBLE. These include the shadow credits market which included all of the mortgage backed

securities and the unregulated derivatives that went with them. Also, the capital that was looking to be invested, which ended up in these markets had a huge influence. The idea that all of these securities and the demand for them and the bankers wishing to profit on selling them can be blamed on government housing policy is either an absurd oversimplification or more likely just the wish (believe it and it becomes true) of right wingers trying to blame this all on liberal housing policies.

I won't be surprised if this isn't published.
Reply to this

Whitney Ross wrote: 3/15/2010 11:17 AM

Link to Comment Response

Reply to this

KMckaig wrote: 3/13/2010 8:59 PM
I have heard allusions to this policy and it being at the root of the housing bubble but you provide specifics from the actual government policy as laid out and implemented. This is the piece that has been missing to clarify how this policy lead to all of the excesses, from Wall Street and all kinds of finance businesses, to the buyers, sellers, appraisers, etc. Wonderful contribution to the overall picture that for me, at least, was not available until I read this. Kudos and thank you!
Reply to this

corntrollio wrote: 3/15/2010 3:50 PM
Does no one remember the Ownership Society? It seems odd to suggest that nothing that happened after 2001 mattered. That was when most of the irrational lending actually occurred.

There are several things people call "subprime" lending. Traditional prime lending means three things:
1) borrowers have good credit (i.e. a high credit score -- this is often called "A-paper" to refer to it being the highest quality);
2) borrowers have good capability to pay -- i.e. banks are checking tax returns and bank accounts to make sure people have adequate income, can put 20% down, and max out at 28% of gross income for principal, interest, taxes, and insurance, and 36% of gross income for all debt; and
3) borrowers have good collateral -- the property is warrantable and habitable and doesn't have factors that might suddenly produce huge liability (e.g. the building isn't up to code or very little of a condo complex is sold so far).

These three factors meant that prime lending had a predictable default rate.

Traditional subprime lending ONLY changed factor #1 -- it meant people go have slightly less good credit. This is where "B-paper" or "C-paper" could come from. But because traditional subprime borrowers still met factors #2 and #3, traditional subprime lending still had predictable default rates, just like prime lending. The default rate was higher than prime, so people paid higher interest for having worse credit, but the rate was still predictable.

After 2001, we saw a huge growth in non-traditional lending. Lots of these loan products were called subprime or Alt-A (i.e. an "Alternative to A-paper") or any number of other things. The problem was that many of these products were based on factor #1 only and ignored factors #2 and #3. As such, these products didn't have predictable default rates. Chaos ensued.

In addition, securitization practices (even if not securitization itself) resulted in different views of risk, ratings agencies produced poor modeling of default rates, and lots of individual bought houses much bigger and more expensive than they could afford.

To ignore the change in loan products and ideologically blame the CRA or NHS is rather misguided.
Reply to this

Tim wrote: 4/25/2010 6:36 PM
Here is the full text of the document above: The National Homeownership Strategy: Partners in the American Dream.

http://rapidshare.com/files/380163749/TheNationalHomeownershipStrategy.pdf
Reply to this