

INDUSTRY  
PERSPECTIVES

# The Homeownership Rate and Housing Finance Policy

## Part 1: Learning from the Rate's History

AUGUST 2021 | DON LAYTON



JOINT CENTER FOR  
HOUSING STUDIES  
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## **The Homeownership Rate and Housing Finance Policy – Part 1: Learning from the Rate’s History**

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August 2021

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## **Introduction**

The homeownership rate, among the thousands of statistics that the government produces to describe the country's economic and social health, has an exalted place among policymakers in Washington. This single statistic – currently running about 65 percent – is regarded as one of the most important comprehensive measures of how well the country's socioeconomic system is “delivering the goods” for the typical American family. A high homeownership rate reflects that many families have income large enough not only to cover monthly living costs but also to generate enough cash surplus to save for a downpayment and then to sustain homeownership.<sup>1</sup> It also indicates that the cost of purchasing a house and financing a mortgage on it is affordable.

In addition, homeownership is regarded as *causing* an improvement in the quality of life of a typical family. It is the most common method for such a family to build wealth: by paying down mortgage principal each month and participating in the long-term appreciation of home values, a family can build wealth that can be used for retirement or other needs, including helping the next generation. Such wealth creation therefore provides a major social as well as economic benefit. Add in protection against being forced to relocate by a landlord due to unaffordable rent increases or other actions, and homeownership is validly seen as a source of family stability.

Not surprisingly, politicians and policymakers are therefore often focused on doing “something” that can push the homeownership rate higher. As a participant in the housing finance policy community since 2012, when I became CEO of Freddie Mac, I have heard often how crucial housing finance was in creating the much higher rate of homeownership that evolved after World War II – roughly 65 percent, compared to less than 50 percent prior to the Great Depression. I have also heard frequently from housing advocates how some proposed change in housing finance, including some that seem quite limited to me, would result in many more families (“millions” is sometimes claimed) becoming homeowners. Unfortunately, despite such claims, through decades of the government's implementing various programs in housing finance aimed at increasing the sustainable rate of homeownership, it remains today at almost exactly the level achieved over fifty years ago – about 65 percent.

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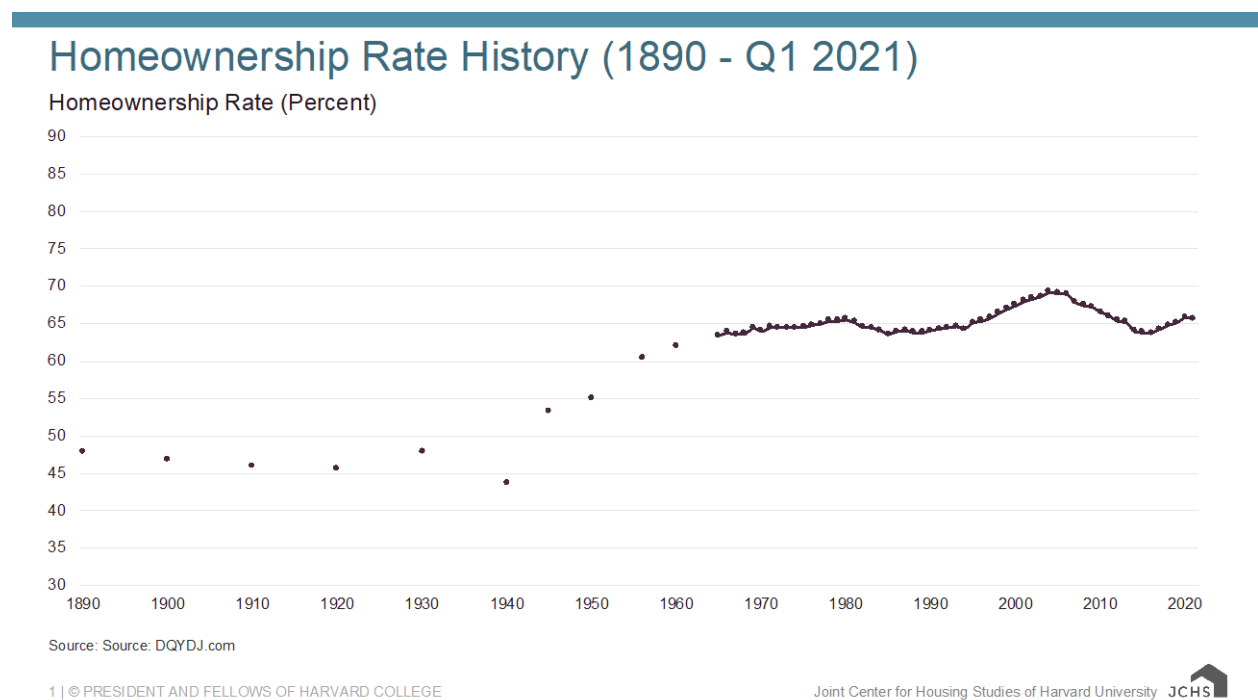
<sup>1</sup> Homeownership will require from time to time significant and hard-to-plan-for cash expenditures, such as paying to fix the heating system or repair the roof. A family that cannot generate a cash surplus to create an adequate pool of savings to pay for such expenditures from time to time will have great difficulty sustaining homeownership. I should note that having enough equity in a home to support a typical home equity line of credit can reduce the burden of such episodes by allowing a homeowner to replace such hard-to-plan-for expenditures with debt repayments that spread out the cash burden over time. By comparison, in rentals, the landlord absorbs such unplanned expenditures, with the tenant having just their usual monthly payment to make.

It thus seemed to me time to step back, take stock, and look for fresh ideas.

I therefore decided to study in more depth the homeownership rate over a long period of time to try to learn the reality of what has happened in the past (in this Part 1) so as to, in turn, discover what might be possible to do in the future (to follow in Part 2) that would, finally, successfully significantly increase the homeownership rate.

Indeed, it would be a great thing if the homeownership rate could move up from its 65 percent level to 70 or 75 percent on a sustainable basis: about 6 to 13 million more families,<sup>2</sup> respectively, would be helped. (As will also explored in Part 2, that can't realistically happen without addressing the major racial homeownership gap that exists.) But, as already noted, after so many government programs designed to do just that have failed for the past half century, it obviously isn't an easy thing to do – in fact, one conclusion from the history is how incredibly hard it is!

**Chart 1: Homeownership Rate History (1890 - Q1 2021)**



As shown above in Chart 1, a simple visual representation of the history of the homeownership rate over the last 130 years reveals that the rate seems to be rather stable over decades-long

<sup>2</sup> There are approximately 126 million households in the country. Of these, about 82.5 million are owner-occupied. Many will be surprised to learn that over 35 percent of households that own their own home do not have a mortgage, but own their home free and clear.

timeframes and falls into three distinct periods. One is the four decades from 1890<sup>3</sup> to 1930, when the rate was 46.5 percent, give or take 1-1/2 percentage points. Another is the five decades from 1970 to today, when the rate has been 65 percent, give or take 2 percentage points (with one exception described below, which makes clear the need to focus on the issue of sustainability). And the third is the four decades from 1930 to 1970, when the rate became destabilized by the Great Depression, which kicked off a period of transition from the 46.5 to the 65 percent level as part of incredibly broad and important changes following World War II in the very fabric of America's socioeconomic system, including the fundamentals of its housing finance system.

Beyond this stability of the sustainable homeownership rate, the history also makes clear that housing finance is just one input among many in determining the general level of the rate. It is therefore challenging to predict which housing finance policy changes might actually be able to make a material dent in sustainably increasing the rate, the topic to be explored in Part 2.

In this Part 1, I quickly summarize the three eras, as defined above, and then do four deep dives into specific topics to gain a more thorough understanding of why the homeownership rate is what it is and why it goes up or down.

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<sup>3</sup> 1890 is the earliest I found records for a homeownership rate. See "Historical Homeownership Rate in the United States, 1890 to Present," <https://dqydj.com/historical-homeownership-rate-united-states/>; this data is based upon Census Bureau records. Data from before 1965, when quarterly reporting was begun and is easily accessible, are summarized at the website dqydj.com from census records at the University of Minnesota. That pre-1965 reporting was done every ten years through 1940, when it began every five years through 1965. Note that the rate may have been stable at about the 46.5 percent level even earlier than 1890.

## A Summary of the Three Eras of the Homeownership Rate

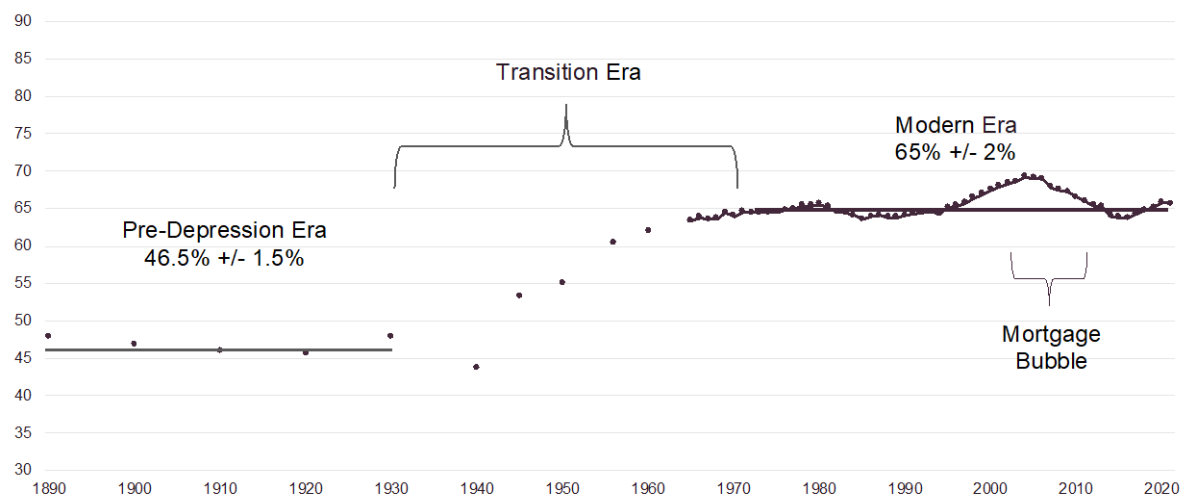
Homeownership records that I have been able to access go back 130 years, to 1890. This date is closer to the 1776 founding of the country than it is to today! As stated above, a simple visual inspection of the homeownership rate plus simple analysis shows that it has very stubborn macro-level<sup>4</sup> stability (i.e. within just one or two percentage points) at about 46.5 percent before the Great Depression and then at 65 percent after 1970. This is a very different perspective than the micro-level focus that I found dominated everyday Washington policy discussions. And this big picture viewpoint gives insight, I believe, that will help determine what might and might not be successful in the future to sustainably and materially increase the rate.

The three eras are marked on the homeownership rate history in Chart 2.

**Chart 2: Homeownership Rate History – The Three Eras**

### Homeownership Rate History (1890 - Q1 2021)

Homeownership Rate (Percent)



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<sup>4</sup> In this paper, I use the term “macro” or “macro-level” to refer to the homeownership rate’s general range (e.g. 65 percent give or take two percentage points), and “micro” or “micro-level” to refer to changes that were small - e.g. just one or one-half percentage points, or less – within the macro-level range. Another way to think of this is that, in the pre-Depression and modern eras, there was a “natural” equilibrium rate of homeownership that was produced by the socioeconomic system of the country. That natural rate set the macro-level at 46.5 percent or 65 percent, respectively, while all other activities just had it deviate around those levels by comparatively minor amounts.

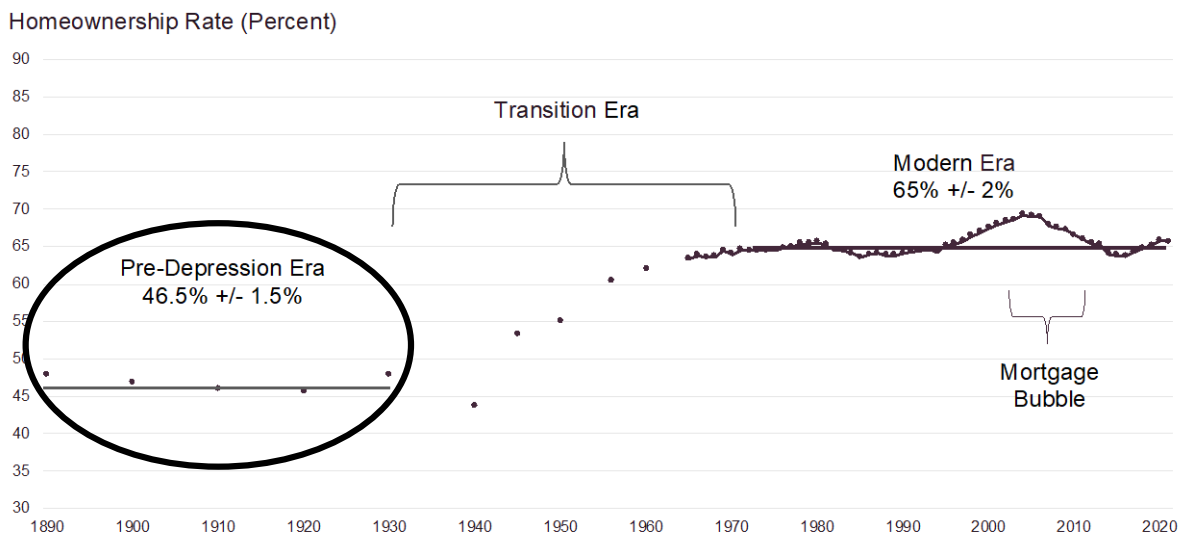


## The Pre-Depression Era: 1890 to 1930

The life of the typical American family during the four decades from 1890 to 1930 changed in dramatic ways. In 1890, it was in essence pre-modern. Sixty-five percent of the population was rural,<sup>5</sup> the first modern electric marvel – the light bulb – had only recently become commercially available on a broad basis, and travel was by horse, railroad, and steamboat as even the earliest version of an automobile was yet to be developed in the US. By comparison, modern life had very much begun by 1930. Most of the population then (56 percent) was urban rather than rural, and technology was changing the very nature of daily life. There were almost 24 million motor vehicles on the road (versus zero in 1890).<sup>6</sup> Seventy percent of households were electrified to support the light bulb, and then-modern electric marvels – such as the radio, the record player, and the telephone – were starting to become common in homes.

Chart 3: Historical Homeownership Rates – The Pre-Depression Era

### Homeownership Rate History (1890 - Q1 2021)



Source: Source: DQYDJ.com

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Yet with all this change, the rate of homeownership was stable at the macro level, as highlighted in Chart 3. It began the four-decade period at 47.8 percent, and ended it at the very same 47.8 percent rate. In between, it only went as low as 45.6 percent (i.e. down by 2.2 percentage points). Given all the

<sup>5</sup> Wikipedia, s.v. "Urbanization in the United States,"

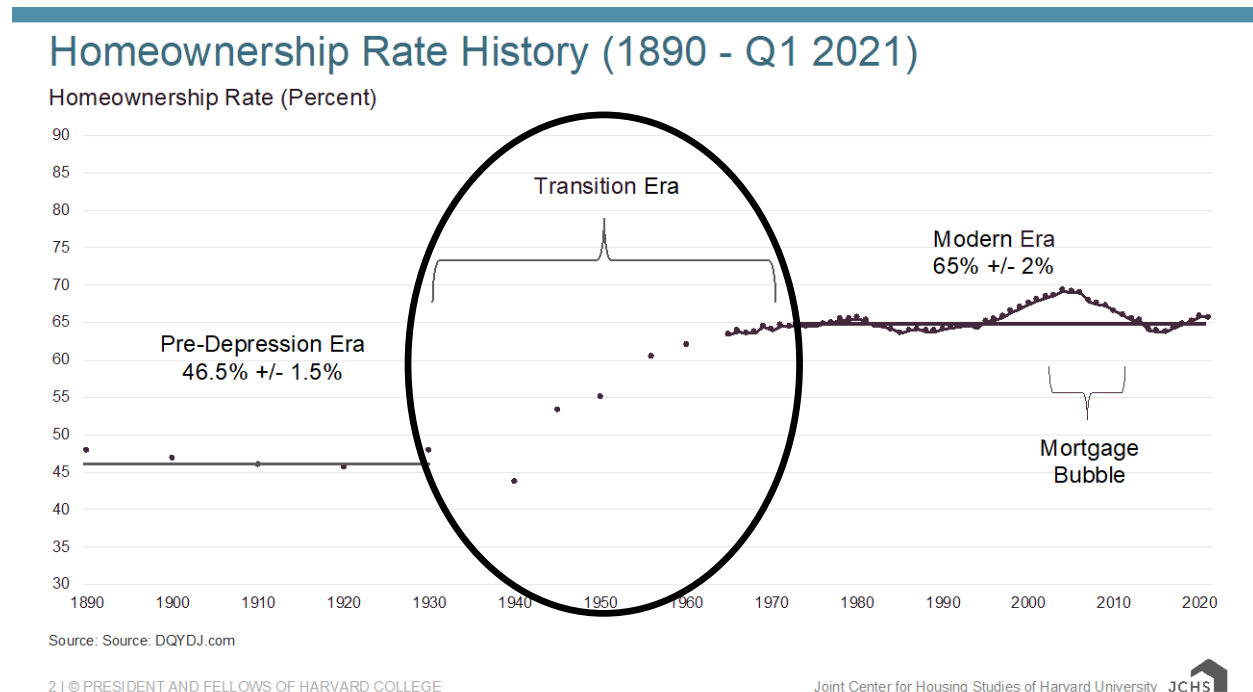
[https://en.wikipedia.org/wiki/Urbanization\\_in\\_the\\_United\\_States](https://en.wikipedia.org/wiki/Urbanization_in_the_United_States), which references census records.

<sup>6</sup> See Federal Highway Administration (Department of Transportation), "State Motor Vehicle Registrations," <https://www.fhwa.dot.gov/ohim/summary95/mv200.pdf>.

changes in American daily life, as summarized above, that is truly an unexpected result. And this result was not due to major government intervention helping or hurting – in that era of small government, housing was overwhelmingly left to the marketplace.

## The Transition Era: 1930 to 1970

Chart 4: Historical Homeownership Rates – The Transition Era



This forty-year transition era really has multiple themes, all rolled together, producing the major changes in the homeownership rate highlighted in Chart 4. First, the Great Depression was an economic downturn that makes anything since (even the Great Recession starting in 2008) seem modest by comparison. The unemployment rate reached almost 25 percent by 1933<sup>7</sup> (its worst year in the Depression) and never dropped below 14 percent until war preparation began in 1940. By 1933, the low point, industrial production had declined 47 percent, real GDP 30 percent, and there was major deflation (wholesale prices declined 33 percent).<sup>8</sup> And banks failed *en masse* – of 25,000 banks at the beginning of the decade, about 9,000 had failed by the end of 1933.<sup>9</sup> This all naturally began a massive destabilization of the homeownership rate with the inevitable wave of foreclosures and the collapse in

<sup>7</sup> Kimberley Amadeo, "Unemployment Rate by Year Since 1929 Compared to Inflation and GDP," *The Balance*, updated March 16, 2021, <https://www.thebalance.com/unemployment-rate-by-year-3305506>.

<sup>8</sup> *Encyclopedia Britannica*, s.v. "Great Depression," <https://www.britannica.com/event/Great-Depression>.

<sup>9</sup> The FDIC: A History of Confidence and Stability," <https://www.fdic.gov/exhibit/p1.html#/10>.



new construction. The federal government, starting under Hoover but mainly under Roosevelt, thus began actions across a broad front to heavily intervene in housing finance to reduce foreclosure levels and to aid new construction (this intervention is explored in a deep dive below); this intervention was, of course, in addition to the many New Deal programs that more generally countered the decline in employment and family income.

These efforts seemed to have been effective to at least a modest degree. While we don't know how much the homeownership rate declined during the mid-1930s (as the only available data was collected as part of the decennial census), we do know that the rate by 1940 had declined only to 43.6 percent – just over four percentage points. To me that decline seems modest relative to the more general breadth and depth of the economic contraction of the era.

Then the US economy was put on a war footing, with the private sector almost wholly devoted to supporting war production and military requirements. (This was an economic time-out of massive proportion, so the war years of 1940 to 1945 are skipped in this analysis.)

There then began in 1945 the economic miracle that was the postwar era. In fact, the next quarter-century was in many ways a “golden era” for the American family, including in terms of homeownership.<sup>10</sup> Specifically, the homeownership rate climbed steadily through this era to reach almost 65 percent by the end of the 1960s: 53 percent in 1945, going to 60 percent in 1955, to 63 percent in 1965, and then over 64 percent by the end of 1969.<sup>11</sup> This rate was about one-half again as high as in 1930, meaning it had reached a level unimaginable in the pre-Depression era. Given the wealth-creation and social stability benefits of homeownership, this increase was an incredible achievement in how much the country delivered a good quality of life for the typical family, and cemented homeownership as a core component of the American Dream.

The causes of this incredible achievement are many, as described below in a deep dive. The changes to housing finance engineered during the 1930s played a major role, but there were other fundamental changes in American life that were significantly responsible as well. These include the major expansion of the middle class via the GI Bill as well as the invention in the late 1940s of the modern suburbs that were and still mostly are centered around the ownership of the traditional single-family home. On a socioeconomic basis, then, 1960s America was very different than 1920s America.

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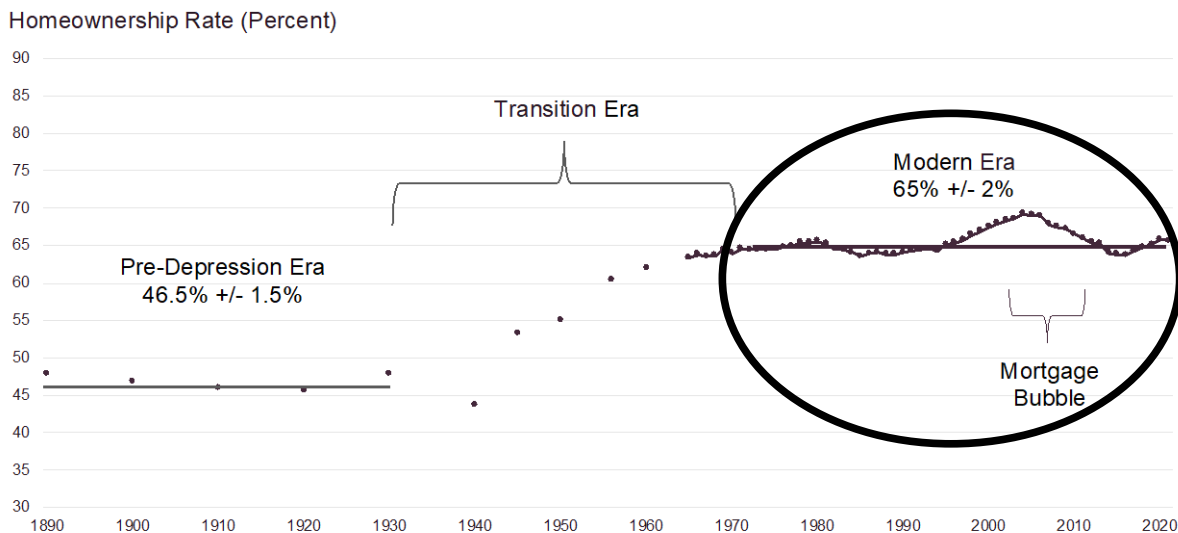
<sup>10</sup> This homeownership golden era, as discussed further below and in Part 2, mostly excluded non-white families, and was also concentrated on suburban rather than urban housing.

<sup>11</sup> The 53 percent homeownership rate for 1945 has to be regarded as potentially distorted by the millions of military personnel just then beginning the multi-year process of being discharged and transitioning to civilian life.

## The Modern Era: 1970 to Today

Chart 5: Historical Homeownership Rates – The Modern Era

### Homeownership Rate History (1890 - Q1 2021)



Source: Source: DQYDJ.com

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Examining the span of fifty-plus years from 1970 to today again demonstrates the incredible macro-level stability of the homeownership rate over long periods of time, as highlighted in Chart 5. During that period, it began at 64.3 percent and ended at 65.6 percent. In fact, for this entire half century, the rate – with the seeming exception of the mortgage bubble developing and bursting – stayed within 2 percentage points of 65 percent, even when viewed on a quarterly reporting basis that became available only in 1965. As described in a deep dive below, there were signature programs in housing finance during this period that were advertised as increasing the homeownership rate both broadly and narrowly. It is clear from the data that they failed to increase it broadly, as there was no sustainable increase above the 65 percent macro-level in that entire half century.

However, looking at the rate on a more fine-grained basis, there was clearly a rare deviation from the 63 to 67 percent range. Specifically, in the late 1990s, the rate climbed to the top of the macro-level range at 67 percent, reflecting a good economy and declining interest rates; representatives of the Clinton administration also claimed that various targeted programs to increase the homeownership rate

(as described below) were being effective.<sup>12</sup> Then, from 2000 through 2003, it pushed through 68 percent and finally reached 69 percent in 2004. Unfortunately, this rise clearly reflects, at least in part, the beginnings of the housing bubble, which started to concretely manifest itself with large increases in sub-prime mortgages financed by the private label securitization (PLS) market in 2001-2.<sup>13</sup>

Then, as now is well known, a tremendous bubble developed and then peaked in 2006, bursting through 2007-8 with incredible collateral damage. The resulting economic downturn was severe, with GDP bottoming out in mid-2009 while unemployment peaked near 10 percent in late 2009 through mid-2010. But the damage to homeownership was considerably more profound, and the homeownership rate continued a long-term decline, eventually reaching its bottom of 62.9 percent in April of 2016, a full *ten years* after the peak of the bubble in 2006, and six to seven years after the recession ended.

At a macro level, then, what was beginning to look like a sustainable increase in the homeownership rate to the 67 percent-and-maybe-higher range in 1999 and 2000 was swamped by the bubble. As a result, we will never know if that increase was, indeed, truly sustainable or not.

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<sup>12</sup> Frederick J. Eggers, "Homeownership: A Housing Success Story," *Cityscape* 5, no. 2 (2001): 43-56, [www.jstor.org/stable/20868515](http://www.jstor.org/stable/20868515).

<sup>13</sup> Urban Institute, "Housing Finance at a Glance: A Monthly Chartbook," June 2021, p. 7, <https://www.urban.org/sites/default/files/publication/104481/housing-finance-at-a-glance-a-monthly-chartbook-june-2021.pdf>.

## **Four Deep Dives**

Beyond the short summary above, learning from this long history of the homeownership rate requires deep dives into particular topics to demonstrate why and how the rate behaved as it did. I have chosen four such topics:

- (1) the Roaring '20s: why the homeownership rate did not go up significantly
- (2) the Depression '30s: the remaking of housing finance
- (3) the post-WWII "golden era" (1945 to 1970): why the homeownership rate increased so much
- (4) the modern era (1970 to today): the failure to materially increase the homeownership rate

### **The Roaring '20s: Why the Homeownership Rate Did Not Go Up Significantly**

The 1920s were known as the "Roaring '20s" for good reason. Economically, it was a time of great growth. Real GDP grew 4.3 percent annually, compounded, from 1920 to 1930 – so the economy in aggregate expanded by just over 50 percent, a very good level.<sup>14</sup> Unemployment rates, reconstructed by economic historians, after apparently peaking over 10 percent in a short postwar recession in 1920-21 were generally low during the decade (mostly under 5 percent).<sup>15</sup> And interest rates (using the 10-year Treasury as a proxy) were trending down, beginning the decade at about 5 percent and relatively smoothly declining to just over 3 percent.<sup>16</sup>

Life became more urban and more modern.<sup>17</sup> As previously described, the decade saw the general commercialization and broad availability of many aspects of modern life.<sup>18</sup> The light bulb, radio, the telephone, electric irons, the record player and much more became commonplace in many homes. Cars became ubiquitous and movie theaters became "the" place for entertainment. Cultural modernization naturally went with these technological changes.

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<sup>14</sup> "Fortunly's Annotated Guide to a Century of US GDP by Year," March 4, 2021, <https://fortunly.com/statistics/us-gdp-by-year-guide/#gref>.

<sup>15</sup> There are widely varying estimates of the unemployment rate in the 1920s. I have referenced those found in a National Bureau of Economic Research paper from 1957 entitled "Annual Estimates of Unemployment in the United States, 1900-1954" by Stanley Lebergott., page 215. <https://www.nber.org/system/files/chapters/c2644/c2644.pdf>.

<sup>16</sup> Trading Economics, "United States Government Bond 10Y," <https://tradingeconomics.com/united-states/government-bond-yield>. Given the nature of the financial system at that time, it is unclear how much such market interest rates on Treasuries translated into mortgage rates, i.e. it's an area for more research.

<sup>17</sup> The census showed that in 1920, for the very first time, more than half the population was located in urban, rather than rural, counties. Culturally, there was even a popular song in 1919 that captured this change: "How Ya Gonna Keep 'Em Down on the Farm (After They've Seen Poree)?," referring to World War I soldiers returning from France.

<sup>18</sup> See, for example, the AP US History Study Guide, <https://ap.gilderlehrman.org/essays/roaring-twenties>, as but one source to describe these aspects of more modern life.

One would think then that, at least during the 1920s, the homeownership rate would be increasing nicely. And this was true, but only within the macro-level 46.5 percent (plus or minus 1.5 percentage points) range – it apparently takes more than good GDP growth and some modestly helpful general market interest rate moves to cause the homeownership rate to increase by more than a micro-level amount. The Census Bureau reported the homeownership rate to be 47.8 percent in 1890, 46.7 percent in 1900, 45.9 percent in 1910, 45.6 percent in 1920 and then 47.8 percent in 1930, just as the Great Depression was beginning (although people did not know it at the time, of course). Thus, all the good things during the 1920s just took the rate from the low to the high end of the range, a move of just 2.2 percentage points. The homeownership rate thus demonstrated incredible macro-level stability in the 45 to 48 percent range over four decades, despite major economic growth, despite a technological revolution, despite the country going from mostly rural to mostly urban, and so on.

There are many factors that can cause the homeownership rate to be so “sticky.” I have found two worth mentioning, although I do not represent that they were the only causes of the stickiness, just the ones most noteworthy to me.

First, prosperity was not shared well during the 1920s. Estimates that the Gini index increased from .41 (a reasonable level) in 1918 to .49 in 1929 (a high rate) indicate increasing income inequality that worked against the positive impact on the homeownership rate of strong GDP growth.<sup>19</sup> That’s because, everything else being equal, a lower Gini index means a greater percentage of families will be able to afford to purchase a home. In other words, the increasingly unequal distribution of income offset some of the positive impact of strong GDP growth.

Second, the country’s financial system then was poorly structured to deliver single-family residential mortgages on reasonable terms to the typical homebuyer.<sup>20</sup> Mortgages were usually made by a somewhat motley group of housing finance institutions (HFIs), such as savings banks, building and loan associations, cooperative banks, and homestead associations – almost of which were then small, local institutions.<sup>21</sup> When it came to larger financial firms, commercial banks – as their name indicates – in that era stuck very heavily to business rather than consumer banking; meanwhile, insurance companies did play a material role in financing mortgages. In contrast to today, the federal government

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<sup>19</sup> See a reconstruction of the Gini index (based upon “equivalized gross household income”) from the “Chartbook of Income Inequality,” <https://www.chartbookofeconomicinequality.com/inequality-by-country/usa/>. The Gini index is also known as the Gini coefficient.

<sup>20</sup> Adam J. Levitin and Susan M. Wachter, *The Great American Housing Bubble* (Cambridge, MA: Harvard University Press, 2020), esp. ch. 1, “Housing Finance before the New Deal.”

<sup>21</sup> Mortgage lending by individuals (e.g., seller-financing) also played a large role prior to the Great Depression, as did outright ownership with no mortgage. These topics are unimportant to this paper and so are not explored.

played little, if any, role in prioritizing mortgage lending or homeownership. As a result, the typical mortgage was expensive and had very homeownership-unfriendly terms: a maximum loan-to-value (LTV) ratio of only 50 percent (versus today's 80 percent or more), a five-to-ten-year maturity (versus today's 30 year), and little or no amortization; borrowers were thus exposed to a real risk of losing their homes if they could not refinance at maturity (versus today's full self-amortization). These terms made homeownership really hard.

I also note that the 1920s was prior to the massive post-World War II development of automobile-based suburbs, as described below. (There were the "streetcar suburbs" then, but they were too small to impact the aggregate figures in a major way.) So, urban housing was heavily rental (as the condominium form of ownership of individual apartments did not yet exist), and high urban land-use density at the time meant there were not large amounts of unused land for the building of additional single-family homes in large numbers.

It was no surprise, then, that homeownership was not really a part of the American Dream that the majority of the population could attain, as the homeownership rate was permanently stuck, for at least four decades, in the 45 to 48 percent range, seemingly immutable despite so many other fundamental changes in the economy and daily life.

And then came the stock market crash of 1929 and the Great Depression, which threatened to push the homeownership rate materially lower.

### **The Depression '30s: The Remaking of Housing Finance**

The 1930s was obviously a period of great economic distress, the likes of which we have not seen since, even in the worst postwar downturn. The history of the Roosevelt administration's efforts to counteract this severe economic contraction is well known, and I will not repeat it here.

However, beyond those efforts – and of specific relevance to this article – the government began a broad and deep intervention to address three simultaneous problems related specifically to housing: (1) collapsing housing finance institutions, such as mutual savings banks; (2) collapsing homebuilding, with its large knock-on impact on employment and GDP; and (3) a collapsing homeownership rate due to foreclosures. That intervention, by historic accounts, consisted of a series of pragmatic – and somewhat experimental – legislation and regulatory actions throughout the 1930s,



heavily focused on housing finance, which were of course in addition to the many others aimed at propping up employment and household incomes more broadly.<sup>22</sup>

The 1932 Home Loan Bank Act is usually considered the first such major intervention tied directly to housing.<sup>23</sup> It created (among other things) the Federal Home Loan Bank Board (FHLBB) and twelve regional Federal Home Loan Banks (FHLBs). Since most home mortgage lending at the time was done by that motley array of HFIs rather than commercial banks, the purpose of the FHLBs was to provide funding – which came to include a hidden subsidy from the government – and general liquidity support to those lenders in order to strengthen their business models and stability during the very difficult circumstances of the Depression years.<sup>24</sup> In addition, the FHLBB soon thereafter was authorized to charter a new type of mortgage-centric financial institution, the federal savings and loan association (S&L) – and it did so. (Eventually thousands of them, along with other thrifts, became the backbone of home mortgage lending in America after World War II.)<sup>25</sup>

Then, through several somewhat convoluted steps (the details of which are unimportant for the purpose of this article), the FHLBB, in a very limited way, and then more importantly a newly-created Federal Housing Administration (FHA), in a very broad way, established a new standard for the terms of a mortgage which was dramatically different from typical pre-Great Depression ones. The new mortgage terms included a fixed rate and full self-amortization (at first over a 15-year maturity). These more borrower-friendly terms were applied, over time and with some additional help from the government, more and more extensively and in fact evolved to become the standard terms used by almost all first-lien home mortgages, along with the maturity later moving out to 20 years and finally to today's 30.<sup>26</sup> This eventually became known as the “American” mortgage, as it is not found elsewhere in the world

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<sup>22</sup> See, for example, Levitin and Wachter, *The Great American Housing Bubble*, 38: “The New Deal reforms were ad hoc responses to different exigencies and interest groups, rather than part of an overall plan for reform of housing finance.”

<sup>23</sup> Interestingly, this piece of legislation was passed under President Hoover before Roosevelt took office.

<sup>24</sup> The liquidity support to them was meant to be akin to the liquidity support given to commercial banks via the Federal Reserve's discount window. The major difference is that discount window usage by commercial banks is meant to be temporary, used only in extraordinary circumstances, whereas for mortgage lenders, borrowing from the FHLB became a routine source of subsidized funding (which continues to this very day).

<sup>25</sup> There were also interventions designed to more directly address the large mortgage loan defaults of the era. For example, the FHLBB created in 1933 the Home Owners' Loan Corporation, which purchased defaulted mortgages from lenders. The HOLC is not explored further in this paper as it is not specifically relevant to the long-term causes of the homeownership rate going up or down.

<sup>26</sup> Adjustable, rather than fixed rates, are a relatively recent alternative. The share of new mortgages that have interest rates that float has varied tremendously, but for the last decade or so, when interest rates have been so low relative to historic benchmarks, floating-rate mortgages are a very small share of the market, i.e. under 10 percent.

(although tiny Denmark does come close). It has a fixed rate, a 30-year maturity, and is fully self-amortizing. Later, free prepayment for any reason at any time became allowed, and it also became possible to lock up the interest rate several months prior to closing on an actual home purchase. Thus, the typical home mortgage had far more borrower-friendly terms by the end of the 1930s than had existed prior to the Great Depression.

Of course, given the dire economic circumstances during the Depression, the hope was that these measures, along with all those others designed to help employment and income, would prevent the homeownership rate from falling too precipitously. These efforts appeared to have been at least modestly successful, based upon the 1940 homeownership rate's having dropped by only 3.8 percentage points to 43.6 percent.<sup>27</sup> (The rate could have been worse during the middle of the 1930s, but the data is not available.)

With the benefit of hindsight, we can see that the result of the intervention described above was to remake the financial system so it would, going forward, strongly prioritize homeownership by making mortgage credit less expensive, more readily available, and with more borrower-friendly terms than pre-Depression. The strategy to reach this objective was for the government to create a variety of new specialized HFIs, some of which were agencies of the US government (like FHA) while others were owned by the private sector (like the S&Ls), and to engineer in subsidies and privileges for both the newly created and already existing HFIs. The impact of these changes would, as described below, be very strongly felt after World War II.

### **The Postwar “Golden Era” (1945 to 1970): Why the Homeownership Rate Increased So Much**

Planning for the postwar economy began several years before the actual end of hostilities in 1945.<sup>28</sup> There was a background fear that, with an upcoming reduction in government military spending, there would be a major downturn (as there had been immediately after World War I) and even a return to the double-digit levels of unemployment of the prewar Depression years. This fear dovetailed with a heavy political focus on “doing right” by the returning soldiers, which was considered to have not gone well after World War I.<sup>29</sup>

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<sup>27</sup> One conclusion that can be drawn from this historic episode is that, once a level of homeownership is established as sustainable and normal, the politics (and arguably good policy) will require government authorities to go to great effort to prevent it from declining in a major way. It's just one reason for the stability of the rate.

<sup>28</sup> As an example, the famous “GI Bill” (officially titled “The Servicemen’s Readjustment Act”) was passed in June, 1944, based upon ideas originally proposed in late 1943.

<sup>29</sup> *Wikipedia*, s.v. “G.I. Bill,” [https://en.wikipedia.org/wiki/G.I. Bill](https://en.wikipedia.org/wiki/G.I._Bill).

As we now know, the postwar era was in fact one of great economic growth. Specifically, from 1946 to 1969, real GDP (i.e., GDP adjusted for inflation) grew on a compounded annual basis 3.9 percent, an extremely strong level for such a long period. Also, interest rates had been set very low during the war years (10-year Treasuries were under 2 percent) and then slowly climbed through this era, finally piercing 5 percent only in the late 1960s under the Vietnam War-era spending pressure of “guns and butter”.

Perhaps more relevant for homeownership, the average family income, also adjusted for inflation, roughly tripled between 1940 and 1965; in fact, it had grown in the ten years following World War II as much as it had in the previous *fifty* years.<sup>30</sup> This increase in income seemed like a true economic miracle, especially to those who had lived through the Depression years.<sup>31</sup>

But more than this type of macroeconomic success was needed to explain the increase in the homeownership rate of not just two or three percentage points (as happened during the strong economic growth of the 1920s) but of fifteen to twenty percentage points. In fact, there was a major change, with respect to homeownership, in the very socioeconomic DNA of America.

This DNA change, in my view, had four reasons behind it, which all fed off each other to create a major change in life in America.

1. *The success of the GI Bill in dramatically expanding the middle class.* The bill’s benefits included low-interest loans to start a business or farm, one year of unemployment compensation, and dedicated payments to fund tuition and living expenses to attend high school, college, or vocational school. The bill was a major investment in human capital – unprecedented really – that significantly helped to expand the middle class by any definition (of which there are many); one source says that by the end of the 1950s about two-thirds of Americans were middle class, double the share of the Roaring ’20s.<sup>32</sup> (While this was certainly not all due to the GI Bill, I think

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<sup>30</sup> Gilder Lehrman Institute of American History, “The Fifties,” *AP US History Study Guide*, <https://ap.gilderlehrman.org/history-by-era/fifties/essays/fifties>.

<sup>31</sup> One reason for such strong growth was that the industrial plant of almost the entire rest of the world had been destroyed in World War II, giving the US a tremendous competitive advantage in international trade across the board in manufacturing. Ditto in terms of finance, so that the “dollar was king,” as embodied in the Bretton Woods agreement linking other major currencies to the dollar, which was in turn linked to gold. With the rebuilding of Western Europe and Japan to become industrial powers again, the manufacturing advantage slowly disappeared – being largely gone by, I would estimate, 1970. Similarly, the dollar lost its “kingness” and was unlinked from gold in 1971.

<sup>32</sup> See “The Prosperous 1950s,” [https://ebrary.net/11453/history/prosperous\\_1950s](https://ebrary.net/11453/history/prosperous_1950s).

it arguable that a lot of it was.<sup>33</sup>) This was on its own a transformative socioeconomic change in what America was.

2. *Broadly shared prosperity.* In 1929, as referenced above, prosperity was not well shared, with a Gini index of .49. The Depression and war years had fundamentally changed this situation: the Gini index was just .37 in 1945. It then kept this relatively low level for the entire next quarter century as the index remained in the .36 to .38 range throughout the period (and even for a decade beyond). This “flattening” of incomes meant that a higher percentage of families, everything else being equal, could afford to buy a home.
3. *The invention of, and subsidies to, the modern suburb.* Homeownership was made immensely more common post-World War II by the invention of the modern American middle- and working-class suburb, which had at its core a more assembly-line method to produce affordable single-family homes (as pioneered by the firm of Levitt & Sons, which opened up Levittown on Long Island in 1947) along with the mass production of automobiles (and cheap gasoline). Simply put, urban housing has a heavy concentration of apartment houses, and so was dramatically more rental-intensive than suburbs consisting of single-family homes. (In fact, apartment house living was almost fully based upon renting prior to the invention of the condominium form of ownership, which first began only around 1960.<sup>34</sup>) The creation of those suburbs was significantly aided by lots of cheap land within commuting distance of the local city center, but was also significantly subsidized by government – at the Federal, state, and local levels – investing in roads and other infrastructure that facilitated the suburbs’ development and their residents’ commuting. (This is in addition to the well-known subsidy from the tax deductibility of mortgage interest and, with some recent limitations, property taxes.) Ten percent of the entire population relocated to the suburbs during the 1950s – a mass movement of population by any measure.<sup>35</sup> Those suburbs consisted overwhelmingly of single-family-

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<sup>33</sup> One can argue that this increase in human capital was also a byproduct of the war years, when there was so much technical, organizational and leadership investment in members of the military that was, to some degree, transportable to civilian life.

<sup>34</sup> The exception would have been “cooperative” apartment houses, known as “co-ops,” which existed earlier. But they were rare, concentrated in New York City and a few other locations.

<sup>35</sup> See, again, the Gilder Lehrman Institute of American History’s AP US History Study Guide re: “The Fifties.”

owned homes,<sup>36</sup> especially for returned GIs and their families.<sup>37</sup> Hence a permanent push up in the homeownership rate was an obvious result.

4. *The revamped housing finance system.* The government intervention in housing finance during the 1930s, designed to counter a decline in the homeownership rate (and also in home construction and HFIs) during those Depression years, created a dramatically different system, indeed. After the war, that revamped system proved able to provide mortgages with very generous terms – the American mortgage, as described above – on a mass scale in order to support the tremendous growth in homeownership that spanned the quarter-century postwar era until 1970. (Again, everything else being equal, if the housing finance system was the same postwar as it had been pre-Depression, a much smaller percentage of families would have been able to purchase a home.) On top of that, the GI Bill gave the Veterans Administration the authority to make mortgages – although the initial terms and various limitations made this program somewhat less impactful than expected in the very earliest years of the era.

All these causes came together to change the socioeconomic equilibrium in the economy, raising the level of homeownership to between 63 and 67 percent rather than the pre-Depression range of 45 to 48 percent.<sup>38</sup> In other words, this rise in the homeownership rate was part and parcel of the dramatic transformation of the socioeconomic DNA of America from the pre-Depression era to the modern postwar era. The result was the golden era of homeownership.

In examining in some more depth the housing finance system's role in this major socioeconomic change, the government's revamping of the housing finance system during the Great Depression, in my view, absolutely enabled the expansion of homeownership that was driven by the other factors listed above (i.e., strong family income growth, broadly shared prosperity, the GI Bill-aided expansion of the middle class, and the invention of and subsidies to the modern suburb). In fact, without the revamped housing finance system being in place, it is hard to see how all the other factors would have been able to successfully translate into quite so large an increase in the homeownership rate.

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<sup>36</sup> In addition to consisting of single-family homes, those suburbs were aimed at white families almost exclusively. See Part 2.

<sup>37</sup> On a personal note, this included my family. My father was a World War II Navy veteran, and we moved in 1950 shortly after my birth into a newly built suburban tract house, where I grew up; our house was one of about 200 in the development, which all looked very much alike.

<sup>38</sup> One can argue that the changes described herein really occurred and were fully implemented by around 1960, with the following decade's increase in the homeownership rate reflecting the momentum of these changes playing out as new families were formed.

Two aspects of the historic revamping of the housing finance system are of particular relevance in that enabling.

1. *Much more affordable mortgage terms.* With the development of the “American mortgage,” the financial terms of the typical mortgage became immensely more affordable postwar than pre-Depression. Required downpayments went from 50 percent to no more than 20 percent (and on VA mortgages could be zero percent). In addition, various government subsidies kept mortgage interest rates relatively low for a mass-market consumer loan such that, even combined with a full self-amortization, monthly payments were quite modest. Also, because the loan was self-amortizing, the borrower had zero risk of losing the home because of not being able to refinance. Thus, for any level of family income, the likelihood of being able to save up for and carry the monthly payments on a mortgage increased very substantially. It was, in its way, a revolution in housing finance.
2. *Better mortgage lenders.* The postwar era’s main providers of mortgages were the thrifts (mostly S&Ls and savings banks), which provided the great majority of such loan dollars. The thrifts had been reinvigorated by the housing finance intervention of the 1930s, which provided deposit insurance to them (via the FSLIC<sup>39</sup>), subsidized them via the FHLBs, made their business model just stronger overall (again, via the FHLBs), and created the new dominant type of thrift, the Federal S&L. The regulatory capital requirement on the thrifts was also low, which provided another indirect subsidy. In other words, Congress had intended in its intervention for the country’s financial system to prioritize housing finance, and the thrifts were its primary channel to do so.<sup>40</sup> And it was those thrifts that were most capable of delivering the low-cost and low-risk American mortgage on a mass market basis that characterized the golden era.

It is worth noting that the revamping of housing finance which proved so successful was not targeted at all – it was a broad-based set of changes that applied to borrowers generally, large and small, regardless

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<sup>39</sup> The Federal Savings and Loan Insurance Corporation, meant to be the thrift analog to the Federal Deposit Insurance Corporation (FDIC) that applied to commercial banks.

<sup>40</sup> In more recent decades, there has been criticism that America over-incentivizes homeownership via both the subsidies in the tax system and via the HFIs. It is unclear what might come of this criticism in terms of the homeownership rate.



of income level or house price.<sup>41</sup> Those changes aimed to help homeownership broadly, period, not a certain subset of homeowner.<sup>42</sup>

Unfortunately, this wonderful era of the transformation of America creating such a high level of homeownership also had two Achilles heels – one racial and one financial. The racial one was the heavy exclusion of the non-white population<sup>43</sup> – the vast majority of which, at that time, was Black – which made up 12 percent of the US population. The GI Bill was designed to accommodate Jim Crow laws, and many of the state and local governments, as well as colleges and other institutions that implemented it, engaged in clear discrimination. (One later critic of the bill called it “affirmative action for whites.”<sup>44</sup>) Similarly, the single-family suburbs were heavily segregated, both initially by law in the South and by other varied mechanisms nationwide, and so all the government investment in them benefitted almost exclusively white families. A result of this discrimination would presumably be an increase in racial disparities in wealth. Nevertheless, evidently more complex socioeconomic processes were at work beyond just the impact of these government programs, as the difference between white and Black homeownership rates was roughly the same by 1970 – about 25 percentage points – as it had been back in the 1920s.<sup>45</sup> In subsequent decades it declined, but it then increased after the 2008 financial crisis to even higher levels.<sup>46</sup>

The financial Achilles heel was a core design defect in how the thrifts managed their interest rate and liquidity risks, as explained below. While seemingly technical to those not steeped in managing financial intermediary risks, the defect directly led to America’s first major financial crisis of the postwar years: the S&L crisis of 1989 (described more below).

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<sup>41</sup> It is worth noting that the increased level of homeownership brought about by this much greater access to credit was almost totally centered in single-family housing in the suburbs, leaving cities to struggle.

<sup>42</sup> The costs to the government of those subsidies and privileges during the golden era were mostly “off-budget,” appearing nowhere as an expenditure (including a “tax expenditure”) on the federal budget. This free-lunch appearance was and still is obviously an extremely attractive feature to politicians.

<sup>43</sup> See *Wikipedia*, s.v. “G.I. Bill,” [https://en.wikipedia.org/wiki/G.I.\\_Bill](https://en.wikipedia.org/wiki/G.I._Bill).

<sup>44</sup> Ira Katznelson, *When Affirmative Action Was White* (New York: Norton, 2005), 140.

<sup>45</sup> William J. Collins and Robert A. Margo, “Race and Home Ownership from the End of the Civil War to the Present,” *American Economic Review* 101, no. 3 (May 2011): 355-59, esp. 356 (Figure 1), <https://www.jstor.org/stable/29783769>.

<sup>46</sup> Urban Institute, “Reducing the Racial Homeownership Gap,” <https://www.urban.org/policy-centers/housing-finance-policy-center/projects/reducing-racial-homeownership-gap>.

## **The Modern Era (1970 to Today): The Failure to Materially Increase the Homeownership Rate**

This half century-long period obviously had a lot going on during it that is relevant to the homeownership rate. To summarize quickly, and as background to examining the rate, there were two themes that dominated most of the fifty years:

1. *The rise of and fight against inflation (1970s and 1980s).* Inflation occupied policymakers heavily during this twenty-year period. In terms of housing, the inflation of these decades produced, as a byproduct, record high mortgage rates, with one peak at just under 16 percent in mid-1980 and a second and even higher peak of over 18 percent in late 1981. As the thrift business model showed itself unable to withstand such a level of interest rates, the direct result was the S&L crisis of 1989, which cost the government \$132 billion (over \$285 billion in today's dollars).<sup>47</sup> It also directly led to the fundamental replacement of the thrifts as the postwar core of mortgage lending by the four "agencies," i.e. the two government-sponsored enterprises (GSEs) of Freddie Mac and Fannie Mae as well as the FHA and the VA (the latter two securitizing their mortgages via Ginnie Mae).<sup>48</sup>
2. *The mortgage bubble begins, grows, and spectacularly bursts (2000s and 2010s).* This has been one of the most reported on and written about topics in economics and finance in recent years, and was quickly summarized above. There is one extra comment to make, however, concerning the second defect in the housing finance system created by the government. The first structural defect, already referenced, was the undue exposure of the thrifts, by the nature of their

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<sup>47</sup> The ultra-high interest rates associated with the fight against inflation revealed the Achilles heel of the thrift-based mortgage system that had powered the golden era: the thrifts made 30-year fixed-rate loans and funded them mainly with savings deposits that could be withdrawn on short notice. This business model worked as long as interest rates stayed low and consumers had few places to put their savings other than in a deposit account. With the skyrocketing of interest rates through the 1970s and into the early 1980s, well above the government-set ceiling of 5.25 percent on thrift savings accounts, the model fell apart. The invention of the money market fund (among other things) gave consumers a secure place to easily invest at higher rates, so thrifts lost deposits on a large scale. The thrifts' own attempts to secure non-deposit replacement funds cost them much more than they were earning from their loan portfolios, dominated by 30-year fixed rate mortgages from years earlier at lower rates and thus locking in negative interest rate margins. It is general opinion that in addressing this crisis, the federal government's elected officials and the industry's regulators handled it all very badly. Interest rate caps on savings deposits were maintained by Congress, ensuring that consumers had to take their money elsewhere to get market returns and thus creating a liquidity drain for the thrifts. Inadequate levels of capital by individual thrifts were excused by the regulators – sometimes shockingly so. And thrifts were allowed to go into new and risky activities in desperate attempts – which seemed to usually prove in vain, spectacularly so in some cases – to earn enough profits to help offset the mortgage-related losses. The result was the S&L crisis of 1989.

<sup>48</sup> During the heyday of the thrifts, the four "agencies" accounted for under 10 percent of mortgage loans. Fast-forwarding to the post-financial crisis era in the 2010s, their share of all single-family first mortgages grew to almost two-thirds!

business model, to interest rate and liquidity risks. The second structural defect was that the GSEs, which provided most of the replacement lending capacity after the decline of the thrifts, concentrated a systemic level of one type of credit risk into just two stockholder-owned companies.<sup>49</sup> (They carried about \$4 trillion of mortgage credit risk by 2008; today, the figure is about \$5.5 trillion.) With the bubble bursting in 2007-8, the lack of wisdom of such risk concentration became readily apparent as the market began to lose confidence in the companies and led directly to them being taken over by the government via conservatorship in September 2008, where they remain to this day.

So, with this background, the government's efforts (mainly federal, but somewhat also at the state and local level) during this fifty-year period to materially increase further the homeownership rate above the 65 percent range really amounted to three types of programs: (1) targeted "goals" programs, (2) downpayment assistance (DPA) programs, and (3) cross-subsidies to reduce high-risk loan interest rates. All will be discussed further in Part 2, and so are just summarized here.

1. *The unfunded mandates of targeted "goals" programs.*

In 1977, Congress passed the Community Reinvestment Act (CRA). The act, which established an obligation for banks and thrifts to offset the impact of historic credit discrimination (exemplified by mortgage "redlining"), was an unfunded congressional mandate that the regulators of those institutions ensure those regulated banks and thrifts appropriately would extend credit in certain low- and moderate-income communities in which they took deposits (expected to be disproportionately those with African American residents). The result – after, I would estimate, maybe two decades to finally get it right – has been some amount more credit to those communities, but across a range of products (small business lending, commercial real estate lending, multifamily lending, and of course single-family lending).

Then, in 1992, Congress created another unfunded mandate, this time for the two GSEs to meet defined affordable lending goals related to the share of business done with low- and very low-income borrowers and in low-income communities. There was no direct-action method for such

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<sup>49</sup> The ability of the GSEs to enjoy market confidence prior to 2008, despite that concentration of risk, and on terms that were nearly equal to what is enjoyed by the US Treasury, depended upon their having the "implicit guarantee" of the federal government. But under the stress of the bubble's bursting, the implicit form of that guarantee was no longer sufficient to maintain market confidence, and so – along with conservatorship – Treasury put in place a formal legal support agreement (called the Preferred Stock Purchase Agreement) that re-established confidence at that time, and it has been retained ever since. In addition, the invention of credit risk transfer, which started in 2013, began to address and reduce this systemic concentration risk in a cost-effective manner.

secondary-market institutions like the GSEs to achieve such goals (e.g., going directly into the community to originate such loans, as they are not permitted to do such direct lending), but it was expected they would accomplish the goals somehow, with HUD doing the goal setting. Unfortunately, the program descended into being dominated by political optics, with large claims of success that were not well founded (i.e., credit was claimed for loans that would have been done anyway). The result was that the program was heavily revamped via legislation in 2008, with goal setting switched to the FHFA (which was thought likely to be more credible, as it was then an independent agency) and with the goals redefined. To date, it is clear that some families were helped, but it is unclear how large the number of such families has truly been; certainly, it has not been anything so large as to be visible in the aggregate homeownership rate.

2. *Downpayment assistance programs.* There are roughly 2,500 DPA programs in America – California alone has 357. They are offered by state governments (usually through a housing finance agency, or HFA), charities, lenders, and also, at least indirectly, somewhat by the federal government. A realistic assessment of all these DPA plans is that they have not been impactful in large numbers.<sup>50</sup> This is apparently primarily for two reasons. First, they are poorly designed to engage the public – the programs are so dispersed through so many organizations with so many different criteria and terms that, collectively, they don't reach the broad mass of the public in a comprehensible way that will be acted upon often enough. Second, the vast majority of the programs are debt-based programs: they are designed to take already high-LTV lending and make it even more leveraged via a second mortgage. That means the loans are still riskier to the borrower (who is more leveraged than ever), with consequent risk to the homeownership family's financial stability – and this is especially true if the house is purchased at a cyclically high price.
3. *Cross-subsidies to high-risk loans.* The agencies – the two GSEs, FHA and the VA – are all subsidized in one form or another to help make affordable mortgage credit available to middle- and working-class American families. On top of that, they also have cross-subsidies embedded in their pricing, in which their riskier loans are charged lower rates than their risk would justify,

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<sup>50</sup> “Many could qualify for DPA, few apply” according to Peter Andrew, “Complete Guide to Down Payment Assistance in All 50 States,” August 18, 2019, HSH.com, <https://www.hsh.com/homebuyer/dpa-guide-down-payment-assistance-all-states.html>.

while their less risky loans are charged higher rates than their risk would justify.<sup>51</sup> The FHA and VA, in fact, have “flat” loan pricing in which the rate is the same regardless of risk – an extreme form of such cross-subsidization. The assumptions behind this practice are that (1) higher-risk loans are strongly correlated with those needing the help (it is unclear how strong that correlation is, as there are also non-needy borrowers taking ultra-high LTV loans in order to take advantage of as much subsidized mortgage credit as allowed);<sup>52</sup> and (2) slightly lower interest rates will make a large difference to those needing the help, net of the damage done to those paying more.

The question must then be asked: Can the impact of these programs be seen at the macro level? All the programs listed above have been running concurrently for decades. Each has its proponents and true believers. The problem is that the homeownership rate from 1970 to today doesn’t show any material impact at a macro level – recalling that the rate has, net, not changed in fifty years. The short history of this era, as described above, saw a possible increase in the fundamental homeownership rate to more than the 63 to 67 percent range in the very late 1990s and early 2000s, but that was also a period of a very strong economy along with declining interest rates. Therefore, the impact of these access-to-credit programs can’t really be seen at a macro level.

This does not mean that some of them were not effective at a micro level, i.e. with an impact limited to perhaps ½ or even 1 percentage point of the homeownership rate. Those are still large numbers of families: today, such an impact would amount to 450,000 to 900,000 homeowners helped. But more was hoped for – a noticeable increase in the homeownership rate, perhaps to 70 percent or even higher. Evidently, the weaknesses of the programs – in particular, almost all are unfunded, made possible only by cross-subsidies in one form or another – were large enough to reduce their impact to something below the macro-level radar screen.

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<sup>51</sup> At the GSEs, the biggest source of subsidy is not lower-risk borrowers but the special products done as accommodations (e.g., mortgages on investment properties and cash-out refinancings). See Michael Stegman and Richard Cooperstein, “A Missing Piece of the Administrative Reform Puzzle: How the GSEs Generate Cross-Subsidies,” Joint Center for Housing Studies of Harvard University, October 2019, 14, <https://www.jchs.harvard.edu/research-areas/working-papers/missing-piece-administrative-reform-puzzle-how-gses-generate-cross>.

<sup>52</sup> According to Stegman and Cooperstein, as shown in their Chart 1, almost half of the 95-percent-LTV-and-over GSE loans are to borrowers who have FICO scores that are very strong (i.e., over 740). This nevertheless creates high-risk loans, which are then currently cross-subsidized, as shown on page 11 of the article. It is unclear that subsidies to such borrowers are appropriate public policy.

## **Conclusion: Big Picture Lessons Learned**

After the financial crisis had passed, there were a lot of lessons learned where everyone in mortgage finance – whether from industry, government, or academia – got smarter and more realistic about how mortgages work and the risks they represent to both lender and borrower. This was perhaps most exemplified by legislation, especially Dodd-Frank, and changes in regulation.<sup>53</sup> My personal take is that there were four key big-picture lessons about the homeownership rate from that time that need to be considered when policies are being developed to sustainably increase it.

1. *House prices go up and down.* For more than half a century, the conventional wisdom was that house prices would, with very rare exception, only go up – it was just a question of how slowly or quickly. We now know better, as the 27 percent peak-to-trough decline during the financial crisis confirms.<sup>54</sup> It is a reminder that buying a house is not guaranteed to generate the social benefits of wealth creation and family stability; this is because, at the very least, buying at cyclically high prices with ultra-high leverage or financed by mortgages with risky design features (see immediately below for more on this topic) has a real likelihood of producing the very opposite results (i.e. wealth destruction and family instability) because the homeownership was never really sustainable. This clearly happened to literally millions of families when the bubble burst. Thus, the test of whether a policy or strategy that increases the homeownership rate is sustainable or not is how much it depends upon constantly rising home prices.<sup>55</sup>
2. *Risky mortgage design is undesirable.* The private-label securities (PLS) market in the bubble was the center of mortgages with lending requirements (e.g., low and no documentation) and product features (e.g., teaser rates, no amortization – i.e. interest only) that had outsized risk to the borrower versus a fully-documented American (i.e., 30-year fixed-rate fully self-amortizing) mortgage. As a result, mortgages with such risky designs are now identified as unwise and even downright abusive in some cases, and definitely push homeownership in an unsustainable direction. The defaults and foreclosures on such loans were extremely numerous when the bubble burst, damaging both borrowers and investors. So, they are now defined as “non-QM”

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<sup>53</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act went into effect in 2010.

<sup>54</sup> This figure, from the peak in July 2006 to the trough in February 2012, is calculated from the S&P/Case-Shiller US National Home Price Index available through the FRED (Federal Reserve Economic Data) database at the Federal Reserve of St. Louis, <https://fred.stlouisfed.org/series/CSUSHPINSA>.

<sup>55</sup> In response to the financial crisis, the government added in the concept of “stress testing” for large banks and the GSEs. For the GSEs, this stress test gets to the heart of determining that sustainability. Needless to say, much of the increase in the homeownership rate prior to the bubble bursting was absolutely unsustainable.



(qualified mortgage) by Dodd-Frank and Consumer Financial Protection Bureau (CFPB)

regulation. The four government agencies will simply not do them, and various legal risks have relegated them to the fringes of the PLS market; this change is broadly considered a good thing.

3. *Ultra-high-LTV lending challenges sustainability.* Ultra-high-LTV lending, which grew to be done extensively in the run-up to the financial crisis (by the PLS market, and also by the GSEs in pursuit of market share and their mandated affordable goals requirements), presents a high-risk situation to the homeowner, in which the risk of being unable to keep ownership of the house is very real.<sup>56</sup> It's a reminder that there is no free lunch – higher leverage always means higher risk, for both borrower and lender.<sup>57</sup> Again, combined with purchasing a home at a cyclically high price (which a lot of families did in the run-up to the bubble bursting starting in 2007-8), the risk of homeownership not being sustainable grows very real.<sup>58</sup>
4. *Troubled mortgages need foreclosure alternatives to help sustainability.* Going into the mass delinquencies that began after the collapse of 2007-8, the only well-understood and implemented response by mortgage lenders – by both the government agencies and the private market – was to begin the foreclosure process. Today, we know better. Having well-defined modification programs on the shelf, ready to deploy, is a key feature of a better mortgage system. In the pandemic, the GSEs in particular showed that they had such programs ready to go, and notably during the pandemic their natural disaster forbearance program was embedded

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<sup>56</sup> This will be explored more in Part 2. One risk factor with such loans is that a lack of any significant equity in a home is associated with a higher default rate as there is a likelihood such borrowers cannot generate the cash savings necessary to ride out any bumps in the road of homeownership, including paying for the inevitable unexpected repairs or covering some months of reduced family income. Another is that, with little equity cushion, a homeowner in financial distress is more likely to go into default (and eventually foreclosure) rather than be able to sell the house in an ordinary manner to monetize the family's equity in it to help start anew elsewhere.

<sup>57</sup> I should note that it is an article of faith among many housing advocates that LTV is almost irrelevant in the riskiness of such loans – a faith manifested in proposals for up to 105 percent LTV mortgages (so fees can be financed as well). This belief is absolutely not shared by lending institutions, credit rating agencies, or anyone else involved in mortgage credit. The Urban Institute, "Housing Finance at a Glance: A Monthly Chartbook," February 2021, analyzing Fannie Mae loan-level data on page 35, shows how LTV does in fact matter, with a default rate for over-90% LTV loans being double that of under-70% LTV loans not just in aggregate but also similarly in each category of (1) low-FICO score borrowers (i.e., under 700), (2) middle-level FICO score borrowers (700 to 750) and (3) high-FICO borrowers (over 750).

<sup>58</sup> Ultra-high-LTV lending was begun again by the GSEs, at the direction of the FHFA, in 2015. With the lessons of the bubble bursting fresh in everyone's minds, it was a much more limited and conservative program than had existed pre-2008, with requirements for strong incomes and FICO scores as there was so little "second way out" protection via the value of the equity in the home.

in legislation that applied to all government agency lenders.<sup>59</sup> Such programs won't eliminate foreclosures, but they will reduce them, and if designed properly are better for both lender and borrower. Greater homeownership sustainability will be a direct result.

I note how much the concept of "sustainability" appears in these big-picture lessons. It is clear, in retrospect, that the bubble – especially in the most abusive years of 2004 to 2006 – had many unsustainable practices. But, as with any bubble, few pointed this out at the time, and politicians and advocates for housing generally cheered on the increase in the homeownership rate to the 69 percent level.<sup>60</sup>

Before turning to the lessons from the history described herein, it is important to first point out that America's current housing finance system, dominated by the four agencies, is already extremely efficient, broad-based and borrower-friendly. It enjoys all sorts of overt and covert support and subsidies from the government, and was designed in the 1930s so that the borrower is protected from many risks (e.g., interest rates going up during the life of a mortgage). There is already, to use a favorite phrase in housing finance policy, very broad access to credit today; also, mortgage interest rates are, especially for a consumer product, very low relative to other interest rates. So, it is hard to see proposed changes to the system of housing finance being anything more than limited and targeted for, at most, a micro-level increase in the homeownership rate.

Now, this article's history of the homeownership rate introduces more big-picture lessons that also should help in constructing future policies designed to sustainably increase the homeownership rate by a material amount. My personal conclusion is that there are three such lessons:

1. *A sustainable macro-level increase in the homeownership rate (e.g., to 70 percent or more) will require some type of major and successful change in America's socioeconomic system.*

This history has shown that a defining feature of the homeownership rate is stubborn stability over long periods of time, and only major changes in "what America is" and/or how housing finance works from 1930 to 1970 produced such a macro-level increase. Because of

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<sup>59</sup> Advocates for a large government presence in the mortgage financing system point to the pandemic forbearance program as an example of why such a presence is a strength: government lenders have greater ability than private sector lenders to be flexible in how to handle defaults, especially during a period of economic distress.

<sup>60</sup> The newly-appointed acting director of the FHFA, Sandra Thompson, in a recent set of public remarks related to the topic of "Closing the GAP to Sustainable Homeownership" stated "I know what expanding access to credit looks like. And I know what irresponsible lending looks like. Irresponsible lending is not an expansion of access to credit." Historically, in my view, the housing industry and advocates have not been good at such a distinction, which is one reason why regulators have to be willing to "take the punch bowl away" in certain circumstances.

- the much lower rate of homeownership by Black and Hispanic families, one high-potential area of policy focus would be to figure out how to significantly reduce the racial homeownership rate gap; if successfully done, it could be a real gamechanger in increasing the overall homeownership rate as the gap is so large. See Part 2 for more on this topic.
2. *Significant increases in the homeownership rate (e.g., 2 or 3 percentage points) historically come from the economy doing well over an extended period.* This history shows that such increases occurred in the 1920s and also the late 1990s, and that long-term economic prosperity was also a key component of the postwar increase to 65 percent. Additionally, such growth should be concentrated in family income levels (as opposed to corporate profits, e.g.) and also be broadly shared for the best effectiveness.
  3. *The various programs from 1970 to today that were designed to sustainably and significantly increase the homeownership rate have not been materially successful.* There is no other conclusion from looking at the data – after all, the homeownership rate is just about the same today as it was fifty years ago. This does not mean that they have not been successful at a micro level (which still can impact positively a large number of families), although such success can't be proven from the aggregate homeownership data.<sup>61</sup> I note that those programs were all unfunded (or very little funded), with virtually no provision of spending from the federal budget, but were rather expected to somehow be effective anyway based solely upon overt or covert cross-subsidies, so perhaps their lack of significant impact is understandable.

So, in looking at ways to increase the homeownership rate at a macro level – e.g., from 65 to 70 percent or more – it is clear that business-as-usual approaches aren't enough. Instead, there will have to be policies that are more creative and large-scale, not just an extrapolation of the past, and they will likely require funding from the federal budget rather than being based upon unfunded mandates and cross-subsidies. Those policies will be addressed in Part 2.

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<sup>61</sup> One objective of those programs was to reduce the racial homeownership gap between non-Hispanic white Americans and Black Americans, but there is no evidence of a major closure of the gap. For example, the gap in Q1 1994 (the beginning of quarterly Census reporting) was 27.7 percent and it increased (not decreased) to 32.1 percent by Q1 2019, just before the pandemic hit a quarter-century later. This will be explored more in Part 2.