*Populism in Housing Policy?*

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It would seem that a government seeking to display a true populist streak by helping its citizens buy houses would do so in a way to ensure prices as low as possible. For those who are not yet homeowners, how is it populism when recovery makes houses more expensive rather than more affordable?

For some time now, demand for houses has been artificially boosted by federal and state tax policies, increasing governmental involvement in residential-debt financing and persistently low interest rates orchestrated by the Federal Reserve. This intensified demand has not been relieved by sufficient new supply of houses, resulting in intractable upward pricing pressure that has put homeownership beyond the reach of increasing numbers of moderate-income buyers. Future housing markets are likely to be increasingly vulnerable to destructive price swings if credit-fueled demand and no-growth sentiment continue to flourish.

The middle class and those aspiring to be part of it are discovering that owning a home has not been a great financial planning option when compared to other long-term investments. Ownership ties up credit and investment capital, saps income and constrains geographic mobility. Even the traditional 80%, 30-year, fixed-rate mortgage now has its skeptics. Little principal is repaid in the early years of such loans, and the housing bust has made it painfully apparent that prices can move more than 20% to the downside.

Despite a more sophisticated investing public and the recent housing debacle, a nascent market revival is taking hold with the old policies intact - all but assuring results at odds with the egalitarian rhetoric. The Fed’s monetary policy prioritizes economic stimulus over potentially dangerous pricing bubbles, notably in hard assets like equities, metals and real estate. Meanwhile, the federal government has virtually nationalized residential lending through the Federal Housing Administration, Fannie, Freddie and other programs, thereby substituting political control for market forces

The push to put people in homes and save the casualties of housing downturns has caused a gradual long-term divergence between housing prices and incomes, paradoxically putting us on an inexorable path to redefine middle class as property-less.

For young, immigrant, wage-earning families with average incomes of $49,445 in 2010, the simple truth is that a home remains unaffordable despite a 22% drop in its median price between 2006 and 2010. Consider:

In 1990, the median price of a home was about 3.25 times median annual income. At the peak of the housing bubble in 2005, the multiple climbed to 4.73, but even in 2010, ostensibly a point of historic affordability, it was still 3.5. To return to the 1990 multiple, the median price of a home would have had to drop another 7.2% below 2010 levels.

Prior to the housing collapse, fluctuation in house prices was the familiar story of supply and demand. New building activity constrained speculation by putting a lid on outsized run-ups in prices. Substantial down-payment requirements – the FHA still backstops loans with as little as 3.5% down - made homeowners less prone to panic selling. Houses were not ideal rental candidates because there was no shortage of apartment units and other for-rent housing options. In such circumstances, downturns occurred when too much supply hit the market at the wrong time.

The trigger for the recent crash was very different: The reversal in fortunes came when demand, fueled by easy money and rampant speculation, collapsed.

If history is any indication and political realities being what they are, once government programs are put in place to help one group of troubled borrowers or another, they will never disappear, thereby locking in the government as a perpetual source of demand stimulus. As markets recover, it’s likely that additional efforts will be made to expand credit availability and reduce the cost of financing. The Federal Reserve may be complicit in all this, as its mandate to boost employment sweeps the entire nation’s housing markets into a basket with all other assets sensitive to interest rates, whatever the needs of local markets.

Another danger for future housing cycles is that the sources of ever-increasing demand -- intensified by policy and population pressures – seem irreversible. Raw land in desirable residential locations has largely run out. Extreme no-growth zoning and building policies have made all but small-scale development impossible, particularly on the coasts. Changes in zoning and building codes continue to transfer many infrastructure and social costs from the public to developers. New construction, forced to the periphery by restrictions and the high costs of urban development, will promote sprawl and dependence on expensive transportation options. And if the supply of apartments continues to be constrained, rents and the prices of homes converted to rentals will continue to support higher housing prices.

The result will be future speculative feedback loops with prices simply running up until the bottom falls out again, leaving in its aftermath the familiar story of the aggrieved looking to the government – complicit in the tragedy - to be rescued, protected and ostensibly made whole.

To make room for a future middle class, policymakers need to abandon the idea that the fortunes of the economy turn on rising home prices rather than the reverse. It’s in everyone’s interest that home values gradually increase. But when housing prices rise faster than middle-class incomes, that’s nobody’s populism and may indeed bring about the end to the cornerstone of middle- class life -- the owner-occupied home.

Note: This graph is optional.

