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Learning Nothing from Past Catastrophe: Will Biden Turn Back the Clock on Housing?

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Returning to ill-conceived policies in the name of social justice will end in tears, just as it did during the Great Recession.

At the center of the housing industry is finance, and at the center of mortgage finance in the U.S. are two behemoths: the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These government-sponsored enterprises (GSEs) are important players in the mortgage market. They purchase mortgages from lenders and package them as securities.

When the housing bubble burst in 2008, the government attempted to stabilize the housing market by injecting about \$190 billion into these giants and by putting them under the conservatorship of the Federal Housing Finance Agency, where they reside today. In short, Fannie and Freddie were effectively nationalized.

In a departure from the Obama administration, the Trump administration allowed Fannie and Freddie to retain some of their earnings and to be recapitalized. Efforts to privatize Fannie and Freddie, however, remained incomplete as Trump left office. President Biden's advisers have now indicated that they will not be in a rush to shrink the government's role in housing and privatize the GSEs. Indeed, the notion that anything will be privatized under President Biden seems rather far-fetched.

To make matters worse, the Biden administration might seek to mandate — as the Obama administration did — that nearly all of Fannie and Freddie's profits be forked over to the government as dividend payments on its senior preferred shares. There is also drumbeat, in the name of "social justice," about affordable housing that can be heard in the corridors of the White House.

These conjectures portend a turning back of the clock. But when it comes to affordable housing, it's worth asking just what turning back the clock would mean. Let's go back to the start of the Great Recession of 2008. Like all post-World War II recessions, except for the one in 2001, the Great Recession was preceded by a downturn in housing. What made the post-Great Recession housing crisis unique was its magnitude. A huge housing bubble had been fueled by what seemed to be a never-ending flood of money from home and abroad earmarked to fund U.S. mortgages. Indeed, the net flow of mortgage funds increased from \$284.8 billion in 1997 to a

staggering \$1,040.4 billion in 2006. With that mortgage fuel, home prices skyrocketed at an unprecedented rate and to unprecedented levels.

Just why were the mortgage floodgates opened? To answer that question, we have to go all the way back to 1994. And that, we fear, is where President Biden might turn the clock back to. On November 3, 1994, President Clinton sent a letter to Housing and Urban Development (HUD) secretary Henry Cisneros, writing:

Homeownership is the American Dream. The United States is the first major industrial country to make homeownership a reality for a majority of its people. However, since 1980, the national homeownership rate has been declining. Reversing this trend is vital to American families, to communities, and to our economy.

That appeared to be a noble idea and goal. But, there was a significant problem: HUD would go on to use mandates designed to weaken mortgage standards to achieve the affordable housing dream.

The Cisneros-Clinton plan was soon enshrined in a National Homeownership Strategy, and the language used to promote it sounded fantastic. HUD stated that

for many potential homebuyers, the lack of cash available to accumulate the required down payment and closing costs is the major impediment to purchasing a home. Other households do not have sufficient available income to make the monthly payments on mortgages financed at market interest rates for standard loan terms. Financing strategies, fueled by the creativity and resources of the private and public sectors, should address both of these financial barriers to homeownership.

Yet scrutinized more closely, HUD's own words — “lack of cash,” “do not have sufficient available income to make the payments,” etc. — identified the plan's fatal flaw.

To address these “little” problems, HUD mandated that the GSEs lower (read: trash) their lending standards. Indeed, it no longer mattered that mortgages were being made to people who could not afford the payments. Not surprisingly, mortgages, with the blessing of Washington, D.C., were pushed willy-nilly on people with dubious employment and credit histories and few or no assets.

In 1997, Fannie was purchasing mortgages that had loan-to-value ratios of 97 percent. By 2001, it was buying mortgages with no down payment at all. And by 2007, Fannie and Freddie were required by HUD to show that 55 percent of their mortgage purchases were for low- to moderate-income home buyers. In addition, 38 percent of all mortgages purchased had to be from underserved areas — usually those in inner cities, and 25 percent had to be for loans that had been made to low-income and very low-income borrowers.

The call for “social justice” had taken over housing policy. As a result, a housing bubble of unprecedented size was created, and like all bubbles, it popped. Among other things, many people who were the intended beneficiaries of U.S. housing policies were badly burnt. And, yes, the foreclosures mounted, balance sheets were shredded, and, with that, we witnessed the onset of the Great Recession.

Not only did the federal government's housing policy trigger the Great Recession, but as night follows day, the government formed a commission to conceal who the culprit was — namely, the U.S. government itself.

The Financial Crisis Inquiry Commission determined that the root of the housing problem had been “deregulation” or lax regulation, greed and recklessness on Wall Street, predatory lending in the mortgage market, unregulated derivatives, and a financial system addicted to excessive risk-taking. No mention was made of HUD's National Homeownership Strategy (read: affordable-housing strategy) and its mandates to the GSEs to purchase substandard mortgages that had been pushed on people with no possibility of repayment. It was a classic Washington cover-up.

Turning back the clock to affordable housing in the name of “social justice,” an idea that Friedrich Hayek dubbed a mirage, will end in tears, just as it did during the Great Recession.

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