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**CENTER FOR REAL ESTATE
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WORKING PAPER SERIES**

WORKING PAPER NO. 89-165

HOMEOWNERSHIP AND AFFORDABLE HOUSING

BY

ROBERT H. EDELSTEIN

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to stimulate discussion and
comment. Therefore, they
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Statement of
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Before the Subcommittee on Housing and Urban Affairs
Committee on Banking, Housing and Urban Affairs
United States Senate

Round Table Hearing on "Homeownership and Affordable Housing"
with Emphasis on Proposed Legislation S.565 and S.566, the
National Housing Act

June 9, 1989

WORKING PAPER NO. 89-165

Mr. Chairman and Members of the Sub-Committee:

Thank you for the opportunity to appear before your sub-committee to participate in the Round Table discussion of S. 565 and S.566. I applaud the introduction of the prospective legislation which represents a potentially important vehicle for commencing the long overdue re-examination and re-direction of our nation's housing policy.

My comments are divided into four parts. First, I will provide a schematic, stylized overview of national housing policy goals. Second, I will explore the underlying demographic forces that have been and will continue to be the key determinants of housing demand. Third, I will address the specific proposal of the National Affordable Housing Act which would create regional differential limits for FHA insured loans. Finally, I will delineate major issues that are likely to confront and confound the future path of housing policy.

I. National Housing Public Policy Goals: An Overview

Housing policy uses scarce public resources. The efficient use of these resources is clearly important. To some extent, housing policy may need to recognize trade-offs between equity (fairness) and efficiency. Fairness goals must not be set aside; how a nation shelters the less advantaged households is a demonstration of its commitment to economic justice. The resources devoted to national housing policies should necessarily be directed at those who are disadvantaged (i.e., low- and middle-income households as well as the indigent homeless).

The Housing Act of 1948 sets a national goal of "a decent home in a suitable living environment" for all Americans. Subsequently, homeownership has been encouraged by a combination of mortgage and tax policies, and the supply of low- and middle-income housing has been promoted by an array of direct and indirect housing programs. This dual focus, until the past several years, reflected the national consensus about the role of housing in our society.

Homeownership has been an important public priority since the end of the Second World War, when the Federal Government established programs to encourage home purchases by Veterans. Federal mortgage and subsidy programs, tax incentives, and low interest long-term mortgage loans have enabled approximately 65 per cent of all American households to own homes.

However, during the last two decades, the ability of housing policy to create sufficient affordable housing for the new generation of Americans entering the housing ownership market has been seriously questioned. Can housing policy prevent periodic housing shortages with their attendant price spirals, and allow continued mobility of our society, which is crucial to meet changing employment patterns? These are the concerns that S.565 and S.566 appear to address and re-evaluate, while continuing to endorse earlier housing goals and social priorities as established by the Housing Act of 1948.

II. The Root Causes of the Housing Ownership-Affordability Crisis: A Closer Look At Changing Demographics

In order to understand the sources of housing demand one needs to examine the underlying demographic patterns. The size and age distribution along with the growth rate of population are the most crucial factors influencing the nature and extent of housing demand. The demographic surge of the 1980s was engendered by the maturation of the World War II baby boomers, and has led to unprecedented demand for housing units in the 1980 decade. At the national level, the implications of this huge demand are that resources used for housing are forced to compete against alternative goals of public policy. Governments at the state and local level must also be involved since housing demand affects not only land use, but infrastructure, as well as increased need for basic levels of government services.

As can be seen in Table 1, the total number of births of the post War baby boom (and the birth rate) peaked in the early 1960s. The birth rate has declined substantially since that point reaching its nadir in the early eighties; while the number of births has declined reaching its lowest point in the late seventies.

This has directly affected the age profile of the U. S. housing relevant population, and its pattern over the next twenty years. In Table 2, abstracting from major changes for morbidity and international migration, we have projected the population levels by age groupings from 1990 through 2010. A careful examination of these data suggests that in the decade of the 1990s a significant decline (approximately 15 per cent) in the

age group between 25 and 34 will reduce the overall pressures of housing demand. We would expect that annual housing demand will decline over the 1990's by 15 per cent from its 1980's peak.

However, the decline in the population growth rate with its impact on housing demand and housing prices is likely to differ significantly across regions. Tables 3 and 4 contain actual and projected regional distributions of population for the United States from 1960 through 2010. Important demographic shifts are expected to continue to expand the populations of the West and Southern parts of the United States vis-a-vis the Northeast and Mid-West. This population expansion implies significant growth in housing demand in these areas, with the result that these regions are likely to experience relatively higher housing prices over the long haul as compared to the other regions.

Finally, Tables 5 and 6 suggest that the demand for housing will not decline proportionally with the decline in the growth rate of population. Besides regional shifts, there are other underlying demographic trend changes. Table 5 demonstrates that the typical household size is continuing to decline, and therefore housing units per thousand of population will not decline at the same rate as population growth. (This will produce increased housing demand at each level of population growth.) Among other things, the cause for this declining housing size relates to the increased rate of divorce as well as the declining death rate (see Table 6).

In summary, the housing crunch of the 1980's is likely to be mitigated by the slowing national population growth rate.

However, it is likely that we will experience significant regional differences in terms of housing demand and attendant price behavior. There could be, of course, further influences by regional economic cycles.

III. Home Ownership: Affordability and Changing the FHA Insured Mortgage Limits

The affordability of housing over time has been a changing and often a confused concept. In the 1970s, in the rapidly appreciating housing markets, there was a clear difference between the current costs of homeownership and the effect of "capital gains" in the asset. During this period, the affordability crisis was a cash flow problem caused by the traditional level of mortgage payments and the inability of households to monetize their expected or actual capital gains in the housing. Since 1980, however, this has changed. The 1980's decade has been characterized by high real interest rates combined with variable housing appreciation rates within and across regions, and has created from time to time both a current cash-flow and capital cost affordability crisis, especially for first-time home entrants.

S.565 and S.566 propose to adjust FHA mortgage insurance limits in order to recognize regional differences in housing markets. In principle, this is equitable and appropriate. It reflects the facts that at any point in time housing costs and prices differ substantially across various geographical areas in the United States.

If loan limits were increased, as proposed, to 95 per cent (or 97 per cent for first-time home buyers) of the area's median

housing price, in parts of California, this would change the FHA insured loan limit to approximately \$180,000. If we were to apply standard borrower qualification measures, this would require households to have incomes in excess of \$75,000.

A policy for changing the regional limits would particularly assist first-time home-buyers with substantial current incomes but who have not accumulated significant down payments. These households would be able to afford ownership at a higher level of housing consumption than might be possible otherwise. It would, also, add demand to the housing market, giving housing prices an upward buoyancy.

Against these social benefits, policy-makers need to weigh the potential social costs. The single best determinant of mortgage default is the loan-to-value ratio of the mortgage. FHA (and VA) mortgages are very high debt-to-value loans in comparison to typical conventional mortgages. As can be seen in Tables 7 and 8, FHA insured loans tend to have significantly higher delinquency and foreclosure rates vis-a-vis conventional private market mortgages. Increasing the regional mortgage limits, especially in the expensive housing markets, may engender a new set of high income households with low down payment (i.e. high debt-to-value) mortgages that exhibit high default and payment delinquency risks.

Should Government be willing to subsidize such loans? Is the private mortgage insurance industry not willing or unable to undertake these risks? What resource trade-offs does the change in FHA regional loan limits imply for the housing for low-income

households and the homeless? These are the types of issues that need to be explored and quantified in terms of benefits and costs for directing housing policy of the 1990s.

IV. The Future Path of Housing Policy

While there is reason to be optimistic about the resource requirements for housing in the future because of the slowing growth of population, housing policy still has a difficult and complex set of tasks ahead. To the extent that home ownership is a goal of housing policy, there are, at least, four major obstacles which impede this policy path. First, and also, paradoxically, the lowering of tax rates along with the increased standard deduction in the 1986 Tax Reform Act reduce the benefits of interest and property tax deductibility. Hence, the cash-flow economic advantages of home ownership at the margin are less attractive. Second, the economies of the United States and the World are significantly more volatile than they used to be. This phenomena increases economic risks which, in turn, make the ownership of long term assets, as in this case, houses, more risky. One only has to think of the recent boom/bust cycles of the oil patch to recognize the potential risks of owning capital assets, including real estate. Unfortunately, regional cyclical and general economic variability are probably increasing, thereby intensifying the risks of ownership. Thirdly, the financial markets crises, as highlighted by the FSLIC bailout and the unanticipated need for Congressional funding of the V.A. Revolving Loan Program, will have special impacts upon the housing finance system. The likely outcome is that the real

costs of borrowing for home ownership over the long run will increase significantly. This, too, will reduce the economic incentives for home ownership. Finally, increased regulatory controls of real estate at the Federal, state and local levels (i.e., land use controls, growth controls, user fees, environmental regulation, and so forth) will tend to increase the supply cost for housing. In the long run this must be translated into higher real costs borne by the buyers and owners of housing.

It is time to re-examine and re-fashion national housing policy. S.565 and S.566 are a good step in this direction. The goals of housing policy should be to re-establish programs to:

- 1) assist the demand side of housing where necessary, especially, for the low-income groups;
- 2) reduce the cost of supplying (producing) houses; and
- 3) determine appropriate overall public sector resource and equity trade-offs for housing and other policy alternatives.

Table 1: Births Per
Annum, 1960-1980.

Year	Total Births (000's)	Births Per 1000
1960	4258	23.7
1965	3760	19.4
1970	3731	18.4
1975	3144	14.6
1976	3168	14.6
1977	3327	15.1
1978	3333	15.0
1979	3494	15.6
1980	3612	15.9
1981	3629	15.8
1982	3681	15.9
1983	3639	15.5
1984	3669	15.5
1985	3761	15.8
1986	3757	15.6
1987	3829	15.7

Source:U.S. Bureau of the Census,
Population Reports, series P-25.

Table 2: Projected Population Levels, Distribution and Percent Change, for 1990, 2000, 2010, by Age Group.

Age Dist'n	Population Projections in 1000's		Population Distribution in %		Percent Change From Previous Decade	
	1990	2000	1990	2000	1990	2000
Under 5	18408	16898	7.4	6.3	11.8	-8.2
Bet. 5&17	45630	48815	18.2	18.2	-3.4	7.0
Bet. 18&24	26140	25231	10.4	9.4	-13.9	-3.5
Bet. 25&34	43925	37149	17.5	13.8	16.7	-15.4
Bet. 35&44	37897	43911	15.1	16.4	46.5	15.9
Bet. 45&54	25487	37223	10.2	13.9	12.0	46.0
Bet. 55&64	21364	24158	8.5	9.0	-1.8	13.1
Bet. 65&74	18373	18243	7.3	6.8	17.4	-0.7
At&Over75	13187	16639	5.3	6.2	31.2	26.2

Source: Statistical Abstract of the United States, 1989, Tables No. 57 and 58.

**Table 3: Regional Population Distribution
of the U.S., Actual and Projected, 1960-2010**

Population in Thousands

Year	Total	By Region			
		North- East	Mid- West	South	West
1960	179323	44678	51619	54973	28053
1970	203302	49601	56589	62812	34838
1980	226546	49135	58866	75372	43172
1990	249891	50577	59777	87276	52261
2000	267747	51810	59596	96919	59422
2010	282055	52496	59018	104919	65622

Source: U.S. Bureau of the Census, Current Population Reports, Series P-25

**Table 4: Regional Population Distribution
of the U.S., Actual and Projected, 1960-2010**

Population in Percent					
Total		By Region			
Year		North- East	Mid- West	South	West
1970	100	24.1	27.8	30.9	17.1
1980	100	21.7	26.0	33.3	19.1
1990	100	20.2	23.9	34.9	20.9
2000	100	19.4	22.3	36.2	22.2
2010	100	18.6	20.9	37.2	23.3

Source: U.S. Bureau of the Census, Current Population Reports, series P-25

Table 5: U.S. Household
and Family Size, 1960-1988.

Year	Households		Average Family Size
	Total (in 000's)	Avg. Size	
1960	52799	3.33	3.67
1970	63401	3.14	3.58
1975	71120	2.94	3.42
1980	80776	2.76	3.29
1985	86789	2.69	3.23
1986	88458	2.67	3.21
1987	89479	2.66	3.19
1988	91061	2.64	3.17

Source: U.S. Bureau of the Census,
Population Reports, series P-20.

Table 6: United States
Deaths and Divorces, 1960-1987.

Year	In 000's		Per Thousand	
	Total Deaths	Total Divorces	Deaths	Divorces
1960	1712	393	9.5	2.2
1965	1828	479	9.4	2.5
1970	1921	708	9.5	3.5
1975	1893	1036	8.8	4.8
1976	1909	1083	8.8	5.0
1977	1900	1091	8.6	5.0
1978	1928	1130	8.7	5.1
1979	1914	1181	8.5	5.3
1980	1990	1189	8.8	5.2
1981	1978	1213	8.6	5.3
1982	1975	1170	8.5	5.0
1983	2019	1158	8.6	4.9
1984	2039	1169	8.6	5.0
1985	2086	1190	8.7	5.0
1986	2105	1159	8.7	4.8
1987	2127	1157	8.7	4.8

Source: U.S. Bureau of the Census,
Current Population Reports, series P-25.

Table 7 Mortgage Delinquency Rates By Type Of Loan
 For One-To-Four-Family Residential Non-Farm Homes

	Delinquency Rates (Per cent of loans 30 days or more late)		
	Conventional Loans	VA Loans	FHA Loans
1970	1.74	3.03	3.65
1975	2.71	4.17	5.45
1980	3.09	5.33	6.56
1985	4.05	6.63	7.46
1987	3.15	6.21	6.56

Source: U.S. Bureau of the Census, Statistical Abstract of the United States: 1989, Washington, D.C., Table Number 812

Table 8: Mortgage Foreclosure Rates By Type Of Loan
For One-To-Four-Family Residential Non-Farm Homes

Foreclosure Rates			
(Per cent of loans in the foreclosure process at year end)			
	Conventional Loans	VA Loans	FHA Loans
1970	.08	.50	.40
1975	.16	.36	.46
1980	.17	.46	.53
1985	.61	.88	1.01
1987	.67	1.28	1.44

Source: U.S. Bureau of the Census, Statistical Abstract of the United States: 1989, Washington, D.C., Table Number 812